You can invest more than Rs.2 Lakh in NPS to save even more tax

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Individuals investing in National Pension System (NPS) can claim tax benefit under three sections of the income-tax Act, namely - Section 80CCD (1), 80CCD (1b) and 80CCD (2). Here's how section 80CCD (2) of the Income-tax Act can help you save tax.

If you have exhausted the maximum limit of commonly used deductions such as those Under sections 80C, section 80D etc., and then the National Pension System (NPS) can help you save tax without any monetary limit (subject to a few conditions). Here's how.
Individuals investing in NPS can claim tax benefit under three sections of the Income-tax Act, namely:
(i) Section 80CCD (1) - which comes under the overall umbrella of Section 80C with maximum investment limit of Rs.1.5 lakh in a financial year;(ii) 80CCD (1b) - additional deduction for maximum of Rs.50, 000 which is over and above Section 80C; and (iii) 80CCD (2) - employer's contribution to an employee's Tier-I NPS account, maximum contribution up to 10 per cent of employee's salary is allowed in a financial year.

How section 80CCD (2) helps you save tax Section 80CCD(2) can help you save more tax even after the maximum tax breaks under (i) and (ii) have been availed. Current income tax laws allow an individual a deduction on the employer's contribution to the NPS account for maximum of 10 per cent of the employee's salary (salary here means basic plus dearness allowance). However, there is no limit on the amount that an employer can contribute to an employee's NPS account.

For instance, if your annual basic salary is Rs.10 lakh, and if your employer contributes Rs.1 lakh in your NPS Tier-I account, then you can claim maximum deduction of 10 percent of your basic salary, i.e., (10 per cent of Rs.10 lakh) Rs.1 lakh.

Remember, employer's contribution exceeding 10 percent of an employee's salary will be taxable in the hands of an employee. Archit Gupta, CEO and Founder, Clear Tax says, "Any excess contributions will be taxed as perquisite, which comes under the head salary”. The amount of tax that you can save on the employer's contribution will depend on the income tax rate applicable to your income slabs.

Income tax saved on employer's contribution of Rs.1 lakh

Income Tax Rate (Rs.)	Tax Amount (Rs.)
5%	5000
20%	20,000
30%	30,000

The contribution made by the employer has no monetary limit for FY 2019-20. The employer can contribute to an employee's NPS account as much as he likes, however, the maximum deduction that can be claimed by the individual cannot exceed 10 percent of an employee's salary (basic plus dearness allowance). This means that effectively the maximum that an employee can get as tax exempt through this route is 10 percent of his/her salary.

However, from FY 2020-21, Budget 2020 has proposed to limit the contributions made by the employer for the employee which are tax exempt in the hands of the employee. According to budget proposals, the employer's contribution to EPF, NPS, and superannuation fund will be taxable in the hands of an employee if the contribution exceeds Rs.7.5 lakh in a financial year on an aggregate basis. How tax benefit under section 80CCD (2) will be claimed, to avail the tax benefit under section 80CCD (2), an individual should check with his/her employer if the employer is willing to contribute to the NPS account of the employee.

Only then can this route be used to increase tax benefit beyond what investing Rs.2 lakh under income tax sections mentioned above can yield. Keep in mind that if an employer contributes any sum to your NPS account, the same is likely to be a part of your CTC or cost to company and may lead to reduction in some other component.

Gupta says, "Employer contribution to NPS will be part of gross salary and employee is eligible to claim deduction under section 80CCD (2). The Form-16 given by the employer will contain all the details of the gross salary paid to any employee and amount of deduction he/she is eligible to claim under section 80CCD (2).

“Available in the new tax regime as well another thing to note is that the deduction under this section is available under the new tax regime proposed in Budget 2020. Though the new tax regime requires an individual to forgo 70 tax-exemptions and deductions in lieu of concessional tax rates, an individual is allowed deduction under section 80CCD (2) in the new tax regime. Therefore, if you are planning to opt for the new tax regime from FY 2020-21, then deduction under 80CCD (2) can help you lower your taxable income and thereby your Income tax liability.