New Tax Regime vs Old Tax Regime "Solution to the Quandary"

1. **Background:** -The Finance Act 2020 introduced a new regime under section 115BAC giving an option to Individuals and HUF taxpayers to pay income tax at lower rates. The new system is applicable for FY 2020-21 i.e., income earned from 1 April 2020.

2. OPT IN - OPT OUT: -

i) A taxpayer who is having Income from Business or Profession cannot switch between the new and old tax regimes every year, it can only for once opt-out of the new tax regime. Once such Tax Payer opts out of the new tax regime, they cannot opt-in again for the new tax regime in the future except where such person ceases to have any income from business or profession.

ii) In all other cases a taxpayer can opt-in and opt-out every year which means taxpayer is free to choose the new tax regime in one year and choose the regular tax regime in another year.

3. Pros and Cons of the New Regime

The Pros:

i) Reduced tax rates and compliance.

ii) Increased liquidity and more disposable income in the hands of the taxpayer who did not invest in specified instruments.

iii) Flexibility of customising the investment choice: As there is no need to investment only in the instruments specified and the manner provided taxpayer has a flexibility of customising their investment choices.

iv) Investor may not prefer to lock-in funds in the prescribed instruments for the specified period.

The Cons:

"Be careful what you wish for, there's always a catch". -Laurie Halse Anderson

A new tax regime with more tax slabs and lower tax rates was long demanded by most taxpayers, but it came with the catch of removal of many deductions and exemptions available.

i) Gradually, the present exemptions will be reviewed and slowly erased from the new tax regime.
ii) With no exemptions, your total taxable amount will be higher as compared during the old tax regime.
iii) Though there are six tax slabs, it may not be beneficial for all taxpayers if the income-tax authorities decide to do away with the old regime completely.

4. Old Tax vs New Tax Regime: Which one would you choose?

There is no specific answer to this question as it depends on tax payer's financial situation and annual earnings. Both the new income tax slab vs old tax slab has its advantages and disadvantages

INCOME TAX SLAB FY 2020-21 (AY 2021-22) for INDIVIDUAL

In this Financial Year we have two Choices either to opt Old Tax Regime or New Tax Regime

OLD TAX REGIME

1) Age is Below 60 Years

Total Income	Rate of Tax
Upto Rs.2,50,000	Nil
2,50,001 to 5,00,000	5%
5,00,001 to 10,00,000	20%
Above 10,00,000	30%

2) Age is 60 Years or more but less than 80 Years

Total Income	Rate of Tax
Upto Rs.3,00,000	Nil
3,00,001 to 5,00,000	5%
5,00,001 to 10,00,000	20%
Above 10,00,000	30%

3) Age is 80 Years or more

Total Income	Rate of Tax
Upto Rs.5,00,000	Nil
5,00,001 to 10,00,000	20%
Above 10,00,000	30%

NEW TAX REGIME

For All Ages

Total Income	Rate of Tax
Upto Rs.2,50,000	Nil
2,50,001 to 5,00,000	5%
5,00,001 to 7,50,000	10%
7,50,001 to 10,00,000	15%
10,00,001 to 12,50,000	20%
12,50,0001 to 15,00,000	25%
Above 15,00,000	30%

Claiming of Exemptions or Deductions Allowed or Not	Old Tax Regime	New Tax Regime
Standard Deduction of Rs.50,000 for Salaried and Pensioner	Allowed	Not Allowed
Deduction for Professional Tax paid	Allowed	Not Allowed
House Rent Allowance Exemption	Allowed	Not Allowed
Leave Travel Concession	Allowed	Not Allowed
Deduction of Interest on Self Occupied House Property up to 2 Lacs	Allowed	Not Allowed
Deduction for Family Pension Up to Rs. 15000	Allowed	Not Allowed
Deduction Under Section 80C to 80U Example: Provident Fund, LIC Premium, PPF, Tuition Fees, GIS, Tax Saver Mutual Fund, Housing Loan Principal Repayment, Medical Insurance, Donation, Interest on Education Loan, Physically Handicapped Deduction etc. 80 TTA (Interest on Saving Accounts Upto Rs.10,000) 80 TTB (Interest on Savings, FDR, others for senior citizens upto Rs.50,000	Allowed	Not Allowed

