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IT'S TIME TO TAKE A FRESH LOOK AT THE NEW TAX REGIME

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

By making adjustments in the salary, taxpayers can benefit from the old regime

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nion Budget 2020 introduced a new tax regime, which came into effect from FY 2020-21.Taxpayers had a choice between the old regime with various deductions and exemptions and the new tax regime that offered lower tax rates for those who were willing to forgo exemptions and deductions. The intention behind this move was to provide significant relief to the individual taxpayers and to simplify the income-tax law.

Typically, an employee is expected to make a declaration to the employer at the start of a financial year as to which exemptions and deductions they would like to claim. Based on this declaration, the employer deducts TDS (tax deducted at source). During the last financial year (FY 2020-21), most employers pre-selected the old tax regime for employees, unless the employee made an express request for the new tax regime. Why would the employer pre-empt the old regime for the employee? This is because a large number of employees claim HRA (house rent allowance) or opt for reimbursements for telephone and/or broadband, fuel and several other eligible benefits. Also, many of them pay insurance premiums (56% of the filers on clear paid health insurance premium in FY 2020-21). Nearly everyone contributes to employee provident fund (EPF) (eligible as a deduction under section 80C), since this is mandated by law. Employers could see that employees benefited from being in the old regime.

Also, most employees are able to utilize the section 1.5 lakh limit of 80C even without making voluntary investments. This is because an employee's contribution to EPF is eligible under section 80C.

A simple analysis of the two regimes shows that by making small adjustments (claiming exemptions) to their salary and claiming some deductions under section 80C, almost all taxpayers would benefit from being in the old regime. Less than 10% of filers on Clear have opted for the new regime.

Now that we are approaching budget 2022, it is time for the government to analyse and evaluate the new tax regime. To improve tax compliance there are a few things the government can consider.

One regime with lower tax burden: Given the backdrop of robust tax collections (as per government data, net direct tax collections have increased by more than 60% in fiscal 2021-22), it is time the government take a deep look at tax rates, and reduce the tax burden in the old regime. One of the ways is to increment standard deduction annually based on inflation. Standard deduction allows salaried taxpayers a flat deduction without submission of any proof.

Offer more choice to taxpayers: One of the claims of the new tax regime was that it allows taxpayers a higher cash flow (albeit more tax payout) and the freedom to invest in products of their choice. Even though 80C allows a host of investments and expenses as deductions, yet most options require a high lock-in, are not equity linked and perhaps may not find favour with those who are looking at flexibility on exit.

The government must consider a separate section where taxpayers can claim other types of investments. Even NPS (national pension scheme) should be kept out of Section 80C and enjoy an equally higher exemption of 1.5 lakh. Taxpayers can then be allowed a choice between 80C and a new section i.e. traditional products vs new age investment products. This would offer taxpayers more choice with tax saving and in turn higher liquidity.

Allow work from home expenses, remove redundant tax breaks: The best way to clean up and offer a simpler tax regime is by removing redundant exemptions such as children's education allowance (100 per month per child up to a maximum of 2 children), hostel expenditure allowance (300 per month per child up to a maximum of 2 children) and allowing deductions for those who work from home and have seen expenses for electricity, broadband, food, etc. shoot up during the pandemic years. Our tax exemptions now require a complete overhaul in line with our needs to favour the new workforce who work in startups and prefer to work flexibly. They need tax benefits to help them buy gadgets and household goods as well as equipment to work from home smoothly.

Remove compliance barriers: This year was difficult for tax filers due to glitches in the newly introduced e-filing tax portal. This was also the year the government introduced AIS. Many taxpayers lament that the compliance burden has increased with two forms to be reviewed, Form 26AS and AIS. With the due date for tax filings for FY 2021-22 around 6 months away, it is time for these two forms to be merged and consolidated into one. A stable portal and smooth experience makes tax filing a pleasant experience for taxpayers and professionals.

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