Class - B. Com II
Subject - Income Tax
Topic - Provisions of income tax regarding Provident fund

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Reference Books - Income tax laws & Accounts - Dr B.K. Agarwal, Nirupam Sahitya Sadan
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Provisions of Income Tax Act regarding Provident fund

Provident Fund

A salaried person has a limited working life during which he earns money. Generally, he gets retirement at the age of 60 or 62 or 65 years. But his money related needs remains continue throughout the life. For this purpose, he is encouraged to contribute in a fund for the future. The employee contributes every month a certain amount in this fund. The employer also contributes an equal or less or more amount to this fund. Both amount so deposited are invested in gilt-edged securities which generate interest which is also deposited in the fund. The entire amount so deposited by employee, employer and interest is paid to the concerned employee at his retirement or his death or at the time of leaving the services. This fund is called provident fund.

Types of Provident fund

A salaried person may be the member of the following provident funds

1. Statutory Provident Fund - This is also known as Government provident fund. It is set up under Provident Fund Act, 1952. Normally, this fund is maintained in Government offices, Semi-Government undertakings, Local bodies, universities, colleges, Government corporations, Banks etc.
2. Recognised Provident Fund - This fund is established under Provident fund Act, 1952 and it is regulated in accordance with the provisions of Part A of the IV th Sechedule of Income tax Act 1961. It has been recognised by Commissioner of Income tax. Normally, this fund is maintained in private sector undertakings like private banks, insurance companies and other institutions.

3. Unrecognised Provident fund – This is the fund which is not recognised by the commissioner of Incometax. This fund is also maintained in private sector undertakings. If this fund is recognised by the Commissioner of Incometax in accordance of Part A of IVth Sechedule of Income tax Act, then it becomes recognised Provident fund.

Following is one more provident fund ~~without~~ in which salaries or non-salaried persons both can invest.

4. Public Provident fund – This fund was started by the Government under Public Provident fund Act, 1968. The salaried persons may have statutory PF, Recognised PF or unrecognised P.F. But to encourage the savings this fund was started. In this fund both salaries or non-salaried or self employed persons may invest to avail the benefits of Incometax provisions. This account may be opened in any branch of Nationalised bank or post offices. The amount deposited in such account is repayable after 15 years, but partial withdrawal after 7 years and loan facility are permissible.

Provisions of Income-Tax

To understand the provisions of Income-tax, each type provident fund is classified in four parts

(i) Employee's contribution
(ii) Employer's contribution
(iii) Interest on accumulated part of employee & employer
(iv) At retirement or termission when lump-sum payment is made

1. Statutory Provident Fund

(a) Employee's Contribution – Employee contributes in the SPF from his salary. Contribution made by employee is already included in his taxable salary. Hence, there will be no separate treatment for this. The amount contributed will only be considered for deduction u/s 80 C

(b) Employer's contribution – Employer also contributes the same or less or more amount in the fund of employee. This amount is tax-free. Hence, it will not be added to the salary of employee. It means, no separate adjustment to be made.

(c) Interest credited on such fund amount – Entire interest amount is tax free. Hence, will not be added in the taxable salary.

(d) Payment at retirement or termination of services – At retirement, the total amount (employee contribution + employer's contribution + interest) is paid to the employee. This entire amount is tax free. It will not be added in the income of assessee.

2. Recognised Provident Fund

(a) Employee's contribution – Treatment is same as in statutory Provident fund. It is already included in salary, so it will not be added to salary amount. Only deduction u/s 80 C will be available on this amount.

(b) Employer's contribution – Employer's contribution is tax free upto 12 % of salary. If employer contributes more than 12%, excess over 12% will be added in the salary of employee.

(c) Interest credited – Interest upto the rate of 9.5% is tax-free. If interest is paid above 9.5%, excess over 9.5% will be included in the salary of employee.

(d) Payment at retirement or termission of services – Entire amount (employee's contribution + Employer's contribution + Interest) received will be tax free in the hand of employee, if he has served atleast 5 years continuously or he is removed from service due to retrenchment, illness or closure of business

3. Unrecognised Provident fund

(a) Employee's Contribution – Employee contributes from his salary to this fund. Therefore, amount contributed is already included in the taxable salary. As the fund is not recognised by commissioner of income tax, the deduction u/s 80 C is not applicable on employee's contribution. No separate treatment is required

(b) Employer's Contribution – This is tax free. It will not be added to the salary of employee

(c) Interest credited – This is also tax free. It will also not be added to the salary of employee, ~~whatevery~~ whatever may be the rate of interest.

(d) Payment at retirement or termission of services – only employer's contribution plus interest thereon will be added to the salary income, Employee's contribution will not be added as tax on that amount has already been paid. Interest on employee's contribution will be the income from other sources. This will not be add to salary income. It will be added in the income from other sources

4 Public Provident fund

(a) Employee's Contribution – This is assessee's contribution. Salaried or non-salaried or self employed any one may contribute in this fund. The amount contributed in this fund will be eligible for deduction u/s 80 C upto ₹ 1.5 lakh. The amount contributed will not be added separately to the income as it is already part of income from where it is contributed.

(b) Employer's Contribution – The employer does not contribute in this fund.

(c) Interest Credited – Entire amount of interest is tax free. Hence, will not be added to income of assessee.

(d) Maturity – At maturity, the entire amount (Amount Contributed + Interest) is exempt from tax.