Taxation Aspects of Provident Fund

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Introduction to Social Security

Particulars	Employees' Provident Fund (EPF)	Employees' State Insurance (ESI):
SCHEME INTRODUCITON	A retirement cum savings benefits scheme mandatorily applicable to establishments with 20 or more employees. Mandatorily applicable to Employees whose “Basic Salary” is less than or equal to Rs 15000 per month	A social security scheme providing medical, monetary, and other benefits to employees earning up to ₹21,000 per month in establishments with 10 or more employees
Contribution Rates	• **Employee:** 12% of Basic Salary + Dearness Allowance. • **Employer:** 12% of Basic Salary + Dearness Allowance, distributed as: • A. 3.67% to EPF. • B. 8.33% to Employees' Pension Scheme (EPS). (If employee earn salary of more than 15000, the employer’s EPS contribution is subject to limit of Rs. 1250 and balance amount of employer contribution , that is 12% of basic salary + DA less 1250 is transferred to EPF)	• **Employee:** 0.75% of wages. • **Employer:** 3.25% of wages.
NOTES:	For employees with a salary exceeding ₹15,000, the employer's contribution to **EPS** is capped at **₹1,800(FOR EPS IT IS 1250) ONLY** per month.	Employees earning up to ₹176 per day are exempted from their contribution in ESI; however, employers must still contribute their share.

Types for Provident Funds Employees

- Employee contributions to EPF are eligible for deduction under Section 80C, subject to the overall limit of ₹1.5 lakh per annum.

Particular	Statutory PF (Govt.,University etc)	Recognized PF (Private Sectory	Unrecognized PF (Privaet Sector)	Public provident fund(Savings Scheme)
Employee Contribution to the Fund	Deduction allowed under section 80C	Deduction allowed under section 80C	The deduction is not allowed under Section 80C	Deduction allowed under section 80C – (Need not be an employee)
Employer's Contribution to the Fund	Exempt from tax	Exempt up to 12% of BS + DA	Not taxed when initial contribution is made	NA as being Savings
Interest Income	Exempt from tax*	Exempt up to 9.5% interest per annum	Not taxed on yearly accrual	Interest is Exempt from tax

Statutory PF

- It is generally applicable to Employees of Government Dept., accredited Universities and Educational Institutions etc., run by Government employees
- It is regulated under the Indian Provident Fund Act 1925
- The Employees are used to contribution around 8% to 10% depends upon the terms of engagement and dept. Employer also makes equal contribution
- Interest is paid Central Government each year and compounded annually.
- The interest and employer contribution is fully exempt.
- If withdrawn before 5 years, they are subject to tax.

Recognized PF (RPF) by EPFO

- Sec 2(*38*) "**recognized provident fund**" means a provident fund which has been and continues to be recognized by the [73][Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner] in accordance with the rules contained in Part A of the Fourth Schedule, and includes a provident fund established under a scheme framed under the Employees' Provident Funds Act, 1952 (19 of 1952) ;
- It is applicable for Private Sector employees.
- Organization with 20 or More employees need to registered with Employees Provident Fund Organization(EPFO) and mandatorily contribute for employees earning less than or Equal to Basic Salary of Rs 15000/ PM
- It is regulated under the Employees Provident Fund and Miscellaneous Provisions Act 1952
- The Employees are to contribution 12% of the Basic Wages by way of deduction by Employer. Employer also makes equal contribution with administration charges of around 1%. Hence, Employer has to contribute 25% every month.
- The said fund are managed by EPFO by investing in various prescribed securities.
- For every year, the EPFO declares the rate of interest applicable for such PF contribution and credited to each member account. The interest and employer contribution is fully exempt.
- It includes Provident Fund created by Employer and Managed by them subject to approval by EPFO through EPF Scheme.
- It is generally permitted if the employer submits a scheme that the scheme framed by them gives better yield and return and safe to their employees.

