Business Standard

Shifting jobs? Take your PF a/c along

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This saves tax and compounding interest will create a bigger corpus

Sanjay Bakshi wanted to withdraw his accumulated provident fund (PF) as he was moving to a new job. But he recently learnt that the Employee Provident Fund Organisation (EPFO) has planned to ban such withdrawals. He is worried if withdrawing his PF amount was a wrong move.

PF is a long-term investment tool for funding your retirement. It should not be used as a short-term funding source each time you shift jobs. You lose out on the power of compounding to build the corpus. Besides you also have to pay tax, depending on the tax slab you fall under, if you withdraw the amount before five years of continuous service in one or multiple organisations. In the highest tax bracket, that means a straight loss of 30 per cent.

Sanjay is 26 today and his retirement age is 58 years. Let's assume he starts with a monthly basic salary of Rs 10,000. As his salary rises, his PF contributions would also rise. In the adjoining table, column A shows that with a monthly basic salary of Rs 10,000, the PF contribution will be Rs 1,200 (annual Rs 14,400). Assuming an annual growth of 10 per cent in his salary over his earning years, he can expect around Rs 1.44 crore as a corpus on retirement if PF gives you 8.5 per cent return. Column B shows if he kept withdrawing his PF every time he moved jobs, he would lose substantially, even when he starts with a higher basic of Rs 31,250 per month. In such cases, even damage control may not help. Suppose he were to continue his PF contributions without withdrawing for the last 20 years of his job. Despite a higher amount of contribution of Rs 45,000 per year (based on a higher basic of Rs 375,000), the other parameters remaining the same, he will still create a corpus of Rs 97 lakh only. A gap of about Rs 47 lakh!

PF also gives you tax benefit under Section 80 C. If you take that into account, your actual returns are much higher. The PF interest rate is fixed by the government. This year, the declared rate is 9.5 per cent. So, for this year, if your PF component is Rs 1 lakh, your interest at 9.5 per cent works out to be Rs 9,500.

	A	B
Annual Basic Salary (Rs)	120000	375000
Annual Employee Contribution (Rs)	14400	45000
Annual Employer Contribution (Rs)	14400	45000
Years for retirement	32	20
Assumed Salary Increase (%)	10	10
PF Rate of Return (%)	8.5	8.5
Corpus (Rs)	1.44 crore	97 lakh

(This is a simplistic representation of PF calculations. It does not consider the break-up of EPS and EPF contributions.)

But since you also save tax at 30 per cent on the invested amount, you are actually earning Rs 9,500 on an amount of Rs 70,000. So, your return works out to be 13.57 per cent.

If you withdraw your PF amount after five years, you do not get taxed on the amount. If you reinvest, you should look at a rate which gives you something more than what you were earning in the PF. That can only be achieved by equity or real estate investments, both of which are risky. If you invested in equities during 2008-09, when stocks were lying low, you might have made about 500 per cent returns from some stocks. But if the markets had gone down further, you could have lost your money.

People who change jobs often forget about their PF accounts with the earlier employer. The EPFO says it will not pay interest on inoperative accounts where no transactions have taken place for more than three years. There might be several small amounts lying in multiple inactive PF accounts that have not been transferred. If you look back and consolidate these amounts by transferring the same to your current employer, it will surely give a boost to your retirement planning.

The writer is a certified financial planner