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Employee Provident Fund (EPF) vs. National Pension Scheme (NPS): What's best for Indian Workers?

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ABSTRACT

The article provides an in-depth comparison of two major retirement savings options available to Indian employees: the Employee Provident Fund (EPF) and the National Pension Scheme (NPS).

The article begins by explaining the foundational aspects of each scheme, including their objectives, eligibility criteria, and the mechanisms through which contributions are made. It outlines the benefits associated with EPF, such as mandatory contributions, government-backed security, and tax advantages, while also discussing the advantages of the NPS, including its flexibility in investment choices, potential for higher returns, and additional tax benefits.

The comparison is further extended to cover the tax implications of both schemes, focusing on the tax deductions and exemptions under Sections 80C and 80CCD of the income tax act. The article highlights the differences in withdrawal rules, annuity options, and liquidity, which are crucial for retirement planning.

Additionally, the article evaluates, these schemes from the perspective of various worker demographics, including salaried employees in the private and public sectors, self-employed individuals, and those with varying risk tolerances and retirement goals.

In conclusion, the article provides a set of guidelines to help readers determine the most suitable option based on their individual circumstances, such as risk appetite, long-term financial goals, and the level of control they wish to have over their retirement corpus. The aim is to empower Indian workers with the knowledge required to make informed decisions about their retirement savings, ensuring financial security in their post-retirement years.

Keywords*: Employee Provident Fund, National Pension Scheme, retirement savings, Indian workers, tax benefits, investment options, retirement planning, financial security, risk tolerance, long-term goals.*

I. INTRODUCTION

Retirement savings in India have gained significant importance as the country's population

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ages and the traditional joint family system, which often provided financial security for the elderly, become less prevalent. With increased life expectancy and rising living costs, the need for a well- planned retirement corpus has never been more crucial.

In India, retirement savings are typically accumulated through government mandated schemes like the Employee Provident Fund (EPF), voluntary savings through the National Pension Scheme (NPS), and other investment avenues such as Public Provident Fund (PPF), mutual funds, and insurance plans. The EPF and NPS are among the most prominent schemes designed to ensure financial stability for individuals post retirement.

Selecting the appropriate retirement saving scheme is vital for securing one's financial future. The right scheme not only helps in accumulating a substantial retirement corpus but also aligns with an individual's financial goals, risk tolerance, and retirement aspirations.

Different schemes offer varied benefits in terms of returns, tax advantages, and flexibility. For instance, while EPF offers a more conservative and secure investment with guaranteed returns, NPS provided the potential for higher returns through market-linked investments but comes with associated risks. Understanding these differences is essential to making an informed decision.

Moreover, the choice of the scheme impacts the liquidity of funds, tax liabilities, and the degree of control over investment decisions. An ill-suited retirement plan can lead to inadequate savings, higher tax burdens or insufficient funds during retirement, making it imperative to carefully evaluate options like EPF and NPS before committing to a long-term savings strategy. Ultimately, choosing the right retirement savings scheme ensures that individuals can maintain their desired lifestyle and financial independence during their retirement years.

II. UNDERSTANDING THE EMPLOYEE PROVIDENT FUND (EPF)

What is EPF?- The Employee Provident Fund is a government –backed retirement savings scheme in India, primarily aimed at salaried employees in both the private and public sectors. Managed by the Employees' Provident Fund Organisation (EPFO), the EPF mandates a fixed contribution from both employees and employers, ensuring a steady accumulation of retirement savings over an individual's working life. The primary goal of the EPF is to provide financial security to employees after retirement, enabling them to maintain a stable income when they are no longer earning a regular salary.

In the EPF scheme, contributions are made by both the employee and the employer. Typically, the employee contributed 12% of their basic salary plus dearness allowance (if applicable)

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towards the EPF. An equivalent contribution is made by the employer, though only 3.67% of the employer's contribution goes directly into the EPF account. The remaining 8.33% is directed towards the Employees' Pension Scheme (EPS). For some industries, the contribution rate might differ, but the standard practice is 12% from both parties.

These contributions are deducted from the employee's salary every month, and together, they form the employee's EPF balance. This balance continues to grow throughout the employee's tenure, offering them a sizeable corpus by the time they retire.

Interest Rate and Returns: The EPF offers a fixed interest rate, which is reviewed and declared annually by the EPFO in consultation with the government. The interest rate is typically higher than what is offered by traditional saving accounts and is compounded yearly. The interest earned is credited to the EPF account at the end of the financial year, further increasing the retirement corpus.

