

Institute of Actuaries of India

**INDIA SPECIFIC LEGISLATION, ENVIRONMENT AND
PRACTICES - PENSION & OTHER RETIREMENT BENEFITS
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INDEX

<i>Particulars</i>	<i>Page Nos</i>
<i>1. Objectives</i>	<i>03</i>
<i>2. Introduction</i>	<i>04</i>
<i>3. Provident Fund</i>	<i>05-08</i>
<i>4. Employees' Deposit – Linked Insurance Scheme</i>	<i>09-10</i>
<i>5. Employees' Pension Scheme</i>	<i>11-14</i>
<i>6. Public Provident Fund</i>	<i>15</i>
<i>7. Gratuity</i>	<i>16-23</i>
<i>8. Superannuation Benefits</i>	<i>24-29</i>
<i>9. Life, Health & Disability Insurance Benefit</i>	<i>30-33</i>
<i>10. Leave Encashment</i>	<i>34-35</i>
<i>11. Voluntary Retirement</i>	<i>36-37</i>
<i>12. PFRDA Pension Scheme for the unorganized sector</i>	<i>38-43</i>
<i>13. Direct Tax Code- Employee Retirement Benefits</i>	<i>44</i>
<i>14. Annexure I and II</i>	<i>45-48</i>

**INDIA SPECIFIC LEGISLATION, ENVIRONMENT AND
PRACTICES –
PENSION & OTHER EMPLOYEE BENEFITS *Version – 1.07 (August 2010)***

1. OBJECTIVES:

- 1.1 This paper is written as study material for subject SA4 of Institute of Actuaries of India.

- 1.2 It is necessary for an actuary to be familiar with the overall view of the environment in which he or she is operating. This involves a number of aspects about which the actuary should be aware of. These aspects include social, demographic and economic conditions; the policies of the Government; specific legislation; the regulatory and supervisory framework; taxation aspects; investment opportunities and the guidance from the actuarial profession of the country concerned.

- 1.3 This paper aims at providing an overall view of pension and other employee benefits available to employees mainly in the organised sector in India. It traces the historical background of various employee benefits and their growth during past six decades. The paper mainly deals with the role of employers and the Government, relevant legislation, regulatory framework and taxation matters connected with various employee benefits. The role of insurance companies in the employee benefit provision is also discussed. Relevant parts of different Acts and Statutes are covered to a limited extent and hence the actuary should read the text of concerned Acts to familiarise with the various detailed provisions therein.

2. INTRODUCTION:

2.1 India is basically an agricultural country. As per 2001 census 72.2% of the population lives in rural India. Earlier, people used to work till almost the fag end of their life time as they were either craftsmen (or other self-employed) working independently or life long servants of the employers who regarded them as members of their family. This intimate personal relationship between the employers and employees could not continue once employers started employing hundreds and thousands of employees due to large scale industrialisation. Further, due to trade competition companies felt it necessary to keep their workforce efficient. The need was thus felt to replace old employees with young ones on a regular basis. The companies started to have a standard and compulsory retirement age for all classes of employee, typically 58 or 60 years.

2.2 The organised working population in India has achieved a number of the employee benefits after a long history of agitation and industrial disputes. Earlier the employees in general were left to look after themselves who largely depended in their old age either on family support or their savings made during their working life time. The practice of age-old joint family system in our society ensured protection for every individual in the family for many centuries. It has almost disappeared now.

2.3 Government has played a vital role in employee benefit provision either by encouraging employers and/or employees to contribute for certain benefits or by making some of the benefits mandatory. Prior to the enactment of Employees' Provident Fund and Miscellaneous Provisions Act, 1952 (EPF & MPA), all employee retirement benefits in India were voluntary. At present, a number of benefits such as Provident Fund, Gratuity, Pension, Insurance and alike are available mainly to the employees of organised sector in India. The details of such benefit along with the relevant legislation and taxation aspects are discussed in later parts of this paper.

3. PROVIDENT FUND.

3.1 The Employees Provident Funds and Miscellaneous Provisions Act, 1952 was enacted to provide a kind of social security to the Industrial Workers. Changes to it have taken place from time to time. It mainly provides retirement or old age benefits such as Provident Fund, Superannuation Pension, Family Pension and Deposit Linked Insurance Benefits.

3.2 Provident Fund is one of the main employee benefits for organised sector in India. It is a defined contribution benefit where contributions are made by both the employer and the employees in equal proportion with optional additional contribution by the employees during the working lifetime of employees. The accumulated value as a lump sum is available to the employee to provide him the economic security in retirement.

3.3 In 1925, Chapter IX A was included in the Indian Income Tax Act, 1922 that enabled private employers to set up “**Recognised Provident Funds**”. During that period Provident Fund Act, 1925 was enacted which was applicable to the employees of Government and Quasi-Government bodies.

