

Direct Tax Code Bill - Changes in Personal Taxation

Its here! With the amount of anticipation that normally accompanies a hotly publicized Bollywood movie, the Direct Tax Code (DTC) bill is finally here. The DTC will replace the Income Tax Act, and rings many changes in personal and corporate taxation. It will come into effect starting April 1, 2012. Here we demystify what the impact of the DTC will be towards the personal taxation for salaried individuals.

Following on from its original proposal last year, the Government had issued a revised discussion paper in June 2010. In its original form the DTC was expected to bring about far reaching changes in the personal taxation slabs and available exemptions. Fast forward to today, and whats been tabled in Parliament appears to be a watered down version of the DTC.

The following are the newly announced tax slabs for individuals

For Individual (Men, Women & HUF)

The big change is that the same tax slabs will apply to men and women. Now both are eligible for Rs 2 lakhs tax free exemption, whereas previously it used to be up to Rs 1.6 lakhs for men and up to Rs 1.9 lakhs for women.

Tax Rate	DTC Parliamentary Bill (Aug 2010)	Current Slab under Income Tax Act	Original DTC
Nil	Upto Rs 2,00,000	Upto Rs 1,60,000	Upto Rs. 1,60,000
10%	From Rs 2,00,001 to Rs 5,00,000	From Rs 1,60,001 to Rs 5,00,000	From Rs 1,60,001 to Rs 10,00,000
20%	From Rs 5,00,001 to Rs 10,00,000	From Rs 5,00,001 to Rs 8,00,000	From Rs 10,00,001 to Rs 25,00,000
30%	Above Rs 10,00,000	Above Rs 8,00,000	Above Rs 25,00,000

For men or women earning up to Rs 8 lakhs the net annual tax saving under the new DTC bill is going to be a maximum of Rs 4,000.

For men or women earning between Rs 8 lakhs to Rs 10 lakhs the net annual tax saving is going to be a maximum of Rs 24,000.

For men or women earning above Rs 10 lakhs, there is no additional net annual saving available under the direct tax code other than the Rs 24,000 as mentioned in the above example as well.

For Senior Citizens

For those above 65 years of age, the tax exemption limit has been raised to Rs 2.5 lakhs from Rs 2.4 lakhs, for a net new saving of Rs 1,000 per annum.

Tax Rate	DTC Parliamentary Bill (Aug 2010)	Current Slab under Income Tax Act	Original DTC
Nil	Upto Rs 2,50,000	Upto Rs 2,40,000	Upto Rs. 2,40,000
10%	From Rs 2,50,001 to Rs 5,00,000	From Rs 2,40,001 to Rs 5,00,000	From Rs 2,40,001 to Rs 10,00,000
20%	From Rs 5,00,001 to Rs 10,00,000	From Rs 5,00,001 to Rs 8,00,000	From Rs 10,00,001 to Rs 25,00,000
30%	Above Rs 10,00,000	Above Rs 8,00,000	Above Rs 25,00,000

Tax Deductions

Currently, the Income Tax Act offers individuals an annual deduction of Rs 1 lakh under 80C that can be used for instruments such as PPF (up to cap of Rs 70,000), PF, NPS scheme, ELSS, premium for pure life insurance or ULIP, principal repayment of home loan, NSC, fixed deposits with a maturity of five years, payment of tuition fees for full-time education for up to 2 children. In the current financial year (April 2010 through March 2011), one can get an additional deduction of Rs 20,000 for investing in certain notified infrastructure bonds under 80CCF. Additionally, 80D gives a deduction of Rs 15,000 towards medical insurance.

Under the DTC Bill, some of the above deductions have changed. What was previously available as the 80C deduction of Rs 1 lakh is now available as a deduction towards investments only in retiral accounts such as PPF, PF, NPS, and in savings schemes as notified by the Government. These are all eligible for taxation under EEE treatment. →EEE refers to the tax incidence - exempt at time of investment, exempt during accumulation, and exempt at withdrawal. These will be available for the tax year starting April 1, 2012.