Note: Health and Education Cess of 4% **of Income is leviable in both Old and New Tax Regime**

Rebate under Section 87A **of Rs. 12500 or 100% of Income Tax (Whichever is less) for Resident Individuals having Total Income up to Rs. 5 Lacs**

[Means No Tax If Resident Individual has Total Income (After Deductions and Exemptions) up to Rs. 5 Lacs

Opportunity loss for Business or Profession

i) Exemption to SEZ u/s. 10AA
ii) Deductions u/s. 32AD, 33AB, 33ABA, 35(1)(ii),35(1)(iia), 35(1)(iii), 35(2AA), 35AD and 35CCC
iii) Additional depreciation u/s. 32(iia)
iv) Carried forward or unabsorbed depreciation of earlier years

Exemptions that remain prevalent in the new system:

i) Interest received on Post Office Savings Account under Section 10(15)(i) the maximum amount of Rs. 3,500.
ii) Gratuity received from employer up to a maximum amount of Rs. 20 Lacs.
iii) Amount received from Life Insurance Policy on maturity under Section 10(10D).
iv) Employer contribution in NPS or EPF up to 12% of salary and interest on EPF up to 9.5% p.a.
v) Income from Life Insurance.
vi) Income from agricultural farming.
vii) Standard reduction on rent.
viii) Retrenchment compensation.
ix) Leave encashment on retirement.
x) VRS proceeds up to Rs 5 lacs.
xi) Retirement cum death benefit.
xii) Money received as a scholarship for education.
xiii) Interest and maturity amount of PPF or Sukanya Samriddhi Yojna.
xiv) Commutation of Pension. The new tax regime offers you to claim deductions u/s 80CCD(2) 80JJAA

5. Tax Calculator for Resident Individuals FY 2020-21

In order to help taxpayers, make an informed decision by calculating and comparing their tax outgo under both the old and new tax regime the income tax department has brought out a tax comparison utility, which is available on their web portal and in which, an individual taxpayer can use to evaluate which option is better for him/her.

The link to the same is as under:

https://www.incometaxindiaefiling.gov.in/Tax_Calculator/

6. Scenarios Wise Comparison of Old Regime vs. New Regime

Scenario 1: Someone claiming few exemptions and deductions

Ritu is a bank employee who earns Rs 8 lakh per annum. She contributes towards EPF and also gets HRA benefits in his salary as he is living on rent. She is also eligible for LTA and this year, she has incurred Rs 25,000 on his travelling and will be claiming it. Due to her family obligations, she is not able to save anything beyond his EPF contribution.

Let's see which tax regime will save more taxes for him.

Income Tax Calculation		
	Old Tax Regime (₹)	New Tax Regime (₹)
a) Annual Income	8,00,000	8,00,000
b) Standard Deduction	-50,000	
c) EPF Contribution (Section 80C)	-25,000	
d) HRA	-30,000	
e) Leave Travel Allowance	-25,000	
f) Total (Deduction & Exemption)	1,30,000	
Net Taxable Income (a-f)	**₹6,70,000**	**₹8,00,000**

Tax Slab	Old Rates	New Rates	Tax (Old)	Tax (New)
0 – 2,50,000	0%	0%		
2,50,000 – 5,00,000	5%	5%	12,500	12,500
5,00,000 – 7,50,000	20%	10%	34,000	25,000
7,50,000 – 10,00,000	20%	15%		7,500
10,00,000-12,50,000	30%	20%		
12,50,000 – 15,00,000	30%	25%		
15,00,000 & above	30%	30%		
Total taxes			**46,500**	**45,000**
Cess			1,860	1,800
Total tax need to pay			**48,360**	**46,800**

As you can see, Ritu will save more taxes in the new tax system, with tax burden going down by **Rs 1,560**.

