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3 September 2021

Income Tax 25th Amendment Rules

The Central Board of Direct Taxes (CBDT) through circular dated 31 August 2021 has issued the Income-tax (25th Amendment) Rules, 2021 according to which, from FY 2021-22 the interest income accrued in the provident fund account of a person above a specified limit will be taxed.

Background:

There are two types of PF:

1. Public Provident Fund (PPF)
2. Recognised Provident Fund (RPF) - where, usually the employer and employee, both contribute their sums.

Present Scenario (Till FY 2020-21)

- The accumulated balance of both, PPF and RPF is fully exempt.
- Annual contribution by the employer in excess of 12% of the salary is taxable in the hands of the employee.
- Interest: For PPF, the entire interest accrued is exempt. For RPF, interest in excess of 9.5% is taxable as salary.

Position from FY 2021-22

The entire provident fund (i.e. PPF and RPF) accounts will be segregated into 2 components:

I. Non-taxable contribution: This will comprise of

a. closing balance in the account as on 31 March 2021;

b. any contribution made by the person in the account during the FY 2021-22 and the subsequent FYs, will be exempt subject to the limits as specified below:

- In case the employer contributes to the PF: INR 2,50,000 per year.
- In case there is no employer's contribution **or** in the case of a PPF account: INR 5,00,000 per year.

c. Interest accrued on a. and b. above

II. Taxable contribution: This will comprise of

a. contribution made by the person in the account during the FY 2021-22 and subsequent FYs, which is in excess of the non-taxable limits specified in **I** above; and

b. interest accrued thereon, as reduced by withdrawals, if any from the account.

Therefore

Till date, the annual contributions made by the employer were exempt upto 12% of the salary. With this provision, the threshold is set at INR 2,50,000, meaning anything above INR 2,50,000 will be the taxable contribution. Employers will now have to work out a reverse way of calculating their contributions in order to accommodate the taxation effect from FY 2021-22 onwards and the same will now have to be adjusted from the contributions of the remaining 6 months of FY 2021-22.

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