Complexities in Taxing the Savings

What is the issue?

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India has a complex tax regime for savers, which distort their freedom to choose options for saving.

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What measures of the government encourage savings?

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- The Income Tax Act, under Section 80C, does create such incentives by allowing savers to deduct up to Rs.1.5 lakh upfront from their taxable income each year towards investments.
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- The 80C has list of 'approved' investments, which includes provident funds, senior citizens' savings, housing loan EMIs, ULIPs (unit linked insurance plans), equity-linked funds and children's tuition fees.
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- Tax laws encourage leveraged investments in property by allowing tax deductions on both the principal (Section 80C) and interest repayments (Section 24B) on home loans.
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- Capital gains earned on selling residential property after three years is not taxed if the proceeds are reinvested in another house.
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- Equity gains are treated as 'long term' after just one year and completely exempt from tax thereafter.
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What are the practical complexities in taxing the savings?

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- The 'approved' investments of 80C list distorts choices for savers to get tax

breaks, due to this some savers choose risky equity savings scheme or housing loans instead of safer fixed deposits in banks.
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- Re-investment benefit is unavailable to financial products like deposits, bonds, securities, etc.
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- Most of the debt investments are termed 'long term' only after three years with gains taxed at 20%.
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- Thus present tax laws ignore individual risk-taking ability, and try too hard to push investors towards equities.
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What reforms needs to be made?

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- Section 80C should stop the compiled deduction and allow investors to choose their own instruments.
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- Instead of micromanaging savings under 80C, government needs to do away with the 'approved' list and offer one time deduction of Rs.2 lakh a year, for financial investments.
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- A uniform definition of 'long-term' and cost inflation benefits for all financial products will make investments attractive.
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- Sale proceeds from financial assets if held long term should be allowed to be reinvested without capital gains tax.
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- At the same time both dividend and interest income must be taxed at similar rates.
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- Such reforms will help savers to decide on their relative allocation between safe and risky assets based on their life stage, income, financial goals and risk appetite.
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Source: The Hindu

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