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Union Budget 2025-26: An Overview Of Direct Tax Reforms

Dr. Vinay Chaturvedi*

*Associate Professor
Faculty of Management Studies
Dr. APJ Abdul Kalam Technical University, Lucknow

Abstract

The Union Budget 2025-26 has won wide applause and appreciation from most of the tax payers, barring the opposition benches who have labelled it as election centric short of long-term objectives. The budget 2025-26 has provided a huge relief amounting to Rs one lakh crore relating to direct taxes to millions of tax payers by restructuring slabs of income and rates of taxes. The ‘nil rate’ slab of income has been increased to Rs 4 lakh from the existing limit of Rs 3 lakh. The highest slab of income taxable at the rate of 30 percent would now start from the threshold of above Rs 24 lakh from the assessment year 2026-27 as against the corresponding present limit of Rs 15 lakh. An additional slab of Rs 20-24 lakh has been proposed to be taxed at 25 percent . The most important relief in direct taxes would arise on account of rise in the limit of rebateable income from the existing limit of Rs 7 lakh to Rs 12 lakh (in case of salaried tax payers this limit is raised to Rs 12.75 lakh) due to the provision of standard deduction under the new tax regime. It means that individual tax payers would bear no tax liability if their taxable income excluding capital gains does not exceed Rs 12 lakh (or Rs 12.75 lakh for salaried assesses). The resultant relief in direct taxes would be 100 percent upto the slab of Rs 12 lakh ; 25 percent in respect of income upto Rs 15 lakh ; 31.03 percent for the slab ending upto Rs 20 lakh ; 26.8 percent upto income of Rs 24 lakh and eventually it comes down to just 1.9 percent for income amounting to Rs 2 crore. Besides, direct tax proposals of the budget 2025-26 have rationalised various rules relating to compliance burden and ease of doing business. The owners of house property would also stand to gain as the annual value of two self – occupied house properties will be treated as nil without any condition as against the provision of such benefit being allowed at present in case of only one self- occupied house property.

Keywords : Slabs of income, Tax Deduction at Source (TDS) and Tax Collection at Source (TCS), Marginal Relief, Annual Value , Tax Compliance and Rebateable Income.

The underlying idea behind the observation, ‘it is difficult to tax and please’, reflects the pain of pinch inflicted upon the tax payers by the burden of taxation. This is why taxes are viewed as the most ‘unsought for social obligations’ the tax payers have to bear for the general cause of the society. However, the Union Budget 2025-26, quite unlike other budgets, is winning overwhelming applause and appreciation from most , if not all, of the tax paying society. The opposition benches have , however, sounded their reservations by labelling the Union Budget 2025-26 as election centric short of long -term objectives. The stand of the opposition has been vindicated to some extent by the ‘flat response of the stock market’ on the budget day (February 1, 2025).[1]

The present paper starts with pointing out the objectives of the tax proposals of the Union budget 2025-26; reveals the anomaly in the provisions of standard deduction designed for the old scheme of taxation vis-à-vis the new tax regime incorporated under Section 115 BAC of the Income Tax Act 1961; and eventually summaries the main features of the direct tax proposals of the budget 2025-26.

Objectives Of The Direct Tax Proposals Of The Budget 2025-26

The Finance Minister has listed the following objectives of the direct tax proposals in budget speech delivered in the Lok Sabha on February 1, 2025.[2]

- **Rationalization of TDS/TCS For Easing Difficulties :**

The budget 2025-26 has sought to rationalize Tax Deduction at Source (TDS) by revising the number of rates and the thresholds above which TDS is deducted. The threshold for tax deduction on interest for senior citizens aged 60 and above has been raised from the present limit of Rs 50000 to Rs 100000. Similarly, the annual limit of Rs 2.40 lakh for TDS on rent is now increased to Rs 6 lakh. This measure aims at reducing the number of transactions liable to TDS , thus benefitting small tax payers who would receive small amount of rental income. The threshold to collect tax at source (TCS) on remittances under RBI's Liberalised Remittance Scheme(LRS) has been enhanced from Rs 7 lakh to Rs 10 lakh. The provision of TCS on education loan taken from a specified financial institution has been removed. In July 2024, the delay for payment of TDS upto the date of filing statement was decriminalized. Similar relaxation in relation to TCS has been made in the budget 2025-26.

