Money

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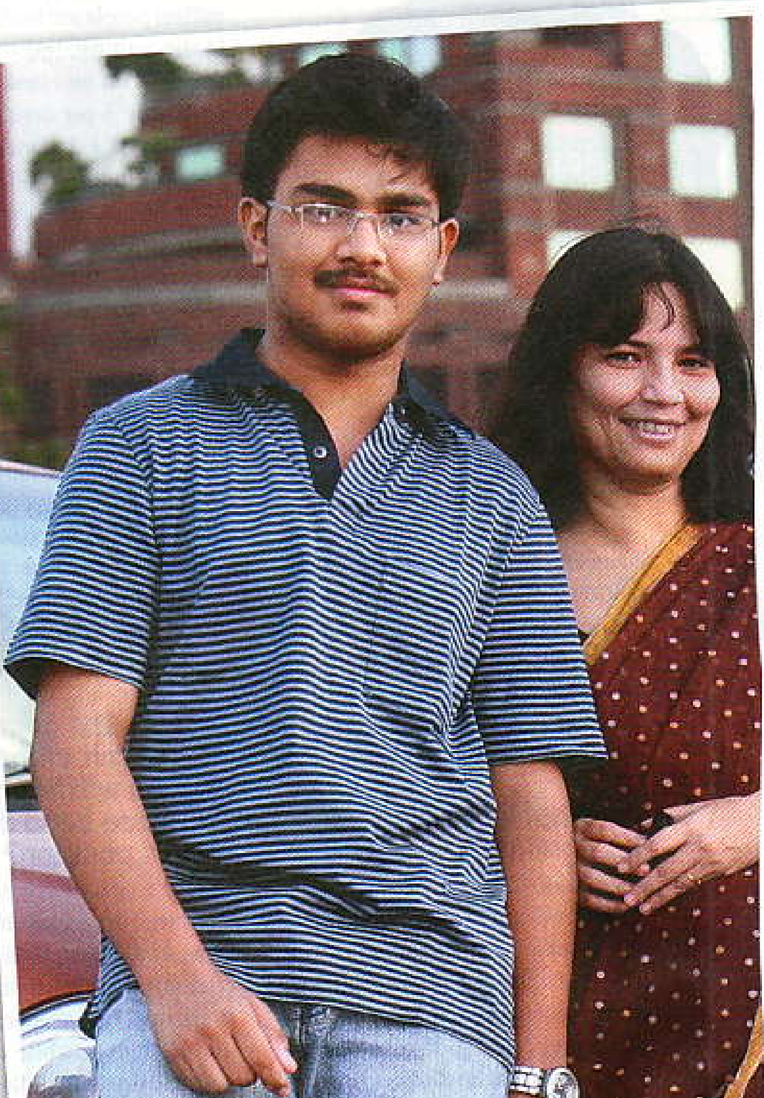
What the Tax Code Means to You

The draft direct tax code, if implemented in its current form, promises to be a game changer for individual taxpayers as well as for personal finance. *BT* shows how. MANU KAUSHIK AND RISHI JOSHI

Person A (names withheld on request), a young software professional based in Noida, was all set to buy his first house. He had already paid the builder Rs 2 lakh as advance and was awaiting approval for his Rs 20-lakh housing loan. But he isn't sure of buying a house anymore, and has requested the bank to put his loan application on hold.

Person B, a Bangalore-based sales executive, has painstakingly created what financial planners would call a balanced insurance portfolio, with term policies making up one half and ULIPS, money-back and children's growth plans the other. But B is now seriously thinking of closing all but the term policies before 2011 and starting afresh.

Indeed, 2011 is weighing on the minds of these individuals. Twenty-eleven is when the direct tax code, a draft of which has been put out in the public domain for comments, will come into force, replacing the Income Tax Act, 1961, that has governed individual taxpayers in the country and shaped their personal finance philosophies. Similar concerns are likely to preoccupy the minds of most salaried individuals, who may be called sooner than later to relook at their personal finance strategies and recast them in accordance with the tenets of the new tax code. But what is it about the new tax code that's forcing individuals such as A and B to rethink their financial plans? What does it mean to individual tax-



RITESH SHARMA

payers? *Business Today* answers these questions as it demystifies the new code for the salaried person in terms of benefits and liabilities to them and how it impacts their investment and tax planning.

