India Pension Research Foundation
Working paper series, No: 11/04

Employee's Provident Fund

Renuka Sane Surabhi Sinha*

October 15, 2004

*Comments of the paper should be mailed to renuka@iief.com or ssinha@iief.com.
We thank Mr. Viswanathan and other officials of the EPFO for assistance.

Contents

1 Introduction **3**

2 Applicability **3**

3 Operational framework **4**

3.1 Contributions 4

3.2 Funding 5

3.2.1 Investment 5

3.2.2 Statutory rate of interest 8

3.3 Administration 8

3.4 Benefits 10

3.4.1 Withdrawals 10

3.4.2 Advance to physically handicapped 11

3.4.3 Payment of full accumulation 12

3.4.4 Nomination 12

3.5 Taxation policy 12

3.6 Exemption 13

3.7 Transfer of accounts 13

3.8 Delayed payments and defaults 14

4 Conclusion **16**

A Recovery of arrears; Section 8B to Section 8G **17**

1 Introduction

Occupational pensions in India are dominated by the schemes run by the Employees Provident Fund Organisation (EPFO) under the provisions of the EPF&MP Act 1952. The Act provides for three schemes for members in organisations with twenty or more employees earning upto Rs.6500 p.m. These are

- Employees Provident Fund (EPF): This is a defined contribution scheme. The contribution rate is 12% by employers and employees respectively.
- Employees Pension Scheme (EPS): This is a defined benefit scheme which provides a monthly pension to employees of covered establishments at a replacement rate of roughly 50%. It is financed by diverting 8.33% of the employers contribution to the *pension fund*.
- Employees Deposit Linked Insurance Scheme (EDLIS): This is an insurance scheme that pays an employee an amount in proportion to the balance in his PF.

This paper describes in detail the provisions under the Employees Provident Fund (EPF) scheme. Section 2 talks about the applicability of the scheme. Section 3 describes the operational framework of the scheme. This includes a discussion on contributions towards the PF, the administration and investment procedure of the EPF, the benefits under the EPF as well as the delays and defaults made by the members. Section 4 concludes.

2 Applicability

The EPF&MP Act 1952 is applicable to all establishments engaged in the 182 specified industries employing twenty or more people earning upto Rs.6500 p.m. The Act does not apply to co-operative societies employing less than 50 persons. [1] The rule under EPFO is that only those institutes that are hitherto being provided pension either by the State or the Central government are not under the aegis of the EPFO. However this Act applies only to members earning upto Rs.6500. Those members above that wage, are exempt from the PF rules of contributions. Table 1 shows the number of members and covered establishments over the past ten years.[2]

[1] Pay includes basic wages with dearness allowance, retaining allowance if any and cash value of food concessions admissible thereon.

[2] The covered establishments include both exempted and unexempted ones. The number of members also include those from both exempt ad unexempted establishments.

Table 1: No. of members and establishments covered

Year	No. of establishments	No. of members (in lakhs)
31.03.1994	236881	179.90
31.03.1995	251013	187.24
31.03.1996	266645	194.85
31.03.1997	277555	202.89
31.03.1998	299204	212.19
31.03.1999	318430	231.19
31.03.2000	326541	245.37
31.03.2001	340013	263.01
31.03.2002	357747	274.18
31.03.2003	344508	394.98

Source: EPFO Annual reports

3 Operational framework

3.1 Contributions

Under the scheme both employers and employees need to contribute an equal amount. The rates of contribution has undergone several changes since the inception of the scheme. The normal rate of contribution by employers and employees was prescribed as 8.33% in the EPF&MP Act 1952. The rate of contribution for both employers and employees was extended to 10% for 98 specified industries/ classes of establishments from 01.06.1989. By an amendment of the Act on 22nd September 1997, the rates of contribution payable by both the employers and employees was raised to 12% of the employees' salary to the Employees' Provident Fund. However the rate of contributions for both the employers and the employees have been fixed at an amount equal to 10% of the employees' salary in the following cases;

- An establishment that has been declared as a sick unit by the Board of Industrial and Financial Reconstruction.[3]
- An establishment that has accumulated financial losses exceeding its net worth for the given financial year.
- Any establishment in the a) Jute industry, b)Beedi industry c) Brick industry d) Coir industry other than spinning sector and Guar gum factories.

[3] Board of industrial and Financial Reconstruction was set up in 1987 to identify sick and potentially sick industrial units and suggest measures to deal with them.

