



A CRITICAL REVIEW OF DEDUCTIONS AVAILABLE UNDER SECTION 16 OF THE INCOME TAX ACT, 1961

¹Khyati Suresh Shah

Research Scholar,
S.D. School of Commerce,

¹Gujarat University, Ahmedabad, Gujarat, India.

Abstract: Deductions to the salaried taxpayers extended under section 16 of the Income Tax Act, 1961 have been there since the foundation of the income tax act. The reason for the same could be the existence of the salaried class in huge number since then. These deductions exist to extend some income tax relief only to the salaried class. Though there have been several amendments in this section, the benefit that it actually extends to such taxpayers is really a matter of probe. The reason is that the maximum amount of deduction under this section if all the required conditions are fulfilled, comes to Rs. 57,500 for a government employee (Rs. 50,000 of standard deduction, Rs. 5,000 on entertainment allowance and Rs. 2,500 on professional tax) while it comes to Rs. 52,500 a non-government employee (Rs. 50,000 of standard deduction and Rs. 2,500 on professional tax). This paper, thus, makes an attempt to critically examine the deductions available under section 16 of the Income Tax Act, 1961 to the salaried class and also make a few suggestions in the said section.

Index Terms - Deduction from Salaries, Section 16, income tax.

I. INTRODUCTION

The existence of exemptions and deductions under income tax has been there to extend a relief to the taxpayers and permit them planning of their taxes such that they are able to reduce their tax liability, to an extent. These exemptions and deductions form a part of the income tax statute and are granted by the legislature from time to time depending upon the various requirements prevalent in the country.

Section 16 of the Income Tax Act, 1961 is also one such deduction granted by the legislature to the persons having Income under the head Salaries. This section has been into existence in the income tax law since the introduction of this law in the year 1961. Since then it deals with "Deductions from Salaries." It is a specific deduction available only to specific category of persons. The basic intention of the legislature to grant this deduction should have been to give some respite to the salaried class in order to perform their duties as well as to meet certain expenses that they incur to perform their duties.

The deductions available under section 16 of the Income Tax Act, 1961 should have been one of the most claimed deductions as salaried taxpayers are one of maximum number of taxpayers in our country. This section, thus, has been amended several times from the period during 1961 to 2020. On one side, it obviously seems very good that the government does take care of its salaried class as they have been the most tax compliant assesseees. The concern of the government can be noticed not only by the number of amendments that have been made to this section but also by making such amendments that change the manner of determining deductions available under this section. It should have been essentially to grant as much benefits as possible to the salaried class. However, on the other side, these many amendments may depict the dearth of long term planning as one cannot overlook the confusion that would have been created year after year, due to the many changes that were brought in this section.

II. SECTION 16 OF THE INCOME TAX ACT, 1961

The existing provisions of this section are as under:

An assessee, having income under the head Salaries, shall be allowed a:

- A. Standard Deduction of Rs. 50,000 or the amount of salary, whichever is lower;
- B. Deduction, of lower of the following, on receipt of salary from a government employer if the assessee has received entertainment allowance:
 - (i) 20% of Salary excluding any allowance, benefit or any other perquisite; or
 - (ii) Rs. 5,000.
- C. Deduction on payment of tax on employment as per the provisions of Article 276 (2) of the Constitution of India and levied under any statute.

One can infer the following from the aforesaid provisions of this section:

- Deduction under this section is available to an individual assessee only. The reason for the same is that only an individual can be employed and can have income under the head Salaries.
- There are in all only three deductions available from Salary income. No further deductions are allowed in computation of salary income except for the ones specified u/s 16 of the Income Tax Act, 1961.
- Standard deduction is available irrespective of the level of salary income one has earned. However, the maximum permissible amount of standard deduction has been restricted to Rs. 50,000.
- The deduction on receipt of entertainment allowance is allowed only to government employees. Further, the maximum amount of deduction that has been restricted for this deduction is Rs. 5,000.
- The last deduction is that of Professional Tax. This tax is a State levy but the Constitution of India has restricted the upper cap of levying professional tax. No State can levy and collect any amount above Rs. 2,500 p.a. as professional tax. Any employee who has paid such tax during the previous year relevant to the assessment year, for which the computation of income is being done, is allowed a deduction of the amount of professional tax so paid by him / her. There is no ceiling limit prescribed for this deduction under the income tax act as it depends of the levy of this tax.

