Taxing Interest Incomes on EPF

Why in News

The **Union Budget 2021-22** proposed to tax the interest income on Provident Fund (PF) **contributions by employees exceeding Rs. 2.5 lakh a year**.

- The Ministry of Finance **expressed concerns over investments as much as Rs. 1 crore each month into PF** and suggested it was **unfair** that they **get tax concessions as well as an assured return**.
- The **Employees' Provident Fund (EPF) Scheme** is managed under the aegis of the **Employees' Provident Fund Organisation (EPFO)**.
  - EPFO is a **government organization** that manages provident fund and pension accounts for the workforce engaged in the organized sector in India.

Key Points

- **About the Employees' Provident Fund (EPF) Scheme:**
  - The Employee Provident Fund is **open for employees of both the Public and Private Sectors**. Additionally, any organisation that employs **at least 20 individuals is mandatorily** liable to extend benefits of EPF to its employees.
  - **Both employer and employee contribute 12% of an employee's monthly salary** (basic wages plus dearness allowance) to the Employees' Provident Fund (EPF) scheme.
    - Of the employer's share of 12%, **8.33% is diverted towards the Employees Pension Scheme (EPS)**.
  - EPF scheme is **mandatory for employees who draw a basic wage of Rs. 15,000 per month**.
  - The **EPF interest rate is declared every year by the EPFO**.
    - EPFO implements **the Employees' Provident Fund and Miscellaneous Provisions Act, 1952**.
    - The EPF Act, 1952 provides for the institution of provident funds for employees in factories and other establishments.
  - This savings scheme offers **tax exemption under Section 80C of the Income Tax Act**.
- **Proposed Tax on Income:**
  - The **annual contribution to EPF and Gratuity** - and also **voluntary contributions to EPF** - will be added. **If the aggregate contribution exceeds Rs 2.5 lakh, the interest income on that will be taxed at the marginal tax rate** in which the income of the individual falls.
  - Importantly, **only the contribution linked to the employees' component will be calculated for taxation purposes**. The **employer's contribution towards the EPF will not be considered** for the calculation.
  - The **interest income on the additional contribution of a year will get taxed every year**.

        - This means that if an individual's annual contribution to PF in FY22 is Rs. 10 lakh, the interest income on Rs 7.5 lakh will get taxed not only for FY22 but also for all subsequent years.
    - The **average normal EPF contributor would not be affected** by this new proposal.
- **Reasons for Taxing Interest Income on PF Contributions:**
    - **Preventing Misuse of the Scheme:**
        - 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.
        - Since any tax exemption is provided through taxpayers' money, it was unfair to allow **High Networth Individuals (HNIs)** depositing large sums in EPF to earn an assured interest (under EPFO) and tax-free income together.
            - **HNIs:** Those people with investable assets above a certain figure.
        - Earlier, the **government had capped the contributions by employers into employee welfare schemes** like the EPF or the **[National Pension Scheme]** or a superannuation plan, at Rs. 7.5 lakh a year.
            - However, government as well as private sector employees are allowed to make voluntary contributions over and above the statutory deductions into the **general provident fund (available only for government employees) or EPF (available for government as well as private sector employees)**.
    - **Promoting Equity among PF Contributors:**
        - Of an estimated 4.5 crore EPF accounts, about 0.27% members had an average corpus of Rs. 5.92 crore and were earning over Rs. 50 lakh a year as "tax-free assured interest".
            - This is a misuse of the welfare scheme aiming to promote savings and provide social security to lower and middle income groups of employees.

Source: TH