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Provident fund interest earned after retirement can be taxed

A PF account allows you to accumulate funds tax-free only till your retirement

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For most employees, their provident fund (PF) account is the most significant accumulator of savings of their lifetime. Photo: iStock

For most employees, their provident fund (PF) account is the most significant accumulator of savings of their lifetime. A significant advantage, in addition to the tax deduction for contributions made by employees to the PF account and the tax exemption for contributions made by employers to the PF account, is that the rate of interest earned on the employee PF account is much higher than that on other debt investments. Besides, it is exempt from tax. This has a multiplier effect on account of the fact that the interest is retained in the account, and is therefore compounded.

Due to these factors, many employees choose to continue their PF accounts even after their retirement, though they and their employers cease to contribute to the accounts. They are often under the impression that this is a good tax-free investment, which will yield far more than other debt investments on account of the fact that the interest is exempt.

However, a recent Income Tax Appellate Tribunal decision, holding that such interest earned post-retirement of the employee is taxable, should serve as a warning to such employees.

In this case, which is before the Bangalore bench of the Tribunal, the taxpayer retired from the company in April 2002 after working there for 26 years. As on the date of retirement, the balance in the PF account was Rs37.94 lakh. The PF balance was withdrawn after 9 years in April 2011, by which time the balance had grown to Rs82.01 lakh, on account of interest earned subsequent to retirement, at rates ranging from 8.5% to 9.5% per annum.

The taxpayer did not include any part of the withdrawal in his income-tax return. The tax department, however, noticed the deposit c Rs82.01 lakh in his bank account. On receiving details of the deposit from the taxpayer, it sought to deny exemption to the entire withdrawal, on the ground that no claim for exemption had been made by the taxpayer in his return of income in respect of Rs37.94 lakh, whereas the balance Rs44.07 lakh, which was interest earned post-retirement, was not entitled to the exemption at all.

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The Tribunal held that, while the balance of Rs37.94 lakh outstanding as at the date of retirement was exempt from tax, the interest earned subsequent to the retirement was taxable. This was on account of the fact that the exemption was for the 'accumulated balance', which was defined to mean the balance standing to the credit of the employee in the fund on the date of his ceasing to be an employee of that employer. The Tribunal, however, also decided that the interest was taxable in the respective years in which it was earned and credited to the PF account, and not in the year of withdrawal.

This decision was rendered in the context of a recognised PF, which means, a PF that was administered by the employer, and which had obtained exemption from contribution to the Employees' Provident Fund (EPF) scheme administered by the Employees' Provident Fund Organisation (EPFO) under section 17 of The Employees' Provident Funds and Miscellaneous Provisions Act, 1952. It would also apply to the PF administered by EPFO, which is deemed to be a recognised PF by virtue of the Act.

There is a separate exemption in respect of the Public Provident Fund (PPF) account. Under that exemption, any payment from PPF is exempt, and not just the accumulated balance as on the date of retirement or cessation of employment. This is on account of the fact that contribution to and continuation of the PPF account is in no way linked to employment.

Therefore, post-retirement, an employee should take a decision as to whether to withdraw the PF balance or leave it with the fund, after factoring in the tax payable on the interest that may be earned. In case she chooses to leave it with the fund, the interest accrued and credited to the account each year should be offered to tax. This is important, particularly since most employees, during their employment, tend to overlook interest earned on their PF accounts and fail to disclose it as exempt income.

Today, therefore, a PF account allows you to accumulate funds tax-free only till your retirement. An employee is most vulnerable financially post her retirement, as she no longer gets a monthly salary. At this juncture, is it appropriate to have the tax benefit that she hitherto enjoyed also taken away, particularly as there are no tax-free investments available today in which she can put her PF money lump sum?

Perhaps, the government should consider extending the exemption to a period of 5 years post-retirement, so that the employee has time to plan and arrange her investments and then withdraw the PF amount. This would also ensure that the government will not have to suffer the burden of an indefinite tax exemption.

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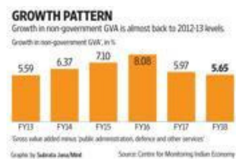

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