Tax on PF withdrawals

Introduction

- The income tax law proposed in the Finance Bill, 2021, has triggered anxieties for the salaried class: withdrawing tax exemption on interest income accrued into Provident Fund accounts arising out of employee contributions exceeding ₹2.5 lakh ‘in a previous year in that fund,’ on or after April 1, 2021.

Issue

- The rationale — some employees are contributing huge amounts into their PF accounts and getting tax-free incomes.

Views of the Revenue Department

- The Revenue Department has pointed out the tax will only affect a small group of ‘high net-worth individuals’ (HNIs); the 100 largest employees’ PF (EPF) accounts had a combined balance of over ₹2,000 crore.
- It can be no one’s case that a social security scheme for formal sector workers should become an investment haven for the well-heeled corporate top brass.

Is there a flaw in the definition of HNI?

- The threshold proposed to exclude the so-called HNIs appears low, as it would end up partially taxing PF income for even those putting away ₹21,000 a month towards their retirement — hardly a typical HNI given it may take the saver decades to attain a one crore rupee PF balance.
- The threshold also does not tie in with the ₹7.5 lakh limit set in last year’s Budget for employers’ contributions into the EPF, National Pension System (NPS) or other superannuation funds (rules for which are yet to be notified).
- This is not the first time this government had tried to tax PF savings, citing its abuse by the rich.
- In the 2016-17 Budget, it proposed to tax 60% of EPF balances at the time of withdrawal, but backtracked after a backlash.
- Now, it has covered even government employees’ contributions into the GPF, but left NPS investments over ₹2.5 lakh a year untouched.
- Tax treatment inequity between India’s limited retirement savings...
instruments aside, employees and employers have some serious doubts on the implementation.

Retro-active tax

- The words ‘in a previous year’, for one, suggest this will be a type of retro-active tax — taxing future income even on past years’ contributions of over ₹2.5 lakh.

Way ahead

- Finally, this may not be smart timing for a government looking to lean on huge borrowings to dent large inflows into EPF — most of its corpus is captively deployed in government bonds.
- While the goal of targeting HNIs using the PF savings to avoid taxation is laudable, the Centre should consider recalibrating the arithmetic and operational details of this tax.