Budget 2020 Announcements: Potential impact on Retirement Benefits

The Finance Minister of India presented the Budget for the financial year 2020-21 in parliament on 1st February 2020. The announcement included some significant amendments to income tax regulations for individuals, which could potentially have implications on retirement and other long-term savings.

In this update, Willis Towers Watson summarises some key implications and considerations for employers and employees.

Announcement 1: Retirement contribution and interest for high-salaried employees subject to tax

- With effect from April 1, 2020, the meaning of perquisite (a subset of salary) would be extended to include the aggregate of any employer-driven contribution to a recognised provident fund, the National Pension System (NPS) and an approved superannuation fund, in excess of INR 750,000 in a given financial year. This excess amount if any, would be subject to Income-tax.

- The fund growth or "annual accretion by way of interest" in relation to the aggregate contribution of any employer-driven contribution to a recognised provident fund, the NPS and an approved superannuation fund, in excess of INR 750,000 in a given financial year would also be included within the meaning of perquisite (salary). This excess amount if any, would be subject to Income-tax, with effect from April 1, 2020.

- The impact would be felt on high earners whose combined employer contributions exceed INR 750,000 per annum.

Implications and recommendations

- This could discourage employees to save for retirement. In particular, voluntary plans, like NPS and Superannuation could be affected as high salaried employees, especially those who would have already exhausted the INR 750,000 limit or are close to this limit by virtue of their PF contributions are unlikely to save further for retirement through additional voluntary vehicles.

- These provisions are likely to cause tracking, accounting and administrative difficulties for employees, employers and retirement fund managers. In particular:

  - It would be extremely complicated for a tax-assessed individual and his / her employer to keep track of what is taxable income from each retirement fund to which the employee is a beneficiary and aggregate such income in order to arrive at his / her tax liability, accurately.

  - It is not clear how the "annual accretion by way of interest" will be calculated, especially on NAV based plans, e.g. NPS and unit-linked Superannuation plans. This can be complicated, and it will also be difficult to carve out the interest explicitly earned on the contributions above the threshold limit.

  - In order to determine the annual accretion for the portion in excess of the threshold limit, there will be an issue in determining the order in which the funds will be considered for the calculation e.g. if the annual contribution to PF is INR 500,000 and annual contribution to NPS is INR 420,000, will the interest on the contribution of INR 170,000 (920,000 – 750,000) be calculated on PF or NPS or both, in some pre-defined basis? The

Government needs to formulate clear guidelines on the computation mechanism to tax such annual accretion.

- There could be further complications if funds are transferred between retirement vehicles during the year, e.g. from Superannuation to NPS.

Announcement 2: All individuals will now have an ability to choose between the 'New Regime' and the 'Old Regime' for income tax assessment

- In order to 'simplify' the tax calculations for individuals, the Government has introduced a 'New Regime' which, if chosen at an individual level, would apply from financial year commencing 1 April 2020. Under this arrangement, the individual would need to forego a significant number of exemptions and deductions in exchange for lower income tax rates.

- The key changes to the income tax rates are for the INR 5-10L and INR 10-15L slabs where the tax rates have been revised from flat 20% and 30% to 10% gradually increasing to 25%. A flat rate of 30% continues to apply for all income exceeding INR 15L.

- However, in order to be eligible for the revised rates, an individual must give up several exemptions / deductions which, if utilised, would have otherwise reduced their net taxable income. Some of the keys ones include S. 10 (13A) - House Rent Allowance (HRA); S. 80C – life insurance premium, employee PF contribution; S. 80CCD(1B) – employee NPS contribution; S. 80D – medical insurance premium for self and family; Standard Deduction of INR 50,000; S. 80 TTA – interest income from savings accounts etc.

- The deductions also include all employee contributions to retiral arrangements such as EPF (12% of Basic Salary) and NPS 80CCD(1B) capped at INR 50,000. These are separate from the employer's contribution to these arrangements (i.e. EPF at 12% of Basic Salary, part of which is diverted to EPS; 80CCD(2) up to 10% of Basic Salary). Subject to Announcement 1 above, the employer's share of the contributions continue to be eligible for tax breaks under the New Regime.

Implications and recommendations

- Before choosing to move to the New Regime, all individuals should consider their personal circumstances as there may not be a clear winner. This is because some individuals may only wish to minimise their tax liability thereby increasing their net take home pay whereas others may choose to continue their long-term savings in order to defer consumption which may lead to a lower take home salary now but focus on building a corpus for their retirement, for example.

- Things get even more complicated when you take into account the other deductions such as HRA / interest on home loan as these will apply differently to individuals. Some households may even consider a 'mix and match' type approach in order to meet their goals as a working couple.

- Overall, the ability to move to a regime with a lower marginal tax rate may well confuse a large group of individuals who are likely to only focus on their net take home pay in exchange for the tax breaks they would have otherwise received in order to create long term savings. Below in an example of an individual who has an overall Gross Salary of INR 12L per annum under both regimes.

Key assumptions for illustration:

Gross Salary = INR 12L;
Basic Salary = 50% of Gross Salary;
HRA = 50% of Basic Salary (actual rent paid = INR 25,000 per month);
Mandatory Employer and Employee contributions towards EPF contributions at 12% of Basic Salary each;
Under Old Regime investment in life insurance of INR 78,000 (total deduction under 80C = INR 150,000); contribution in NPS under 80CCD(1B) of INR 50,000; Standard Deduction of INR 50,000 applies under the Old Regime.

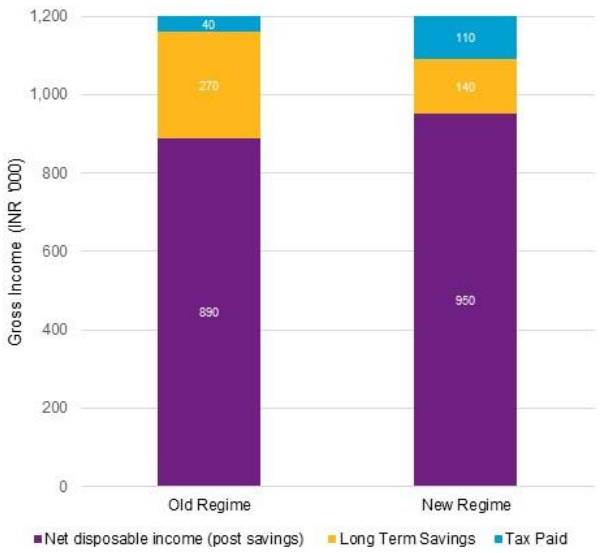

Figure: Indicative impact on income

As can be seen from the table above, opting for the New Regime can have a significant impact on the composition of current and deferred income. While the New Regime may lead to higher disposable income, this is likely to come at a cost:

- Potentially higher tax liability overall*;
- Lack of any significant insurance cover due to the removal of tax breaks;
- Only mandatory contributions being made towards long term savings under the mandatory provisions of the EPF.

**subject to compensation levels and exemption options utilised by the individual*

Overall, while we understand that the objective of the New Regime is to drive higher consumption by increasing the disposable income in the hands of employees, there is a risk that this may also create a disincentive for employees to save for the long term. From a retirement perspective, 12% of statutory EPF contribution is not going to be enough – according to study conducted by Willis Towers Watson, employees need to save at least 20% of gross salary to build a reasonable retirement corpus.

Disclaimer: Nothing set out above should be taken to be formal legal or tax advice.

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