Rule for Taxing Contributions to EPF

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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 **Economic Survey** 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 **Budget** proposed that **tax exemption** will not be available on interest income on **Provident Fund** (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 **Central Board of Direct Taxes (CBDT)** 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 tax-free interest income on their large contributions, the government has proposed to impose a threshold limit for tax exemption.

Source: IE