III. RESEARCH METHODOLOGY

Data and Sources of Data:

The data is secondary in nature and majority of the data has been collected from the Income Tax Act, 1961, Union Budget Speech of Finance Ministers and Annual Finance Acts.

Tools and Techniques:

The study undertaken here is an Analytical Research and so document review is the technique used to collect data.

IV. ANALYSIS AND SUGGESTIONS

The detailed analysis of the deductions available under section 16 of the Income Tax Act, is as under:

A. Standard Deduction:

Analysis: -

One can clearly observe from amendments made to this section that the most amended deduction is standard deduction. For some period of time, this standard deduction was dependent upon the range of salary income earned by the taxpayer while sometimes it was available irrespective of the level of salary income earned.

The major concerns of standard deduction are as under: -

1. Adequacy of the amount of deduction granted: -

At present, the amount of standard deduction that an assessee can claim has been capped at Rs. 50,000 irrespective of the amount of salary earned. The purpose of standard deduction has been to give some advantage to the salaried person in order to meet the costs that he / she incurs in performance of his / her duties. The government needs to see that is the amount of standard deduction enough for a salaried employee as compared to the deductions available to a businessman / a professional person. I am not undermining the risk that the businessman / professional takes to earn but they also get more benefits of deductions under the head Profits and Gains from Business or Profession.

2. Designing of Salary Structure: -

An employee for whom the employer has not designed a tax savvy salary structure, it as a disadvantage as compared to that employee whose employer has designed a tax savvy salary structure. Let us understand this with the help of following example:

Assuming that cost to the company (hereinafter referred to as CTC) is same, one company has designed the salary structure having house rent allowance (hereinafter referred to as HRA) as one of the components of salary structure while the other company does not have HRA as one of the components of salary structure. Now, for an employee who stays in a rented premise would be better off with the company whose CTC has HRA as a component of salary structure because he/she gets a benefit of exemption for HRA as specified u/s 10 (13A) of the Income Tax Act, 1961 as against the company whose CTC does not have HRA as a component of salary structure because he/she cannot avail the exemption of HRA. However, such employee can resort to deduction available under section 80GG of the Income Tax Act, 1961 but the maximum deduction permissible is Rs. 5,000 p.m. while there may be chances of getting a higher exemption u/s 10 (13A) of the Income Tax Act, 1961. So such employees may ultimately take a resort to only standard deduction.

Suggestions: -

My humble submission to the government would be to rework on the standard deduction available to the assessee under this section so that he / she actually gets certain advantage of the same. Further, the government can come up with a new provision of standard deduction depending upon the salary income earned by an assessee and withdraw all specific exemptions. This will not only simplify the computation of income under the head Salaries but will also remove the inequality prevalent between employees with different salary structure.

B. Deduction Available on Receipt of Entertainment Allowance:**Analysis: -**

The other deduction available under this section is that on receipt of entertainment allowance. This deduction has two pre-requisites:

1. An employee has to receive such entertainment allowance; and
2. Such allowance must be received from a government employer.

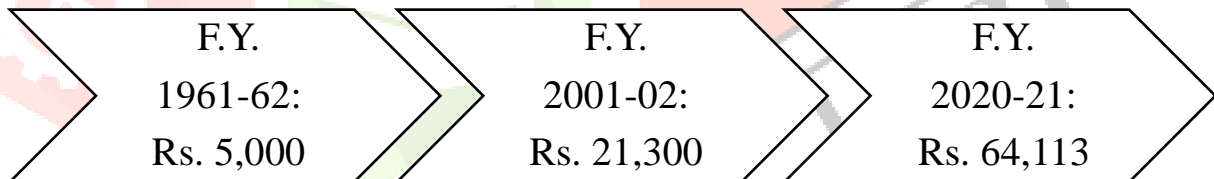
I have a couple of questions here. These are listed as under: -