3.4 Before 1952, provident fund was a voluntary benefit. Now almost every employer employing 20 or more employees has to contribute towards Employees’ Provident Fund (EPF) Scheme. The Scheme is administered by Employees’ Provident Fund Organisation (EPFO) through Board of Trustees.

3.5 Contributions:

The Rules and Regulations of the Scheme are given in the Employees’ Provident Fund Scheme, 1952. Employer contributes every month at the rate of 10% of wages and an equal amount is contributed by the employees. The rate of contribution may be 12% in respect of an establishment, which may be specified by the Central Government. The wages include basic wages, dearness allowance, cash value of any food concessions and retaining allowance. An employee can make optionally an amount exceeding 10% (or 12%) of the wages.

3.6 Benefits:

Investment Pattern of the fund is made as per the pattern prescribed and given as annexure I to this paper. Interest is credited to the member’s account at a rate declared by the Central Government in consultation with the Central Board of Trustees. Till 31 March 1993 interest was credited on the amount standing to the credit of a member as on 1st day of April every year. From 1 April 1993 the yearly interest is computed on monthly running balances. Full accumulated amount may be withdrawn by the member on normal retirement from service (after attaining the age of 55 years) or on retirement on account

of permanent & total disablement, voluntary retirement etc. In case of death of the member, the amount will be paid to the nominee. Ninety percent of the amount can be withdrawn by the member within one year before the retirement or after attainment of age of 59 years, whichever is earlier

3.7 Withdrawals:

Provident Fund is recognised as the main, if not the sole retirement benefit in India. Initially, provisions did not allow withdrawals ordinarily while the member remained in service. It was with a view to ensure that the accumulated fund is not frittered away by the employee on expenses which otherwise should be met by him out of his regular income or other savings. However, non-refundable withdrawals were earlier allowed for investment purposes such as housing and insurance (i.e. financing life insurance policy on member's own life). Now, non-refundable withdrawals are permitted for some other purposes also such as illness in certain cases (involving hospitalisation etc.), marriage or post-matriculation education of children etc. However, such withdrawals are made subject to certain conditions and within certain limits.

3.8 Exemption from Centrally administered EPF:

Appropriate Government may exempt an establishment under Section 17 of the Act if the rate of contribution is not less than that of Employees' Provident Fund Scheme and at the same time, the benefits on the whole are not less favourable than those of EPF Scheme. Exemption may also be granted to certain classes of employee or even individual employees under paragraph 27 (or 27-A) of EPF Scheme. However, the employer has to pay inspection charges payable under the EPF Scheme in respect of employees granted exemption. The terms and conditions of exemption are given in Appendix A of the Act.

3.9 Administration of Exempt Schemes:

3.9.1 An exempt Provident Fund Scheme is to be constituted under an irrevocable Trust with not less than two Trustees. The Scheme has to be recognised under Part "A" of Fourth Schedule of Income Tax Act, 1961 by the Commissioner of Income Tax. The recognition is necessary in order to avail income-tax concessions. The conditions to be satisfied by a fund to qualify for recognition are given in Rule 4 and 5 of Part "A" of fourth Schedule of the Income Tax Act. These include limits on contributions made by the employer and employees, number of trustees, irrevocable nature of the Trust (except that in cases such as dismissal of an employee for misconduct, the employer can recover the sum from the fund), investment of Trust moneys etc.

3.9.2 The employer has the responsibility to deduct contributions (as well as repayment installments along with interest, if any, of refundable withdrawals) from employees'

salaries and pay the same to the trustees along with his own contributions. The trustees are responsible for the investment of the moneys of the Fund in accordance with Rule 67 of Income Tax Rules, 1962 (the present pattern of investment of trust moneys is given as Annexure I this paper).

3.9.3 The trustees are obliged to administer the Fund free of cost but can appoint a paid secretary or Accountant for day-to-day administration. Such Secretary/Accountant may be paid salary from the Fund. There may also be a provision in the Rules of the Fund that all expenses of management of the Fund shall be borne by the employer. However, in that case the expenses attributable to the investment such as brokerage, bank charges, interest collection charges, charges for maintenance of securities etc have to be borne by the Fund.

3.9.4 The day-to-day administration will include maintenance of individual accounts, investment of fund moneys, settlement of benefits, granting refundable and non-refundable withdrawals etc. It also includes maintaining proper accounts of the Fund as per Rule 74 of the Income Tax Rules, 1962 and to submit returns to the Income-Tax authorities as prescribed therein. The returns are also to be submitted to the concerned Regional Provident Fund Commissioner where the Fund includes employees granted exemption.

3.9.5 Though Employees' Provident Fund is a defined contribution scheme, exempt provident funds have an embedded interest rate guarantee. It is as per condition 7 of the Appendix A of the Act as per which any deficiency in the interest declared by EPFO is to be made good by the employer to bring it up to the statutory limit. Due to such guarantee these schemes are treated as defined benefit schemes in terms of Para 26(b) of AS-15 (Revised) and value of such interest rate guarantee is needed to be arrived at.

