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Article

Taxability of interest on provident funds

By **Samyak Navedia**

Introduction

Provident funds, for the purpose of the Income Tax Act, 1961 ('**IT Act**') can broadly be classified into three classes. First are Statutory Provident Funds, which are established under the Provident Fund Act, 1925 for employees working in Government or Semi-Government organizations, etc. Second are Funds set up under the Employees' Provident Fund Act, 1952 or any other Fund as defined under Section 2(38) of the IT Act and those which have been recognised in conformity with the rules contained in Part A of the Fourth Schedule to the IT Act. Third class of Funds are those that are not recognised under the IT Act.

Section 10 of the IT Act provides certain incomes which are exempt from tax and are not included in total income. Prior to its amendment, blanket tax exemption was allowed under Clauses (11) & (12) of Section 10 of the IT Act to any payment received from the First and Second class of Provident Funds.

Finance Act of 2021

This position of complete exemption has been changed *vide* Finance Act, 2021 by introducing two identical Provisos to both clauses of Section 10. The amendment seeks to tax notional interest on Employee's contribution to specified provident fund, exceeding the threshold limit made on or after 1st April 2021. The threshold limit has been stated to be INR 2.5 lakh, which shall be increased to INR 5 lakh in the scenario where there is no contribution in the Provident Fund by the employer. The Act has empowered the Central Board of Direct Taxes to notify the manner of computing the notional interest.

In furtherance of the amendment, Central Board of Direct Taxes *vide* Notification No. 95 dated 31 August 2021 notified Rule 9D in Income Tax Rules, 1962 ('**IT Rules**'). It lays down the manner of computation of taxability of interest whereby Financial Year 2021-22 onwards, Provident Funds shall maintain two separate accounts within the Employee's Provident Fund Account for taxable and non-taxable contributions. Only interest in 'Taxable Contribution Account' will be taxable in the hands of employees. This account includes employee's contribution to specified provident fund exceeding the threshold limit beginning Financial Year 2021-22 and any interest thereto. On the other hand, employee's contribution to specified provident fund up to the threshold limit beginning Financial Year 2021-22 and closing balance till 31 March 2021 along with any interest accruing on both will be treated as the 'Non-Taxable Contribution Account'.

Charge of tax

Any sum received from a Provident Fund can be divided into four separate sources- employee's contribution, employer's contribution, interest on employee's contribution and interest on employer's contribution. Employee's contribution to the fund, when returned to the employee after his retirement should not be treated as income of the employee on first principles. The Supreme Court held that

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Employer's contribution to the fund, not interest accruing thereon, cannot be treated as income of the employee, either in the year in which the contribution is made[1] nor in the year in which the sum is withdrawn from the fund[2]. Independently, money received from a provident fund was held as not taxable, having been received from a person other than an employer[3]. These judgments have been statutorily overruled now to certain extent.

To sum up. the position on taxation of contribution and accretion to a Recognised Provident Fund, as it stood prior to amendment by Finance Act, 2020 can be summarised as under:

1. Employer's contribution up to 12% of salary is not treated as income– law laid down in *LW Russel* continues,
2. Employer's contribution in excess of 12% of treated as salary – Section 17(2)(vi) r/w Rule 6(a) of Fourth Schedule to IT Act,
3. Interest on Employer's contribution up to notified rates is not taxable– law laid down in *LW Russel* continues,
4. Interest on Employer's contribution in excess of notified rates is treated as salary – Section 17(2)(vi) r/w Rule 6(b) of Fourth Schedule to IT Act.
5. Interest on Employee's contribution is exempt u/s 10(12) of the IT Act.

While the recent amendments have now sought to disallow the tax exemption of Clauses (11) & (12) of Section 10 of the IT Act on such interest on Provident Fund contributions, there is absence of any provision in the IT Act creating a charge on the same. While carrying out the amendment, the legislature should have similarly amended the relevant provisions to introduce a charging provision to allay any confusion and difficulties that will be faced by affected parties. Until such time, the accretion to the employee contribution, though income, is not in the nature of salary and to the best of author's understanding, will be taxed under the residuary provision of Section 56 under the head Income from Other Sources in the hands of the employee.