Unrecognized PF

- Any savings scheme framed by Employer of their own, not recognized by EPFO shall be termed as Unrecognized PF.
- For example, an employer having less than 20 employees can frame a scheme for retirement benefit, with the consent of the employees, But it is known as Unrecognized PF.
- However, it may be noted that ***such organization can voluntarily enroll with PF organization with the consent*** of all the members, then existing.
- Once made applicable, then, all the provisions are mandatorily applicable

Taxation of Contributions made and Interest there

Particulars	RPF	URPF	SPF	PPF
Employer's Contribution	Monthly Contribution in excess of 12% of salary is taxable as "salary" u/s 17(1).	~~Not Taxable at the time of Contribution~~ **(Exempt - taxed only at withdrawel)**	Fully exempt	N.A. (as there is only assessee's own contribution)
Employee's Contribution	Eligible for deduction u/s 80C	Not eligible for Deduction under Sec 80C	Eligible for deduction u/s 80C	Eligible for deduction u/s 80C
Interest Credited on employer contribution	Amount in excess of 9.5% p.a. is taxable as "salary" u/s 17(1)	Not taxable at the time of credit of interest	Fully exempt	NA (as there is no employer contribution)

Taxation of Contribution and interest…..

Particulars	RPF	URPF	SPF	PPF
Interest Credited on Employee's Contribution	Amount in excess of 9.5% p.a. is taxable as "salary" u/s 17(1) [See Note below]	Not taxable at the time of credit of interest	Exempt up to certain limit of contribution [See Note below	Fully exempt
Amount withdrawn on retirement/ termination	Exempt u/s 10(12) subject to certain conditions (taxable if withdrawn with in 5 years)	Employee's contribution is not taxable. • Interest on Employee's contribution is taxable under 'Income from Other Sources'. • Employer's contribution and interest thereon is taxable under Salary	Exempt u/s 10(11)	Fully exempt u/s 10(11)

Taxation on Withdrawal of Contributions

- **On death of the employee <u>while still in active service</u>, Any withdrawal of amount by their legal heirs are not taxable in the hands of such legal heir vide CBDT Circular No: 573 dated 21-08-1990**
- **Withdrawal of amount of PF on retirement is taxable as detailed below**
  - **Government employee(from Statutory PF) – Fully Exempt**
  - **Private Sector Employees (From RPF) –**
    - **Interest in excess of 9.5% is taxable.**
    - **Employees Contribution is exempt**
    - **Employer Contribution is Exempt u/s 10(12)**
- **Any withdrawal of Employer Contribution before 5 years of becoming member of PF Organization for reason other than stated above is taxable. fully**
- **Any loan availed from PF dept does not tantamount to withdrawal**

TDS on withdrawal

- **PF dept is obligated to withhold a portion of amount withdrawn as TDS if**
  - The employee withdraws more than INR 50,000
  - The employee has not completed 5 years of continuous membership
  - The Rate of TDS is 10% of the amount withdrawn, if PAN of the employees is provided. If they don't have PAN, PF dept is bound to deduct at 30% of the amount withdrawn.

Exemption from TDS on EPF withdrawals

Under the Following nature of withdrawal, TDS is not deducted by PF Dept on its withdrawal even when it crosses Rs 50000/-

- On death of the employee
- When the EPF is **transferred** from one PF account to another PF account (generally done in case of a job change)
- When the employee's services are terminated because of his bad health when the business is discontinued, when the project is completed, or in case of any other reason that is not under the control of the employee
- If the employee has submitted his PAN details and Forms 15G or 15H

Tax Impact due premature withdrawal

Financial year	Salary income	Mr. Sharma's contribution	Interest @8% (assumed)	Employer's contribution	Interest @8% (assumed)
2015-16	6 lakhs	72,000	5760	72000	5760
2016-17	8 lakhs	96,000	7680	96,000	7680
2017-18	10 lakhs	1,20,000	9600	1,20,000	9600
2018-19	12 lakhs	1,44,000	11520	1,44,000	11520

