

# COMPUTATION OF TOTAL INCOME AND TAX LIABILITY OF AN INDIVIDUAL IN INDIA

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**BEST CITATION** – JAYESH MITTAL, COMPUTATION OF TOTAL INCOME AND TAX LIABILITY OF AN INDIVIDUAL IN INDIA, *INDIAN JOURNAL OF LEGAL REVIEW (IJLR)*, 5 (4) OF 2025, PG. 1095-1104, APIS – 3920 – 0001 & ISSN – 2583-2344.

## ABSTRACT

The Indian taxation system, governed by the Income Tax Act, 1961, aims to collect taxes from individuals, businesses, and corporations to fund government expenditures. The computation of an individual's total income and tax liability is a multi-step process that involves determining different sources of income, applying exemptions, and calculating deductions. With the introduction of the new tax regime and several amendments over the years, understanding how to accurately compute tax liabilities has become crucial. This paper delves into the various aspects of income computation for individuals, explores the available deductions and exemptions, and explains the tax liability calculation process, thus providing a comprehensive overview for taxpayers in India.

## 1. Introduction

Income tax is a direct tax levied by the government on the income of individuals, companies, and other entities. The Income Tax Act of 1961 provides the framework for this taxation system in India. This Act covers a wide range of issues, including income assessment, deductions, exemptions, tax computation, and filing of returns.

For individual taxpayers, understanding how to compute their total income and corresponding tax liability is vital. With the dynamic nature of tax laws, particularly in recent years with the introduction of a new tax regime, individuals must stay informed about the latest developments and benefits that they are entitled to under the law. By following the procedures outlined in the Income Tax Act, an individual can ensure they are both tax-compliant and optimized in terms of minimizing tax liabilities.

This paper will examine the methodology for calculating total income and tax liability, highlighting the importance of deductions, exemptions, and available tax regimes.

Additionally, the discussion will include an overview of various income sources, the relevant tax rates, and how tax planning can reduce the tax burden.

## 2. Heads of Income

In India, the Income Tax Act classifies all income into five primary heads. These heads help in determining the nature of the income, how it will be taxed, and the specific deductions that can be claimed. The five heads of income are:

### 2.1 Income from Salaries

Income from salaries is one of the most common sources of income for individuals in India. This income includes wages, pensions, and other benefits received from an employer or organization.

The tax calculation for income from salaries is based on the total amount received by an individual as salary, minus any exemptions or deductions allowed under the Act. For example, individuals can claim exemptions on house rent allowance (HRA), leave travel allowance (LTA), and special allowances. In addition, the employee is eligible for deductions under

Section 80C, 80D, and other sections that help reduce the taxable amount.

The income from salaries includes the following components:

- **Basic Salary:** This is the fixed component of a salary that is received every month.
- **Allowances:** These are payments made to an employee to meet certain expenses, like HRA and transport allowances.
- **Perquisites:** These are benefits provided by the employer, such as the use of a company car or accommodation.
- **Bonus and Incentives:** Any additional payment beyond the basic salary to reward performance.

## 2.2 Income from House Property

Income from house property refers to the rental income earned by an individual from property owned by them. This could include income from commercial or residential property, provided the property is used for earning rent.

If an individual owns a house and rents it out, they must report this rental income under this head. However, the calculation of taxable income is not as straightforward as simply adding the rent received. The Income Tax Act allows deductions on this income under Section 24 of the Act.

Deductions available under this head include:

- **Standard Deduction:** A 30% standard deduction is available on the annual value of the property.
- **Municipal Taxes:** If the individual has paid municipal taxes on the property, this amount is deductible.
- **Interest on Home Loan:** An individual can also deduct interest paid on home loans under this head.

## 2.3 Profits and Gains of Business or Profession

For self-employed individuals or business owners, income from business or profession is a critical head for tax computation. This includes

income derived from activities such as the sale of goods, providing services, or conducting trade.

To calculate taxable income under this head, the individual must subtract business expenses from the gross income. Business expenses can include rent, salary paid to employees, depreciation on assets, and other costs necessary for running the business.

Additionally, individuals in this category can claim deductions for investments made in specified schemes like the Provident Fund or for contributions made towards professional development.

## 2.4 Capital Gains

Capital gains are derived from the sale of capital assets such as property, stocks, and bonds. When a person sells a capital asset for a price higher than its original purchase cost, the difference is considered a capital gain.

