

When does EPF become taxable?

The main USP of the Employees' Provident Fund (EPF), apart from safety and high returns (compared to other fixed options such as PPF, FD), is that it has exempt-exempt-exempt tax status. That is, it is exempted from tax at the time of maturity. Further, contributions to EPF and the interest received on the EPF contributions are exempted from tax as well, subject to certain conditions. However, did you know that there are certain instances when EPF can become taxable?

That is right, for instance, the employer's contribution to the EPF account can become taxable if it exceeds a certain limit in a financial year. There are few more such instances when you will have to pay tax on EPF.

Here is a look at when contributions, interest earned and withdrawals from one's EPF account will become taxable.

- **When contribution to EPF account becomes taxable**

As per current law, an employee's own contribution to the EPF account is not taxable. However, effective from April 1, 2020, onwards, employer's contribution to the EPF account can become taxable if it exceeds Rs 7.5 lakh in a financial year.

Aarti Raote, Partner, Deloitte India says, "The excess employer's contribution to EPF, NPS and/or Superannuation fund will be taxed as perquisite in the hands of an employee. The employer needs to calculate the amount that will be taxed as perquisite and will be reflected in your Form 16."

As per a new law announced in Budget 2020, if the employer's contribution to an employee's National Pension System (NPS) account, superannuation fund and EPF account on an aggregate basis exceeds Rs 7.5 lakh in a financial year then the excess contribution will become taxable in the hands of an employee.

Abhishek Soni, CEO & founder, Tax2win.in, an ITR filing website, explains the situations where the employer's contribution to EPF account becomes taxable in the hands of an employee.

Case I: When total contribution to NPS, superannuation fund and EPF account by your employer exceeds Rs 7.5 lakh in a financial year

Suppose an employer in a financial year contributes Rs 1 lakh to the superannuation fund, Rs 5 lakh in NPS and Rs 2 lakh in the EPF account. This is a total contribution of Rs 8 lakh, i.e., it exceeds the Rs 7.5 lakh tax-exempt limit by Rs 50,000. Thus, an employee is liable to pay tax on the excess contribution.

Case II: When contribution to EPF account exceeds Rs 7.5 lakh in a financial year and no contribution is made to NPS and superannuation fund

Suppose an employee does not have an NPS account and superannuation fund. However, the employer's contribution to the EPF account is Rs 8.5 lakh in a financial year. In this case, as well, excess amount will be taxable in the hands of the employee.

Thus, in this case also, the employer's contribution to the EPF account becomes taxable in the hands of an employee.

- **When interest on EPF account becomes taxable**

Although interest earned on the EPF account is tax-exempt, there are two situations where the interest earned becomes taxable. Effective from April 1, 2021, onwards, if an employee's own contribution to the EPF account along with excess contribution via Voluntary Provident Fund (VPF) exceeds Rs 2.5 lakh in a financial year, then the interest earned on excess contributions will be taxable in the hands of an employee.

However, in case there is no employer contribution to the EPF account, which is usually the case for government sector employees, then interest will be tax-exempted for the employee's own contribution up to Rs 5 lakh in a financial year.

Raote says, "Interest accruing on the employee's contribution in excess of Rs 2.5 lakh or Rs 5 lakh, as the case may be, would probably be taxed as income from other sources. However, specific guidelines need to be issued by the government to clarify TDS and other aspects."

As mentioned above, if the employer's contribution to the EPF, superannuation fund and NPS exceeds Rs 7.5 lakh in a financial year, then the interest earned on the excess contribution will also be taxable.

Raote adds, "There is a challenge around calculating the interest/returns earned on the employer's contribution to NPS exceeding Rs 7.5 lakh in a financial year. The government is yet to issue guidelines in this regard."

There are cases where money is left in inactive EPF accounts or money is not withdrawn from the EPF account after the employee has left the job. In such cases, the EPF account continues to earn interest on the EPF deposits. Soni informs that the interest earned on the deposits lying in inactive EPF accounts are taxable in the hands of an employee.

- **When withdrawal from EPF account is taxable**

If the money is withdrawn from the EPF account at the time of maturity or partial withdrawal is made as allowed under the EPF scheme (such as for the purpose of marriage, building a house etc.), then the withdrawal is exempted from tax.

Raote says, "If you have withdrawn money from your EPF account to deal with a financial emergency on the account of novel coronavirus pandemic, then the amount withdrawn is not taxable."

Full withdrawal from the EPF account is allowed if an employee has left his/her job and has not joined any other new job after two months. In such a scenario, taxation of the withdrawal from EPF account will depend on the how long the EPF account has been active.

Raote says, "If the withdrawal from EPF account is made after working for 5 continuous years, then such withdrawal is exempted from tax. On the other hand, if the continuous service is less than five years, then the amount withdrawn becomes taxable in the hands of an individual. Further, if the withdrawal amount exceeds Rs 50,000, then TDS will be applicable at the rate of 10%."

Soni adds, "Do keep in mind that TDS on EPF withdrawal is applicable on withdrawal amount exceeding Rs 50,000 before the completion of 5 years of service."

There are certain exceptions to the 5-year continuous service rule.

Raote says, "Withdrawals can also be exempt if an individual leaves job due to ill-health, the closing of a business unit, or any other reasons that are beyond the employee's control in which case the 5-year threshold would not apply."

Five continuous years will be calculated from the date of joining the EPF scheme. Thus, even if you have switched your jobs during the five years, ensure that your Universal Account Number (UAN) is the same for all the employers to be eligible for the five-year continuous rule.

Source: Economic Times