Government withdraws proposed taxation of provident fund and superannuation

Background

- India’s Union Budget 2016 was presented on 29 February 2016.1
- In this Budget, the following changes were inter-alia proposed:
  
  **Recognised Provident Fund (RPF)**
  
  - Tax on lower of employer contribution to RPF in excess of 12 per cent of salary or INR150,000 per annum (hitherto exempt from tax, if amount was less than 12 per cent of salary)
  
  - Limit on tax exemption on withdrawal from RPF, of 40 per cent of accumulated balance attributable to contributions made by an employee (other than excluded employee), on or after 1 April 2016 (currently fully exempt, subject to certain conditions).

  **Approved Superannuation Fund (SAF)**
  
  - The increase in exemption limit, in relation to perquisite taxation on employer contribution to SAF from INR100,000 to INR150,000 per annum.
  
  - Tax on payments in lieu of or commutation of annuity, purchased out of contributions made on or after 1 April 2016, in excess of 40 per cent of the amount payable (currently exempt)

  
  **National Pension Scheme (NPS)**
  
  - Tax exemption proposed for NPS for 40 per cent of the amount payable at the time of closure or opting out of NPS.
  
  - Tax exemption for any amount received by a nominee from NPS on the death of assessee.
  
  - Tax exemption proposed for transfer of entire balance from RPF or SAF to NPS.

Proposed Withdrawal

- The Finance Minister has clarified the following in the Lok Sabha today2:
  
  - The purpose of proposed reforms to retiral viz., RPF/SAF/NPS, in the tax regime was to encourage more number of private sector employees to go for pension security after retirement instead of withdrawing the entire money from RPF.
  
  - It was expected that employees of private companies will place the remaining 60 per cent of the corpus in an annuity, to obtain a regular pension. Such investment in annuity would mean that no tax would be chargeable on the amount transferred. Only the periodic return on annuity would be taxable.

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2 http://164.100.47.192/loksabha/Debates/uncorrecteddebate.aspx (as accessed on 8 March 2016). This Flash is not advice and is prepared based on the basis of information publicly available at the hyperlink above.
- Representations had been made to the Finance Ministry from various sections of the society suggesting that this change will force people to invest in annuity products.

- Alternative suggestions have also been made to the Finance Ministry government to achieve the policy objective of encouraging people to join the pension scheme.

- In view of the representations made, the government proposes to carry out a thorough review of the budget proposals given above.

- Therefore, the Finance Minister proposed to withdraw paragraphs 138 and 139 of the Budget speech, which are reproduced as under:

  Quote

  **138.** In the case of superannuation funds and recognized provident funds, including EPF, the same norm of 40% of the corpus to be tax-free will apply in respect of corpus created out of contributions made after 1.4.2016.

  **139.** Further, the annuity fund which goes to the legal heir after the death of pensioner will not be taxable in all three cases. Also, we are proposing a monetary limit for the contribution of the employer in recognized Provident and Superannuation Fund of Rs 1.5 lakh per annum for taking tax benefit.

  Unquote

- The tax exemption proposed under Section 10(12A), at 40 per cent of the amount payable, at the time of closure or opting out of NPS would remain unchanged.
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