Provident Fund

Taxability

April 2019

Contents

- Taxability of PF withdrawal
- TDS implications – EPFO & Trust
- PF & Corporate Tax

Taxability of PF withdrawal

Provident Fund

Particulars	Domestic workers	International Workers
Basic criteria	• Indian passport holder	• Non Indian passport holder
Taxability of withdrawal after continuous service for 5 or more years	• Exempt	• Exempt
Withdrawal on resignation before 58 years of age	• Balance to be transferred to another employer if in India • Balance may be withdrawn if moving out of country permanently	• Withdrawal allowed if from / passport holder of country with which India has SSA • Else wait until 58 years of age
Taxability of withdrawal before continuous service for 5 or more years	• Taxable under respective heads of income	• Taxable under respective heads of income

Taxability of PF withdrawal – key provisions

Exemption from taxation of PF withdrawal-Section 10(12)

Accumulated balance due and payable to an **employee** is exempt if conditions provided in Rule 8 of Part A of Schedule IV are met.

Meaning of accumulated balance -Rule 2(f)- Part A of Schedule IV

Accumulated balance means the balance due to his credit or such portion thereof as may be claimable by him under the regulations of the fund, **on the day he ceases to be an employee of the employer maintaining the**

Rule 8 of Part A of Schedule IV

The **accumulated balance due and becoming payable to an employee shall be excluded from taxation** if he has

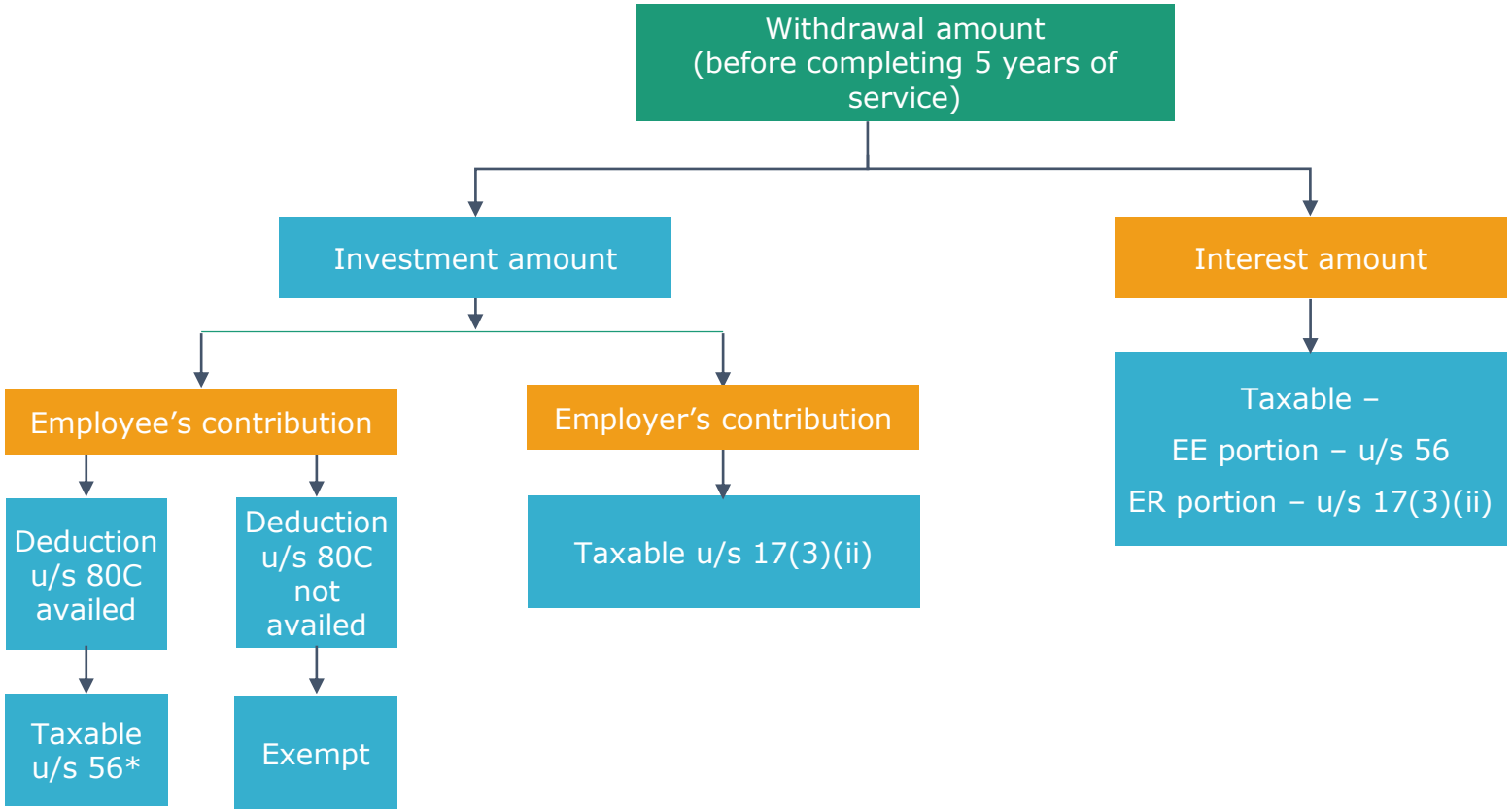
- Rendered continuous services for 5 years or more
- Terminated service before rendering 5 years of service due to ill- health or discontinuance of employer's business or other cause beyond his control.
- On cessation of employment, has obtained employment with any other employer and transfers **the accumulated balance due to the PF fund** of the other employer
- **Entire balance** standing to the credit of employee is transferred to NPS