Table 2: Contributions to PF

Year	Contributions received (in crores)
1993-94	2541.10
1994-95	2795.87
1995-96	3203.02
1996-97	2915.29
1997-98	3643.49
1998-99	4954.18
1999-00	5778.08
2000-01	6399.55
2001-02	6910.13
2002-03	7528.77

Source: EPFO Annual reports

If an employee so desires, he can contribute at a rate higher than 12% (or 10% in the given cases)of his salary. However in this case the employer is not obliged to contribute at such a higher rate.

The employers are required to deduct the employees' contributions payable from their respective wages before the payment of wages. This together with the employers own contributions and administrative charges have to be remitted to the Fund through a cheque or bank draft within 15 days of the close of every month.

Since the inception of the Employees' Pension Scheme, an amount equal to 8.33% of the employees' salary is diverted out of the employers' contributions to the Employees' Pension Fund, leaving the balance in the EPF account. The total contributions received by the Employees' Provident Fund during the years 1994-2003 are outlined in Table 2

3.2 Funding

3.2.1 Investment

All funds are to be deposited with the State Bank of India. The funds have to be invested as per the directions of the central government in the securities listed in Section 20 of the Indian Trusts Act. Table 3 shows the pattern of investment prescribed by the Government of India with effect from 1st April 2003.

Table 3: Investment pattern of the EPFO

	Investment pattern	% To be invested
i)	Central government securities as defined in Section 2 of the Public Debt Act, 1944 and/or units of mutual funds which have been set up as dedicated funds for investment in g-secs and which have been approved by SEBI	25%
ii)	a) government securities as defined under section 2 of the Public Debt Act 1944 created and issued by the State government and/or units of such mutual funds which have been set up as dedicated funds for investment in govt. securities and which have been approved by the SEBI and or b)any other negotiable securities the principal whereof and interest whereon is fully and unconditionally guaranteed by the Central Government or any state government except those covered under iii)(a) below	15%
iii)	a) Bonds/Securities of Public Financial Institutions as specified under Section 4(1) of the Companies Act, "Public Sector Companies" as defined in Section 2(36-A) of the Income Tax Act, 1961, including public sector banks and/or Short duration (less than a year) Term Deposit Receipt (TDR) issued by public sector banks	30%
iv)	To be invested in any of the above three categories as decided by the Board of Trustees	30%
v)	The Trusts, subject to their assessment of the risk return prospects, may invest up to 1/3rd out of (iv) above, in private sector bonds/securities which have an investment grade rating from at least two credit rating agencies	

Source: Ministry of Labour, 2003

Table 4: Investment of EPF (in Rs. crores)

Investment head	1999-00	2000-01	2001-02
Central Government securities	686.48	1102.43	648.93
State Government securities	399.70	335.79	400.39
Government Guaranteed securities	95.50	242.11	34.20
Special deposit schemes	4158.13	4361.71	4261.60
Public sector financial institutions	1239.90	1211.85	800.29
Total	6579.71	7253.89	6145.41

Source: EPFO Annual reports

Table 4 shows the investment of Employees' Provident Fund in the years 1999-2003

Over the years there has been a decline in the investments in public sector financial institutions. The investment guidelines have been changed from time to time by the Central Government. The share to be invested in public sector financial institutions has been reduced from 40% in the 1997 guidelines to 30% at present. A change has also occurred in the status of the top public sector financial institutions in the country. The Industrial Credit and Investment Corporation of India was merged with ICICI Bank in the year 2002. Industrial Finance Corporation of India has has run into problems lately with a rise in its non-performing assets. With the conversion of Industrial Development Bank of India into a commercial bank, it is likely that the investment of the funds in government securities would further increase. This is not healthy considering the fact that such securities are unfunded and may not be used productively. The funds have a greater possibility of being put to a more productive use if they are invested in a public financial institution which is functioning well. In this sense the decline in the share of investment in Public Sector Financial Institutions is not a healthy sign.

The other problem with EPF investments is the rule that requires the EPFO to invest the interest receipts from one category of investment (for example government securities) in the same category. This essentially implies that the EPF contributions are a captive source of funds for the government and the liability of the EPFO cannot really be measured.

Table 5: Interest rate declared by the EPFO

Year	Rate of interest
1995-96	12.00
1996-97	12.00
1997-98	12.00
1998-99	12.00
1999-00	12.00
2000-01 (April-June)	12.00
2000-01 (July onwards)	11.00
2001-02	9.50
2002-03	9.50

EPFO Annual reports

3.2.2 Statutory rate of interest

Under para 60(1) of the EPF Act 1952, the Central Government on the recommendation of the Central Board of Trustees, declares the rate of interest to be credited to the members' accounts annually. (See Table 5) In recent times, there has been demand by trade unions to raise this interest rate back to its previous levels of 12%, but given the falling interest rate scenario in the market, this does not seem wise or likely. (See Table 6 for yields on government securities.)

