#KPMG josh

# TAX FLASH NEWS

2 September 2021

## Computation of taxable interest on employee’s contribution to their Provident Fund account in excess of specified limit

### Background

The Finance Act, 2021, vide amendment in the relevant provision[1] of the Income-tax Act, 1961 (the Act), has bought to tax the interest income relating to the contributions made by the employee (in excess of specified limits) in a financial year (FY) to a recognized provident fund.

Accordingly, the interest income accrued/ received on employee’s contribution in excess of INR 2,50,000 / INR 5,00,000 as applicable, during the tax year towards recognized provident fund would be taxable.

In this regard, the Central Board of Direct Taxes (CBDT), vide Notification[2], has inserted a new Rule[3], wherein the mechanism of calculation of taxable interest on the contributions exceeding the specified limit, has been specified.

### Details of the Circular

- Interest earned on an employee’s contribution to Provident Fund above INR 250,000 in a year will become taxable in the hands of the employee. This monetary ceiling for the government sector employees is INR 500,000.
- Contributions made by an individual till March 31, 2021, would be considered non-taxable contributions.
- For the purpose of calculation of taxable interest from FY 2021-22 onwards, separate accounts (for taxable contribution and non-taxable contribution made by a person) to be maintained within the provident fund account.
- Accordingly, the interest on employee’s contribution to PF, would be separately calculated on both these PF accounts, as follows:
  - Non-taxable contribution: Non-taxable contribution includes the total balance of the provident fund as on 31st day of March 2021, non-taxable contributions made during FY 2021-22 and subsequent years (i.e. contributions which are less than the threshold limit of INR 250,000 or INR 500,000 as applicable) along with the interest component accrued on the above contribution (within the specified limit).
  - Taxable contribution: Taxable contribution, in theory, includes the contribution made by the employee during FY 2021-22 and subsequent years in excess of the specified limit (i.e INR 250,000 or INR 500,000 as applicable) along with interest on the above contribution exceeding the limit.
- The calculation under both the PF accounts would be undertaken after factoring in the withdrawals, if any.

### Our comments

Finance Act 2021 did not provide clarity on discharging the tax liability on such interest. Maintenance of separate accounts would ease the calculation of taxable interest on a year on year basis.

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[1] Section 10(11) and 10(12) of the Act
[2] Notification No. 95/2021/ F. No. 370142/36/2021-TPL dated 31 August 2021
[3] Rule 9D of the Income-tax Rule, 1962

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