Point of taxation

Income is taxable in the year in which it accrues to a person. Payments received by the employees in the form of employer's contributions towards Provident Funds become liable to be taxed as 'profits in lieu of salary' under Section 17(3)(ii) of the IT Act. But Section 17 cannot be read in isolation and must be read in conjunction with Section 15 of the IT Act. The term 'due' followed by the qualifying expression 'whether paid or not' in Section 15 shows that the present/former employer must be obligated to pay that amount which in turn creates a right in the employee to claim the same. A combined reading of Sections 15 and 17 leads to the inference that payments received from Provident Funds become taxable in the hands of the employee only when the amount becomes due from the employer, and such payments become due only upon the employee reaching the age of superannuation. Only upon the happening of one of the contingencies provided under the Provident Fund Scheme, can the beneficiary under the trust be determined. Until this condition is fulfilled, amount contained in the Provident Fund does not vest in the employee but rather remains vested in the trustees of the Provident Fund.

The Supreme Court while deciding the similarly worded Section 7 of the Income Tax Act,

[1] CIT v. L.W. Russel [1964] 53 ITR 91 (SC)

[2] CIT v. BJ Fletcher [1937] 3 ITR 428 (PC)

[3] CIT v. Rangoon Electric Tramway & Supply Co. Ltd [1933] 1 ITR 315 (RANG.)

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1922 in *L.W. Russel (supra)* held that '*Unless a vested interest in the sum accrues to an employee it is not taxable. No interest in the sum contributed by the employer under the scheme vested in the employee, as it was only a contingent interest depending upon his reaching the age of superannuation. It is not a perquisite allowed to him by the employer or an amount due to him from the employer within the meaning of S. 7(1) of the Act.*' This landmark judgment continues to be the law on the matter till this day, being upheld by Courts time and again and the said view is also supported the Commentary of Sampath Iyenger's Law of Income-tax. It can similarly be extended to interpret the newly added Provisos to Clauses (11) & (12) of Section 10 of the IT Act as any interest that accrues on the balance of Provident Funds becomes payable to the employee only upon attaining the age of superannuation, and not before. Until such time, such interest will at best have a notional value.

Thereby, the liability to pay tax on any interest that accrues on any amount in excess of the threshold limit in 'Taxable Contribution Account' under Rule 9D(2)(b) of Income Tax Rules r/w Provisos to Clauses (11) & (12) of Section 10 of the IT Act will arise only when the same actually becomes due and payable to the employee on attaining the age of superannuation, irrespective of the computation of interest taking place on a monthly or annual basis.

Deduction of TDS

Deduction of TDS is to be carried out by the entity from whom the income is received. Based on this principle, the charging provision plays a vital role in deciding the entity that is responsible to withhold tax. For the limited purposes of this paper, only aspects related to tax deductible as TDS as to interest on employee's contribution is examined. In the case of a Provident Fund, it could either be the trustees of Provident Fund or the employer.

Here, the trustees are responsible for crediting the Provident Fund Account balance to the account of employees. It can safely be stated that as the employer is not responsible for paying the sums from the Provident Fund, the employer will not be liable to withhold tax on such sums. Moreover, the interest on employee contribution is earned on the basis of notified rates, or in other words, it is neither based on employer-employee relationship, nor receivable in the nature of salary to employee. This leads to the implication that Section 192 of the IT Act is not applicable as this interest is not in the nature of salary, thereby, even trustees of Provident Fund will not be liable to withhold tax on such sums. Another provision that holds relevance is Section 194A that deals with TDS on interest income. This in turn requires analysis of the definition of 'interest' under Section 2(28A) of the IT Act which is applicable to sums payable in relation to monies borrowed or a debt incurred. This is not pertinent to the present discussion as the resultant accretion of income due to the interest on employee's contribution is being considered under this recent Amendment. Hence, even this provision is not useful.