The question of the interest rate that is credited to members' accounts has come to be dominated more by political considerations than economic ones. The very idea of determining interest rates at the start of the year, before any interest is realised on investments is antithetical to sound management of a provident fund. It is time the government now started crediting the interest rate at the year end on the basis of the investment earnings of the EPFO. This will ensure that the EPF does not go into the red in the future or impose burden on either the EPFO or the central government and hence the tax payers.

3.3 Administration

Each member is alloted an account number and all contributions received in his name and interest credited to him are recorded in this account. The account numbers are alloted to the employees after the employer furnishes details about them. The employers are required to submit a statement written

Table 6: Annual gross redemption yield on Government of India securities

Year	Short term (1-5 yrs)	Medium term (5-15 yrs)	Long term (15 yrs& above)
1995-96	6.00-14.28	5.75-14.07	11.84-14.02
1996-97	5.21-16.21	5.75-14.44	09.00-14.40
1997-98	5.50-17.69	5.20-14.00	09.00-13.17
1998-99	4.45-17.73	5.75-13.74	10.00-13.48
1999-00	3.16-14.30	6.50-13.84	09.79-13.11
2000-01	4.94-16.66	9.37-12.50	10.58-11.89
2001-02	5.32 -10.96	5.14-13.85	07.41-10.86
2002-03	5.12-10.98	5.60-10.9.27	06.10-8.26
2003-04	3.93-07.16	4.41-06.78	05.44-07.72

Source: RBI Handbook of statistics, 2004

by each employee stating that he is covered by the Provident Fund. The employers are required to submit details of all the employees covered under the EPF within 15 days of close of every month. The problem with this system, however is that accounts are maintained at a decentralised level. Transfers of an employee from one region to the other become a very cumbersome procedure as it involves co-ordination with the regional provident fund offices. The EPF however is in the process of centralisation of its record keeping by issuing unique ID numbers to its members which will stay with them regardless of transfers. This is a positive step in improving the efficiency of the EPFO.

The EPF& MP Act 1952, provides for the administration of the scheme through a Board of trustees appointed by the Central Government. This Board is referred to as the Central Board and consists of the following members;

- A Chairman and a Vice Chairman appointed by the Central Government.
- Central Provident Fund Commissioner.
- Upto 5 members appointed by the Central Government from amongst its officials.
- Upto 15 members representing State Governments appointed by the Central Government
- 10 persons representing employers of the covered establishments, appointed

by the Central Government after consultations with organisations of employers.

- 10 persons representing employees of covered establishments, appointed by Central Government after consultation with employees' organisations.

The Central Government also appoints an executive committee and a regional committee to assist the Central Board in its operations. The composition of the apex administrative body is highly skewed towards members from the government. This is not a healthy practice, if the provident fund hopes to be insulated from government interference in its policy decisions. The EPFO board and the government need to make a move towards a more holistic representation of its members in the board. There is also a need to constitute financial and management experts on to the committee who could guide the EPFO towards modernisation.

The EPFO maintains three separate accounts;

- Provident Fund Account-The total contributions received from the employers and employees are credited to the Provident Fund Account.
- Central Administration Account- The administrative expenses of the fund, including the charges that the fund is authorised to levy are recorded in this account.
- Interest Suspense Account- All interests, rents and other income realised are recorded in this account. This excludes the transactions recorded in the administrative account. It also excludes brokerage and commission on the purchase or sale of securities. This amount is included in the purchase or sale price of the securities as the case may be.

3.4 Benefits

The EPF benefit primarily consists of a lumpsum withdrawal of the accumulations in a member's account at the time of retirement. EPF also has generous rules for premature withdrawals, which often defeats the purpose of the provident fund being a mechanism for saving for old age income security.

3.4.1 Withdrawals

The EPF&MP Act 1952 allows for withdrawals as well as advances prior to retirement. See Appendix for the withdrawal benefits and advances allowed

under various sections of the EPF&MP Act 1952. The withdrawals policy of the EPF is antithetical to the purpose of a provident fund which is to provide old age income security to the member. The government on its side is also losing considerable tax revenue by giving tax benefits to the PF contributions. If inspite of such provisions, the average terminal balance of members are found to be about Rs.30000, the purpose of providing old age income security is lost. The government and the EPFO need to take some bold steps in ensuring that withdrawals are not permitted and the provident fund accumulations are used for the purpose they have been designed i.e. old age income security.

