Tax on PF Incomes

What is the issue?

- Finance Minister has stressed that Budget 2021-22 raises resources to push the economy without increased taxation.
- However, one change proposed to the income tax law has caused concern for the salaried class.

What is the proposed change?

- The Union Budget has proposed taxing the income on provident fund (PF) contributions of over Rs. 2.5 lakh a year.
    - The contributions are made on a voluntary basis.
- The Bill has proposed withdrawing tax exemption on interest income accrued into PF accounts for contributions exceeding Rs.2.5 lakh ‘in a previous year in that fund,’ on or after April 1, 2021.
- For contributions up to Rs.2.5 lakh a year into Employees’ Provident Fund, tax exemptions will remain along with guaranteed returns.

What is the rationale?

- Some employees are contributing huge amounts into their PF accounts and getting tax-free incomes.
- The exemption, without any threshold, benefits only those who can contribute a large amount to these funds as their share.
- Thus, the Revenue Department has pointed out that the proposed tax would only affect a small group of ‘high net-worth individuals’ (HNIs).

What is the concern though?

- A social security scheme for formal sector workers should not become an investment haven for the well-heeled corporate top brass.
- However, the threshold proposed to exclude the so-called HNIs appears low.
- This would end up partially taxing PF income for even those putting away Rs. 21,000 a month towards their retirement.
- This is hardly a typical HNI, given the fact that it may take the saver decades

to attain a one crore rupee PF balance.

- The threshold also does not tie in with the Rs.7.5 lakh limit set in last year's Budget for -
    - employers' contributions into the EPF, National Pension System (NPS) or other superannuation funds (rules for which are yet to be notified).

What are the other uncertainties?

- There is tax treatment inequity between India's limited retirement savings instruments.
- But this aside, employees and employers also have some serious doubts on the implementation of the proposal.
- The words 'in a previous year' suggest this will be a type of retro-active tax.
    - This would mean taxing future income even on past years' contributions of over Rs.2.5 lakh.
- It is also not clear when and how the tax is to be paid — at retirement or each year that the PF rate is announced.
- The CBDT chief has said employees should include such income in their annual tax returns.
    - This may work for GPF (General Provident Fund) members whose interest rate is announced every quarter.
    - This would however be difficult for EPF accounts, as interest rates are declared late and credited even later.
- The goal of targeting HNIs using the PF savings to avoid taxation is laudable.
- But the Centre should consider recalibrating the arithmetic and operational details of this tax.

Source: The Hindu