The interest rate for EPF is generally influenced by government policies and the performance of the EPFO's investments. Historically, EPF has provided stable and attractive returns, making it a preferred option for conservative investors who prioritize security over high returns.

Tax Benefits of EPF: EPF is highly beneficial from a tax perspective, making it an attractive retirement saving option. Contributions made by the employee towards EPF are eligible for tax deductions under Section 80C of the Income Tax Act, up to a limit of ₹1.5 lakh per year. Additionally, the interest earned on the EPF balance and the amount withdrawn at maturity are exempt from tax, provided certain conditions are met, such as completing a continuous service period of five years. This makes the EPF a tax-efficient investment vehicle, particularly for long-term savings.

The EPF falls under the Exempt-Exempt-Exempt (EEE) category, meaning that the contributions, the interest earned, and the maturity amount are all tax-exempt, offering substantial tax relief to employees.

Withdrawal Rules and Maturity: The EPF is designed to be a long-term savings instrument, with the primary goal of providing financial security after retirement. However, the scheme does allow partial withdrawals under specific circumstances, such as purchasing or constructing a house, marriage, higher education, or medical emergencies. These partial withdrawals are subject to certain conditions, such as the minimum number of years of service and the maximum withdrawal limits.

Upon retirement, typically at the age of 58, the employee can withdraw the entire accumulated balance, which includes the employee's contributions, the employer's contributions, and the

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interest earned. In case of premature retirement or resignation, the employee can still withdraw the EPF amount, though some tax implications may apply if the service period is less than five years.

Moreover, EPF accounts continue to earn interest even after retirement if the account is not immediately withdrawn, providing additional financial benefits to the retiree.

In summary, the EPF is a secure, tax-efficient, and reliable retirement savings scheme that ensures a steady accumulation of funds for an individual's post-retirement life, with the flexibility of partial withdrawals when needed.

III. EXPLORING THE NATIONAL PENSION SCHEME

What is NPS? The National Pension Scheme (NPS) is a government-sponsored retirement savings plan designed to provide a stable income to Indian citizens after retirement. Launched in 2004 by the Government of India, the NPS was initially introduced for government employees but was later extended to all Indian citizens on a voluntary basis. The NPS is regulated by the Pension Fund Regulatory and Development Authority (PFRDA) and offers individuals the opportunity to contribute regularly to a pension account during their working life, which is then invested in a mix of equity, corporate bonds, and government securities. Upon retirement, a portion of the accumulated corpus can be withdrawn as a lump sum, while the remaining must be used to purchase an annuity, ensuring a steady stream of income post-retirement.

Contribution Structure and Tier Options: The NPS has a flexible contribution structure, allowing individuals to decide how much they want to contribute and when. Contributions can be made regularly or at any time during the year, with the amount varying based on the individual's financial capacity. There is no fixed percentage of salary that needs to be contributed, giving individuals greater control over their retirement planning.

NPS accounts are divided into two tiers:

- **Tier I Account**: This is the primary NPS account and is mandatory for individuals who want to avail the benefits of the scheme. Contributions made to the Tier I account are locked in until the age of 60, with some exceptions for partial withdrawals under specific circumstances. The Tier I account enjoys various tax benefits and is primarily focused on long-term retirement savings.
- **Tier II Account**: The Tier II account is a voluntary savings account that offers more flexibility compared to the Tier I account. Contributions to the Tier II account can be

withdrawn at any time without any restrictions, making it more akin to a savings account. However, the Tier II account does not offer the same tax benefits as the Tier I account.

Investment Choices and Fund Management: One of the key features of the NPS is the flexibility it offers in terms of investment choices. Individuals can choose from a variety of asset classes, including:

- **Equity (E)**: Investments in equities or stocks, which have the potential for higher returns but come with higher risk.
- **Corporate Bonds (C)**: Investments in fixed-income instruments issued by corporations, offering moderate returns with relatively lower risk.
- **Government Securities (G)**: Investments in government bonds and securities, which are considered the safest but typically offer lower returns.
- **Alternative Investments (A)**: Investments in alternative assets such as Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs).

Individuals can opt for either the *Active Choice* or *Auto Choice* investment options:

- **Active Choice**: Allows individuals to actively decide the proportion of their contributions to be invested in each asset class, up to a maximum of 75% in equities.
- **Auto Choice**: Automatically allocates the investment based on the individual's age, with higher exposure to equities when the individual is younger, gradually shifting to safer assets as they approach retirement.