(See Table 7 for number of cases of partial withdrawal)

Table 7: Withdrawals

Category	1999	2000	2001	2002
Financing Life Insurance policies	13154	14257	14488	18354
House building	72972	62750	101080	137321
Temporary closure of establishments	58153	56749	47351	51584
Illness of members/family members	62481	68729	66864	78846
Member's/ family member's marriage or post matriculation studies of children	156878	171537	176764	181828
Others	34338	19971	28900	11812
Total	369437	390200	435447	479745

Source: EPFO Annual reports

3.4.2 Advance to physically handicapped

A non-refundable advance may be allowed to a physically handicapped member for purchasing an instrument that would reduce his hardships. The advance would be given only after the member produces a medical certificate. The advance paid would be the minimum of the price of the instrument, the member's share of contributions with interest on it and the basic wages plus dearness allowance of the member for six months.

3.4.3 Payment of full accumulation

The full accumulations are paid in the following cases;

- On retirement from service after attaining 55 years of age
- On retirement on account of permanent and total incapacity for work due to bodily or mental infirmity
- Migration from India and permanent settlement abroad
- Termination of service in the case of mass or individual retirement.

3.4.4 Nomination

Each member is required to nominate a person who would receive the amount standing to his credit in the Fund in case of his death. The member can also nominate more than one person and distribute the amount among them according to his discretion. The nominee should be a family member. Only if the member does not have a family can he nominate any other person. If the member dies without nominating anyone, the fund in his account is distributed among the family members in equal amount. However the following members would not receive any share as long as there are other members in the family;

- Sons who have attained maturity.
- Sons of a deceased son who have attained maturity.
- Married daughters whose husbands are alive.
- Married daughters of deceased sons whose husbands are alive.

3.5 Taxation policy

- Employers' treatment - The contributions made by employers at the specified rates, are tax deductible in the employer's tax assessment.
- Employees' Treatment - The contribution made by the employer on behalf of the employee is not considered a prerequisite in the tax assessment of the employee and is hence, tax free. The employees' own contribution is eligible for a tax rebate as per section 88 of the Income Tax Act, 1961. If the employee leaves service before completing 5 years,

any lump sum withdrawn by him is taxable. In case of withdrawal from service after a minimum of 5 years the full lump sum is tax free.

- The investment income and capital gains that accrue to the investments made by the trust fund are free of tax.

3.6 Exemption

An establishment can be exempt from the provisions of the EPF scheme if

1. The employees of the establishment are covered by a provident fund scheme whose rates of contribution are no less than that of the Employees' Provident Fund scheme.
2. The employees of the establishment enjoy the benefits of a provident fund and the benefits of such a fund are at least at par with those provided under the Employees' Provident Fund Scheme.

An employee can also apply for exemption from the scheme. In this case he would be granted exemption only if he is entitled to provident fund benefit under any other scheme and these benefits are at least at par with those provided under the Employees' Provident Fund Act.

The exempt establishments run their own schemes but they remain covered under the EPF&MP Act, 1952 and are subject to a number of terms and conditions mentioned In the Act. One important condition here is that the contribution rates under the provident fund rules of any establishment should not be less than those under the EPF. There are other conditions in respect of maintenance of accounts, submission of reports, etc.

Of the total establishments under the EPFO (exempt and unexempt), about 98% are seen to be providing the benefits under the EPFO itself. These establishments also have the bulk of the members under the EPFO. (See Table 8

3.7 Transfer of accounts

If an employee employed in an establishment covered by the Act leaves his job and attains employment in another establishment to which the Act does not apply, the provident fund accumulations in his account would be transferred to the credit of his provident fund account in the new establishment, if the employee so desires and if the rules of that provident fund allow. If an

Table 8: Coverage of the provident fund scheme

Year	% of total establishments	% of total members
1994	98.6875	74.7304
1995	98.7479	75.6569
1996	97.5544	76.293
1997	98.9299	77.6431
1998	99.0147	79.2497
1999	99.0193	82.2267
2000	99.141	82.3124
2001	99.2283	83.8029
2002	99.276	85.7904
2003	99.2558	90.5033

Source: EPFO Annual reports

employee leaves an establishment to which the Act does not apply and joins an establishment covered by the EPF Act, the accumulations to his credit in the provident fund of the establishment left by him would be transferred to the Employees' Provident Fund if the employee desires and if the rules of the concerned provident fund allow.

3.8 Delayed payments and defaults

The EPF& MP Act 1952, has a number of sections that outline the actions that can be taken to deal with the problem of defaults.

