INDIAN JOURNAL OF LAW, POLITY AND ADMINISTRATION

ROLE OF NATIONAL PENSION SCHEME AS A TAX DEDUCTION INSTRUMENT

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Abstract

Every individual works very hard to have secured life in future by sacrificing many things during his working days. Hence pension plans become very important inorder to have a secured future. National Pension Scheme is a nothing but a saving instrument for availing benefits in the future. The main objective of the research article is to study the features and benefits of National Pension Scheme. The researcher would also answer the controversy between 7th pay commission benefits versus National Pension Scheme. This research article would also focus on the need for launching National Pension Scheme and problems faced by the non-government employees prior to this pension scheme.The long term objective of this research project is to understand the tax liabilities and tax structure associated with the National Pension Scheme and other pension schemes such as provident fund. This research paper aims at salaried employees and other job holders who should invest under NPS for a secured and better future after retirement.

Introduction

Pension can be defined as a monetary support provided by the state or any financial institution to a person who is officially retired, or is a widow or is physically challenged[1]. Pension plans helps an individual to avail those benefits and lifestyle that maybe a person could not have enjoyed during his employment. If a person invests in a pension plan it will act as a source of income after his retirement. India is unlike western countries who provide their citizens with certain social security. Hence, in India it becomes very important for a person to have well planned-pension scheme which will make his life secure after his retirement. For a better future pension planning is essential because of increasing life

[1] Julia Kagan, *Pension Plan*, INVESTOPEDIA , https://www.investopedia.com/terms/p/pensionplan.asp (last visited Aug 2, 2020).

expectancy and increase in cost of living. Due to a breakdown of traditional old age support and also rise in elderly population it is become quite important for strengthening the existing pension schemes in India to acquire people lead a better and secured future post-retirement.

Pension scheme was introduced in India when the British's ruled and Indians struggled for Independence in 1857. It was reflection of pension scheme which was followed in Britain. But this scheme did not allow the employees to avail benefit post-retirement hence it was replaced by Indian Pension Act 1871. Further various acts were brought up by the government of India in the year 1919 and 1935 where provisions were added which provided retirement benefits to the working population.

Post-Independence several changes were made to the pension scheme and provident funds were brought up which helped the private sector employees to acquire benefit. Provident fund is a fully funded program which helps specifically the private sector employees to avail lump-sum benefit post-retirement.

India has been growing largely with the pension schemes with the growing rate of elderly or retired population. Post-Independence various retirement schemes like gratuity, provident fund and pension plans have been evolving. Pension Fund Regulatory and Development Authority (PFRDA) was established by the Indian Government in the year 2003, on 10th October in order to regulate the pension schemes in India[2]. In the year 2004 on 1st October the Government of India launched this new scheme for the betterment of elderly population called National Pension Scheme or NPS[3]. Prior to this government provided pension to all its employees, however this scheme aimed at providing retirement plans to all the citizens and not only government workers. The main objective behind NPS is to establish the habit of saving money among all the citizens of the country. The main objective of such pension scheme is that citizens shall not compromise with their way of living during retirement ages.

Financial planning for the retirement ages not only lets an individual to fulfill his monetary requirement but also helps to sail through retirement phase smoothly. Keeping this concern and with the growing rate of senior population demography, Government of India has introduced National Pension Scheme to help all the citizens including unorganized sectors to

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[2]National Pension System - Retirement Plan for All | National Portal of India, , https://www.india.gov.in/spotlight/national-pension-system-retirement-plan-all (last visited Aug 2, 2020).
[3] Supra note 1

lead a hassle free life post retirement age. The government had initially launched the National Pension Scheme only for the government recruits except armed forces, but from 1st May, 2009 it has been open for all citizens across the country including workers from unorganized sectors.

Initially, in 2004, Pension Fund Regulatory and Development Authority had introduced NPS as New Pension Scheme, which was reserved for new government recruiters. Gradually in 2009 the scope of the scheme was widened to people from all the sectors and was name as 'National Pension Scheme'[4]. NPS can be defined as voluntary contribution scheme for all the citizens across the country, during their employment and get lump-sum money after retirement when they can enjoy their lives without any compromise. This scheme allows every subscriber to enjoy systematic and flexible investments. It also allows the subscribers to partially withdraw from the scheme anytime they wish to before retirement.

Taxation on the National Pension Scheme

Tax is a mandatory financial charge which is imposed by the government on a taxpayer which helps in funding the government as well as carrying out various public expenditures such as roads construction, funding the army, building colleges, hospitals, schools etc. Failure in paying taxes is a punishable offence under the law. The government of India has divided the taxation system into various slabs and the citizens are required to pay according to it. Majority of the population would not want to pay taxes if it was not mandatory. In order to help the working of government efficiently it is necessary to pay taxes. However, the Income Tax Act, 1961 helps the tax payers to invest in certain annuity or pension schemes in order to get an exemption from paying taxes[5].