The funds within the NPS are managed by professional pension fund managers (PFMs) appointed by the PFRDA. Individuals have the option to choose their preferred PFM and can even switch fund managers if they are not satisfied with the performance.

Tax Benefits of NPS: The NPS is highly tax-efficient, offering multiple tax benefits that make it an attractive retirement savings option:

- **Under Section 80CCD(1)**: Contributions made by the individual are eligible for tax deductions up to 10% of their salary (for salaried employees) or 20% of their gross income (for self-employed individuals), within the overall limit of ₹1.5 lakh under Section 80C.
- **Under Section 80CCD(1B)**: An additional deduction of up to ₹50,000 is available exclusively for contributions made to the NPS, over and above the ₹1.5 lakh limit under

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Section 80C.

- **Under Section 80CCD(2)**: Employer contributions to the NPS are also eligible for tax deductions, without any upper limit, subject to 10% of the employee's salary. This benefit is particularly advantageous for salaried individuals.

At the time of withdrawal, 60% of the accumulated corpus can be withdrawn tax-free, while the remaining 40% used to purchase an annuity is also tax-exempt.

Withdrawal Rules and Annuity Options: The NPS is designed as a long-term retirement savings scheme, with the main focus on ensuring a steady income during retirement. The withdrawal rules and annuity options reflect this objective:

- **Withdrawal at Maturity**: At the age of 60, individuals can withdraw up to 60% of the accumulated corpus as a lump sum, tax-free. The remaining 40% must be used to purchase an annuity, which provides a regular pension for life. The annuity options available include different types of annuities, such as lifetime annuity, annuity with a return of purchase price, and annuity for a spouse after the subscriber's demise.
- **Partial Withdrawals**: Individuals can make partial withdrawals from their Tier I account before the age of 60, under specific conditions, such as higher education, marriage, purchasing or constructing a house, or for medical treatment of self or dependents. Partial withdrawals are limited to 25% of the contributions made by the individual and are allowed after completing at least three years in the scheme.
- **Premature Exit**: If an individual wishes to exit the NPS before the age of 60, they can withdraw up to 20% of the accumulated corpus, while the remaining 80% must be used to purchase an annuity. However, this option is subject to conditions and is generally less favorable due to tax implications.
- **Exit upon Death**: In the event of the subscriber's death, the entire accumulated corpus is paid to the nominee or legal heir, who can choose to withdraw the amount as a lump sum or continue with the annuity option.

The NPS offers flexibility in terms of investment choices and tax benefits, coupled with a robust structure to ensure financial security in retirement through a combination of lump-sum withdrawals and annuity options.

IV. EPF VS. NPS: A COMPARATIVE ANALYSIS

When planning for retirement, choosing the right savings scheme is crucial for ensuring

financial stability in the later years of life. The Employee Provident Fund (EPF) and the National Pension Scheme (NPS) are two of the most popular retirement savings options in India, each with its own set of benefits and drawbacks. This comparative analysis highlights the key differences between EPF and NPS to help individuals make an informed decision based on their financial goals, risk appetite, and retirement needs.

- **Table 1**

Features	**EPF**	**NPS**
Security and Risk Profile	The EPF is a government-backed scheme that offers guaranteed returns, making it a highly secure investment option. The interest rate is predetermined by the government, providing stability and predictability. EPF is ideal for risk-averse individuals who prefer safety over high returns.	The NPS, on the other hand, is market-linked, meaning the returns depend on the performance of the underlying investments in equities, corporate bonds, and government securities. While it offers the potential for higher returns compared to EPF, it also comes with associated market risks. NPS is suitable for individuals willing to take on some level of risk for potentially higher long-term gains.
Flexibility in Contributions and Withdrawals	EPF contributions are fixed, with both employee and employer contributing 12% of the employee's basic salary and dearness allowance. The withdrawal rules are relatively rigid, with partial withdrawals allowed only under specific circumstances such as	NPS offers more flexibility in terms of contributions, allowing individuals to decide how much they want to contribute and when. There are no fixed percentages, and individuals can increase or decrease their contributions based on their financial situation. The NPS

