

Budget 2020 may tax employer's excess contribution to EPF, NPS twice.

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Budget 2020 has proposed to limit the total tax-exempt amount of employer's contribution To an employee's EPF, NPS and superannuation account. As per the proposal, if the employer's contribution to EPF, NPS and superannuation fund on aggregate basis exceeds Rs.7.5 lakh in a financial year, then the excess amount will be taxed in the hands of An employee.

The proposal was made with an objective to restrict the tax-free benefits extended to the employees in the high-income bracket. Contribution to Superannuation fund, Recognized provident fund and National Pension System (NPS) fall in the EEE (Exempt-Exempt Exempt) taxation regime whereby no tax is levied at the time of contribution, accrual of interest and withdrawal if same are within a certain limit.

However, this proposal may lead to double taxation of excess part contributed by your employer in an employee's EPF and NPS account. Let us understand how this may happen.

Double taxation of some part of salary Salary of an employee is defined under section 17 of the Income-tax Act. It has three clauses (1), (2) and (3) which defines the term 'Salary', 'perquisite' and 'profits in lieu of salary', respectively.

As per section 17(1), salary includes wages, pension, gratuity, fees, commission, perquisites, and profits in lieu of salary, advance salary, leave encashment, employer's contribution to the recognized provident fund in excess of 12% of salary and employer's contribution to NPS.

Section 17(2) comprises of eight clauses which provide for taxability of various facilities provided and contributions made by an Employer for his employee.

According to current income tax laws, employer's contribution to superannuation fund exceeding Rs 1.5 lakh in a financial year is taxed as perquisite under section 17(2). However, contribution to PF exceeding 12 percent and NPS contribution by the employer is taxed as Salary under section 17(1).

The proposed amendment will tax the contribution exceeding Rs 7.5 lakh in a financial year as perquisite under section 17(2).

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Thus, if employer's contribution exceeding Rs 7.5 lakh in a financial year to PF and NPS is treated as perquisite due to proposal of taxing under section 17(2) then there will be double taxation in the hands of the employee. First, when employer's contribution to these Funds is taxed under section 17(1) (which has been kept unchanged by the budget proposals) and subsequently when the same amount is taxed as perquisite under section 17(2) (which is proposed to be amended in the budget) on crossing the threshold.

This can be explained with an example.

Particulars	Amount (in lakhs)
Basic Pay	50
Special Allowances	10
Employer's contribution to recognized provident fund	8
Employer's contribution to NPS	7
Employer's contribution to the superannuation fund	10
Total	85

S. No.	Particulars	Existing income tax law	Income tax law proposed in Budget
a)	Basic Pay (Section 17 (1))	50	50
b)	Special Allowance (Section 17(1))	10	10
c)	Employer's contribution to recognized provident fund (in excess of 12% of basic pay) [Rs. 8 lakh (less) Rs. 6 lakh (Rs. 50 lakh * 12%, taxable under section 17(1)]	2	2
d)	Employer's contribution to NPS [Section 17(1)]	7	7
e)	Employer's contribution to the superannuation fund in excess of Rs. 1.5 lakhs [Old Section 17(2)]	8.5	0
f)	Perquisite arising from Employer's aggregate contribution to the superannuation fund, PF and NPS in excess of Rs. 7.5 lakhs [New Section 17(2)]	0	17.5
g)	Income chargeable to tax under the head "Salary"	77.5	86.5

Due to the budget proposals (the fourth column) employer's excess contribution to PF i.e. Rs. 2 lakh (at c) and NPS contribution of Rs .7 lakh (at d) is getting added but is already part of Rs.17.5 lakh (at f) under section 17(2). Therefore, (c) and (d) are getting counted twice. As a result the taxable salary at (g) is going up to Rs.86.5 lakh although the actual salary received is only Rs.85 lakh. This is happening because of the double taxation on the amount of contribution made by the employer to PF and NPS.

Further, the amount of contribution made by the employer in the superannuation fund is Rs.10 lakh. However, due to the proposed amendment in section 17(2), only Rs.2.5 lakh is chargeable to tax. Currently, employer's contribution to superannuation fund is taxable

If it exceeds Rs.1.5 lakh in a financial year. This means that if there is no employer contribution to NPS and EPF for the employee but the contribution to superannuation fund is say Rs.10 lakh then Rs.7.5 lakh of this would be tax exempt as against Rs.1.5 lakh currently. It is unclear whether this was the intention of the budget proposals.

Conclusion

The proposed amendment in section 17(2) is leading to absurd double taxability of the same income in the hands of an employee. This is because as per section 17(1), the full amount of contribution made by the employer to NPS is already taxable in the hands of the employee. Further, contribution to recognized provident fund is also taxable where it exceeds 12% of the salary of the employee.

Thus, logically, employees with high salary income can escape from the tax liability only when their employer contribute to the recognized provident fund within the limit of 12% of salary. Thus, the amendment should have been made only to provide for the upper limit of Rs.7, 50,000 in case of employer's contribution to recognized provident fund and existing provision relating to taxability of superannuation should remain intact.