

Rejig wages to benefit from EPF rule change

If employer contribution is low, get salary restructured to enjoy higher tax-free interest

**BINDISHA SARANG
& SANJAY KUMAR SINGH**

Finance Minister (FM) Nirmala Sitharaman had announced in the Union Budget 2021-22 that interest earned on employees' annual contribution to the Employee's Provident Fund (EPF) exceeding ₹2.5 lakh will be taxed from April 1, 2021.

This provision of Finance Bill 2021, which was passed by the Lok Sabha on Tuesday, has been amended. Now, the threshold of ₹2.5 lakh has been hiked to ₹5 lakh in cases where employees alone contribute to the provident fund (PF), and the employer does not.

The rationale

When a person contributes to the EPF, the employer makes an equivalent contribution. From the government's point of view, the interest on both employer's contribution and employee's contribution is tax-free. If a person contributes ₹2.5 lakh and his employer also contributes a similar amount, such an employee enjoys tax-free interest income on ₹5 lakh.

However, there are cases where only the employee contributes to the EPF, and the employer does not.

"Earlier, such a person would have got the benefit of tax-free contribution only up to ₹2.5 lakh. To provide parity to such employees, the government has doubled the limit from ₹2.5 lakh to ₹5 lakh," says Deepesh Raghaw, founder, Personal-FinancePlan, a Securities and Exchange Board of India-registered investment advisor.

Who will this affect

Once companies grow beyond a certain size, their employers have to adhere to rules governing PF contribution.

Suresh Surana, founder, RSM India says, "According to the EPF Act, employers engaging 20 or more employees are mandatorily required to register and contribute 12 per cent of the basic wages plus dearness allowance plus retaining allowance to the PF account, and an equivalent amount is contributed by the employee."

This change in rule will apply to government employees who are part of the statutory or general PF (GPF). "In the case of GPF, the employer, which is the government, does not contribute; only the employee contributes. Without this change in rule, they would have got the benefit of tax-free contribution only up to

NEW EPF RULES FROM APRIL 1

- Earlier, interest earned on entire contribution to EPF (plus voluntary PF or VPF) was tax free
- So, people contributed huge amounts and enjoyed tax-free return of 8.5 per cent, which is very high in the current low-rate scenario
- In the Budget, the government imposed a limit of ₹2.5 lakh
- Interest earned on contributions above this amount would be taxed at slab rate
- In case of people in the highest tax bracket, whose EPF (plus VPF) contribution exceeds 2.5 lakh, the post-tax return will now come to 5.85 per cent
- This is still a good rate of return (PPF gives 7.1 per cent tax free)

₹2.5 lakh, unlike private-sector employees who would enjoy tax-free contribution of ₹5 lakh," says Neha Malhotra, director, Nangia Anderson LLP.

On the private-sector side, the effect will be minimal.

"Nowadays private-sector

companies mostly follow EPF norms. In almost all of them, you will have a contribution into EPF from both the employer and the employee. This will only have an impact in cases where the company is not adhering to the labour code," says Prashant Singh, business head-compliance and payroll outsourcing, TeamLease Services.

The FM said this amendment will affect only 1 per cent of contributors. Experts say greater clarity will emerge once these new rules are notified.

What you can do

Employees in some organisations can make this change of rule work in their favour. EPF contribution by the employer is mandatory for workers whose basic salary is up to ₹15,000. It is not mandatory above that amount. And 12 per cent of ₹15,000 equals ₹1,800. In many cases, the employer only contributes the minimal amount of ₹1,800 per month. Suppose there is an employee who contributes ₹40,000 per month. This amounts to a yearly contribution of ₹4.8 lakh. His employer contributes ₹1,800 per month, which would amount to a yearly contribution of ₹21,600. "Such a person may ask his employer to not contribute at all and get the benefit of tax-free interest on his ₹4.8-lakh contribution," says Raghaw.



**YOUR
MONEY**