National Pension Scheme launched by the Government of India is one of the most attractive schemes which provides retirement safety to the old age. It is a long-term saving instrument which is safely regulated by providing market-based returns. Anyone who is an employee or

[4]New Pension Scheme - Features and Benefits - ABC of Money, , https://www.adityabirlacapital.com/abc-of-money/features-and-benefits-of-new-pension-scheme (last visited Aug 2, 2020).
[5]Diva Rai, *Tax savings investments in a nutshell*, IPLEADERS (2020), https://blog.ipleaders.in/tax-savings-investments-in-a-nutshell/ (last visited Oct 26, 2020).

an employer or even a person who is self-employed in between the age of 18 to 60 can invest under the National Pension Scheme.

NPS is an attractive scheme even from the tax point of view. It allows a subscriber to acquire additional tax benefit of up to Rs. 50,000 during a financial year according to Section 80 CCD (1B) of the Income Tax Act over the deduction of Rs. 1,50,000 according Section 80C and 80 CCE of the said Act. Tax-free withdrawal upon retirement was allowed up to 40% of corpus which is now increased to 60%.

There are majorly two types of account available under the NPS. Tier I Account is mandatory retirement account for a subscriber and offers numerous tax benefits but, Tier II Account is a voluntary account which is linked with PRAN and does not provide any sorts of tax benefit, but from Tier II Account money can be withdrawn at any point.

Tax Benefits available to Subscribers of NPS upon contribution[6]

- According to section 80 CCD (1) of the Income Tax Act, 1961 under Employee Contribution, there is a deduction of 10% of basic salary earned i.e. (Basic + DA) 10% of GTI for self-employed contributors. This deduction comes within the vault of Rs. 1, 50,000 under section 80C or 80 CCE of the IT Act.
- NPS provides an additional tax benefit of up to Rs. 50,000 over and above the limit of Rs. 1, 50,000 by additional contribution from the employee under Section 80 CCD (1B).
- Under employer contribution, according to section 80 CCD (2) there is a tax deduction of 10% of the basic salary wherein an employer can claim as business expenditure under section 36 of the Income Tax Act, 1961. From 1st April, 2019 onwards a central government employee can claim up to 14% tax deduction from his basic salary.

Tax benefits under NPS upon withdrawal[7]

[6]Taxation of NPS & Return From the Scheme, , TAXGURU , https://taxguru.in/income-tax/taxation-nps-return-scheme.html (last visited Oct 26, 2020).
[7]*Id.* Supra note 6.

- Presently the subscribers under NPS are allowed to withdraw 60% of the corpus tax free on reaching the age of 60, while the rest 40% are compulsory to be invested on annuity in order to get pension on regular intervals.
- Usually partial or pre mature withdrawal from NPS is not allowed but in special circumstances such as higher education of children, marriage of children, critical illness treatment or housing etc. partial withdraw of money can be made. 25% of partial withdrawal is possible for such emergency case of the employee contribution.
- While closing the NPS account before retirement 20% of the corpus can be withdrawn without implementation of any tax and rest 80% will be utilized to buy annuity.
- NPS also grants death benefit, the nominee is allowed to withdraw money from NPS account tax free, but if the corpus has been annuitized by the nominee then the pension income would be taxed as per the nominee's income tax slab.
- Purchasing annuity with is completely exempted from being taxed. But, the income that would come from the annuity or the pension amount is subjected to income tax.
- If the total accumulated corpus amount is less than or equal to Rs. 2 lakhs then a subscriber has a right to claim 100% withdrawal during superannuation or after attaining the age of 60 years, and the amount is exempted from being taxed.
- A subscriber under NPS has a right to withdraw lump-sum amount up to 10 installments for over a period of 70 years with any tax. But it is mandatory for the subscriber to buy annuity before withdrawing in installments.
- NPS allows a subscriber to continue his contribution under his NPS account after attaining the age of 60 up to 70 years of age. Such a contribution beyond the age of 60 is also available and eligible for tax benefits.

How is National Pension Scheme (NPS) beneficial as compared to other pension scheme?