There is no specific charging provision to determine the responsibility to deduct TDS. As discussed above, in the present scenario, to the best of author's understanding, the interest on employee's contribution will be taxed under Section 56 under the head Income from Other Sources in the hands of the employee. It must be noted that income under this provision does not attract the provisions of TDS of the IT Act and leads to outcome of the recent amendment

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possibly not creating any TDS liability and will remain so until requisite amendments are brought into the IT Act to introduce charging provisions.

Conclusion

The amendments in Clauses (11) & (12) of Section 10 *vide* the Finance Act of 2021 were brought in with the legislative intent to curtail excessive parking of monies in Provident Funds rather than using it as a secure investment scheme for the larger public, which was the reason for which it was introduced. Statistics show that only a small percentage of the investors in Provident Fund schemes will be affected by this amendment. Nevertheless, it cannot but be observed that this amendment is half baked in many ways. While it limits the tax exemption, it is severely lacking in creating both charging and machinery provisions that are necessary to ensure smooth procedure for assessees for an income that was hitherto granted blanket exemption. It remains to be seen how judiciary interprets this new tax or if the legislature proactively removes all doubts by promulgating specific provisions, similar to those that exist for the employer's contributions towards provident fund account of employees.

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Notifications & Circulars

Form No. 52A for production of cinematograph revised

Section 285B in The Income-tax Act, 1995 provides the statement to be furnished by the cinematograph films association read with Rule-121A of the Income-tax Rules, 1962. The CBDT recently notified a revised Form No. 52A– Statement to be furnished to the Assessing Officer under Section 285B of the Income-tax Act, 1961, in respect of production of a cinematograph film under Rule 121A of Income-tax Rules, 1962 *vide* Notification No. 132/2021-Income Tax, dated 23 November 2021. The Form No. 52A consists of the name and address of the producer, relevant previous year, details of the film, date on which the production of the film was started, if the production of the film has been completed, the date of completion, financial year to which the statement relates, details of payments of over INR 50,000 in the aggregate made by the producer or due from him to each person engaged in the production of the film as an employee or otherwise including details of the person to whom payment has been made or is due and verification. Statement to be furnished to the Assessing Officer under Section 285B of the Income-tax Act, 1961, in respect of production of a cinematograph film.

No TDS under Section 194-O will be made applicable to E-auction services

The Finance Act 2020 inserted a new Section '194-O' under the Income-tax Act, 1961 which requires an e-commerce operator to deduct TDS @ 1% of the gross amount of sale of

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goods/ services or both carried out through its digital or electronic platform. This provision came into effect from 1 October 2020. The CBDT has clarified that the provisions of Section 194-O of the Act shall not apply in relation to e-auction activities carried out by e-auctioneers subject to the following conditions being satisfied :-

a. The e-auctioneer conducts e-auction services for its clients in its electronic portal and is responsible for the price discovery only which is reported to the client.

b. The price so discovered through the e-auction process is not necessarily the price at which the transaction takes place and it is up to the discretion of the client to accept the price or to directly negotiate with the counter-party.

c. The transaction of purchase/ sale takes place directly between the buyer and the seller party outside the electronic portal maintained by the e-auctioneer and price discovery only acts as the starting point for negotiation and conclusion of purchase/ sale.

d. The e-auctioneer is not responsible for facilitating the purchase and sale of goods for which the e-auction was conducted on its electronic portal except to the extent of price discovery.

e. Payments for the transactions are carried out directly between the buyer and the seller outside the electronic portal and the e-auctioneer does not have any information about the quantum and the schedule of payment which is decided mutually by the client and the counterparty.

f. For payment made to e-auctioneer for providing e-auction services, the client deducts tax under the relevant provisions of the Act other than Section 194-O of the Act.

CBDT has clarified that the provisions of Section 194-O of the Act shall not apply in relation to e-auction activities carried out by e-auctioneers if all the facts listed above are satisfied. This clarification shall not apply if any of these facts are not satisfied. Further, it is clarified that the buyer and the seller would still be liable to deduct/ collect tax as per the provisions of Section 194Q and 206C(1H) of the Act, as the case may be.

