

Stopped working before completing 5 years? Your EPF could be taxable

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As an employee there are many things that you need to take care of when you decide to switch your job. The amount lying in the corpus of your provident fund account (under the Employees Provident Fund and Miscellaneous Provisions Act, 1952) at the time of switching your job is one aspect which many a times is not given importance by the employee. A little caution exercised can help the employee to save tax and ensure that the benefit of compounding of the retiral corpus is available over a period of time.

The contribution to PF is two-fold; employer contribution and employee contribution. The employee contribution is eligible for deduction u/s 80C of the Income-tax Act, 1961 (the Act) and as per the existing provisions of the Act the employer contribution to PF falls under the “EEE” category. This means that the contribution made by the employer on behalf of the employee is exempt from tax (provided the amount contributed by your employer is upto 12% of salary), the interest earned on the said contribution is exempt and the withdrawals from the fund are also exempt subject to certain conditions.

The accumulated balance due and becoming payable to an employee participating in a recognized provident fund shall be exempt in the following cases –

- (i) If the employee has rendered continuous service with his employer for a period of 5 years or more, or
- (ii) If, though he has not rendered such continuous service of 5 years, the service has been terminated (a) by reason of such employee’s ill health or (b) by the contraction or discontinuance of the employer’s business or (c) or other cause beyond the control of the employee, or
- (iii) If, on the cessation of his employment, the employee obtains employment with any other employer, to the extent the accumulated balance due and becoming payable to him is transferred to his individual account in any recognized fund maintained by such other employer (the process of transferring has now been simplified by the PF authorities).

In the case referred in point (iii) above, for the purposes of calculating the period of continuous service of 5 years, the time spent with the previous employer shall also be counted. In other words, say Mr. A works with ABC Pvt. Ltd for 2 years. ABC Pvt. Ltd. had a recognized provident fund. After completion of 2 years Mr. A resigns. He does not withdraw his accumulated balance lying in his PF account. After a gap of 1 month he gets a job with XYZ Pvt. Ltd and then transfers his accumulated balance of PF to his individual account in a recognized PF maintained by the new employer. If he serves a period of 3 years with XYZ then he would fulfill the condition of rendition of service for continuous period of 5 years. The gap in the employment for one month will not be considered for the purposes of counting the continuous period of 5 years. Further, the interest earned on the accumulated balance during the period when the employee is not in employment would be taxable in the year of credit of such interest as per the decision of the Bangalore ITAT in the case of Dilip Ranjekar.

There could be a case where the employee is not able to find a new job or the employee takes a break/sabbatical (especially in the case of women employees). Irrespective of the period of break, as per the latest Government guidelines, the account will earn interest. As and when the employee

rejoins work he/she can get the PF account transferred using the Unique Account Number (UAN is a number allotted to every PF account holder). In such a case, the PF account of the employee would get transferred to the account of the new employer.

If the accumulated balance due to an employee participating in a recognized provident fund is paid to him otherwise than in the circumstances referred to above i.e. where the employee voluntarily resigns from his/her employment before the completion of 5 years' service with the employer and withdraws the accumulated balance of PF, then the amount paid to the employee would be subject to tax. The tax would be levied on the aggregate amount of the employer's contribution, interest thereon and the interest earned on the employee's own contribution. As far as the principal amount of investment made by the employee is concerned, the same would be taxable if the employee has claimed a deduction u/s 80C of the Act.

The taxation is triggered in the year of withdrawal; however, the tax is computed as per the mechanism laid down in Rule 9 of the Fourth Schedule to the Act. The Income tax return form has also been amended to align the taxability and the disclosure requirements in accordance with the said Rule. As per the said Rule, the tax is computed for each of the earlier years as if the fund was not a recognized fund and the differential tax is worked out which has to be paid in the year of withdrawal. This means that the tax to be paid on the withdrawal is calculated as per what would have been payable by the individual if no deduction were allowed for EPF and according to income tax slab applicable to him/her at that time.

At the time of switching jobs, the employee therefore must decide whether he/she wants to withdraw the amount of corpus and pay tax and utilize the money or to get his/her individual PF account transferred to his/her individual account in any recognized provident fund maintained by the new employer. Ofcourse, the latter option is available only if the person does take up another job where he/she becomes a member of the EPF again.