A pension scheme is nothing but a savings plan which helps to save money for financial security later in the life. It is quite important to have a sturdy retirement plan. Pension or a retirement plan helps a person to have a social security as well as enjoy his life post retirement. It is usually advisable to have a pension scheme planned from the very beginning of drawing salary. Many organisations in the country open an EPF account for the new joiners by default. According to the rules prescribed by the government 12% of the basic salary earned would automatically be transferred every month into the EPF account. The employer of the company would also contribute the same amount into the EPF account of an employee which helps the employee to have a retirement benefit post-employment. However, it is not sufficient just to have a employees provident fund in order to maintain the lifestyle as well as standard of living considering the growth of market. This is where the need of having a pension scheme arises.

There are different types of pension scheme available to the employees[8].

1. Deferred Annuity: This is an investment type of pension scheme which allows a user to enjoy absolute taxation benefits. A user is required to pay premiums for a limited period of time or maybe throughout the policy as per the terms and conditions. Once the phase has accumulated the user would receive annuities on a regular basis throughout life.
2. Immediate Annuity: This type of pension scheme suits best for those who planned retirement at a later stage of employment. In the case of immediate annuity a user is required to pay a lump sum amount for the annuities to start immediately. This also allows a nominee to receive the annuity in case of unfortunate circumstances.
3. Traditional and Unit-Linked Pension Plans: A pension scheme is nothing but investing hard earned money at the user's own risk. There are majorly two types of plans available-traditional and unit-linked. In case of traditional plan investment is mostly done in Government securities. Whereas in case of unit-linked plan investment is done in bonds, stocks and equities etc. all-together.

Annuity v National Pension Scheme (NPS)

Retirement planning helps a person to be independent financially and lead a good lifestyle post retirement. In order to help the employees save money the government has come up with National Pension Scheme which is said to be one of the best options to rely upon for pension plans. The NPS in India is administered by the Pension Fund Regulatory and Development Authority while offering tax-saving advantages to its subscribers.

[8] Archana Singh, *4 Types of Pension Plans in India !*, MEDIUM (2016), https://medium.com/@as7001693/4-types-of-pension-plans-in-india-e76bb845e79b (last visited Oct 20, 2020).

Besides National Pension Scheme there are various other options for an employee to invest for his retirement. In case of NPS a subscriber can voluntarily contribute at point during a financial year whereas investing a lump sum amount in an annuity plan helps a subscriber get regular payment[9].

	National Pension Scheme	Annuity
Minimum Contribution	Rs. 6,000	Ranges between Rs. 18,000 and Rs. 24,000.
Investment Mode	Upto 75% can be invested in equity which helps the investors to acquire long term capital gains.	There is no such equity funds.
Penalty	In case of NPS the option of re-activation can be acquired after paying a nominal penalty.	The policy holders have to pay all the premiums that are pending within the revival period else the annuity plan may lapse.
Maturity	Withdrawal of 60% is allowed and 40% is converted to annuity.	In the case of annuity one-third of corpus is allowed to be withdrawn and the rest 66% is to be bought.

Gratuity v National Pension Scheme (NPS)

Gratuity in simple terms can be said as a gift offered by the organisation wherein an employee has served his services. One of the common interest and requirement of every

[9]NPS vs annuity plans: The better retirement investment option, , https://www.timesnownews.com/business-economy/personal-finance/planning-investing/article/nps-vs-annuity-plans-the-better-retirement-investment-option/644461 (last visited Oct 25, 2020).

employee is security as well as maintenance for the rest of the life. Gratuity is basically one-time payment offered to an employee by the employer for serving in the organisation[10].

	Gratuity	Pension
Meaning	Gratuity is offered as a form of appreciation or gift to the employee by the employer for rendering his services in the company which also acts as a security benefit after his retirement.	Pension is an investment scheme, wherein an employee voluntarily invests in order to have social and financial security post-retirement.
Payment	Payment is made in one-shot.	Can be withdrawn from time to time.
Service Period	Minimum of five-year service shall be rendered to claim gratuity.	Minimum of 10 years' service is required to invest in pension scheme.

Employees Provident Fund v National Pension Scheme (NPS)

Employees' provident fund also known as EPF is a statutory body which is administered by the government. The reason why EPF was implemented to secure the post-retirement financial requirements of an employee after his retirement from an organisation in India. Those employees who want to benefit from EPF have to deduct a certain percentage of their net income towards EPF account and an equal amount would be contributed by the employer towards the EPF account. Eventually the employee would receive a whole sum amount along with an interest once the corpus is accumulated[11].

	NPS	EPF

[10]Difference Between Gratuity and Pension (with Comparison Chart), , KEY DIFFERENCES (2017), https://keydifferences.com/difference-between-gratuity-and-pension.html (last visited Oct 25, 2020).
[11]Nps Can Build A Bigger Retirement Corpus Than Epf. But Which Is Better?, , https://www.adityabirlacapital.com/abc-of-money/national-pension-scheme-vs-employee-provident-fund-which-is-better (last visited Oct 25, 2020).