Continued …

His tax liability for the said-mentioned financial years would be as follows

Financial year	Salary income	Section 80C deduction for EPF contribution	Tax liability
2015-16	6 lakhs	72,000	10% on 2.5 lakhs + 20% on 28,000 = 30,600
2016-17	8 lakhs	96,000	10% on 2.5 lakhs + 20% on 2.04 lakhs = 65,800
2017-18	10 lakhs	1,20,000	5% on 2.5 lakhs + 20% on 3.8 lakhs = 88,500
2018-19	12 lakhs	1,44,000	5% on 2.5 lakhs + 20% on 5 lakhs + 30% on 56,000 = 129,300

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His tax liability will be calculated as follows

Financial year	Salary income	EPF contributions of self and employer, including interest earned on both	Withdrawal Section 80C deduction for EPF contribution	Total taxable income	Revised Tax liability	Tax already paid	Tax payable
2015-16	6 lakhs	1,55,520	72,000	8,27,520	10% on 2.5 lakhs + 20% on 327,520 = 90,504	30,600	59,904
2016-17	8 lakhs	2,07,360	96,000	11,03,360	10% on 2.5 lakhs + 20% on 5 lakhs + 30% on 103,360= 156,008	65,800	90,208
2017-18	10 lakhs	2,59,200	1,20,000	13,79,200	5% on 2.5 lakhs + 20% on 5 lakhs + 30% on 379,200= 226,260	88,500	1,37,760
2018-19	12 lakhs	3,11,040	1,44,000	16,55,040	5% on 2.5 lakhs + 20% on 5 lakhs + 30% on 655,040 = 309,012	1,29,300	1,79,712

Taxation and Benefits for Employers

- As per Section 43B of the Income Tax Act, certain expenses are allowed on payment basis. One among them is PF and ESI Contributions.
- The employers are obligated to remit the Contributions on or before the relevant dues prescribed under the PF and ESI Law
- The due date for PF is 15th of the following month. For ESI it is 21st of the following month.
- Employer contributions and Administration charges to EPF and ESI are treated as business expenses and are deductible under Section 36(1)(iv) of the Income Tax Act, but as per Sec 43B, allowed as expenditure only on payment basis.
- To claim these deductions, employers must have deposited the contributions before the said due dates or atleast before the due date of filing of IT return
- Damages paid to PF dept is disallowed.

Tax Impact if NOT paid before due date

- If the dues (both employer and employee's share) are not paid before due date, the employers are penalized on both part of contributions.
- Sec 2(24)(x) reads as follows:

  (24) "income" **includes-**

  (i) Profits and gains

  (ii) Dividend

  .....

  (x) any sum received by the assessee (employer) from his **employees as contributions** to any **provident fund** or superannuation fund or any fund set up under the provisions of the **Employees' State Insurance Act**, 1948 (34 of 1948), or any other fund for the welfare of such employees **;]**

  (xi).....

- Sec 2(24)(x) of the Income Tax Act, empowers the Dept and treats the Employees Contributions as Income in the hands of the Employer (assessee). Hence, even though it is not created to the P&L a/c, the said amount need to added in the Memo Separately

Tax Impact if NOT paid .....

- Employer Contribution is an expenditure to the employer(assessee). Hence, it is debited to Profit and Loss account.
- If the dues are not paid within the due date, the said contribution is treated as Inadmissible expenditure under Sec 43B and to be disallowed at the time of computation of Income.
- Hence, a default on remittance of tax would have the following impact on the Employer

Under PF Act	Under Income Tax
❖Payment of Interest at the rate of 12% PA ❖Damages at ❖5% PA for delay of less than 2 months ❖10% PA for delay between 2-4 months ❖15% PA for delay between 4-6 months ❖25% PA for delays more than 6 months, subject to a maximum of 100%	Tax Impact at 30%/25% on ❖ the addition of Employees Contribution as Income under Sec 2(24)(x) and ❖ on disallowance of Employer Contribution and Admn charges under Sec 43B.

- **Hence, it is worth paying the PF dues in time, even borrowing at hefty interest rate**

Thank You All