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EY Tax Alert

CBDT permits employers to consider new concessional tax regime for salary withholding

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Executive summary

This Tax Alert explains Circular No. 4/ 2023 dated 5 April 2023 issued by Central Board of Direct Taxes (CBDT)[1] which provides clarification on the manner of application of salary withholding provisions by employer in view of the new concessional tax rate (CTR) regime applicable to certain non-corporate taxpayers as a default regime unless opted out by the taxpayer. The CTR regime provides lower tax rates and surcharge than old regime but without specified exemptions and deductions.

The CBDT has directed employers to seek information from their employees regarding their choice of tax regime and each employee shall intimate whether he/she is availing CTR or old regime. The intimation is to be furnished every tax year to enable employer to withhold taxes on salary income as per regime opted by the employee. If employer does not receive any intimation, employer shall withhold taxes at lower slab rates as per CTR regime. The CBDT clarification is applicable from tax year 2023-24 onwards.

[1] The apex administrative body for direct taxes

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Earlier CTR regime

- The Finance Act 2020 introduced CTR for individuals and Hindu Undivided Families (HUF) from tax year 2020-21 onwards. The CTR provided for lower tax rates provided the taxpayers forgo certain specified deductions and exemptions. For salaried taxpayers, the exemptions/deductions that were required to be foregone included most popular items like house rent allowance (HRA), leave travel allowance/concession (LTA/LTC), standard deduction from salary, interest on housing loan for self-occupied property, Chapter VIA deductions like life insurance premium, employee's contribution to provident fund, mediclaim premium, etc.

- The taxpayer not carrying on business or profession (like salaried taxpayers) had to opt for CTR on year-on-year basis while filing return of income (ROI). Taxpayers carrying on business or profession had to furnish Form 10IE by due date of furnishing ROI to opt for CTR and once having opted for CTR, the choice was irrevocable such that if taxpayer withdraws the option for any tax year, then he/she could not opt in again until he/she ceases to have business or professional income. For salaried taxpayers, the old regime was default tax regime unless CTR was opted in ROI.

- The CTR regime raised ambiguity whether the employer can consider CTR regime for salary withholding tax purposes since the employer would not know whether employee will choose CTR or old regime in ROI. To address genuine hardships for employers in such cases, the CBDT issued a Circular No. C1 of 2020 dated 13 April 2020 clarifying as follows:

    - An employee not having business or professional income and intending to opt for CTR had to intimate his/her intent to employer and in such case, the employer had to apply CTR for salary withholding tax purposes.

    - If no intimation was made by employee, the employer had to apply old regime for salary withholding tax purposes

    - The intimation to employer was only for salary withholding tax purposes for the particular tax year and could not be modified during that tax year. However, the employee was free to opt for either regime in ROI i.e., even if employee had intimated to opt for CTR for salary withholding tax purposes, he/she could avail old regime in ROI.

    - The above clarification also applied for employees having business or professional income with the modification that intimation to employer for subsequent tax years must not deviate from the option for CTR once exercised in a particular tax year.

New CTR regime

- The Finance Act, 2023 (FA 2023) has amended the CTR regime to make it more attractive for non-corporate taxpayers by providing for, *inter alia*, following benefits (new CTR regime):

    - Expansion of scope of eligible taxpayers to other non-corporate taxpayers like association of persons (other than co-operative societies), body of individuals and artificial juridical persons.

    - Higher threshold of maximum amount not chargeable to tax[2]

    - Recalibration of slab rates to provide more lower tax rates

    - Standard deduction can be claimed from salary or family pension income

    - Higher threshold[3] for rebate from tax with marginal relief

    - Capping of higher surcharge to 25% instead of 37% for total income exceeding INR 50M[4]

- Importantly, the new CTR regime will now be the default regime and taxpayers desiring old regime are required to opt out of the new CTR regime. The option has to be exercised in every tax year where the taxpayer does not have business or professional income. Such taxpayers need to exercise the option in ROI to be filed on or before the due date provided under the provisions of Income-tax Act, 1961 (ITL).