Scenario 2: Someone claiming all major exemptions and few deductions

Chandni earns Rs 13 lakh a year. Being salaried, she contributes towards the EPF. Also, she has invested Rs 40,000 in tax saving mutual fund (ELSS) and purchased a term life insurance with a coverage of Rs 1 crore. For this, she has paid a premium of Rs 10,000. Moreover, she is also eligible to claim tax exemption for Rs 30,000 in HRA, Rs. 20,000 in LTA, and Rs 26,400 for Sodexo meal coupons respectively in her taxable income.

Now, let's see how her tax liability changes in either of the tax structures

Income Tax Calculation		
	Old Tax Regime (₹)	New Tax Regime (₹)
a) Annual Income	13,00,000	13,00,000
b) Standard Deduction	-50,000	
c) Section 80C	-75,000	
d) HRA	-30,000	
e) Sodexo (Meal Coupons- 2200*12)	-26,400	
f) Leave Travel Allowance	-20,000	
g) Total (Deduction & Exemption)	2,01,400	
Net Taxable Income (a-g)	**₹10,98,600**	**₹13,00,000**

Tax Slab	Old Rates	New Rates	Tax (Old)	Tax (New)
0 – 2,50,000	0%	0%		
2,50,000 – 5,00,000	5%	5%	12,500	12,500
5,00,000 – 7,50,000	20%	10%	50,000	25,000
7,50,000 – 10,00,000	20%	15%	50,000	37,500
10,00,000-12,50,000	30%	20%	75,000	50,000
12,50,000 – 15,00,000	30%	25%		12,500
15,00,000 & above	30%	30%		
Total taxes			**1,87,500**	**1,37,500**
Cess			7,499	5,500
Total tax need to pay			**1,94,999**	**1,43,000**

As you can see, in this case too, the new tax system is better than the old tax regime, Chandni will end up paying Rs ***51,999 more*** in taxes. However, Tax benefits should not be seen as an advantage and the primary reason to invest or buy insurance.

Scenario 3: Someone availing all major exemptions and deductions

Parva earns Rs 20 lakh annually. He avails the full Rs. 1.5 lakh limit of Section 80C through a combination of contribution to EPF and ELSS mutual funds. Besides this, he bought health insurance, for which he paid a premium of Rs 25,000 that he claims as tax deduction under Section 80D. Also, to save more taxes from his salary, he made additional investments of Rs 30,000 in NPS. he also claimed an LTA amount of Rs 25,000, which is tax exempted. Now let's see which tax regime will give more money in his hand.

Income Tax Calculation		
	Old Tax Regime (₹)	New Tax Regime (₹)
a) Annual Income	20,00,000	20,00,000
b) Standard Deduction	-50,000	
c) Section 80C (EPF +ELSS Mutual fund)	-1,50,000	
d) HRA	-50,000	
e) Health Insurance	-25,000	
e) Leave Travel Allowance	-25,000	
e) NPS 80CCD (1B)	-30,000	
f) Total (Deduction & Exemption)	3,30,000	
Net Taxable Income (a-f)	**₹16,70,000**	**₹20,00,000**

Tax Slab	Old Rates	New Rates	Tax (Old)	Tax (New)
0 – 2,50,000	0%	0%		
2,50,000 – 5,00,000	5%	5%	12,500	12,500
5,00,000 – 7,50,000	20%	10%	50,000	25,000
7,50,000 – 10,00,000	20%	15%	50,000	37,500
10,00,000-12,50,000	30%	20%	75,000	50,000
12,50,000 – 15,00,000	30%	25%	75,000	62,500
15,00,000 & above	30%	30%	51,000	1,50,000
Total taxes			**3,13,000**	**3,37,500**
Cess			12,540	13,500
Total tax need to pay			**3,26,040**	**3,51,000**