The capital gain is classified into two types:

- **Short-Term Capital Gain (STCG):** If the asset is sold within three years of acquisition, the gain is considered short-term and taxed accordingly.
- **Long-Term Capital Gain (LTCG):** If the asset is sold after three years of acquisition, the gain is considered long-term and enjoys tax benefits such as lower tax rates.

The tax treatment of capital gains is distinct based on whether the asset is listed or unlisted. Taxpayers must also consider indexation benefits for long-term capital gains on the sale of property, which can further reduce the tax burden.

## 2.5 Income from Other Sources

Income from other sources is a residual head that includes any income that doesn't fit into the other categories. Common examples include:

- **Interest on Savings Account:** Interest earned from savings bank accounts is taxable under this head.

- **Dividends:** Earnings from stocks or mutual funds are categorized here.
- **Winnings from Lotteries, Races, etc.:** These are taxable, and there are no deductions available under this head.

While this category encompasses various income types, it is subject to different tax rates, and only certain deductions are allowed.

### 3. Computation of Total Income

To compute an individual's total income, it is essential to consider all income sources. The total income is calculated by summing up the income from each of the five heads discussed above. Once all sources of income have been aggregated, taxpayers can proceed to subtract allowable exemptions and deductions.

#### 3.1 Deductions and Exemptions

The Income Tax Act offers a range of exemptions and deductions that can be used to reduce taxable income. Deductions can be claimed under various sections of the Act, primarily under Chapter VI-A.

- **Section 80C:** This is the most widely used deduction, offering tax relief for investments made in specified financial instruments. The maximum deduction that can be claimed under Section 80C is ₹1.5 lakh. Eligible investments include the Public Provident Fund (PPF), National Savings Certificates (NSC), life insurance premiums, and 5-year fixed deposits with banks.
- **Section 80D:** This section provides deductions for premiums paid on health insurance policies. Individuals can claim deductions for policies covering themselves, their spouse, children, and parents.
- **Section 80E:** Offers a deduction for the interest paid on loans taken for higher education. This deduction is available for a maximum of eight years.
- **Section 24(b):** Provides a deduction of up to ₹2 lakh for interest paid on home

loans under the head 'Income from House Property.'

In addition to these, exemptions are available for specific income sources. For example, HRA can be exempted up to a certain limit, depending on the salary structure and the city of residence.

#### 3.2 Additional Deductions under Chapter VI-A

Beyond Sections 80C, 80D, 80E, and Section 24(b), the Income Tax Act under Chapter VI-A offers several other deductions that individuals can claim based on their specific financial activities and life circumstances. These provisions serve the dual purpose of offering tax relief and encouraging socially or economically desirable behavior, such as supporting charitable institutions, securing health insurance, or pursuing education.

**Section 80G:** This section provides deductions for donations made to specified funds, charitable institutions, or government relief efforts. The quantum of deduction can be 50% or 100% of the donated amount, with or without restriction based on gross total income. For instance, donations to the Prime Minister's National Relief Fund are eligible for 100% deduction without limit, whereas donations to certain other institutions may be subject to a ceiling of 10% of the adjusted gross total income.

**Section 80GG:** This section benefits individuals who do not receive House Rent Allowance (HRA) as part of their salary but still incur rent expenses. The least of the following is allowed as a deduction:

- ₹5,000 per month,
- 25% of total income, or
- Actual rent paid minus 10% of total income. This is particularly useful for self-employed individuals or salaried individuals without HRA components in their compensation.

**Section 80TTA / 80TTB:** Section 80TTA allows a deduction of up to ₹10,000 on interest earned from savings bank accounts (not fixed deposits) for individuals below 60 years. Senior

citizens, however, can avail a broader deduction of up to ₹50,000 on interest from savings and fixed deposits under Section 80TTB.

**Section 80U:** Individuals with disabilities are eligible for fixed deductions under this section, irrespective of actual expenses incurred. For a person with a disability (at least 40%), the deduction is ₹75,000, and for a person with severe disability (80% or more), the deduction increases to ₹1,25,000.

**Section 80DD:** This section allows a deduction for individuals who have dependents with disabilities and incur expenditure on their treatment, training, or rehabilitation. Similar to Section 80U, the deduction is ₹75,000 or ₹1,25,000, depending on the severity of the dependent's disability.

