

## Re-examining the EPF Tax Rules

### Why in news?

The new EPF tax rules will come into effect from April 1, 2021 as announced in the Union Budget of 2021.

### What was the existing rule?

- If a person contributes more than the limit prescribed under **Section 80C of the Income Tax Act**, he cannot get a tax break on his excess contribution.
- The earnings on contributions rarely suffered taxation since tax laws pegged tax-free earnings to higher rates than the interest rate on the EPF.
- Moreover the person will pay tax on their corpus, only if he withdrew it within 5 years from the comment of the contribution.
- This taxation framework incentivised employees to use the EPF as their primary retirement saving and it acted as risk-free retirement savings mode.

### What is the new rule?

- The new tax regulation will label a person as a high net worth individual if he misuses EPF by contributing more than Rs 2.5 lakh per annum to the EPF.
- The limit is Rs 5 lakh in cases where employers do not make contributions to the provident fund.

### What is the issue with new rules?

- With the new rule coming into effect, government assumes what is adequate for an individual on retirement.
- The decision on a common threshold of adequacy is incorrect and suffers from the flaw of one-size-fits-all approach.
- Moreover the word '**misuse**' that was used to justify the imposition of the tax is difficult to comprehend.
- This is because EPF is solely a payroll deduction and cannot be contributed in any other manner.
- The new clause of taxing the amount exceeding the limit prescribed in the act brings the EPF to the borders of double taxation.
- 65% of EPF is invested in government securities and rest is invested in largely in PSU bonds and earnings available to the employee through

interest credit mechanism.

- Despite the stickiness of these interest rate declarations and their often being higher than market rates, it is certain that the government does not subsidise this interest rate credit.

### **Why it is difficult to administer?**

- In addition to these flaws, there are difficulties in administering the new tax rule.
- Due to the changed of threshold from Rs 2.5 lakh to Rs 5 lakh, there can be various interpretations surrounding the applicability to EPF.
- It is also unclear if the interest on such excess contributions is taxed once during the year of contribution or throughout the term of investment in EPF.
- The mechanism of tax communication from the EPFO to the member also remains uncertain.

### **What are the takeaways from this?**

- The EPF remains a subsidy-free, pay-what-is-earned retirement fund and typifies safety with governance.
- Though pension funds are seen by governments in multiple policy contexts, they should remain, foremost, the retirement funds of the beneficiaries.
- Regulations governing contributions, taxation, investments, administration and benefits should be made in the interest of the beneficiary.
- But it seems that other imperatives dominate the agenda in pension policymaking in India.
- Therefore, the resultant outcomes are sub-optimal from a beneficiary point of view.
- Therefore the policy makers need to relook the new rules and the immediate rollback of it demonstrates the will of the policymakers to encourage retirement savings.

**Source: The Hindu**



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