Additionally, an aggregate deduction of Rs 50,000 is available for premium for pure life insurance, health insurance and tuition fees for two children.

As a result, the total deduction available is Rs 1.5 lakhs.

Please note that under the previous 80C deduction investments in ELSS and ULIPs were eligible for the Rs 1 lakh deduction, as was a deduction towards repayment of principal for an outstanding home loan. Under the DTC Bill all these three options are no longer eligible for a deduction.

To show you an actual example of the scope of savings, let's look at the hypothetical case of Mr Prakash, an individual tax payer aged 40. His salary income is Rs 18 lakhs and he takes advantage of investing in certain instruments that offer him a tax deduction. The table below compares Mr Prakash's tax liability under the three scenarios: the DTC Bill as introduced in the Parliament, the Current Slabs under the Income Tax Act, and the Original DTC when it was first announced.

Particulars	DTC Parliamentary Bill (Aug 2010)	Current Slab under Income Tax Act	Original DTC
Mr. Prakash's Salary Income for the Year	Rs 18,00,000	Rs 18,00,000	Rs 18,00,000
Investments in tax free instruments*	Rs	Rs	Rs

	1,50,000	1,50,000	1,50,000
Computation of Taxable Income			
Salary Income	Rs 18,00,000	Rs 18,00,000	Rs 18,00,000
Less: Savings eligible for tax deduction*	Rs 1,50,000	Rs 1,00,000	Rs 1,50,000
Net Taxable Income	Rs 16,50,000	Rs 17,00,000	Rs 16,50,000
Computation of Tax Liability			
Tax Liability on:			
- Rs 0 to Rs 160,000	Nil	Nil	Nil
- Rs 160,001 to Rs 200,000	Nil	Rs 4,000	Rs 4,000
- Rs 200,001 to Rs 500,000	Rs 30,000	Rs 30,000	Rs 30,000
- Rs 500,001 to Rs 800,000	Rs 60,000	Rs 60,000	Rs 30,000
- Rs 800,001 to Rs 10,00,000	Rs 40,000	Rs 60,000	Rs 20,000
- Rs 10,00,001 and above	Rs 1,95,000	Rs 2,10,000	Rs 1,30,000
Total Income Tax	Rs 3,25,000	Rs 3,64,000	Rs 2,14,000
Add: Education Cess	Rs 9,750	Rs 10,920	Rs 6,420
Total Tax Liability	Rs 3,34,750	Rs 3,74,920	Rs 2,20,420

Note: The above example does not consider the additional tax benefit this current financial year for Rs 20,000 for investments in notified infrastructure bonds under 80CCF.

* Under the current Income Tax Act these are up to Rs 1 lakh under 80C, but under the DTC Bill they can total up to Rs 1.5 lakhs.

As you will see in the above table, the tax liability under the DTC Bill is lower by approximately Rs 40,000 compared to the current rules. However, these savings could have been far more if the DTC in its original form been implemented, as can be seen if one compares the total tax liability in the columns marked DTC Parliamentary Bill vs. Original DTC. For this reason we believe that the Bill has watered down some of the exemptions and the deductions.

Nevertheless, the following are the sources of the total Rs 40,000 of savings for Mr Prakash under the DTC Bill:

Source	Amount of Saving compared to Existing Income Tax Act
Additional Rs 50,000 deduction	Rs 15,000 (Rs 50,000 x 30% marginal tax rate = Rs 50,000, Mr Prakash is in the highest tax bracket, and this is the additional saving that he can get by the additional Rs 50,000 deduction now available for tuition fees, pure life insurance and medical allowance)
Tax saving up to Rs 2 lakhs	Rs 4,000
Tax saving between Rs 8 lakhs to Rs 10 lakhs	Rs 20,000
Education Cess	Rs 1,170

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