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THE TAX GAMBIT: THE HINDU EDITORIAL ON THE HIKE IN TAX-FREE CEILING UNDER NEW INCOME-TAX SYSTEM

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

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Much ink has been spilled by now on the Budget’s hike in the tax-free ceiling under the new income-tax system introduced in 2020, to 7 lakh from 5 lakh, with lower tax rates for those who give up existing tax exemptions. Experts outline varying arithmetic to determine at what levels of income and savings taxpayers should consider to switch to the new “default” regime. The Opposition has raised concerns that the government eventually wants to do away with the exemptions that “give some social security to the middle class” altogether. Industry captains are worried this may affect the savings rate and hit investments. So far, government mandarins have said, among other things, that the savings rate would not be affected; lower income earners do not save enough to avail the tax exemptions and end up paying higher rates. “As an adult, you have to be the best judge on what suits you,” Finance Minister Nirmala Sitharaman summed up on Saturday. All of them are individually valid arguments. However, the bigger picture needs to factor in that many are not in a position to be the best judge for themselves — especially not the lower income earners who the government believes will benefit the most in the new tax system.

India’s literacy and financial literacy levels mean many taxpayers cannot deem the right mix of consumption and savings, leave alone directing savings into an appropriate medley of safe as well as inflation-beating investments. Adult humans do not behave as rationally as economists would assume. For instance, there is a propensity towards more conspicuous consumption among the youth who may find the new tax regime with higher take-home salaries alluring. Financial products are routinely mis-sold to those not equipped to understand market nuances and the risks embedded in fine print. In a country that cannot yet provide universal social security and health benefits, the old exemption-based regime helps guide families towards some level of prudent asset allocation to cope with life’s uncertainties, with a leg-up for building a critical asset over their working lives — a roof over their head. India’s retail participation in stocks may have risen in recent years, but not everyone can handle the risks of equity markets or avoid being conned by influencer-operators. So the nudge away from the old tax regime must be accompanied by greater financial literacy efforts from the government and regulators and a crackdown on unethical selling practices that could lead to people ending up in penury. If people did not need the government’s prodding to act in their own best interest, there would have been no need for mandatory contributions to provident funds and pensions.

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