Explanation

- Where the accumulated balance due and becoming payable to an employee participating in a recognised provident fund maintained by his employer **includes any amount transferred from his individual account in any other recognised provident fund or funds maintained by his former employer or employers, then, in computing the period of continuous service for the purposes of clause (*i*) or clause (*ii*) the period or periods for which such employee rendered continuous service under his former employer or employers aforesaid shall be included**.

Taxability of PF withdrawal

If PF is withdrawn before completing 5 years of service, taxation is triggered.



- It is essential to obtain the bifurcation of components of the PF withdrawal from the employee pass book and tax appropriately under the proper head of income
- Employer's contribution in excess of 12% will be taxable. (Section 17(2)(vi) read with Rule 6 of Part A of Fourth Schedule)
- Exempt income has to be reported in the ITR.
- * Individual slab rates applicable in the year of contribution

Interest earned post cessation of employment

Summary

- PF Trust has to deduct tax on the interest paid post cessation of employment (even though 5 years of service is completed).
- Provisions of the Act clearly indicates that the exemption u/s 10(12) of the Act is available only to a person who being an employee withdraws the accumulated fund from the PF account as on the date of retirement or termination of employment.
- Interest accrued post cessation of employment cannot be said that such accrual of the interest was qua an employee.

Provisions

- Section 10(12) of the Income Tax Act -The accumulated balance due and becoming payable to an employee participating in a Recognized Provident Fund to the extent provided in Rule 8 of Part A of the 4th Schedule.
- Rule 2 (f) of Part A of 4th Schedule -"Accumulated balance due to an employee means the balance to his credit, or such - portion thereof as may be claimable by him under the regulations of the fund, on the day he ceases to be an employee of the employer maintaining the fund"

Caselaws

- Principal CIT vs. Dilip Ranjrekar[2019] 101 taxmann.com 114 (Karnataka HC)
- Asstt. CIT v. Dilip Ranjrekar[2018] 98 Taxmann.com 362 (Bang Trib)
- Anurag Singh - Lucknow ITAT (ITA No. 35/LKW/2014)
- ONGC Ltd. v. Income-tax Officer (TDS), Dehradun [2005] 4 SOT 333 (Delhi Trib)

Provisions

Rule 8 of Part A of 4th Schedule -the amount of the accumulated balance due and becoming payable to an employee on the termination of his employment is excluded from the computation of his taxable income if the employee has ……

Dilip Ranjrekar – Karnataka HC

Facts

The assessee retired on 1-4-2002. As on that date, the amount accumulated in the Provident Fund was Rs. 37,93,888/-. He did not withdraw the same. He sought to withdraw it on 11-4-2011. The accumulated balance as on that date was Rs. 82,00,783/- which comprised of Rs. 37,93,588/- the balance on the date of retirement plus interest of Rs. 44,07,195/- on the accumulated balance from 1/4/2002 (the date of assessee's retirement) upto 11/4/2011; the date of withdrawal.

