

# Employee Provident Fund - Move From EEE to EET Regime of Taxation

Jan 27, 2023



## Preeti Sharma

Partner/Global Employer Services Tax and Regulatory Services BDO India LLP



## Kunal Banga

Manager at BDO India LLP

1. Indian Government in its mode to promote National Pension Scheme and tax high net worth individuals has done away with the few of the tax benefits available on Employee Provident Fund (EPF). EPF, being a limited social security framework for employees, for the longest time has been part of the Exempt, Exempt, Exempt taxation framework, i.e., EPF was tax free at:

- Contribution stage: The employee's portion of contribution to EPF is eligible for deduction under section 80C of IT Act upto INR 150,000. The entire amount of employer's contribution upto 12% of PF salary (as defined under EPF regulation) was exempt without any ceiling;
- Accrual stage: Any interest declared by the Government on the accumulated PF balance and credited to EPF account of the employees on annual basis was not taxable at accrual stage; and
- Withdrawal stage: The amount withdrawn from the fund after rendering 5 years of continuous services or subject to meeting other exemption criteria is exemp

2. However, in last few years, the Government has introduced many changes in the above taxation framework that has impacted the limited population with high taxable income. Such changes are summarised below:

### **2.1. Contribution Stage:**

#### **2.1.1. Employee's contribution:**

Employee's contribution to the EPF account is allowed as a deduction from your taxable income under Section 80C of IT Act, but within the overall limit of INR 0.15 mn. There is no change in this provision. An individual taxpayer who has already planned his tax saving investment, pay insurance premium and contribution to Public Provident Fund is likely to exhaust this limit with other investment avenues and hence an increase in the overall threshold of Section 80C is very much warranted and expected in the Union Budget 2023.

#### **2.1.2. Employer's contribution:**

Employer's contribution to the EPF account of an employee is exempt upto 12% of the 'PF Salary'. Any excess contribution by employer over and above 12% of 'PF Salary' was taxable in hands of employee.

There is no change in this provision. However, there is an overall cap on exemption limit was introduced in the Union Budget 2020. Effective 1st April 2020, any employer's contribution to Provident Fund (PF), NPS and superannuation exceeding INR 0.75 mn a year is taxable as perquisites in the hands of the employee under section 17(2)(vii) of IT Act under the head 'Income from Salary'.

Necessary withholding to be done by the employer on the same and required to be reported in Employee's Form 16 and Form 12BA.

## **2.2. Accrual Stage:**

To understand the updates in taxability at accrual stage, let's divide it in two sections:

a. Accrual on Employee's Contribution

b. Accrual on Employer's Contribution

### **2.2.1. Accrual on Employee Contribution:**

As per the Union Budget 2021, any interest on employee's contribution to EPF upto INR 0.25 mn per year is tax free, any interest earned on contribution over and above INR 0.25 mn is taxable in the hands of the employees. The threshold of INR 0.25 mn is increased to INR 0.5 mn in case the employer is not contributing towards EPF.

Subsequently, a notification was issued by Income tax department dated 31 August 2021, which stated that Regional Provident Fund Commissioner (RPFC) will maintain the EPF balance of individuals in two separate accounts for taxation purposes. Contribution within the limit of INR 0.25 mn/ INR 0.5 mn in one account and the excess contribution along with the interest accrued on it shall be maintained in a separate taxable account. RPFC shall deduct TDS on such interest paid on the account maintaining taxable contribution.

The above amendment in rules is applicable from 1 April 2022.