To begin with, the draft code proposes to widen the taxpayers' base by simplifying the provisions for the common man and increasing the tax slabs substantially to encourage compliance. Also, applying the concept of give and take, while the new code lowers tax rates, it seeks to do away with current exemptions. So, how does all this impact a salaried person? The bad news is that tax will now be calculated on a person's net pay. Explains Amitabh Singh, Partner (Tax & Regulatory Services), Ernst & Young: "Typically, for a person earning a gross salary of Rs 10 lakh a year today, cash and perks is in the ratio of 60:40. At present, he is taxed on the entire 60 per cent cash part, while the remaining 40 per cent is either tax-free or partially taxed. The new code would tax both cash and perks."

But the good news is that an individual's tax burden would reduce substantially with the new code expanding the tax slabs, thereby putting more money in his hands. Another major plus is expansion of the exemption limit on savings to Rs 3 lakh from Rs 1 lakh earlier *(see case studies)*. However, people with annual incomes between Rs 10 lakh and Rs 25 lakh, i.e., mid- and senior-level executives, stand to benefit more from the expanded slabs than those earning less. A back-of-the-envelope calculation shows that while the tax liability of a man earning Rs 7.5 lakh a year would go down by 56 per cent under the new code, it would reduce by a whopping 80 per cent for an individual with an annual income of Rs 20 lakh. "Besides the expanded tax slabs, individuals in the higher bracket will benefit hugely from the removal of surcharge and education cess as well" says Surya Bhatia, Principal Consultant, Asset Managers.

By withdrawing exemptions on perquisites, the new code puts an end to the practice of structuring salary to save that extra penny in tax.

Arin Chakraborty (with wife and son), 47,
Country Manager in a Multinational; CTC: Rs **19,52,401**

Income	Existing	Proposed
Basic	5,65,440 O	5,65,440 O
HRA	2,82,720 ⊙	2,82,720 O
Allowances*	4,04,174 ⊙	4,04,174 O
Bonus	3,43,200 O	3,43,200 O
PF	67,854 ⊗	67,854 O
Perquisite Loan	86,000 O	86,000 O
Gross Salary	17,49,388	17,49,388
Less Exemptions	-4,14,630	NA
Less Interest on Housing Loan	-1,50,000	NA
Less Deductions u/s 80C	-1,00,000	-3,00,000
Net Taxable Income	10,84,758	14,49,388
Income Tax#	2,29,427	1,73,878
Education Cess @ 3%	6,883	NA
Total Income Tax	2,36,310	1,73,878
Income Tax/ Gross Salary	13.51%	9.94%

O Fully taxed ⊙ Partially taxed ⊗ Not taxed
*Includes conveyance, medical & leave travel allowances
# Tax is calculated on pro rata basis based on the tax slabs
NA= Not applicable in the new tax code All figures in rupees
Source: TaxManager.in

RITESH SHARMA

Deepak Sharma (with wife and son), 32
Senior Specialist in a software MNC; CTC: Rs 8,06,562

Income	Existing	Proposed
Basic	2,49,600 ○	2,49,600 ○
HRA	1,49,760 ⊙	1,49,760 ○
Allowances*	1,66,922 ⊙	1,66,922 ○
PF	29,952 ⊗	29,952 ○
Variable Pay	40,328 ○	40,328 ○
Gross Salary	6,36,562	6,36,562
Less Exemptions	-1,74,992	NA
Less Deductions u/s 80C	-1,00,000	-3,00,000
Net Taxable Income	3,61,570	3,36,562
Income Tax#	27;314	17,656
Education Cess @ 3%	819	
Total Income Tax	28,133	17,656
Income Tax/ Gross Salary	4.26%	2.77%

○ Fully taxed ⊙ Partially taxed ⊗ Not taxed
*Includes executivel & leave travel allowances
#Tax is calculated on pro-rata basis based on the tax slabs
NA= Not applicable in the new tax code All figures in rupees
Source: TaxManager.in

However, a more profound impact of the new code will be on the investment and tax planning habits of individuals. By withdrawing exemptions on perks, the new code seeks to put an end to the practice of structuring salary to save that extra penny in tax. Says Vikas Vasal, Executive Director, KPMG: "While some clarity still needs to come on how the perks and reimbursements will be taxed, it seems that government is willing to tax every source of your income."