Contribution	Investing under NPS is voluntary for the employee.	It is mandatory to have an EPF account for every employee who earns less than Rs. 15000 and it is optional for others.
Investment	Minimum of Rs. 6000 is to be invested for an NPS account.	It is mandatory to invest 12% of salary per month towards the EPF account.
Taxation	Under NPS 60% of the matured amount can be withdrawn tax-free.	EPF comes under EEE category hence the accumulated money is exempted from being taxed.
Tax deduction (if any)	Tax benefits can be claimed up to Rs. 1.5 lakh p.a u/s 80CCD (1) of the Income Tax act, 1971 i.e. if the contribution is not exceeding 10% of the basic salary or even 20% of the total income.	In case of EPF up to Rs. 1.5 lakhs p.a u/s 80C of the Income Tax Act, 1971 is exempted from being taxed.

Public Provident Fund (PPF) v National Pension Scheme (NPS)

Public Provident Fund also known as PPF is a long-term saving scheme which is offered by the Government of India. Under this scheme users can avail income tax benefits. However, the benefits under PPF is available to the HUFs and NRIs[12].

	NPS	PPF
Eligibility	Any individual who is of the age of 18 to	Anyone can invest under PPF

[12]NPS vs PPF: Comparison, Tax Benefits & Which is Better, , GROWW , https://groww.in/p/savings-schemes/nps-vs-ppf/ (last visited Oct 25, 2020).

	65 years can invest.	except for HUFs and NRIs.
Taxation	NPS allows the subscribers to claim tax benefits under Section 80C, S-80CCC and S-80CCD (1) of the Income Tax Act, 1961 up to Rs. 1.5 lakhs. Subscribers can also claim additional tax benefit of Rs. 50,000 according to Section 80CCD (1b).	Under PPF a subscriber can avail tax benefit of up to Rs. 1.5 lakhs according to Section 80C of the Income Tax Act, 1961. However, no tax benefit can be availed under Section 80CCD (1b) under PPF.
Withdrawal	Only after the completion of 10 years, withdrawal is possible.	In case of PPF withdrawal is possible from 5th year onwards.

Atal pension Yojna (APY)v National Pension Scheme (NPS)

Atal Pension Yojna (also known as APY) and National Pension Scheme are quite similar. Both of the pension schemes allow the subscribers to claim tax benefit of up to Rs. 1.5 lakhs, under the Income Tax Act, 1971. However, under the Atal Pension Scheme any individual between the ages of 18 to 40 can only invest and only Indians can invest under the said scheme.

APY does not guarantee additional taxation benefits as that of NPS. Tax benefits under APY are available only under S-80 CCD (1) and 80 CCD (1B) of the Income Tax Act, 1971[13].

Taxation on Pension in other countries

Taxation on Pension Plans in US

Maximum pension schemes in foreign are based in the US taxation system. Foreign pension schemes are not qualified plans and hence there is no reduction on taxation income of a person in US. In the same way if an employer is contributing towards foreign pension scheme or fund it increases the taxable income of an employee. This is the case of taxation of foreign

[13] APY vs. NPS: Detailed Differences Between NPS & APY (Updated 2020), , TURTLEMINT , https://www.turtlemint.com/apy-vs-nps-differences/ (last visited Oct 25, 2020).

pension contributors. In case of qualified pension in the US income that arises is tax-free. Foreign pensions are regarded as the income of a person and hence are subjected to be taxed annually. Foreign pensions are also subjected to double taxation. At first the pension is taxed in the US and then the country wherein the participant is a resident. According to the laws in US a person is subjected to be taxed twice, once when the money is accrued and again when the money is paid to the employee[14].

Taxation on Pension in Australia

In Australia a person is not allowed to withdraw from in pension scheme in lump sum until and unless the subscriber attains the age of 65 or has retired. Here the maximum pension of a person cannot go beyond 10% of the balance in the pension fund nor can be less than 4% of the balance. However, in Australia once a person is of the age of 60 or above his entire pension is tax free, whereas if he is somewhere in between 55 to 59 years of age then he qualifies for a 15% tax offset. But the entire amount deposited on the basis of earning to the pension fund is entirely tax free[15].