	medical emergencies, home purchase, or higher education.	also allows partial withdrawals for specific purposes like higher education, home purchase, or medical treatment, although the overall structure is designed to encourage long-term savings until retirement.
Returns on Investment: Guaranteed vs. Market-Linked	EPF provides fixed, government-declared interest rates, typically offering stable but moderate returns. The returns are not influenced by market fluctuations, making EPF a low-risk investment option with guaranteed outcomes.	NPS returns are market-linked and depend on the performance of the chosen asset classes (equity, corporate bonds, government securities). The potential for higher returns exists, particularly with higher exposure to equities, but so does the risk of lower returns in a volatile market.
Tax Efficiency and Deductions	EPF falls under the Exempt-Exempt-Exempt (EEE) tax regime, where contributions, interest earned, and withdrawals are all tax-exempt, provided certain conditions are met (e.g., a minimum of five years of continuous service). This makes EPF a highly tax-efficient investment.	NPS also offers attractive tax benefits. Contributions are eligible for tax deductions under Sections 80CCD(1) and 80CCD(1B) of the Income Tax Act. Additionally, 60% of the corpus withdrawn at maturity is tax-free, while the remaining 40% used for annuity purchase is also tax-exempt. However, the tax treatment of NPS

		withdrawals is less favorable compared to EPF, especially since only a portion of the withdrawal is tax-free.
Accessibility and Ease of Management	EPF accounts are managed by the Employees' Provident Fund Organisation (EPFO), and the investment decisions are entirely managed by the government. This lack of involvement makes EPF easy to manage for employees, though it also means less control over how the funds are invested.	NPS provides greater control to the individual, allowing them to choose their pension fund manager and investment mix. However, this requires a more active involvement in managing the account, which might be a drawback for those who prefer a more hands-off approach.

Case Scenarios: Choosing Between EPF and NPS

- **Table 2**

Scenario	**1. Conservative Investor**	**2. Young professional**	**3. Mid-Career Self Employed**
Profile	Ramesh, 45, public sector employee, risk averse.	Priya, 28, private sector, high risk appetite.	Anil, 40, entrepreneur, looking for flexible contribution.
Goals	Stable retirement corpus with guaranteed returns.	Maximize long term returns with market linked investments.	Flexibility in contributions with potential for growth.
Recommendation	EPF for guaranteed returns and tax benefits.	NPS for higher equity exposure.	NPS for flexibility and growth

			opportunities.

V. Tax Implications of Employee Provident Fund (EPF) and National Pension Scheme (NPS)

The **Employee Provident Fund (EPF)** and **National Pension Scheme (NPS)** offer significant tax benefits under Indian law, making them popular choices for retirement savings.

Under the EPF, employee contributions qualify for tax deductions under **Section 80C** of the Income Tax Act, up to a limit of ₹1.5 lakh per financial year. This is part of the overall limit under Section 80C, which includes other investments like PPF and life insurance premiums. The interest earned on EPF is tax-free, provided the employee has completed five years of continuous service. However, if the EPF is withdrawn before completing five years, the entire amount (including interest) becomes taxable. The amount withdrawn would be added to the individual's income for that year and taxed according to their income tax slab. A relevant case law here is the **Commissioner of Income Tax v. Hindustan Coca-Cola Beverages Pvt. Ltd. (2007)**[2], where the Delhi High Court held that withdrawals before five years of continuous service are taxable under Section 10(12).

In contrast, the NPS offers not only the standard tax deduction under Section 80C but also an additional exclusive deduction of ₹50,000 under **Section 80CCD(1B).** This additional deduction is available over and above the ₹1.5 lakh limit under Section 80C, making NPS an attractive option for those looking to maximize their tax benefits. During the accumulation phase, the growth of investments within the NPS account (interest, dividends, capital gains) is tax-deferred, meaning no tax is levied until withdrawal. At maturity, 60% of the accumulated corpus can be withdrawn tax-free under **Section 10(12A)**. However, the remaining 40% must be used to purchase an annuity, and the pension received from this annuity is taxable as per the individual's income tax slab. The **UoI v. Bombay Tyres International (2016)**[3] case clarified that the 60% lump-sum withdrawal at maturity is tax-exempt, while the annuity portion is taxable. Another case, **D. Shanmugham v. CIT (2017)**[4], reaffirmed that the annuity payments under NPS are taxable as income, either under the head "Salaries" or "Income from Other Sources."