The ruling

- A perusal of the provision of section 10(12) of the Act and the definition of 'Accumulated Balance' in Part A of 4th Schedule clearly indicates that the exemption u/s 10(12) of the Act is available only to a person who being an employee withdraws the accumulated fund from the PF account as on the date of retirement or termination of employment.
- Interest earned post employment cannot be said that such accrual of the interest was qua an employee.
- The exemption u/s 10(12) of the Act is limited to the accumulated balance due and payable to an employee upto the date of retirement/end of employment.
- In this view of the matter, we are of the considered opinion that the accumulated interest of Rs.44,07,195/- post retirement of the assessee on 1/4/2002 is not eligible for exemption u/s 10(12) of the Act.

Taxability of PF- Different scenarios

Issues for consideration

Continuous service	• PF accumulation with Employer X transferred to PF fund under Employer Y • PF accumulation with Employer X is not transferred and separate PF account held with Employer X and Y • PF accumulation with Employer X withdrawn before joining Employer Y
Taxability of interest	• Taxability of interest earned during Year 4 to 5 and Year 9 to 12
Taxability of PF under different scenarios	• Where PF fund held with Employer X is transferred to PF fund of Employer Y and PF balance withdrawn at the end of year 12 • Where PF fund held with Employer X is not transferred and 2 separate PF accounts maintained. PF balance of X and Y withdrawn at the end of year 12 • PF balance transferred to NPS

Taxability of PF withdrawal

Scenario	Taxability
Where PF fund held with Employer X is transferred to PF fund of Employer Y and PF balance withdrawn at the end of year 12	• Balance transferred from Employer X includes interest earned post cessation of employment with Employer X before the amount transferred to Employer Y. • As the continuous service criteria of 5 years as provided in Rule 8(i) read with explanation 8 is satisfied at the time of withdrawal, the accumulated balance due at the end of 8th year will be exempt. • However, as per Rule 8(iii) only accumulated balance due to employee which is transferred to new employer PF fund will be excluded. • Interest earned post cessation of employment with Employer X till the PF balance transferred to Employer Y and Interest earned post cessation of employment with Employer Y is taxable.
Where PF fund held with Employer X is not transferred and 2 separate PF accounts maintained. PF balance of X and Y withdrawn at the end of year 12	• As the PF balance is not transferred from Employer X, service period with Employer X will not be counted while determining continuous service of 5 years • Entire PF balance (excluding employee's contribution on which deduction under section 80C has not been claimed)
PF balance transferred to NPS	• Accumulated balance due and becoming payable on cessation of employment transferred to NPS is tax free – Rule 8(iv) • Interest earned post cessation of employment is tax free • Trust deed / PF Act would require necessary amendment to allow transfer from PF to NPS • Tax cost benefit analysis needs to be done based on tax provisions relating to NPS withdrawal vis-a vis transferring fund balance to other employer where possible and withdrawing the fund balance

TDS implications – EPFO & Trust

TDS Implications - EPFO

Tax provisions

- PF withdrawal before rendering 5 years of continuous service is taxable
- EPFO deducts tax @ 10% u/s 192A
- Any accumulations to PF post cessation of employment is taxable.
- No tax deducted on interest payments post cessation of employment where the 5 year criteria

Compliances

- Deduction and deposit of taxes
- Though there is no withholding tax certificate issued, the TDS appears in Form 26AS.

