How to avoid paying taxes on interest income?

Do you wonder why interest earned from your FDs or interest bearing securities like bonds gets reduced due to tax deducted at source?

Does it irritate you that tax has been charged even though you aren't eligible to pay taxes? Here, we tell you about why TDS applied and ways to avoid this tax deduction if you meet certain criteria.

Why should I know this?

If you are like most Indians, chances are the bulk of your liquid savings are in a bank account or in an FD. Some of us are invested in bonds. While these fixed income instruments are good for guaranteed returns, they are relatively tax inefficient instruments because you end up paying taxes on the interest income that you earn.

This tax is usually deducted at source, and there might be a situation where tax is being deducted even though you are not eligible for paying taxes. This could result in a cash flow problem because your tax outflow is today, but your refund might take many months to arrive.

How much is the TDS on interest from deposits and securities?

The tax on interest income is deducted at source, i.e., at the bank where you hold your deposit, or from the issuer of the bond who pays you interest. The rate of this TDS is a flat 10% if your interest income exceeds a certain limit. Unlike salary income where TDS is according to your tax slab, the TDS on your interest income is irrespective of the tax slab applicable to you.

Let's understand the above by way of an example. Radha, a 27-year-old woman, is employed and also has an FD at a bank. The following is her income and taxability situation.

Salary income:	Rs. 1.40 lakhs per annum
FD interest income:	Rs. 30,000 per annum
Statutory exemption limit for women:	Rs. 1.90 lakhs annually

As Radha earns more than Rs. 10,000, she will be liable to a tax deduction at source. However, as we can see, Radha's total income (salary + interest income) is below the annual exemption of Rs. 1.90 lakhs available to women. Nevertheless, taxes will be deducted from her interest income at the bank where she holds her FD.

As you can imagine, this can cause some cash flow problems for Radha if she is going to get lesser cash in hand, even though she should never have been taxed on the interest.

How can I avoid undue deduction from interest income?

If your analysis shows that your total income is below the taxable slab, then there are provisions in the Income Tax Act under which you legally avoid having tax deducted from your interest earned on your FDs and bonds.

You will need to furnish a declaration using the prescribed form to the bank or entity responsible for deducting tax. This declaration needs to state that no tax deduction is required because the income level does not fall into the taxable slab.

What are these prescribed forms?

Different forms are used for different sources of income and types of taxpayers.

Form 15G: Applicable for a resident individual, other than a senior citizen
Form 15H: Applicable for a senior citizen (These forms can be downloaded online)

What incomes can be declared in the above forms?

The declaration in Forms 15G and 15H can be furnished mainly if the taxpayer has income from:

- Interest on securities
- Interest other than interest on securities, like FDs

What should I take care of while using these forms?

1. The declaration should be filed only if tax on total estimated income for the relevant year is nil.

2. Delivery of the form to the entity deducting your TDS must be made any time before receiving the income either directly or by credit to the account.

3. The entity to whom the declaration is given must file one copy of the declaration with Commissioner Income Tax before 7th day of the next month.

Source: iTrust.in, BankBazaar.com.