- In other cases, i.e., taxpayer carrying on business or profession, the option for old regime has to be exercised by furnishing prescribed form on or before ROI filing due date and once exercised it is irrevocable until business/profession ceases. However, having opted for old regime, the taxpayer can opt out and move into CTR once in any tax

[2] Enhanced from INR 250,000 to INR 300,000
[3] Enhanced from INR 500,000 to INR 700,000
[4] Introduced in provisions of the Finance Act 2023

year. But, having moved into CTR, such taxpayer cannot opt in again to old regime till the business/profession ceases.

- The new CTR regime is applicable from tax year 2023-24 onwards.

- While FA 2023 made the new CTR regime as default regime and enabled the taxpayers to pay advance tax as per CTR regime, there was ambiguity whether the employer can consider CTR regime for salary withholding purposes given that the employee can opt out of the CTR regime. Furthermore, although new CTR regime is default regime, on a literal reading of the provisions of ITL and FA 2023, the salary withholding provisions require the employer to deduct salary withholding tax as per old regime tax rates. This raised ambiguity for employers on the approach to be adopted for salary withholding tax in the light of change in CTR regime.

CBDT Circular No. 4 of 2023 dated 5 April 2023:

- In the wake of representations from various stakeholders, the CBDT noted that since the employees (not earning any income from business or profession) can exercise the option along with ROI, the employer, at the beginning or during the tax year is not aware whether the employees would opt for new CTR regime or old regime.

- In order to avoid genuine hardships in such cases, by exercising its powers under the ITL to give directions, the CBDT has directed the employers to adopt the following approach for withholding taxes under salary withholding provisions for tax year 2023-24 and onwards:

  Where the employee furnishes intimation on remaining within CTR or opting for old regime:

  - The employer shall seek information from each employee in each tax year regarding their intended tax regime.

  - The employee should furnish an intimation to his/her employer of his/her intention of new CTR or old regime. Such intimation shall be furnished for each year.

  - On receipt of the intimation, the employer shall withhold tax as per new CTR or old regime as per option exercised by the employee.

  - The CBDT has clarified that such intimation shall only be for the purposes of salary withholding during the relevant tax year. Since the option for old regime has to be exercised while filing the ROI, intimation to employer would not amount to exercising the option for the purposes of filing ROI. The employee shall be required to exercise option for old regime separately as per provisions of ITL.

  Where the employee does not furnish any intimation:

  - If no intimation is made by the employee, it shall be presumed that the employee continues to be in default CTR regime and has not exercised the option for old regime. Accordingly, in such case, the employer shall withhold tax as per CTR regime.

- This Circular supersedes the earlier CBDT Circular No. C1 of 2020 which applied for old CTR regime operative till tax year 2022-23.

- The Circular shall apply for tax year 2023-24 and subsequent tax years.

Comments

The CBDT clarification is a welcome relief amidst the unintended hardship of higher salary withholding arising in the hands of employees intending to be covered under new CTR regime.

While the CBDT requires the employee to furnish intimation of intended regime, the exact manner, format, time limit and frequency of furnishing intimation are not specified leaving it to individual employers to implement the mechanism in an administratively convenient manner (whether in physical or electronic mode).

Since new CTR regime is default tax regime and the Circular also directs the employer to consider new CTR regime for salary withholding tax purposes in absence of intimation from employees, it effectively means the intimation from the employee is relevant only if the employee intends to opt for old regime. In such case, the employer will have additional compliance of considering exemptions and deductions after verifying the claims and documentary evidence submitted by the employees.

Circular No. C1 of 2020 clarified that intimation once made by the employee cannot be modified during the relevant tax year. There is no such clarification in present Circular No. 4. Nevertheless, once the intimation is furnished by the employee to opt for old regime, it would be reasonable on employer's part not to allow switch over to new CTR regime during the tax year.

In case of change in employment during the year or concurrent employment with more than one employer, the employee will need to ensure that a uniform intimation is provided to all the employers to avoid mismatch in salary withholding.

The present CBDT Circular clarifies that the employee is not bound by the intimation of intended regime to the employer and can switch to other regime while filing ROI. This is most likely to happen if the employee finds that other regime is more beneficial while filing ROI.

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