**Section 80DDB:** Deduction under this section is allowed for expenses incurred on the treatment of specified diseases for self or dependents. The maximum deduction allowed is ₹40,000, which can go up to ₹1,00,000 for senior citizens.

These additional deductions are crucial when computing total income, as they significantly reduce the tax liability of eligible taxpayers. Taxpayers must maintain appropriate documentation to substantiate their claims, as these deductions often require proof of payment, medical certificates, or receipts.

### 3.3 Exemptions Under the Income Tax Act

While deductions reduce taxable income, exemptions refer to specific income components that are entirely or partially excluded from the calculation of total income. Below are some of the most common exemptions applicable to individual taxpayers:

**House Rent Allowance (HRA):** As discussed earlier, salaried individuals residing in rented accommodations can claim partial exemption on HRA received. The exempted amount is the least of:

- Actual HRA received,
- 50% of salary (for metro cities) or 40% (for non-metro cities), or
- Rent paid minus 10% of salary.

**Leave Travel Allowance (LTA):** Salaried employees can claim exemption for travel expenses incurred during leave periods, provided the travel is within India and undertaken with family members. LTA can be claimed for two journeys in a block of four years, subject to conditions and submission of actual travel bills.

**Gratuity:** For non-government employees covered under the Payment of Gratuity Act, 1972, the least of the following is exempt from tax:

- ₹20 lakh (as per current threshold),
- Actual gratuity received,
- 15 days' salary for every completed year of service.

For government employees, the entire amount of gratuity received is exempt.

**Leave Encashment:** At the time of retirement or resignation, the encashment of unused leave is partially exempt for non-government employees, up to a specified limit. For government employees, it is fully exempt.

**Provident Fund Withdrawals:** Amounts withdrawn from recognized Provident Funds after five years of continuous service are fully exempt. Partial exemptions may apply to withdrawals made before five years, subject to certain conditions.

**Voluntary Retirement Scheme (VRS) Compensation:** Compensation received at the time of voluntary retirement is exempt up to ₹5 lakh under Section 10(10C), provided the scheme complies with prescribed guidelines.

**Agricultural Income:** Under Section 10(1), agricultural income is entirely exempt from tax. However, for individuals with both agricultural and non-agricultural income, a marginal tax calculation may apply to determine the effective tax rate.

These exemptions play a crucial role in lowering the gross total income before tax liability is calculated. Proper planning and understanding of these exemptions can lead to significant savings for the taxpayer.

### 3.4 Clubbing of Income

While calculating total income, taxpayers should be aware of provisions related to clubbing of income, which aim to prevent tax avoidance by transferring assets or income to family members. As per Sections 60 to 64 of the Income Tax Act, income arising from certain transfers without adequate consideration may be clubbed with the income of the transferor.

Common scenarios where clubbing provisions apply:

- Income of a minor child (except when earned through talent or skill) is added to the income of the parent with the higher income.
- Income from assets transferred to a spouse without adequate consideration is clubbed with the transferor's income.
- Income from revocable transfers is also taxable in the hands of the transferor.

Understanding and complying with clubbing provisions is important for accurate tax computation and to avoid scrutiny from tax authorities.

### 3.5 Set-off and Carry Forward of Losses

While computing total income, taxpayers can also adjust losses against gains in the same or different income heads. The Income Tax Act permits:

- Intra-head adjustment: For example, loss from one house property can be set off against income from another house property.
- Inter-head adjustment: For example, loss from house property (up to ₹2 lakh) can be set off against income from salary or business.

Unabsorbed losses that cannot be fully adjusted in the current year can be carried forward for set-off in subsequent assessment years, subject to conditions. For instance:

- House property loss can be carried forward for 8 years.
- Business loss (non-speculative) can be carried forward for 8 years.

- Capital losses can be carried forward for 8 years, with short-term losses adjustable against both short-term and long-term gains, but long-term capital losses only against long-term gains.

Accurately computing income after adjusting for allowable losses ensures a fair and often reduced tax liability.

## 4. Deductions and Exemptions

The Income Tax Act of 1961 provides a series of deductions and exemptions that allow individuals to reduce their taxable income, thus lowering their tax liability. These provisions encourage savings, investments, and other financial activities that can contribute to long-term economic growth.

