

How the proposed new Direct Tax Code could cut your income tax

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The Akhilesh Ranjan taskforce, set up to suggest an overhaul of the income tax act, has also suggested changes.

When the corporate tax rate was reduced to 25% last month, it was termed as an early Diwali for the corporate sector. Now, taxpayers are hoping the government will gift them a similar tax relief. According to former Niti Aayog Chairman Arvind Panagariya, “there is a strong case for a similar reform of personal income tax”.

The Akhilesh Ranjan taskforce, set up to suggest an overhaul of the Income Tax Act, has also recommended sweeping changes in the tax slabs. It submitted its report on the new Direct Taxes Code to the government in August. However, the report has not been made public.

According to news reports, the taskforce has retained the basic exemption level at Rs 2.5 lakh for general taxpayers. For senior citizens (above 60 years) the basic exemption stays at Rs 3 lakh and for very senior citizens (above 80 years) it stays at Rs 5 lakh.

The big change is the widening of the income slabs. The 10% tax slab extends right up to Rs 10 lakh, which will bring a significant relief to a large chunk of taxpayers. According to the Central Board of Direct Taxes (CBDT), more than 27% of the 5.52 crore individual taxpayers who filed returns for 2017-18 had an income between Rs 5 lakh and Rs 10 lakh. If the recommendations of the task force are implemented, these 1.47 crore taxpayers would move from the 20% slab to the 10% slab.

What the new slabs could look like

EXISTING		PROPOSED	
TAX RATE	INCOME	INCOME	TAX RATE
37% surcharge	Above ₹5 crore	Above ₹2 crore	35%
25% surcharge	Above ₹2 crore	₹20 lakh-2 crore	30%
15% surcharge	Above ₹1 crore	₹10-20 lakh	20%
10% surcharge	Above ₹50 lakh	₹2.5-10 lakh	10%
30%	Above ₹10 lakh		
20%	₹5-10 lakh		
5%	₹2.5-5 lakh		
NO TAX	Up to ₹2.5 lakh		NO TAX

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Currently, there is a 4% cess on total tax and full tax rebate for incomes up to Rs 5 lakh a year. The new DTC has reportedly recommended scrapping of the surcharges but retained the tax rebate.

Bigger impact on higher income slabs

The impact will not be very significant for low income taxpayers. Middle income earners with taxable income of up to Rs 5-6 lakh will not see a major change in their tax liability under the new slabs proposed by the DTC panel. However, they can escape the tax net by availing deductions that will take their net taxable income below the Rs 5 lakh tax-free threshold. The taskforce has retained the full tax rebate offered under Section 87A to taxpayers earning up to Rs 5 lakh a year.

Annual taxable income Rs 6 lakh

Std deduction	₹50,000	No change, as the DTC has retained the full tax rebate for taxable income of up to ₹5 lakh.
80C deduction	₹1 lakh	
Net taxable Income	₹5 lakh	
	EXISTING (₹)	PROPOSED (₹)
Tax	12,500	25,000
Rebate under Sec 87A	-12,500	-25,000
TOTAL TAX	NII	NII
SAVINGS	No change. Will not pay any tax.	

Annual taxable income Rs 9 lakh

Std deduction	₹50,000	Marginal change in tax because income between ₹2.5 lakh and ₹5 lakh is taxed at 10% and not 5%
80C deduction	₹1.5 lakh	
NPS (80CCD 1b)	₹50,000	
Net taxable Income	₹6.5 lakh	
	EXISTING (₹)	PROPOSED (₹)
Tax	42,500	40,000
4% cess	1,700	0
TOTAL TAX	44,200	40,000
Tax saved	4,200	
TAX CUT BY	9.5%	

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Even someone with a net taxable income of Rs 7 lakh a year would not get a significant break. He would see his tax reduce from Rs 44,200 to Rs 40,000, a drop of just 9.5%. However, the tax relief would be significant for taxpayers with higher incomes. A taxpayer with a net taxable income of Rs 10 lakh would see his tax reduce by about 34%, from Rs 1.06 lakh to Rs 70,000.

Annual taxable income Rs 12 lakh

Std deduction	₹50,000	Big savings in tax because large chunk of the income moves from 20% tax to 10% slab.
80C deduction	₹1.5 lakh	
NPS (80CCD 1b)	₹50,000	
Net taxable Income	₹6.5 lakh	
	EXISTING (₹)	PROPOSED (₹)
Tax	1,02,500	70,000
4% cess	4,100	0
TOTAL TAX	1,06,600	70,000
Tax saved	36,600	
TAX CUT BY	34.3%	

Annual taxable income Rs 24 lakh

Std deduction	₹50,000	Tax savings are high because a large chunk of the income is taxed at 20% instead of 30%.
80C deduction	₹1.5 lakh	
NPS (80CCD 1b)	₹50,000	
Net taxable Income	₹21.5 lakh	
	EXISTING (₹)	PROPOSED (₹)
Tax	4,57,500	3,05,000
4% cess	18,300	0
TOTAL TAX	4,75,800	3,05,000
Tax saved	1,70,800	
TAX CUT BY	35.9%	

The changes will be even more spectacular for taxpayers in the higher slabs. According to CBDT data, if the tax slabs are rejigged, another 40 lakh taxpayers would move from the 30% slab to the 20% slab. A taxpayer with a net taxable income of Rs 22 lakh would save Rs 1.7 lakh in tax every year. His tax outgo will reduce 36%, from Rs 4.75 lakh to Rs 3 lakh.