Ratio Decidendi

BCCI cannot be denied income tax exemption because Indian Premier League (IPL) makes profits

The BCCI ('Assessee'), which is a society registered under the Tamil Nadu Societies Registration Act, had a registration under Section 12A of the Income Tax in 1996. In 2018, the Society filed an application for fresh registration in terms of the changes in its memorandum of association effected based on the Justice Lodha Committee recommendation. This was rejected by the Principal Commissioner. The application was rejected on the basis that IPL activities are in the nature of commercial activities and cross the threshold for exemptions in proviso to Section

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2(15), which defines 'charitable activities'. Challenging this, the Assessee approached the ITAT.

The ITAT held that (a) even though IPL may be more profitable, BCCI is entitled to tax exemptions as long as the primary objective of BCCI to promote cricket remains intact; (b) improvising the rules of the game, adding entertainment value to it and making it economically attractive can also be viewed as radical and innovative ideas to popularize a game, and (c) the Principal Commissioner erred in applying the proviso of Section 2(15) at the stage of application for registration. [*Board of Control for Cricket in India* v. *Principal Commissioner* – ITA No. 3301/Mum/2019, Order dated 2 November 2021, ITAT Mumbai]

ITAT cannot recall its order by invoking power under Section 254(2) of the Income-tax Act

The Supreme Court has held that the Income Tax Appellate Tribunal ('**ITAT**') cannot recall orders passed by it invoking power under Section 254(2) of the Income Tax Act. According to the Court, in exercise of powers under Section 254(2), the Appellate Tribunal may amend any order passed by it under sub-section (1) of Section 254 with a view to rectifying any mistake apparent from the record only. It held that while considering the application under Section 254(2), the Appellate Tribunal is not required to re-visit its earlier order and to go into detail on merits. Going through the orders passed by the ITAT, the Court observed that while allowing the application under Section 254(2) and recalling its earlier order the ITAT had re-heard the entire appeal on merits as if the ITAT was deciding the appeal against the order passed by the C.I.T. The Apex Court was hence of the view that order passed by the ITAT recalling its earlier order which was passed in exercise of powers under Section 254(2) was beyond the scope and ambit of the powers of the Appellate Tribunal conferred under Section 254 (2). [*Commissioner* v. *Reliance Telecom Limited* – LL 2021 SC 708, Judgement dated 3 December 2021, Supreme Court]

Educational institute is eligible for exemption under Section 11 based on registration of its parent society

The Assessee was engaged in imparting education in Engineering and Technology and it was established by the Society named as Raebareli Polytechnic Association ('Association'). The assessee was established in pursuance of and in line with aims and objects of the Association as one of the objects of the society was to impart education in the field of agricultural, technical, vocational, industrial technology and other allied scientific subjects. After the establishment of assessee, the parent society applied to All India Counsel of Technical Education for affiliation and on this application of Raebareli Polytechnic Association, the assessee got affiliation, the parent society was granted approval for conducting under graduate courses in Engineering and Technology with effect from academic year 2004-05. It was submitted that the parent society did not obtain PAN number and the assessee institute obtained its PAN on a wrong professional advice and continued to file its return of income and also continued to claim exemption under Section 11 of the Act and which was granted by the Income Tax Department also. The parent society Raebareli Polytechnic Association was duly registered under Section 12A but the returns were being filed in the name of Feroze Gandhi Institute of Engineering & Technology and it was only in the year 2014-15 that parent society obtained its own PAN. The Revenue held that Assessee was not eligible to claim exemption under Section 11 for AY 2014-15, which was upheld by the CIT(A). The Assesee approached the ITAT.