In this section, we will explore some of the key deductions and exemptions available to taxpayers, categorized under different sections of the Income Tax Act.

### 4.1 Deductions Under Section 80C

One of the most commonly utilized sections for tax savings is **Section 80C**. This section provides deductions for various investments, savings schemes, and insurance premiums. The maximum amount that can be deducted under this section is **₹1.5 lakh** per year. Some of the eligible investments and expenditures under Section 80C include:

- **Public Provident Fund (PPF):** A government-backed, long-term savings instrument with tax-free returns.
- **Employee Provident Fund (EPF):** A retirement savings scheme for salaried employees, where both employer and employee contribute a fixed percentage of salary.
- **National Savings Certificates (NSC):** A fixed-income investment scheme issued by India Post, which provides guaranteed returns over a specified period.
- **5-Year Fixed Deposit with Banks:** Fixed deposits with a minimum tenure of five

years qualify for deductions under Section 80C.

- **Life Insurance Premiums:** Premiums paid for life insurance policies for the taxpayer, spouse, or children are deductible.
- **Tuition Fees:** Payments made towards tuition fees for the education of children (up to two children) are deductible.

Additionally, investments in **Sukanya Samridhi Accounts** and **Senior Citizens Savings Schemes** also qualify for deductions under Section 80C.

#### 4.2 Deductions Under Section 80D

Health insurance is an important aspect of financial planning, and the Income Tax Act recognizes this by providing deductions under **Section 80D** for premiums paid on health insurance policies. The deductions available under Section 80D are as follows:

- **For Self, Spouse, and Children:** A deduction of up to ₹25,000 per year is available for premiums paid on policies for the taxpayer, their spouse, and children.
- **For Parents:** An additional deduction of up to ₹25,000 is available for premiums paid for the health insurance of parents. If the parents are senior citizens (aged 60 years or more), the deduction increases to ₹50,000.

This encourages taxpayers to secure health coverage for themselves and their families, while also reducing their taxable income.

#### 4.3 Deductions Under Section 80E

Section 80E allows individuals to claim deductions on the interest paid on loans taken for higher education. The key features of this deduction are:

- The loan must be taken for pursuing higher education for oneself, spouse, children, or a student for whom the individual is a legal guardian.

- The deduction is available for a maximum of **eight years** or until the interest is paid in full, whichever is earlier.
- Only the **interest component** of the loan is eligible for deduction; the principal repayment does not qualify for deduction under this section.

This provision helps students and their families offset the financial burden of higher education costs while promoting education.

#### 4.4 Section 24(b): Deductions for Home Loan Interest

Under **Section 24(b)** of the Income Tax Act, taxpayers can claim a deduction of up to ₹2 lakh per year on the **interest paid on home loans**. This deduction is available under the head "Income from House Property" and is beneficial for individuals who have taken loans to purchase or construct a house.

The deduction of ₹2 lakh applies only to **self-occupied properties**, while properties that are rented out or used for business purposes qualify for an additional deduction of municipal taxes and other expenses under Section 24.

This deduction significantly reduces the tax burden for homebuyers and is a powerful tool in promoting affordable housing and homeownership.

#### 4.5 Other Key Deductions

Apart from the deductions mentioned above, there are other sections under the Income Tax Act that provide additional tax-saving opportunities:

- **Section 80G:** Deductions for donations made to charity or recognized NGOs. The amount that can be claimed depends on the type of donation and the recipient institution.
- **Section 80TTA/80TTB:** Provides deductions for interest income from savings accounts (up to ₹10,000 for non-senior citizens and up to ₹50,000 for senior citizens).

- **Section 80GGA:** Allows deductions for donations to scientific research or rural development.

## 5. Tax Computation

Once the total income has been determined and relevant deductions applied, the next step is to calculate the tax liability. In India, income tax is levied progressively, meaning higher income levels are taxed at higher rates.

### 5.1 Tax Slabs and Rates

As of the 2023-24 financial year, India has a dual tax regime: the old tax regime and the new tax regime. The key difference is that while the old tax regime allows individuals to claim various exemptions and deductions, the new tax regime provides lower tax rates but does not allow most exemptions and deductions. The taxpayer must choose the regime that is more beneficial for them.