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Annual taxable income Rs 60 lakh

Std deduction	₹50,000	Tax savings not very high in percentage terms but taxpayer still gets to save a lot.
80C deduction	₹1.5 lakh	
NPS (80CCD 1b)	₹50,000	
Net taxable Income	₹57.5 lakh	
	EXISTING (₹)	PROPOSED (₹)
Tax	15,37,500	14,00,000
10% surcharge	1,53,750	
4% cess	67,650	0
TOTAL TAX	17,58,900	14,00,000
Tax saved	3,58,900	
TAX CUT BY	20.4%	

Fourth income slab introduced

The taskforce has also introduced a new 35% slab for incomes above Rs 2 crore. If you factor in the 25% surcharge and the 4% cess, the highest effective tax rate for those earning between Rs 2 crore and Rs 5 crore is 39%. So taxpayers falling in this income slab may not see as big a decline in their tax liability as other taxpayers. Even so, they still stand to gain from the widening of the 20% tax slab from Rs 10 lakh to Rs 20 lakh.

Annual taxable income Rs 1.2 crore

Std deduction	₹50,000	Big saving in tax due to removal of 15% surcharge and rejig of the slabs.
80C deduction	₹1.5 lakh	
NPS (80CCD 1b)	₹50,000	
Net taxable Income	₹1.175 crore	
	EXISTING (₹)	PROPOSED (₹)
Tax	33,37,500	32,00,000
15% surcharge	5,00,625	
4% cess	1,53,525	0
TOTAL TAX	39,91,650	32,00,000
Tax saved	7,91,650	
TAX CUT BY	19.8%	

Annual taxable income Rs 2.5 crore

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Std deduction	₹50,000	Saves tax due to removal of 25% surcharge but introduction of new 35% slab dents savings.
80C deduction	₹1.5 lakh	
NPS (80CCD 1b)	₹50,000	
Net taxable Income	₹2.475 crore	
	EXISTING (₹)	PROPOSED (₹)
Tax	72,37,500	73,37,500
25% surcharge	18,09,375	
4% cess	3,61,875	0
TOTAL TAX	94,08,750	73,37,500
Tax saved	20,71,250	
TAX CUT BY	22%	

Will the surcharge on tax go?

There could be good news for the super rich as well. The taskforce has recommended that tax surcharges should be used only as temporary measures. When the then Finance Minister P. Chidambaram had introduced the 10% surcharge on income of over Rs 1 crore in 2013, it was meant to be a one-time measure. Indeed, Chidambaram had stressed that it was a temporary levy when he said in his budget speech that “I am confident that when I ask the relatively prosperous to bear a small burden for one year, just one year, they will do so cheerfully.”

However, the surcharge on tax became a permanent feature of successive budgets. The measure was extended by the then Finance Minister Arun Jaitley in the 2014 budget. The following year, it was raised to 12%. In 2016, a new 10% surcharge was introduced for those earning above Rs 50 lakh while the surcharge on income above Rs 1 crore was enhanced to 15%. The cavalcade of misery did not stop there. This year, the rich were hoping for some relief. Instead, the surcharge was hiked to 25% for incomes above Rs 2 crore and to 37% for incomes above Rs 5 crore.

The hike in surcharge means that a taxpayer with a net taxable income of Rs 6 crore pays Rs 2.53 crore, or more than 42% of his income, in tax. The surcharge alone is Rs 65 lakh. If this levy is removed and the tax slabs are rejigged, the tax liability will reduce 33% from Rs 2.53 crore to Rs 1.97 crore. According to the CBDT data, there were 2,850 taxpayers reporting an income of above Rs 5 crore in 2017-18. These individuals were badly hit by the hike in surcharge and would be obviously be relieved if it is removed.

Revenue collections will be hit

Of course, the proposed changes in the income tax slabs will come at a heavy price. The generous cut in the corporate tax rate would mean an estimated revenue loss of about Rs 1.45 lakh crore to the exchequer. According to a Bank of America-Merrill Lynch report, the

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rejig of the income tax slabs would cost the exchequer another Rs 1.75 lakh crore. Of this, Rs 1 lakh crore would be borne by the Centre and Rs 75,000 crore by states.

As of now, officials are tightlipped about the proposed changes and tax professionals are not willing to hazard an opinion. But everybody does expect a big (and possibly populist) change in the tax structure soon. Incidentally, reducing the corporate tax rate to 25% was one of the proposals of the task force. It has also suggested the removal of the Dividend Distribution Tax (DDT).

If all goes well, taxpayers could have a bright and happy Diwali.