1. Why entertainment allowance is granted as a deduction from gross salary and not an exemption like other allowances?
2. What is the need to create unnecessary confusion as first this allowance has to be fully taxable and then to be claimed as a deduction under this section?
3. Why is the deduction granted only to government employees?
4. Why aren't the limits for deduction revised after 1961? One of the limits of deduction is stipulated in relative terms and hence, the amount will increase with the increase in salary. So despite of no revision in this, it actually doesn't matter. However, the upper cap has been mentioned in absolute terms. This upper cap was fixed since the inception of the Income Tax Act, 1961 and has not been updated after this. Rs. 5,000 that was fixed in 1961 has been kept intact and no revisions have been made despite of the changing prices that one can observe over the years. So if we have to look at it keeping in mind the concept of time value of money then, Rs. 5,000 of 1961 does not have the same value in the year 2020. Let us consider the Cost Inflation Index (hereinafter referred to as CII) and see what the value of Rs. 5,000 will be in today's value. The computation is done at two levels as the value of Rs. 5,000 was fixed in 1961-62,;
 - I. Considering financial year (hereinafter referred to as F.Y.) 1981-82 as the base year and computing the value in terms of F.Y. 2001-02 and then
 - II. Considering F.Y. 2001-02 as the base year and computing the value in terms of F.Y. 2020-21.

The reason for the two level computation is that the base year has been shifted from F.Y. 1981-82 to 2001-02. Due to the shift in base year, the inflation over the period from 1961-62 to 2001-02 will be completely ignored and hence, the said computed value may not reflect a true picture.

Base Year is F.Y. 1981-82			Base Year is F.Y. 2001-02		
F.Y.	CII	Amount (in Rs.)	F.Y.	CII	Amount (in Rs.)
1961-62	100*	5,000	2001-02	100*	21,300
2001-02	426	??	2020-21	301	??

*Base year is CII = 100



The amount has gone up by more than twelve times in F.Y. 2020-21 and the value of Rs. 5,000 is obviously not the same today as it was in the year 1961.

Suggestions: -

It seems that this deduction exists only for the namesake and has been completely ignored over the years as there has not been a single revision in the upper cap fixed since the inception of this section in the year 1961. Looking at this, the government should completely remove this deduction. However, if it still intends to extend the benefits of this deduction, the upper cap should be revised and also the restriction of granting this deduction only to government employees should be removed.

C. Deduction Available on Payment of Professional Tax:**Analysis: -**

Coming to the last deduction under this section is that of professional tax. Granting of this deduction seems fine as it is based upon the payment of professional tax made by the assessee during the previous year. It actually gives a relief, though a meagre one, to the taxpayer as he / she gets a deduction from income tax on payment of other tax to the state government. Thus, in a way, it can be seen that the taxes that the salaried person pays to the state government, the central government takes a note of it and extends the benefit of the same to its taxpayers so that they are not unnecessarily burdened.

V. CONCLUSION

The salaried class thus, is entitled to only a handful of deductions under the head Income from Salaries. These deductions still should be streamlined in a manner such that these actually extend the benefits of income tax to the salaried class. Most of the times, salaried class has a feeling of injustice due to the meagre amount of deductions that they are entitled to under the head Income from Salaries as compared to the deductions that are available under the head Profits and Gains from Business or Profession. This definitely calls for an action from the government such that it is able to justify the benefits given under both these heads and in way to give a relief to the most honest taxpayers of this country.

Further, with the introduction of the new personal tax regime under section 115BAC of the Income Tax Act, 1961, a salaried taxpayer who opts for it has to forego all the deductions mentioned u/s 16 of the Income Tax Act, 1961 over and above foregoing other exemptions and deductions while computing his / her total income as stipulated under section 115BAC of the Income Tax Act, 1961. In order to continue availing the benefits of this deduction, such taxpayer needs to continue with the existing personal tax regime only. However, such taxpayer cannot decide to opt for new or existing personal tax regime merely on this parameter as there are other factors too that need to be considered.

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