#### Old Tax Regime Slabs (For Individuals Below 60 Years):

- **Up to ₹2.5 lakh:** No tax
- **₹2.5 lakh to ₹5 lakh:** 5%
- **₹5 lakh to ₹10 lakh:** 20%
- **Above ₹10 lakh:** 30%

#### New Tax Regime Slabs (For All Individuals):

- **Up to ₹3 lakh:** No tax
- **₹3 lakh to ₹6 lakh:** 5%
- **₹6 lakh to ₹9 lakh:** 10%
- **₹9 lakh to ₹12 lakh:** 15%
- **₹12 lakh to ₹15 lakh:** 20%
- **Above ₹15 lakh:** 30%

In both tax regimes, taxpayers are also subject to **Health and Education Cess**, which is levied at **4%** on the total income tax payable.

### 5.2 Choice Between Old and New Regimes

Choosing between the old and new tax regimes is one of the most critical decisions for individual taxpayers. The new regime offers a more straightforward approach with lower tax rates but eliminates several deductions and

exemptions, such as those under Sections 80C, 80D, 80E, and others.

In contrast, the old regime provides higher tax rates but allows taxpayers to benefit from a range of exemptions and deductions, thus reducing the overall tax liability for those who qualify.

Taxpayers can evaluate their individual financial situations, including income sources, eligible deductions, and exemptions, to determine which regime is more advantageous.

### 5.3 Example Calculation

Let's consider a simple example to demonstrate the computation of tax under both regimes.

- **Gross Income:** ₹12,00,000 (Salary)
- **Deductions under 80C:** ₹1,50,000 (Investments)
- **Taxable Income under Old Regime:** ₹12,00,000 - ₹1,50,000 = ₹10,50,000
- **Taxable Income under New Regime:** ₹12,00,000 (No deductions)

The tax liability would be computed based on the applicable slabs for both regimes, and the difference in tax payable will help the taxpayer choose the most beneficial option.

## 6. Recent Developments and Reforms

In recent years, India has seen several reforms aimed at simplifying the tax computation process and boosting compliance. One such reform is the **faceless assessment system**, which was introduced in 2020 to reduce the human interface between taxpayers and tax authorities, thereby minimizing the scope for harassment and errors in tax assessments. Additionally, the **finance budgets of 2023 and 2024** introduced further changes in the tax slabs and rates to provide relief to the middle class and to stimulate consumption during economic slowdowns (KPMG, 2024).

## 7. Tax Planning and Strategies to Reduce Tax Liability

Tax planning is a critical aspect of financial planning for individuals. Efficient tax planning

can significantly reduce the tax burden, thereby increasing the individual's savings and investment potential. In India, there are several strategies that individuals can use to optimize their tax liability while staying compliant with the law. Below, we discuss key tax planning strategies:

### 7.1 Investment in Tax-Advantaged Instruments

One of the most common and effective methods of reducing tax liability is to invest in tax-saving instruments that qualify for deductions under **Section 80C** and other sections of the Income Tax Act.

- **Public Provident Fund (PPF)** and **National Savings Certificates (NSC)** offer tax-free returns and deductions on contributions.
- **Equity-Linked Savings Schemes (ELSS):** These are tax-saving mutual funds that come with a 3-year lock-in period and offer tax benefits under Section 80C. ELSS also offers the potential for high returns due to its equity exposure.
- **Employee Provident Fund (EPF):** Contributions to the EPF are eligible for deductions under Section 80C, and the interest earned on EPF balances is tax-free under Section 10(12).

By making strategic investments in these tax-advantaged instruments, individuals can not only grow their wealth but also reduce their taxable income.

### 7.2 Utilization of Section 80D for Health Insurance

As healthcare costs continue to rise, it is important for individuals to ensure they are covered by health insurance. The Income Tax Act provides deductions under **Section 80D** for premiums paid on health insurance policies for the taxpayer, their spouse, children, and parents. This section provides a dual benefit:

1. **For Self, Spouse, and Children:** A maximum deduction of ₹25,000 is available for premiums paid on policies.

2. **For Parents:** A further deduction of up to ₹25,000 is available for premiums paid on policies for parents. If the parents are senior citizens, the maximum deduction increases to ₹50,000.

This not only provides financial security in case of medical emergencies but also helps reduce taxable income.