Impact of EET Rule

The new code also proposes to bring the various saving schemes under the EET (exempt-exempt-tax) regime from the current EEE (exempt-exempt-exempt) rule. This would mean that investments in schemes such as the Public Provident Fund, National Savings Certificate, National Savings Scheme, Unit-linked insurance policies (ULIPS) and money back insurance plans schemes will be exempt from tax at investment and during the investing phase but the withdrawal amount will be added to your total income and taxed as per the applicable income tax rates at the time of withdrawal. "However, there will be no tax on rollover of money withdrawn from one account of the permitted savings scheme to another as it will not be considered a withdrawal," says Deepak Jain, CEO, TaxManager.in. On the other hand, proceeds from a pure life plan and policies of life insurance and policies whose premium is less than 5 per cent of the sum assured have been kept tax-free. In addition, incentives for medical insurance have been retained. So, individuals will continue to enjoy tax benefits on medical insurance premiums up to a maximum of Rs 15,000 (Rs 20,000 for senior citizens) for themselves and their spouse and kids and an additional Rs 15,000 (Rs 20,000 for senior citizens) for their parents.

Insurance

Experts think the EET regime will have a significant negative impact on the insurance industry, which has been aggressively selling investment products couched as insurance policies, as well as on certain sections of taxpayers, such as senior citizens. "It is evident that the government is discouraging people to look at insurance schemes as high-return, short-term savings instruments. The focus is to push people to invest in schemes such as the New Pension Scheme and superannuation funds, which will help them secure their retirement," says Himanshu Kohli, Founder Partner, Client Associates.

Market observers believe the EET regime can mop up the savings of the retirees as well as people with imminent retirement. "The proposed threshold (Rs 2.4 lakh) for senior citizens is very low. Typically, senior citizens manage their expenses from the money they periodically get from various saving schemes. If the government wants to tax those schemes, then the threshold should be raised to Rs 6 lakh," says Vasal, adding that the age qualification for senior citizens should be brought down from 65 to 60.

Lesser Avenues to Save

The new code allows only four specified savings intermediaries, including approved provident funds, superannuation funds, life insurance and new pension system trust. Both equity-linked savings schemes (ELSS) and fixed deposits (FDs) with a tenor exceeding five years will no longer enjoy the tax benefits. "This is a big shift. Some years ago, ELSS schemes were introduced to boost the retail investors' presence in the stock markets. I think the government now realises that the participation of retail investors in markets is fairly good," says Vasal. The code retains the rebate on tuition fees of children.

Home Loans

The code deals a major blow to home loan borrowers. In addition to taxing the house rent allowance, it disallows waiver on interest payment up to Rs 1.5 lakh if a person is staying in his own house. Nevertheless, if the same house or a second house is given on rent, the person will get the tax benefits on interest payout and, that too, unlimited interest payment. Tax experts feel the removal of tax benefits on interest on housing loan may prevent individuals from going for a housing loan. "In order to promote people to have their own house, this section needs some alteration. Owning a house is still a dream for many Indians," says Vasal.

SATISH KAUSHIK

"While clarity needs to come on how the perquisites and reimbursements will be taxed...government is willing to tax every source of your income"

Vikas Vasal/ Executive Director/ KPMG

UPSIDE

- Simple tax regime. All direct taxes will be under a single code.
- Expansion of I-T slabs should put more money in your hands.
- You can claim deductions up to Rs 3 lakh on investments. It's Rs 1 lakh now.
- Deductions on interest on educational loans will continue.
- Securities transaction tax (STT) will be abolished.

DOWNSIDE

- Perks like free housing, medical care, LTA, etc., will be part of your taxable income.
- Retirement savings to be taxable at withdrawal.
- Fewer investment instruments will be eligible for tax deductions.
- Up to Rs 1.5 lakh deduction on interest on home loans to go.
- Uniform capital gains to be applicable on all transactions.
- Only pure life insurance products to be tax exempt on maturity.

Stock Investments

The code scraps the distinction between long-term and short-term capital gains, and does away with the securities transaction tax (STT). Experts believe these moves will increase retail participation in the stock markets—through both direct and mutual fund route. "Stock market investors won't have to wait for 12 months to reap the benefits of an upsurge in a fund or the stock price. This will benefit those who conduct a higher number of transactions in the stock markets or mutual funds," says Kohli. So, if a person sells the asset, whether property or stock or debt fund, capital gains will be included as a part of income and taxed accordingly. ⊙

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