Challenges

- Employees have to specifically report the PF withdrawal and remit additional taxes as applicable
- Triggers advance tax liability
- Remit tax on interest accumulated post cessation of employment
- Taxability in overseas country for internationally mobile employees and IWs (specific treaty to be examined)

Employees to get credit for TDS only if PAN is updated

TDS Implications - PF Trust

Tax provisions

- PF withdrawal before rendering 5 years of continuous service is taxable
- Any accumulations to PF post cessation of employment is taxable.
- TDS on taxable PF withdrawals
- TDS on interest payments post cessation of employment
- TDS on Interest payment exceeding the EPFO prescribed rate

Compliances

- Deduction and deposit of taxes
- Filing quarterly and Annual TDS returns
- Issuance of withholding tax certificates

Challenges

- Point of deduction of tax – on credit (monthly or annually) or on payment
- Taxability of interest – on credit or on receipt basis
- Determination of Residential status of PF members
- Applicability of section 194A to the trust
- Determination of taxable withdrawal - 5 years of continuous service vs 5 years of contributory period.
- Authority of the Trust to deduct tax from on interest for payments post cessation of employment
- Compliance ? Collect cash?
- Tax rate to be applied for deducting tax
- Consistent tax position which could be applied across all the years / all matters.
- Ongoing communication with the ex-employees

- Trusts are getting notices under section 133(6) of the Income tax Act for compliance with the TDS provisions (specifically with reference to interest paid post cessation of employment)

PF & corporate tax

PMRPY & 80JJAA

The Government of India had launched Pradhan Mantri Rojgar Protsahan Yojana scheme to incentivize employers registered with EPFO.

01

PMRPY

- This scheme is applicable for all establishments registered with EPFO
- The Government of India would pay 12% of employer contribution in respect of new employee for an initial period of 3 years.
- Scheme was made effective from August 9, 2016 and applicable to employees with wages up-to INR 15,000. New employees earning wages more than INR 15,000 is not eligible.
- Such employees should not be working in any establishments registered with EPFO in the past.
- Employer should have a labour identification Number allotted to them under the Shram Suvidha Portal.

02

80JJAA

- Provides deduction of 30% towards additional employee cost incurred during the financial year for 3 years
- Employee total salary should not exceed INR 25,000 per month.
- Employees must be contributing to recognized provident fund & should not be covered under the PMRPY scheme.
- Employees employed for a period of less than 240/150 days during the relevant financial year or during immediately succeeding year
- A certificate from an accountant is required to avail this deduction.

PMRPY and Section 80JJAA benefit are mutually exclusive

Deductions for the company

Provisions of the Income Tax

2(24)(x) : Contributions deducted from the employee to be treated as income

36(1)(va): deduction allowed if sum collected from employees is credited to employees account before the due date

43B(b): Deduction for PF contribution by employer is available only on actual payment / before the due date of furnishing the returns of income under section 139(1)

Deduction for interest and penalty / damages remitted by a company

Challenges:

- Whether there is distinction between deduction of employee contribution u/s 36(va) and employer contribution u/s 43B(b)?
- CBDT circular No. 22/2015 dated 17th December 2015 for employer contributions remitted u/s 43B
- Corporate tax deductibility for retrospective payments - litigative
- Inconsistency in the definition of “pay” as per Income Tax Act and PF Act

Judicial precedence in India

Deduction for both employer and employee contribution u/s 43B is available if remitted before filing of Income tax return

Deduction not available

- Kerala HC in CIT v. Merchem Ltd. [2015] 61 taxmann.com
- Kerala HC in CIT v. South India Corporation Ltd. [2015] 58 taxmann.com 208/232 Taxman 241

Deduction available

- Karnataka HC in CIT vs Sabari Enterprises (2008 298 ITR 141 KAR)
- Karnataka HC in Essae Teraoka (P.) Ltd. v. Dy. CIT [2014] 43 taxmann.com
- Rajasthan HC in CIT v. Jaipur Vidyut Vitran Nigam Ltd. [2015] 228 Taxman 214 (Mag.)
- Rajasthan HC inCIT v. State Bank of Bikaner & Jaipur [2014] 43 taxmann.com 411/225
- Himachal Pradesh HC in CIT v. Nipso Polyfabriks Ltd [2013]

Not free from litigation

Questions

Q&A

This material is prepared for the purpose of Workshop on labour laws program conducted by the Institute of Chartered Accountants of India on 13 April 2019 for the reference of its members. The information contained herein is meant for general purposes and is also not an exhaustive treatment of such subject(s) and accordingly is not intended to constitute any kind of professional advice or services. The information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser. By using any part of the information in this material the user accepts that none of the author, presenter or any organization with which she or he may be associated, shall be liable to the user for any decisions made or reliance placed on such information.