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Re-examining the EPF Tax Rules

Why in news?

The new EPF tax rules will come into effect from April 1, 2021 as announced in the Union Budget of 2021.

What was the existing rule?

- If a person contributes more than the limit prescribed under **Section 80C of the Income Tax Act**, he cannot get a tax break on his excess contribution.
- The earnings on contributions rarely suffered taxation since tax laws pegged tax-free earnings to higher rates than the interest rate on the EPF.
- Moreover the person will pay tax on their corpus, only if he withdrew it within 5 years from the comment of the contribution.
- This taxation framework incentivised employees to use the EPF as their primary retirement saving and it acted as risk-free retirement savings mode.

What is the new rule?

- The new tax regulation will label a person as a high net worth individual if he misuses EPF by contributing more than Rs 2.5 lakh per annum to the EPF.
- The limit is Rs 5 lakh in cases where employers do not make contributions to the provident fund.

What is the issue with new rules?

- With the new rule coming into effect, government assumes what is adequate for an individual on retirement.
- The decision on a common threshold of adequacy is incorrect and suffers from the flaw of one-size-fits-all approach.
- Moreover the word **'misuse'** that was used to justify the imposition of the tax is difficult to comprehend.
- This is because EPF is solely a payroll deduction and cannot be contributed in any other manner.

- The new clause of taxing the amount exceeding the limit prescribed in the act brings the EPF to the borders of double taxation.

- 65% of EPF is invested in government securities and rest is invested in largely in PSU bonds and earnings available to the employee through interest credit mechanism.
- Despite the stickiness of these interest rate declarations and their often being higher than market rates, it is certain that the government does not subsidise this interest rate credit.

Why it is difficult to administer?

- In addition to these flaws, there are difficulties in administrating the new tax rule.
- Due to the changed of threshold from Rs 2.5 lakh to Rs 5 lakh, there can be various interpretations surrounding the applicability to EPF.
- It is also unclear if the interest on such excess contributions is taxed once during the year of contribution or throughout the term of investment in EPF.
- The mechanism of tax communication from the EPFO to the member also remains uncertain.

What are the takeaways from this?

- The EPF remains a subsidy-free, pay-what-is-earned retirement fund and typifies safety with governance.
- Though pension funds are seen by governments in multiple policy contexts, they should remain, foremost, the retirement funds of the beneficiaries.

- Regulations governing contributions, taxation, investments, administration and benefits should be made in the interest of the beneficiary.
- But it seems that other imperatives dominate the agenda in pension policymaking in India.
- Therefore, the resultant outcomes are sub-optimal from a beneficiary point of view.
- Therefore the policy makers need to relook the new rules and the immediate rollback of it demonstrates the will of the policymakers to encourage retirement savings.

Source: The Hindu