2.2.2. Rule 9D has been introduced by the Income tax department to ascertain how taxable and non-taxable contribution will be calculated. Let's understand the same as follows:

### **Calculation of Non- Taxable Contribution:**

	<b>Particulars</b>	<b>Amount</b>
	Closing Balance in the PF accountxxx as on 31 March 2021	
Add:	Any contribution made by thexxx person in the account for Financial Year (FY) 2021-22 and subsequent years, within the limit of INR 0.25 mn / 0.5 mn	
Add:	Interest accrued on above twoxxx components	
Less:	Withdrawal, if any, from non-xxx taxable account	
	<b>Balance of Non- Taxablexxx Contribution Account</b>	

### **Calculation of Taxable Contribution:**

	<b>Particulars</b>	<b>Amount</b>
	Any contribution made by thexxx person in the account for Financial Year (FY) 2021-22 and subsequent	

	years, above the limit of INR 0.25 mn / 0.5 mn
Add:	Interest accrued on abovexxx component
Less:	Withdrawal, if any, from taxablexxx account
	<b>Balance of Taxablexxx Contribution Account</b>

### 2.2.3. Accrual on Employer's Contribution

Further, in addition to the contribution made by the employer in excess of INR 0.75 mn a year that is taxable as perquisites in the hands of employees, any interest earned on such excess contribution will be taxed as well in the hands of the employee under section 17(2)(viiia) of IT Act.

Rule 3B has been introduced by the Income tax department to ascertain how interest, dividend etc. will be calculated on the above employer contribution. The rule provides the below formula to calculate the taxable perquisite under section 17(2)(viiia) of IT Act:

$$TP = (PC/2)*R + (PC1 + TP1)*R$$

Where, TP= Taxable perquisite for the financial year;

TP1 = Taxable perquisite (interest on excess contribution of last year) from the previous financial years on which tax has been paid.

PC= Amount of contribution made by the employer in excess of INR 0.75 mn to EPF, NPS and superannuation fund for the financial year

PC1= Amount of contribution made by the employer in excess of INR 0.75 mn to EPF, NPS and superannuation fund for the previous financial year

R= Interest Earned during the current Previous year / average of opening and closing balances of the funds i.e., EPF, NPS and superannuation fund.

### 2.3. Withdrawal Stage

No tax is required to be paid on the contribution amount and accumulated interest in case accumulated balance in Recognized Employee Provident Fund is withdrawn after five years of continuous service.

However, in case the accumulated balance from Recognized Employee Provident Fund is withdrawn prior to completion of 5 years of continuous service (allowed by RPFC in case of prescribed circumstances) or in cases where the amount is withdrawn from an Unrecognised Employee Provident Fund, then the balance and interest won't be fully exempted from tax. Tax on such withdrawal shall be calculated as follows:

#### 2.3.1. Employer's Contribution and corresponding interest

Employer's contribution and interest on the same is fully taxable in the hands of the employee under the head Income from salary in the individual's Income tax return.

#### 2.3.2. Employee's Contribution

In cases where deduction under Section 80C is claimed at the time of making contribution, the amount of employee's contribution shall become taxable as 'Income from Salary'. In other cases, the amount withdrawn on employee's contribution may not be taxable.

There is a capping on the amount of deduction available under section 80C, i.e. INR 150,000. Any contribution made over and above this capping shall not be taxed at withdrawal as no deduction was

available for that amount in the year of payment in the first instance.

### **2.3.3. Interest on Employee's Contribution**

Amount of interest earned on employee's contribution to EPF shall be taxable in the hands of the employee as 'Income from Other Sources'.

The RPFC shall deduct TDS @10% under section 192A on the total amount withdrawn (if more than INR 50,000) before completion of five years of continuous service. In case the PAN of an individual is not available, RPFC shall deduct TDS @30%.

Individual may also submit Form 15G/Form15H if tax on his/her total income including EPF withdrawal is nil. No TDS shall be deducted in that case.

It is worthwhile to note here that there is no taxability in the hands of an individual on transfer of PF from one account to another at the time of job switching.

### **3. Impact and budget expectation**

The above changes may not affect individuals who are earning basic salary upto INR 2 mn and contributing 12% of their basic salary towards EPF. Most individuals in India fall under this category.

While it is expected that the above provisions on EPF taxation may not change in Union Budget 2023, there is an expectation that the limit of deduction available under Section 80C of the IT Act may be increased from the current limit of INR 0.15 mn.

*\* Views expressed above are personal & may not reflect that of the organisation.*