Get set for the Budget

With just a few days for the Union Budget presentation, expectations are quite high. To start with personal taxation, can the common man who has been reeling under price rise expect some relief in income tax, which will increase his spendable income and boost savings? For the government, this could be the last opportunity to roll out some beneficial measures before the next elections in 2014.

Currently, an individual gets a deduction of Rs 1 lakh for expenditure on specified purposes/investments under section 80C of the Income Tax Act. With an all-round increase in cost of living, there is an urgent need to raise this deduction, say, to Rs 3 lakh. Similarly, deduction under section 80D for medical insurance premium could be upped from Rs 20,000 (when the policy includes a senior citizen) to Rs 30,000. Also, there is a tax break of Rs 10,000 on savings bank interest, which should be increased to at least Rs 20,000 and should also include interest on fixed deposits.

With spiralling costs, the current tax breaks set ages ago for transport allowance of Rs 800 a month should be raised to Rs 5,000 a month and for medical expenditure reimbursement, from Rs 15,000 a year to about Rs 30,000 per year. Similarly, education allowance of Rs 100 a month per child (for up to two children) and hostel monthly allowance of Rs 300 per child (for up to two children) need drastic revision to, say, Rs 5,000 per child per month separately for education and hostel expenditure. Also, the LTA (leave travel allowance) exemption could be made applicable every year and should include hotel costs, too, boosting the tourism sector.

The salaried employee is currently taxed on gross salary. An employee does incur costs to keep himself in an employable condition including costs for acquisition of new skills/upgradation of existing skills. Thus, the standard deduction from gross salary available till 2006 should be re-introduced.

Currently, a tax break for interest up to Rs 1.5 lakh is available on a loan taken for acquisition of house property. With multi-fold appreciation in property prices and rise in housing loan interest rates resulting in higher EMI (equated monthly instalments), the tax break on interest could be raised to Rs 3 lakh, along with a separate tax break for principal repayment of home loans, rather than inclusion in section 80C of the Income Tax Act.

Investors are currently paying short-term capital gains tax on sale of listed equity shares at a special rate of 15 per cent, even when they are otherwise in a 10 per cent tax bracket. This aspect needs rationalisation. **(**EXPECTING SOME RELIEF IN THE COMING BUDGET**)**

There is room for further relief in respect of the tax slabs for senior and ‘super senior’ citizens and the higher slab benefit for women should be reintroduced.

One should remember that India's economic situation at present is nothing to cheer about. There is inflation, significant slowing in growth, a rising fiscal deficit as well as lower-than-targeted tax revenue, to name a few challenges. Achieving all this might be a Herculean task for the finance minister.

In this backdrop, there is pressure on the government to identify alternative taxation routes. Therefore, will the rich be taxed more?

Taking a cue from the West, including the US and France (which has proposed a 75 per cent tax for the super rich), the idea of a higher rate of tax for the 'super rich' is being discussed in finance ministry circles and found support from C Rangarajan, chairman of the Prime Minister's Economic Advisory Council, as well as from Azim Premji, chairman of Wipro.

How does one define the 'super rich'? In India, the maximum marginal rate of tax of 30.9 per cent starts at a much lower threshold income of Rs 10 lakh. Thus, any increase in tax rate should be at a substantially high level of income, say, above Rs 50 lakh, such that it is truly the 'super rich' who pay higher taxes. And what about the agricultural super rich who don't pay any income taxes today? Clearly, they are not the 'aam aadmi' and a plan to tax the super rich should not have any exclusions.

Again taking a cue from the West, 'inheritance tax' is also being discussed as a tool to tax the super rich. Inheritance tax or estate duty payable by the executors of the estate of a deceased till 1985. In its earlier avatar, estate duty was a very complex piece of legislation and was payable on a slab basis. The levy started at a threshold of Rs 1 lakh, with a rate of 7.5 per cent and the maximum rate was 40 per cent of the principal value of the estate in excess of Rs 20 lakh. Due to insignificant tax collections and heavy litigation resulting in a very high collection cost, the levy was discontinued in 1985. Thus, inheritance tax, if re-introduced, would hopefully be levied after a high threshold and at a moderate rate.

Interestingly, in the BRIC (Brazil, Russia, India, China) bloc, high-growth countries such as China and Russia do not levy inheritance tax and only Brazil has an estate tax.

The proponents of measures for taxing the super rich, including inheritance taxes, describe these as tools to increase direct tax revenues and achieve reduction in income and wealth disparities between people, helping create a sustainable socio-economic model. Also, inheritance taxes should not harm the inheritor, since the tax is on what essentially is a windfall.

On the other hand, opponents of the super rich tax warn this might result into a regime of multiple taxation rather than simplification. In the past, India has witnessed higher tax rates and that did not help strengthen our fiscal health. Empirical evidence suggests the direct tax-to-GDP ratio goes up when tax rates are slashed. Further, higher taxes on the super rich could hurt investor sentiment and hamper capital formation. It might also prompt such individuals to relocate to low tax jurisdictions, such as Singapore.

Also, the number of declared wealthy tax payers is too small and these taxpayers, with income over Rs 20 lakh, already contribute 63 per cent of tax collections. Taxing these rich any more may not be the best policy to substantially increase revenues.

Inheritance tax could raise tax administrative costs, including uncertainty regarding computation issues and consequential litigation. It could also induce people to undertake planning measures such as transferring property to trusts, gifting of assets to immediate relatives, etc.

Therefore, rather than ‘super rich’ and ‘inheritance tax’, the preferred way forward is to increase overall tax compliance (as less than 5 per cent of the population files returns) and to introduce the common Goods and Services Tax at the earliest.

On the one hand, there are expectations of rationalisation of personal taxes and, on the other, there is the prospect of introduction of taxes on the super rich and inheritance taxes. The finance minister has to do a fine balancing act between the hopes of the common man and the promise of fiscal prudence.

(Business Standard)