# Your EPF account will now show taxable and non-taxable balance

## Those earning high salaries should think twice before getting it restructured

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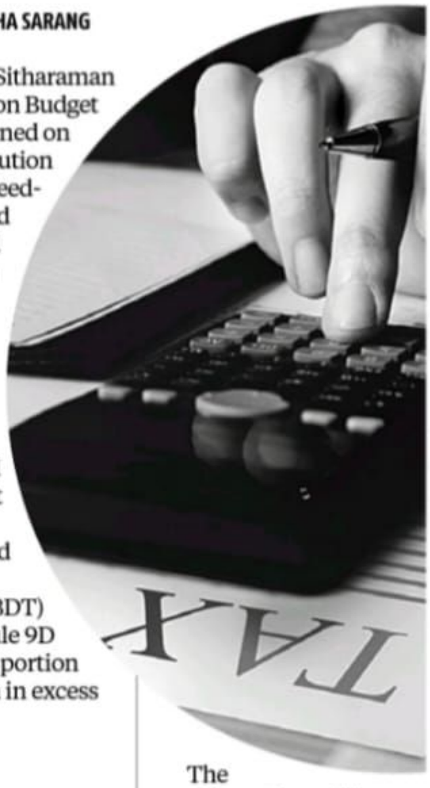

Finance Minister Nirmala Sitharaman had announced in the Union Budget for 2021-22 that interest earned on employees' annual contribution to Provident Fund (PF) exceeding ₹2.5 lakh would be taxed from April 1. The threshold was subsequently hiked to ₹5 lakh for cases where employees alone contribute (and the employer does not).

The upshot of these changes is that the Employee Provident Fund (EPF) subscriber's account will henceforth have two components — taxable and non-taxable. The Central Bureau of Direct Taxes (CBDT) on Wednesday notified Rule 9D for calculating the taxable portion of interest on contribution in excess of the threshold limit.

### HOW TAXABLE AND NON-TAXABLE CONTRIBUTION WILL BE CALCULATED

**Employee's salary structure**

| Particulars | Monthly (₹) | Annual (₹) |
|---|---|---|
| Basic salary | 2,00,000 | 24,00,000 |
| Special allowance | 24,200 | 2,90,400 |
| Employee's contribution to PF (12% of basic salary) | 24,000 | **2,88,000** |
| Employer's contribution to PF | 1,800 | 21,600 |
| **Total CTC** | **2,50,000** | **30,00,000** |

**Tax calculation**

| Particulars | Non-taxable contribution (₹) | Taxable contribution (₹) |
|---|---|---|
| Opening balance | **5,50,000** | |
| Non-taxable contribution during the year | **2,50,000** | |
| Non-taxable contribution (₹2.88 lakh less ₹2.5 lakh) | | **38,000** |
| Total balance (before interest) | **8,00,000** | **38,000** |
| Interest income (at assumed rate of 8.5%) | **68,000** | **3,230** |

Source: Taxmann

**Curtailing benefit**

Earlier, interest on EPF was completely exempt from tax, with no limits. "Many high networth individuals (HNIs) used to invest a substantial portion of their salary in EPF to reap the benefit of a high tax-free rate of interest. The government amended the Income-Tax Act to curtail this practice," says Gopal Bohra, partner, NA Shah and Associates.

**How tax will be calculated**

Here's an example to illustrate how liability on the taxable portion of contributions will be calculated. ABC contributes 12 per cent of his basic salary to EPF, which is ₹24,000 per month or ₹2.88 lakh annually. His employer contributes the minimal mandatory amount, which is ₹1,800 per month.

ABC's opening balance for the year is ₹5.5 lakh. While ₹2.5 lakh of his contribution will be non-taxable, the excess amount of ₹38,000 will get taxed. At the end of the year, his non-taxable contribution will be ₹8 lakh, on which, assuming an interest rate of 8.5 per cent, he will earn ₹68,000 interest.

The taxable portion will earn interest of ₹3,230. "This amount earned in 2021-22 will get taxed in the employee's hands in assessment year 2022-23 under the head 'income from other sources'," says Naveen Wadhwa, deputy general manager (DGM), Taxmann.

YOUR MONEY

If interest income exceeds the threshold limit of ₹5,000 under Section 194A, tax will be deducted at source (TDS).

According to Suresh Surana, founder, RSM India: "EPFO will issue TDS certificates to employees from whose accounts tax gets deducted."

Adds Deepesh Raghaw, founder, PersonalFinancePlan, a Securities and Exchange Board of India-registered investment advisor: "After TDS deduction, taxpayers will have to pay the balance tax liability out of their pockets, not from the interest earned."

**Implications for your finances**

These amendments call for a rethink. "First, determine whether the threshold of ₹2.5 or ₹5 lakh will apply to you," says Aditya Chopra, managing partner, Victoriam Legalis-Advocates & Solicitors. Only a small percentage of employees—high-salaried ones—will be affected.

Employees should think twice before getting their salary restructured to reduce the basic salary. "Doing so will reduce the employer's contribution, which is still tax exempt. Your house rent allowance (HRA) and any other component linked to basic salary will also decline," warns Raghaw.

High-salaried employees may, however, reconsider their contributions to Voluntary Provident Fund (VPF). Stopping this contribution won't affect employer contribution, HRA, etc. The post-tax rate of return (on EPF + VPF contribution above ₹2.5 lakh) has declined from 8.5 per cent to less than 6 per cent (for those in the 30 per cent or higher tax bracket). "Consider alternatives like equity mutual funds, since this is long-term money," says Raghaw.

While you should market the most of Public Provident Fund's tax-free return of 7.1 per cent, you can only contribute ₹1.5 lakh to it annually.