Taxability of Interest on PF contributions effective from FY 2021-22

(As introduced in Finance Act 2021)

What is Employees Provident Fund?

An employee's provident fund (EPF) is a government-managed retirement savings scheme for employees. Every month, employees contribute a part of their salary towards provident fund. The goal is to receive lump sum payments with interest at the time of retirement from employment. In India, the Employees' Provident Fund Organisation ('EPFO') is responsible for the regulation and management of provident funds.

Background:

- The Finance Act, 2021 (FA 2021) inserted new provisos to sections 10(11) and 10(12) of the Income-tax Act, 1961 ('the ITA'), which state as follows:

  - The exemptions granted under section 10(11) of the ITA [relating to exemption of payment received from specified provident fund] and 10(12) of the ITA [relating to exemption of accumulated balance payable to an employee, participating in a recognised provident fund], would not be available for interest accrued on contribution in excess of specified amounts during the Financial Year (FY) 2021-22 or subsequent FYs.

  - The specified contribution by the taxpayer employee is amount / aggregate amounts in excess of INR 250,000 (INR 500,000 in cases where there is no contribution by the employer) in any FY in such specified provident fund or recognised provident fund.

  - Further, the manner of computation of such taxable interest would be as prescribed.

- The Central Board of Direct Taxes (CBDT) has issued Notification No. 95 of 2021 dated August 31, 2021 ('the Notification') introducing new Rule 9D of the Income-tax Rules, 1962 ('the Rules') to provide the manner of calculation of taxable interest, relating to contribution to specified provident fund or a recognised provident fund in relation to sections 10(11) and 10(12) of the ITA.

Highlights of the Notification:

- These Rules would come into force with effect from April 1, 2022.

- For the purposes of the provisos to sections 10(11) and 10(12) of the ITA, income by way of interest accrued during the FY, which is not exempt from inclusion in the total income of a person under the said clauses (hereinafter referred to as the "taxable interest"), shall be computed as the interest accrued during the FY in the taxable contribution account.

- For the purpose of calculation of taxable interest separate accounts shall be maintained during the FY 2021-2022 and all subsequent FYs, for taxable contribution and non-taxable contribution made by the employee/taxpayer. It is interest on taxable contribution which shall be taxed every year. It is important to note that interest will be taxed not only for the year of contribution but also for the subsequent years as well.

- Such interest will be taxable under the head Income from Other sources and not under the head salaries. Applicable TDS u/s 194A of the ITA at 10% will be deducted on amount of interest by EPFO.

Explanation:

For the purposes of this rule,

(a) Non-taxable contribution account shall be the aggregate of the following, namely:—

(i) closing balance in the account as on 31st day of March, 2021;

(ii) any contribution made by the person in the account during the previous year 2021-2022 and subsequent previous years, which is not included in the taxable contribution account; and

(iii) interest accrued on sub-clause (i) and sub-clause (ii),

as reduced by the withdrawal, if any, from such account;

(b) Taxable contribution account shall be the aggregate of the following, namely:-

(i) contribution made by the person in a previous year in the account during the previous year 2021-2022 and subsequent previous years, which is in excess of the threshold limit; and

(ii) interest accrued on sub-clause (i),

as reduced by the withdrawal, if any, from such account; and

(c) The threshold limit shall mean:

(i) five lakh rupees, if the second proviso to clause (11) or clause (12) of section 10 is applicable; and

(ii) two lakh and fifty thousand rupees in other cases.]

Our Comments:

The Notification introducing new Rule 9D of the Rules, will provide clarity to the employees as well as employers, while computing the taxable portion of the interest accruing in specified provident fund or a recognised provident fund account for a particular FY. Since this is applicable from FY 2021-22, one must consider this while computing taxes and filing the ITR.