

Rule for Taxing Contributions to EPF

Why in News

Recently, the Finance Ministry has notified the rules for taxing interest income on contributions made to the **Employees' Provident Fund (EPF)**.

Employees' Provident Funds Scheme

- EPF is the main scheme under the **Employees' Provident Funds and Miscellaneous Act,** 1952.
- This scheme offers the institution of provident funds for factory employees and other establishments.
- The employee and employer each contribute 12% of the employee's basic salary and dearness allowance towards EPF.
 - The <u>Economic Survey</u> 2016-17 had suggested that employees be allowed to choose whether or not to save 12% of their salary into EPF or keep it as take home pay.
- As per current laws, a person mandatorily becomes a member of EPF if his monthly salary does not exceed Rs. 15,000.

Key Points

Background:

- In February 2021, the <u>Budget</u> proposed that <u>tax exemption</u> will not be available on interest income on <u>Provident Fund</u> (PF) contributions exceeding Rs 2.5 lakh in a year.
- In March 2021, the government introduced an amendment to the Finance Bill, 2021 in which it proposed to double the cap on contribution from Rs 2.5 lakh to Rs 5 lakh for tax-exempt interest income, if the contribution is made to a fund where there is no contribution by the employer.
 - With this, the government provided relief for contributions made to the **General Provident Fund** that is available only to government employees and there is no contribution by the employer.

New Rules:

- Interest income on **contributions made to the EPF beyond Rs. 2.5 lakh** (for private sector employees) and **Rs.5 lakh** (for government sector employees) **will be taxed.**
- Beginning this Fiscal Year (FY) 2021-22, the government will tax interest on contributions made in excess of these limits, with separate accounts to be maintained within the provident fund account for 2021-22 and subsequent years for taxable contribution and non-taxable contribution made by an individual.
 - A Fiscal Year (FY), also known as a budget year, is a period of time used by

the government and businesses for accounting purposes to formulate annual financial statements and reports.

• The <u>Central Board of Direct Taxes (CBDT)</u> has inserted Rule 9D in the Income-Tax Rules, 1962, according to which income through interest accrued during the previous year that is not exempt (over Rs 2.5 lakh for private and Rs 5 lakh for government employees) shall be computed as the interest accrued during the previous year in the taxable contribution account.

Perpetuity of Tax:

- As per the notification, the interest income on the additional contribution (over Rs 2.5 lakh for private and Rs 5 lakh for government employees) for a year will get taxed every year.
 - This means that if one's annual contribution to PF in FY 2021-22 is Rs 10 lakh, the interest income on Rs 7.5 lakh will get taxed not only for FY 2021-22 but also for all subsequent years.

Need:

- The Budget proposal had noted that the government has found instances where some employees are contributing huge amounts to these funds and are getting the benefit of tax exemption at all stages — contribution, interest accumulation and withdrawal.
- With an aim to exclude High Net-Worth individuals (HNIs) from the benefit of high taxfree interest income on their large contributions, the government has proposed to impose a threshold limit for tax exemption.

Source: IE

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