- **Encouraging Voluntary Compliance** :

With a view to easing the difficulties of tax payers , the Central Government brought in updated return facility in 2022 for voluntary compliance by tax payers who had failed to report their correct income. Keeping in view the encouraging response of tax payers to this measure , the budget proposals for 2025-26 have extended the time-limit to file updated return for any assessment year from the current limit of two years to four years.

- **Reducing Compliance Burden** :

The budget 2025-26 has sought to increase the period of registration of small charitable trusts / institutions from 5 years to 10 years in order to reduce the compliance burden. Besides, the owners of self-occupied house properties have been provided great relief in the budget 2025-26 by allowing them to claim the annual value of two – self occupied house properties as nil in contrast to the availability of such facility being allowed in respect of only one such house property at present. The new provisions are not subjected to any condition for getting this benefit.

- **Ease Of Doing Business** :

In order to streamline the process of international transactions, a scheme for determining arm's length price of international transaction has been introduced for a block period of three years. Besides, withdrawals from old National Savings Scheme Accounts by senior citizens have been exempted on or after the 29th of August 2024. In July 2024 the Government introduced the Vivad Se Vishwas Scheme to resolve income tax disputes in appeal. The scheme has evinced very good response with nearly 33000 tax payers having availed of this scheme to settle their disputes. Further, the scope of safe harbour rules has been expanded in order to reduce litigation and provide certainty in international taxation.

- **Promotion Of Employment and Investment** :

The budget 2025-26 has designed following measures for promoting employment and investment :

a) **Tax Certainty for Electronics Manufacturing Schemes** : The budget 2025-26 provides a presumptive taxation regime for non-residents who provide services to a resident company that is establishing or operating an electronics manufacturing facility.

b) **Tonnage Tax Scheme for Inland Vessels** : Presently the tonnage tax scheme is available to only sea going ships. The benefits of existing tonnage tax scheme have been extended by the Union Budget 2025-26 to inland vessels registered under the Indian Vessels Act, 2021 to promote inland water transport in the country.

c) **Extension for Incorporation of Start-Ups** : In order to support the Indian Start-Up eco-system, the Union Budget 2025-26 has extended the period of incorporation of start-ups by 5 years to allow the benefit available to them which are started before April 1, 2030.

d) **International Financial Services Centre(IFSC)** : In order to attract and promote additional activities in the IFSC the Budget 2025-26 has provided for specific benefits to shipping units, insurance offices and treasury centres of global companies which are set up in IFSC. Further, to claim benefits, the cut-off date for commencement in IFSC has also been extended by five years to 31-3-2030.

e) **Extension of Investment Date for Sovereign and Pension Funds :** To promote funding from Sovereign Wealth Funds and Pension Funds to the infrastructure sector, the Budget 2025-26 has extended the date of making an investment by five more years to 31st March, 2030.

- **<u>Personal Income Tax Reforms With Special Focus On Middle Class</u>**

The Union Budget 2025-26 has provided the much sought after relief to the middle class by rationalizing slabs and rates applicable to tax payers who have opted for the new tax regime. The budget 2025-26 has raised the basic exemption limit to Rs 4 lakh; widened the tax slabs; .introduced an additional 25% tax slab for income falling between Rs 20-24 lakh and stepped up the highest 30% tax slab for income above Rs 24 lakh.[3] The greatest relief provided to tax payers has resulted from raising the threshold of rebateable income from Rs 7 lakh to Rs 12 lakh as per section 87A of the Income Tax Act 1961. This limit will be Rs 12.75 lakh for salaried tax payers, due to standard deduction of Rs 75000 .[4] The resultant relief in the burden of direct taxes due to these proposals is estimated to be about Rs 1,00,000 crore.[5]

The following table shows the existing tax structure applicable to the assessment year (A.Y.) 2025-26 and the new one chargeable from the A.Y. 2026-27.

Table 1: The Existing and the Proposed Tax Structure under New Tax Regime

Existing Slab for A.Y. 2025-26	**New Slab for A.Y. 2026-27**	**Tax Rates**
Upto Rs 3 lakh	Upto Rs 4 lakh	Nil
Rs 3-7 lakh	Rs 4-8 lakh	5%
Rs 7-10 lakh	Rs 8-12 lakh	10%
Rs 10-12 lakh	Rs 12-16 lakh	15%
Rs 12-15 lakh	Rs 16-20 lakh	20%
--------------------------	Rs 20-24 lakh	25%
Above 15 lakh	Above 24 lakh	30%

Source: Compiled from the Budget Speech of Finance Minister for 2024-25 and 2025-26

It is clear from the above table that the budget for 2025-26 has raised not only the basic exemption limit i.e. the nil rate slab but also hiked the highest tax slab of 30% from the slab exceeding Rs 15 lakh to above Rs 24 lakh.

