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How standard deduction will apply on pensioners' income

A standard deduction of Rs40,000 for employees, subject to the limit of actual amount of salary, was reintroduced in Union Budget 2018

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In Union Budget 2018, standard deduction for employees has been reintroduced. It has been fixed at Rs40,000, subject to the limit of actual amount of salary. Even if salary is received from more than one employer, the total deduction can't exceed Rs40,000. Simultaneously, two other exemptions available to employees have been withdrawn—medical reimbursement of Rs15,000 per annum, and conveyance allowance of Rs19,200 per annum. So the additional benefit of exemption to most employees is only Rs5,800.

Standard deduction had been discontinued from the financial year 2005-06, on the ground that the general exemption limit was being raised, and the income slabs were being broadened. The reasons given by the finance minister for restoration of this standard deduction were to provide relief to salaried taxpayers, reduce paper work and compliance, and help middle-class employees in terms of reduction of their tax liability.

It was also clarified that standard deduction would also significantly benefit pensioners, who normally do not have the benefits of medical reimbursement or conveyance allowance.

The Central Board of Direct Taxes recently issued a clarification that a taxpayer, who receives pension from his former employer, would also be eligible to claim such standard deduction, since such pension would be taxable under the head of income "Salaries".

This amendment gives rise to some interesting issues, particularly for pensioners. Often, the pensioner receives pension not from his former employer, but as an annuity from an insurance company. Is such amount also eligible for standard deduction?

In such cases, the pension is the contractual obligation of the employer, who normally creates a superannuation fund to meet such obligation, and funds it from year to year. On retirement of the employee, the superannuation fund purchases an annuity from an insurance company out of the accumulated funds, to meet the pension obligation to the retired employee. Therefore, the annuity is in discharge of the employer's contractual obligation to pay pension to the retired employee. Such annuity would also therefore be taxable under the head "Salaries", and would qualify for standard deduction.

Again, often a former employee may receive arrears of salary or bonus in a year subsequent to her retirement, on account of salary revision, or other reasons. Such arrears would also be taxed as salary, and qualify for standard deduction. Similarly, sum received by an ex-employee under a Keyman Insurance policy taken by her ex-employe would also qualify, being taxable as "Salaries".

Even salaries or pensions received from foreign employers qualify for standard deduction, provided such salaries or pensions are taxable in India. Often, if the employ or pensioner is a non-resident, or on account of provisions of a tax treaty, such foreign salaries or pensions may not be taxable in India, in which case the question of allowability of standard deduction does not arise.

However, in a case where the annuity is purchased by the employee herself out of her retirement benefits (for example, by purchasing a Varishtha Jeevan Bima Yojana policy), such annuity, not being in discharge of the employer's obligation to pay pension, is taxable as "Income from Other Sources", and not as "Salaries". So, such annuity would not qualify for standard deduction.

There could also be a situation where an employee receives pension from the Employees' Provident Fund Organisation (EPFO). This pension is funded by a part of the employer's contribution. Such pension is not in discharge of the obligation of the former employer to pay a pension, but is an additional benefit provided by the EPFO, funded out of the employer's contribution. Would this be taxed as "Salaries"? The definition of the term "salary" includes any annuity or pension, and since this is coming indirectly from the former employer (out of his contributions), a view is possible, that it is taxable as "Salaries", for which standard deduction is available.

Similar is the position in respect of annuities received by an employee or ex-employee on account of an annuity purchased out of National Pension System (NPS). Though the contribution made by the employer to the NPS is not in discharge of the employer's obligation to pay pension to the employee, but is in discharge of his obligation to contribute to the NPS, since this annuity is funded by the employer's contributions, such annuities may be taxed as "Salaries". Obviously, where the NPS contribution is made directly only by the employee, or by a self-employed person, without any contribution by the employer, such annuity would be taxable as "Income from Other Sources", and not as "Salaries", without any standard deduction available.

Salary received by a partner of a partnership firm would not qualify for the standard deduction, since such salary is taxable as "Business Profits", and not as "Salaries". Similarly, pension received by the spouse or children of a deceased employee (family pension) is taxable as "Income from Other Sources", and not as "Salaries". This is eligible for a separate lower standard deduction of one-third of such family pension, subject to a maximum of Rs15,000, and would not qualify for standard deduction of Rs40,000.

The easing out of exemptions and introduction of standard deduction would make life easier for employers, on account of less paperwork, and provide significant benefit to ex employees, but not to employees who were receiving medical reimbursement and conveyance allowance.

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