Taxation on Pension in Kenya

The taxation upon pension in Kenya is governed under section-8(5) of the Income Tax Act. There are certain exemptions on tax in Kenya with respect to pension of a person. The first 600,000 Kenyan shillings are exempted from taxation if there is lump sum commutation from a registered pension or even if it is under an individual's pension scheme. Contribution made by their citizens below 20,000 Kenyan shillings per month or 30% of the total pensionable salary are not to be taxed. In Kenya income earned out of any investment is not taxed by their government. The government of Kenya doesn't tax any individual after attaining the age of 65 for their pension payments. However, any benefit received by a member under pension scheme are taxed but they can opt for a tax free payment of a lump sum amount of 60,000

[14] US Taxation of Foreign Pensions: What Expats Need to Know, , GREENBACK EXPAT TAX SERVICES (2020), https://www.greenbacktaxservices.com/blog/foreign-pensions-treatment-us-taxation/ (last visited Oct 26, 2020).
[15] 10 Top Australian Tax Tips for Retirement, , DUMMIES , https://www.dummies.com/personal-finance/personal-finance-taxes/10-top-australian-tax-tips-for-retirement/ (last visited Oct 26, 2020).

Kenyan shillings on their retirement for every year upon membership for maximum of 600,000 Kenyan shillings[16].

Is NPS is serving the need of the hour?

Indian Government has constantly strived to make variety of benefits and provide security to old citizens of India once they retire. National Pension Scheme implemented by the government of India is one the best ways to invest and save for the future of an individual after retirement. National Pension Scheme allows its subscriber to get several tax benefits as well pre-mature withdrawal benefits. No citizen of India can be exempted from paying taxes however, they can claim for tax deductions under Section- 80 CCD (1) of the Income Tax Act, 1961. One of the best features provided by the NPS is that any individual whether employed under the government or works under private organisation or even a self-employed person can invest under the NPS and can enjoy the taxation benefits offered by the said scheme.

If a person is a salaried employee then he can claim tax deduction of 10% of his basic salary under Section 80 CCD (1) of the Income Tax Act, 1961. A self-employed individual can claim tax benefit up to 20% under the said Act. In the year 2015 sub-section 80 CCD (1B) was added to the Income Tax Act, 1961 which helps the subscribers under NPS to claim an additional deduction of Rs. 50,000 irrespective of the type of employment[17].

Therefore, it can be said that NPS introduced by the Government of India, administered and regulated by the PFRDA or Pension Fund Regulatory Authority and Development Authority under the PFRDA Act, 2013 is the best tax deduction scheme in India which serves the objective of helping people save their money from being taxed and instead invest for their future endeavors.

Conclusion and Recommendations

The Pension System in India is quite elaborate which has been originated since the British period of rule. Prior to the introduction of NPS the non-governmental employees or self-

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[16] Pensions & Retirement Plans, Jan Van Gysegem, Claeys & Engels https://mman.co.ke/sites/default/files/docs/Getting%20the%20Deal%20Through%20-%20Pensions%20%20Retirement%20Plans%202017.pdf (last visited Oct 23, 2020)

[17]NPS (National Pension System): Tax Saving Benefits & Withdrawal Rules, , https://www.etmoney.com/income-tax-saving/nps (last visited Oct 21, 2020).

employees did not have any benefits provided by the government to invest towards pension for their better future.National Pension Scheme is one of the best ways to save tax and it can be called as tax saving instrument as this is the only scheme which allows Rs. 50,000 additional benefit over Rs. 1.5 lakhs. NPS is better as compared other pension schemes and annuity schemes available for an employee. It is low cost and grants choice of investment funds. NPS is regarded as one of the cheapest pension schemes available globally considering the economic scale. It also grants huge advantage on long-term goals post-retirement with a better taxation scheme. Owing to partial withdrawal benefits and additional tax deduction schemes it is one of the best methods to invest during a person's employment.

Tax structure on Pension in India is quite simple and secured as compare to countries like US, as all the pension income is US is taxed according to the US legislations. However, in countries like Australia the earnings that are deposited by a person in the pension fund is completely tax free if withdrawn after attaining the age of 60. Similarly the Kenyan government also doesn't tax any individual after the age of 65 for the pension income. But the tax structure i.e. NPS in India helps the citizens to save up to 2 lakhs of their income and invest in National Pension Scheme and gives tax-free withdrawal once a person retires. NPS also is suitable for the self-employed as well as private employees who work hard during their lifetime in order to have a good financial life post-retirement.

NPS being a great initiative taken by the government of India there is still a lack of awareness among the people. As the pension economics in India remains quite low it is recommended that the PFRDA needs to take financial education with a great urgency. There is also lack of assistance for the elderly population. There is a need of portability, improvement in investment choices, nationalizing long-term returns, tax policies are required to be consistent and increasing the accessibility and visibility while ensuring consumer rights. With this the NPS will move a step closer in providing old-age security to a maximum number of individuals.

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