[2] Commissioner of Income Tax v. Hindustan Coca-Cola Beverages Pvt. Ltd., [2007] 293 ITR 163 (Delhi) - Delhi High Court.
[3] Union of India v. Bombay Tyres International, Civil Appeal No. 1784 of 2016 - Supreme Court of India.
[4] D. Shanmugham v. Commissioner of Income Tax, [2017] 85 taxmann.com 127 (Madras) - Madras High Court.

These tax provisions and judicial interpretations provide a framework for individuals to optimize their retirement savings while minimizing tax liabilities, making EPF and NPS both attractive but distinct options based on individual financial goals and risk profiles.

(A) Advantages and Disadvantages of Employee Provident Fund (EPF) and National Pension Scheme (NPS)

Advantages of Employee Provident Fund (EPF) and National Pension Scheme (NPS)

- **Table 3**

Feature	Employee Provident Fund (EPF)	National Pension Scheme (NPS)
Guaranteed Returns	Offers a fixed interest rate declared annually by the government, ensuring predictable growth.	Potential for higher returns due to market-linked investments, especially with equity exposure.
Government Backing	Managed by the government, making it a highly secure investment option with minimal risk.	Regulated by PFRDA, offering transparency and credibility, though market-linked.
Tax Benefits	Contributions, interest earned, and maturity amount are tax-exempt under certain conditions (EEE status).	Contributions eligible for tax deductions under Sections 80C and 80CCD(1B); partial tax benefits at maturity.
Compulsory Savings	Automatic payroll deductions enforce disciplined savings without requiring active management.	Flexible contributions with options to increase or decrease based on financial situation.
Employer Contribution	Employer contributes to the EPF, boosting retirement savings without additional cost to the employee.	No employer contribution unless specifically agreed upon in the employment terms.

Loan and Withdrawal Facility	Partial withdrawals allowed for specific purposes like home purchase, education, or medical emergencies.	Allows partial withdrawals for specific purposes with more flexible options for liquidity.

Disadvantages of Employee Provident Fund (EPF) and National Pension Scheme (NPS)

Feature	Employee Provident Fund (EPF)	National Pension Scheme (NPS)
Fixed Returns	Lower returns compared to market-linked investments, which may not keep pace with inflation.	Subject to market risks, with fluctuating returns depending on the performance of the underlying assets.
Limited Flexibility	Rigid contribution structure and withdrawal rules, limiting adaptability to financial needs.	Requires active management and financial literacy to choose investment options and pension fund managers.
Lower Transparency	Investment decisions are made by the government, with no control or visibility for the employee.	Greater involvement needed from the investor to manage the account and choose investments.
Long Lock-in Period	Long lock-in period until retirement, with limited options for early withdrawal.	Long lock-in period until age 60, with restrictions on early withdrawal and mandatory annuity purchase.
Tax on Early Withdrawal	Withdrawals before five years of continuous service are taxable.	40% of the corpus used for annuity purchase is taxed, reducing immediate liquidity.

Annuity Compulsion	No compulsion to purchase an annuity, allowing full withdrawal at maturity.	Mandatory purchase of an annuity with 40% of the corpus, limiting flexibility at retirement.

Both the table provides a clear comparison of the advantages and disadvantages of EPF and NPS, making it easier to evaluate which scheme may be more suitable for an individual's retirement planning needs.

VI. Conclusion

The choice between the Employee Provident Fund (EPF) and the National Pension Scheme (NPS) is a pivotal decision for Indian workers focused on building a secure retirement. EPF is well-suited for individuals seeking stability with guaranteed returns and tax-free withdrawals after five years of continuous service. Its simplicity and government backing make it a reliable option for those who prefer low-risk investments.

On the other hand, the NPS offers greater flexibility, with the potential for higher, market-linked returns, and additional tax benefits under Section 80CCD(1B). However, this comes with exposure to market volatility and a mandatory annuity purchase, which can affect the post-retirement income stream.

Ultimately, the best choice depends on an individual’s financial goals, risk tolerance, and retirement planning strategy. A balanced approach, possibly incorporating both EPF and NPS, could provide a diversified and robust retirement corpus, ensuring financial security in the later years. Understanding the nuances of each scheme, along with the tax implications, will help Indian workers make informed decisions that align with their long-term financial well-being.

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- Section 10(12): Exempts EPF withdrawals from tax after five years of continuous service.
- Section 10(12A): Exempts 60% of the NPS corpus from tax at maturity, with the remaining 40% used for a taxable annuity.

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