Provision of Marginal Relief :

The concept of marginal relief ensures that the tax liability of a tax payer having income marginally above the Rs 12 lakh (or above Rs 12.75 in respect of salaried tax payers) does not exceed the amount of income just crossing over the threshold of no tax. For example, tax calculated on total income of Rs 12,10,000 would be Rs 61,500 without marginal relief, but the actual tax payable after the provision of marginal relief would be limited to Rs 10,000 by which the total income is exceeding Rs 12,000. The simple message of marginal relief is: carry home income of the tax payer will in no case be less than Rs 12,00,000 when total income has just exceeded this limit.

Impact Of The Budget Proposals on Different Tax Payers According to Taxable Income :

The following table shows the amount of tax relief resulting from the proposals of the Budget 2025-26 at different levels of income.

Table 2 : Impact of the Budget 2025-26 on Tax Payers Having Different Slabs of Income :

Limit of Income	Rs 10 lakh	Rs 12 lakh	Rs 15 lakh	Rs 20 lakh	Rs 24 lakh	Rs 2crore
Existing Tax liability for A.Y. 2025-26	Rs 50,000	Rs 80,000	Rs 1,40,000	Rs 2,90,000	Rs 4,10,000	Rs 56,90,000
Tax Payable for A.Y. 2026-27 as per Budget 2025-26	Nil	Nil	Rs 1,05,000	Rs 2,00,000	Rs 3,00,000	Rs 55,80,000
Amount of Tax Gain	Rs 50,000	Rs 80,000	Rs 35,000	Rs 90,000	Rs 1,10,000	Rs 1,10,000
Relative Tax Gain	100%	100%	25%	31.03%	26.8%	1.9%

Notes : (i) Tax liability for A.Y. 2025-26 and 2026-27 has been computed on the basis of Table 1.

(ii) Relative Tax Gain in % = $\frac{\text{Amount of Tax Gain X 100}}{\text{Tax Liability for A.Y. 2025-26}}$

(iii) The figures of tax liability do not include cess @4%.

It is clear from the above table that the tax relief is more pronounced at the bottom of the income pyramid. The relative tax relief is 100 percent upto Rs 12 lakh of the taxable income. Thereafter it reaches the proportion of 25 percent for income at Rs 15 lakh ; 31.03 percent for income at Rs 20 lakh ; 26.8 percent for income at Rs 24 lakh and eventually has fallen to the level of 1.9 percent for income at Rs 2 crore. The steep fall in the proportion of tax relief at income of Rs 2 crore is attributable to the fact that the absolute amount of tax relief remains constant at income level of Rs 24 lakh and above. The resultant tax relief will leave more disposable income in the hands of the tax payers to spend more on consumption baskets such as education, healthcare, tourism, payment of home loan EMI's . Such enhanced personal spending would boost the demand for these items whereby the growth engine would also be accelerated. It is pertinent to mention here that all these changes apply only to the new tax regime keeping the provisions of old tax regime intact since very inception of the former scheme. Despite the changes in the new tax system, the old tax regime means lower taxes for those who manage to claim tax deductions and exemptions. The Government has pegged the standard deduction for salaried tax payers at Rs 50,000 since long whereas the same figure for the new tax regime stands now at Rs 75,000. This anomaly needs to be corrected by the Government in order to establish equity between the old and new regimes of taxation. Further, the budget 2025-26 does not provide for saving-related measures for promoting household savings. Provisions of deduction of interest on bank deposits upto Rs 50,000 for senior citizens should be restored in respect of the new tax regime also.

In the end, it might be concluded that the budget proposals for 2025-26 are all set to provide a major relief for the middle class because it would free up a significant portion of their earnings for savings, investment and consumption whereby the pace of development of our economy would be stepped up. The ongoing process of rationalizing the compliance route and ease of doing business would help build better relationship between tax payers and tax authorities.

References :

1. Vide, The Economic Times, dated February 2, 2025 Lucknow Edition page 6
2. Vide, Budget 2025-26 Speech of the Finance Minister , pages 24-27
3. Vide, Annexure to Part B Amendments Relating to Direct Taxes
4. Vide, Budget 2025-26 Speech of Finance Minister, page 27
5. Vide, Budget 2025-26 Speech of Finance Minister , page 28