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The Lucknow ITAT found that (a) there was no dispute as to the Assessee's non-registration under Section 12A, but the parent society was duly registered under Section 12A, and the only source of income for the parent society was from running of the institute; (b) the application for PAN allotment made by the Assessee, the copy of certificate granted by Registrar of Societies was accepted as proof of identity and address and stated that when Department allotted PAN to the assessee on the strength of a certificate of registration in the name of Raebareli Polytechnic Association, it became apparent that the society and the institution are one and the same; (c) the parent society and the Assessee are one and the same, and thus Assessee was eligible to claim benefit under Section 11 on the basis of registration granted to the parent society and (d) noting that the Revenue had allowed the benefit to Assessee since AY 2010-11, therefore, on the principle of consistency as well, Assessee was entitled to claim the benefit under Section 11. [*Feroze Gandhi Institute of Engineering & Technology* v. *A.C.I.T.* – ITA No.244/Lkw/2018, Order dated 2 November 2021, ITAT Lucknow]

Credit of tax deducted at source but not deposited by the employer, available

The Petitioner, a pilot by profession was an employee of Kingfisher Airlines. The Kingfisher Airlines deducted the Tax Deducted at Source ('**TDS**') for the Assessment Years 2009-10 and 2011-12. The amount since had not been deposited by the Airlines in the Central Government Account, the credit when claimed by the Petitioner, was not given by the Respondent and the demand had been raised with interest. The Petitioner's application under Section 154 of the Income Tax Act, 1961 for cancellation of demand for both the years, based on the contention that the employer's obligation could not be thrusted upon him, was ignored by the Respondent. The Petitioner was served recovery notices for both the AYs and thus aggrieved, the Petitioner approached the Gujarat High Court.

The Gujarat High Court found the issue to be covered by the decision of this very Court rendered in case of *Devarsh Pravinbhai Patel* v. *Assistant Commissioner* [SCA No. 12965/2018 with SCA No. 12966/2018] where too, the petitioner was an employee of the Kingfisher Airlines and worked as a pilot. In his case also the TDS on the salary made to the petitioner had not been deposited. Reliance in this regard was also placed on the decision of the Gauhati High Court rendered in case of *Assistant Commissioner* v. *Om Prakash Gattani* [(2000) 242 ITR 638]. The Gauhati High Court, in the context of tax deducted on prize money but not paid to the credit of the Government, had held that '*On the amount being deducted the assessee only gets a certificate to that effect by the person responsible to deduct the tax. In a case where the amount has been deducted by the person responsible to deduct the amount under the statutory provisions, the assessee has no control over the matter. In case of default in making over the amount to the account of the Central Government, it is obviously the person responsible to deduct or the person who has made the deduction who is held responsible for the same*'. The Gujarat High Court followed both the rulings and held that no separate reasoning was desirable in the present case, thus, precluding the Revenue from denying the benefit of tax deducted at source by employer to the Petitioner. [*Kartik Vijaysinh Sonavane* v. *Deputy Commissioner* – R/Special Civil Application No. 6193 of 2021, Order dated 15 November 2021, Gujarat High Court]

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Registration as charitable trust when cannot be cancelled – Amendment of Trust Deed, not contrary to charitable objects not relevant

The Assessee, a Charitable Trust, was granted registration under Section 12A, premises of the Assessee was subjected to a survey based on which the Revenue opined that the Assessee was running an educational institution on commercial basis which was violative of Section 13(1)(c) of the Act. It was further noted that the Assessee had carried out amendments to the Trust Deed without the prior approval of the Department. On these grounds, a notice was issued to the assessee proposing to cancel the registration granted under Section 12A. After considering the reply of the assessee, the Revenue rejected the same and confirmed the proposal made in the show-cause notice, thereby cancelling the registration granted to the assessee by invoking Section 12AA. The ITAT held that the reasons assigned by the Revenue cannot be considered as valid reasons to cancel the registration. Aggrieved with the order passed by ITAT, the Revenue preferred this appeal before the Karnataka High Court.

The High Court held that as per Section 12AA the registration granted under Section 11 or 12 can be cancelled or revoked only in case where i) the activities of the institution are not genuine, or ii) such activities are not being carried on in accordance with the objects of the Trust. The Court allowed the exemption under Section 11 of the Act and agreed with the ITAT's findings that the said fees are not disproportionate to the services rendered by the said trustees and upheld the findings of ITAT that the objects of the assessee trust even after the due amendments, continues to be charitable and that the amendments made were in the capacity of powers conferred upon the Trust. [*Commissioner* v. *Krupanidhi Educational Trust* – I.T.A. No. 47/2013, Order dated 22 October 2021, Karnataka High Court]

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