### 7.3 Home Loan and Interest Deductions

For individuals who have taken home loans, **Section 24(b)** provides a significant tax-saving opportunity. The interest paid on a home loan can be deducted up to ₹2 lakh per year, reducing the taxable income under the head "Income from House Property."

Additionally, **Section 80C** allows taxpayers to claim deductions on the principal repayment of the home loan, contributing to further reductions in taxable income.

### 7.4 Strategic Use of Capital Gains Exemptions

Capital gains taxation in India offers several opportunities for tax planning, especially for long-term capital gains (LTCG). By utilizing **indexation benefits**, individuals can reduce their taxable capital gains from the sale of long-term assets. Indexation adjusts the cost of acquisition of an asset for inflation, thus reducing the overall taxable gain.

Additionally, investments in **specified bonds** (such as those under Section 54EC) allow individuals to claim exemptions on long-term capital gains arising from the sale of property if the proceeds are reinvested in these bonds within six months.

### 7.5 Taxation of Salary and Investment Income

Effective tax planning also involves managing the composition of one's income. Individuals can benefit from lower tax rates by ensuring a balance between salary income, capital gains, and other income types.

For example, capital gains from long-term equity investments are taxed at a lower rate (10% for gains above ₹1 lakh), compared to salary income, which is taxed at higher rates. Thus, strategically increasing long-term capital

gains and reducing salary-based income can reduce tax liability.

### 7.6 Charitable Donations and Section 80G

Donations to registered charities and institutions can provide significant tax benefits under **Section 80G**. The amount of deduction varies depending on the type of charity and the institution receiving the donation.

For example:

- Donations to **Prime Minister's National Relief Fund** or similar government-recognized bodies may qualify for a 100% deduction.
- Donations to other charitable organizations may qualify for a 50% deduction with or without a qualifying limit.

These contributions not only help support charitable causes but also provide individuals with tax savings.

### 7.7 Opting for the New Tax Regime

The introduction of the **new tax regime** in 2020 provides taxpayers with a simplified tax structure. The new regime offers lower tax rates but eliminates most exemptions, deductions, and incentives available under the old regime.

The new tax slabs are as follows:

- **Up to ₹3 lakh:** No tax
- **₹3 lakh to ₹6 lakh:** 5%
- **₹6 lakh to ₹9 lakh:** 10%
- **₹9 lakh to ₹12 lakh:** 15%
- **₹12 lakh to ₹15 lakh:** 20%
- **Above ₹15 lakh:** 30%

While this regime is attractive for those who do not have many deductions to claim, taxpayers with significant deductions (such as under **Section 80C, 80D, and home loan interest**) may find the old tax regime more beneficial. It is important to analyze the taxpayer's specific financial situation before making a decision.

### 8. Filing of Tax Returns and Compliance

Filing tax returns is an essential aspect of tax compliance in India. Under the Income Tax Act, every individual whose income exceeds the basic exemption limit is required to file an income tax return (ITR). The key benefits of timely filing include:

- **Avoiding Penalties:** Late filing of tax returns results in penalties and interest charges.
- **Claiming Refunds:** If excess tax has been deducted at source (TDS) or paid, individuals can claim refunds.
- **Legal Protection:** Timely filing ensures that taxpayers maintain their compliance with the law, safeguarding them from scrutiny and audits.

The **Income Tax Department** has made the process easier with the introduction of **e-filing portals**, allowing individuals to file their returns online. The various ITR forms (ITR-1, ITR-2, etc.) are based on the taxpayer's sources of income, and individuals must choose the correct form to file their returns.

### 9. Conclusion

The computation of total income and tax liability is a crucial process for all individuals in India. With a range of deductions, exemptions, and tax-saving instruments available under the Income Tax Act, taxpayers have multiple avenues to reduce their taxable income and minimize their overall tax liability. The introduction of the new tax regime has provided an alternative approach with reduced tax rates, but individuals must carefully evaluate their specific circumstances to choose the most beneficial tax structure.

Through careful tax planning and utilizing available exemptions and deductions, individuals can optimize their tax liabilities while adhering to the tax laws. Understanding the intricacies of the Income Tax Act, selecting the right tax-saving instruments, and ensuring compliance through proper filing are vital steps for effective financial management in India. By

staying informed about the latest tax regulations and making strategic financial decisions, taxpayers can achieve long-term financial stability while minimizing their tax burdens.

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