In this case, the old tax regime works better. It will result in lower taxes with the difference of ***Rs 24,960***

7. Tax outgo comparison under old and new regime:

Scenario-1 In case of Rs 1.5 lakh deduction

COMPARISON OF TAX OUTFLOW VIS -A- VIS OLD AND NEW REGIME

GROSS SALARY	DEDUCTIONS	NET INCOME	TAX UNDER OLD REGIME	TAX UNDER NEW REGIME	SAVINGS / (EXTRA OUTFLOW)
7,50,000	1,50,000	6,00,000	33,800	39,000	(5,200)
10,00,000	1,50,000	8,50,000	85,800	78,000	7,800
15,00,000	1,50,000	13,50,000	2,26,200	1,95,000	31,200
20,00,000	1,50,000	18,50,000	3,82,200	3,51,000	31,200
25,00,000	1,50,000	23,50,000	5,38,200	5,07,00	31,200
30,00,000	1,50,000	28,50,000	6,94,200	6,63,000	31,200

Scenario-2 In case of Rs 3 lakh deduction

COMPARISON OF TAX OUTFLOW VIS -A- VIS OLD AND NEW REGIME

GROSS SALARY	DEDUCTIONS	NET INCOME	TAX UNDER OLD REGIME	TAX UNDER NEW REGIME	SAVINGS / (EXTRA OUTFLOW)
7,50,000	3,00,000	4,50,000	NIL	39,000	39,000
10,00,000	3,00,000	7,00,000	54,600	78,000	23,400
15,00,000	3,00,000	12,00,000	1,79,400	1,95,000	15,600
20,00,000	3,00,000	17,00,000	3,35,400	3,51,000	15,600
25,00,000	3,00,000	22,00,000	4,91,400	5,07,00	15,600
30,00,000	3,00,000	27,00,000	6,47,400	6,63,000	15,600

8. The 20% Mechanism:

The 20% mechanism can also to some extent help the taxpayers decide on which regime to choose. As per this mechanism if tax payers claim a deduction of 20% on their income, they are better off remaining in the old regime.

Steps:

1) first estimate the income to be generated in the financial year from various heads.
2) Take stock of all available eligible deductions.
3) Apply the Mechanism.

Let's say if income is expected to be Rs 7.5 lakh. So, do various deductions add up to Rs 1.5 lakh? If so, it's quite likely there are enough deductions to benefit by remaining in the old regime because your taxable income will be lower.

To understand better, let's take for instance income of Rs. 7.5 lakh. If your taxes under the old regime were Rs 65,000 assuming no deductions, in the new regime, your taxes on the same income reduce to Rs 39,000. But in the old regime, if you had claimed deductions of Rs 1.5 lakh, your taxes would be the lowest at Rs 33,800.

Also Remember that Income tax deduction limits favour those in lower-income brackets. For those in large incomes, the mechanism may not help.

For example, someone with an income of Rs. 35 lakhs will find it difficult to claim deductions of Rs 7 lakh, and therefore will not achieve 20% deductions. But people whose incomes are between Rs 5 lakh and up to around Rs 20 lakh can claim 20% deductions through smart financial planning. Those in lower-income brackets – Rs 12 lakh or lower – 20% deductions can be easily availed through deductions in Sections 80C and 80D alone.

9. Takeaway

Prima facia, it can be seen that the taxpayers who do not have many deductions to claim can opt for the new regime, and those who have substantial deductions to claim resulting in lower tax can continue with the old regime. If yearly income is on the higher side, it is a safer bet to choose the old tax regime as compared to the new one. However, the question remains a point of bias where no straight-jacket formula can give a clear distinction between both the options in general, and it depends on case-to-case basis as to what fits best for a taxpayer's benefit.

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