Budget 2014: Private sector contributions to NPS may be taxed for past 5 years

Multinational corporations such as Vodafone Plc may not be the only entities ensnared by retrospective taxation.

Contributions by private sector subscribers to the National Pension System (NPS) over the past five years may have become taxable in certain situations, because of a provision in the budget intended to correct an anomaly between government and private employees.

The NPS was initially meant to build up a post-retirement corpus for government employees joining service on or after January 1, 2004, with employer and employee contributions to the scheme being tax free since that date. However, the wording of Section 80CCD of the Income-Tax Act,which grants this tax break, was not changed when private sector firms were allowed to enroll employees into the scheme from May 1, 2009 - thus restricting the tax break to government employees who joined service after 2004.

A clause in the new Finance Bill is aimed at correcting this. But the wording appears to make past contributions taxable, said industry experts and finance heads of companies that have joined the NPS.

Section 80 CCD to allow private sector employees, whose date of joining the service could be any date, to join NPS and receive tax benefits on par with central government employees with effect from April 1, 2015... and the assessment year 2015-16," a ministry statement issued on Friday said.

This would allow private sector NPS subscribers — including those who have joined as individuals rather than through an employer — to contribute to the scheme and claim tax breaks irrespective of when they started working.

But it is the reference to assessment year 2015-16 — which is the same as the fiscal year beginning April 1,2014 — which has created the uncertainty, said the finance heads of three companies, including a software major which had offered the NPS option to its employees way back in 2009.

"Since this aberration has been corrected only from this fiscal, employee contributions to the NPS claimed within the overall tax-free limit of Rs 1 lakh granted for savings like PPF and EPF in recent years, could be construed as wrong tax deduction claims," said Amit Gopal, senior vice-president at India Life Capital, which advises top corporates on funding employee benefits.

"Moreover, if such employees had started working prior to 2004 then it could again be construed as wrong deduction of tax by the employer to the extent of such contributions," he said, adding that even employer contributions to the NPS which were believed to be tax-free up to 10% of salary, irrespective of the employees' date of joining of employment, could be taxable for the period between 2009 and 2014.

The NPS currently enjoys an Exempt-Exempt-Tax or EET treatment, which means contributions and earnings are not taxed, but the corpus accumulated by the time of retirement is taxable at the time of withdrawal.

For private sector employees, however, the Budget could end up offering TE-T treatment as their contributions till March 31, 2014 could be taxed, said the finance heads of the companies cited above.

The rationale for the provision, according to finance ministry officials, is that for private sector subscribers the date of joining service and the date of their joining the NPS might have been different, as the scheme was not open to non-government employees before 2009.

This is not the only area of concern for private firms as far as retirement savings of employees are concerned as around 300-odd firms who manage their employees' provident fund savings in-house through PF trusts could come under the income tax net this year as they have failed to secure an exemption licence from the EPFO mandated by former Finance Minister P Chidambaram in the Finance Bill of 2006. The Budget has provided no extension for the deadline to get such licences that was extended annually in the past eight years, and had lapsed in March 2014.

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