Section 7A It gives powers to the Central Provident Fund Commissioner (CPF) Additional Central Provident Fund Commissioner, Deputy Provident Fund Commissioner, Regional Provident Fund Commissioner, Assistant Provident Fund Commissioner to determine the dues, conduct enquiry and recover dues under various sections of the Act.

Section 7Q It makes employer liable to pay a simple interest at the rate of 12% on the amount from the date the amount was due till the time when the payment is actually made. Inspite of this provision, the EPF scheme has been charactertised by mounting arrears. (See Table 10). [4]

[4] The arrears in 10. include arrears in payment of Provident Fund contributions, pension fund contributions, EDLI contributions, administrative charges, and penal damages.

Table 9: Payment of penalty

Period of default	Rate of damages as percentage of arrears
Less than two months	17
Above two months but less than four months	22
Above four months but less than six months	27
Six months and above	37

Section 8 It gives permission to the CPF and other officers to recover the arrears from the establishments in the manner specified in Sections 8B to 8G. These sections have been outlined in appendix .

Section 14 It states that an employer who avoids payment intentionally is punishable with imprisonment for a term upto one year and/or a fine of Rs.5000. In case of default in payment of inspection charges and administrative charges the imprisonment can extend upto 3 years.

Section 14B It gives the CPF and other officers the right to recover damages from the employers by way of penalties. The rates of damages applicable are shown in Table 9.

The Central Board can however reduce or waive the damages in the following cases;

- In case of a change in the management including transfer of the undertaking to workers' co-operative or in case of merger or amalgamation of the sick industrial company with another company, complete waiver of damage may be allowed.
- On the recommendation of Board of Industrial and Financial Reconstruction, complete waiver of damages may be allowed.
- In other cases depending on merit, upto 50% waiver maybe allowed.

The EPFO has been actively taking steps under the above mentioned sections in an attempt to punish the defaulters and ensure timely payment. 1051 cases were filed with criminal courts in the year 2003. The total number of cases pending at the end of the year stood at 21235. FIRs were also lodged under Section 406/409 of IPC. During the year 2002-03 945 FIRs were filed with the

Table 10: Provident Fund arrears (in crores)

Year	Arrears
1996	421.40
1997	466.56
1998	463.97
1999	573.18
2000	1058.30
2001	1184.10
2002	1336.24
2003	1511.79

Source: EPFO Annual reports

police authorities and 32 FIRs were filed directly with the court under these Sections. Damages worth Rs. 79.33 crores were levied during the year 2003. However very small proportion of employers pay damages and a large part of damages levied also remain outstanding. It is essential that the prosecutions are quickly disposed and the damages are easily recovered for the provisions to have impact and for the reduction in the number of defaulters.

4 Conclusion

The Employees' Provident Fund not only provides lumpsum benefits to individuals on retirement, it also helps the individuals meet the various requirements arising during their working lives. However there is an obvious tradeoff between the two benefits. The generous withdrawal rules of EPF has often lead to highly inadequate accumulations in employees' account at the end of their working lives. Considering the fact that EPF was aimed at providing benefits to the employees after they retire, it is essential to restrict the withdrawals and advances to ensure that the scheme serves the basic purpose of providing retirement benefits.

A Recovery of arrears; Section 8B to Section 8G

- Section 8-B states that when an amount is in arrear the authorised officer can issue a certificate to the recovery officer stating the amount due from an establishment. The recovery officer can then recover the arrears by sale of movable or immovable property of the establishment. The recovery officer can also get the employer and detain him in the prison.
- Section 8-C states that the certificate has to be forwarded to the Recovery Officer within whose jurisdiction the principal place of establishment is situated or where the employer carries on his business.or where the employer resides or where any immovable property of the establishment or the employer is located.
- Section 8-F states that irrespective of the issue of recovery certificates, the Central Provident Fund Commissioner or any other authorised officer can also recover the dues in any of the following ways;
    1. If any amount is due from any person to an employer in arrears, such a person may be asked by the CPFC to pay the employer's arrears to the credit of CPFC and pay the balance money to the employer.
    2. If there is a court which has money belonging to the employer under it's custody, the CPFC or any other officer can apply to the court for payment of an amount equal to the arrears or the entire amount under the court's custody if the money is not enough.
    3. The Central Provident Fund Commissioner or any other officer (not below the rank of Assistant Provident Fund Commissioner) can recover the arrears from an employer or an establishment by sale of their movable property in the manner laid down in the 3rd Schedule of the Income Tax Act.
- Section 8-G states that the the Second and Third Schedule of Income Tax Act 1961 and the Income Tax rules 1962 which deal with the recovery of income tax arrears would also apply to arrears due from an employer.