3.10 Income Tax Relief:

3.10.1 Provident Fund is a nearly tax-free build-up retirement provision as is clear from the following:

- i. Employer's contribution under Section 36(1) (iv) of the IT Act is treated as a deduction in the computation of profits and gains of the business or profession of the employer.
- ii. The employer's contribution to PF is not treated as income of the concerned employee, if it does not exceed ten percent of his salary.
- iii. An employee's own contributions shall be deducted under Section 80C (iv), (v) and (vi) of IT Act up to one lac along with other investments such as life insurance, annuities, PPF etc.

- iv. Income of the Trust (interest and capital gains) is exempt from tax as per section 10(25) (ii) of IT Act.
- v. Interest allowed to individual member's accounts at a rate in excess of that notified by the Government will become taxable in the hands of the employees as per Rule 6 of Part A of the Fourth Schedule of IT Act.
- vi. In terms of Section 10(12) of Income-Tax Act, the accumulated balance payable to the employee is tax-free to the extent provided in rule 8 of Part A of the Fourth Schedule. However, if the balance is withdrawn after putting in less than five years continuous service, then the same may be taxed except where the termination of service is due to ill-health or by contraction or discontinuance of employer's business or other cause beyond the control of the employee. In case of transfer to other recognised Provident Fund also, no tax is payable.

3.10.2 At present provident fund is among some of the savings instruments which are exempted from tax at all the three stages, i.e. contribution, accumulation and benefit delivery. The view of the Government in 2005-06 was that there is considerable variation in the taxation at these three stages under different savings instruments which caused distortions and bias resulting into economic inefficiency and inequity among such instruments. The government at that time appeared to be interested to remove such distorting effects and wanted to adopt the (Exempt-Exempt-Taxed) EET approach where contribution and accumulation would be tax free and benefits would be taxed.

3.10.3 Vide notification dated 5.8.2005, a committee under the Chairmanship of Dr R Kannan was appointed by the Government of India to suggest a roadmap for moving towards EET approach of taxation for various savings instruments. The committee submitted its report in October 2005 to the Government. The Government is likely to introduce new taxation system (Direct Tax Code) and a bill to that effect has been placed in Parliament. Presently the Government intends to introduce it with effect from 1 April 2012.

4. EMPLOYEES' DEPOSIT LINKED INSURANCE SCHEME:

4.1 The Employees' Provident Fund Scheme is a defined contribution arrangement wherein monthly contributions of employees and employer are accumulated with interest. In case of death of an employee accumulated balance standing to the credit of the deceased employee becomes payable to his family. If death occurs in early part of an employee's service, the accumulated balance would be a meager amount. Therefore, to supplement the benefit available under the Scheme on death of an employee, the Government introduced provision of insurance by amending the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. The Employees' Deposit Linked Insurance Scheme, 1976 popularly known as EDLIS, was introduced with effect from 01.08.1976.

4.2 The Scheme is administered by the EPFO through the Central Board of Trustees.

4.3 Contributions:

The contributions under the Scheme are made by the employer. The employer pays 0.50 percent of the employees' wages for every employee who is a member of the EPF. (Salary / Wages for the Scheme are defined similar to EPF Scheme, though for the purpose of making contribution, the salary of each employee is limited to a maximum of ` 6,500/- per month). In addition, the employer pays 0.01 per cent of wages for meeting expenses of administration of insurance Scheme. No contribution for the Scheme is recovered from the employees. Even those employers have to make contribution under EDLIS who have got exemption from EPF Scheme unless they obtain exemption separately from EDLIS as per Para 4.5 below.

4.4 Assurance Benefit:

The amount of assurance benefit is equal to the average balance in EPF account of the deceased member during the twelve months (or during the period of membership, if less) preceding the month in which death of member occurs. However, if average balance exceeds ` 50,000/- the amount payable shall be ` 50,000/- plus 40% of the amount in excess of ` 50,000, subject to a ceiling of ` 1,00,000/-.

4.5 Exemption from EDLIS:

An employer may make an application under Section 17 (2A) of the EPF & MP Act to the Central Provident Fund Commissioner for exemption from the applicability of the EDLIS to any employee or class of employees or to the whole establishment. Such exemption may be granted prospectively or retrospectively, by notification in the official Gazette if the Commissioner is satisfied that the concerned employee or class of employees or all the employees of such establishment, as the case may be, are –

- In enjoyment of the benefits in the nature of life insurance, and
- Such benefits are more favourable to such employee/s than the benefits admissible under the EDLIS, and
- No contribution or payment of premium is made by the employee/s concerned.

The employer may arrange such alternative benefits under a Scheme of insurance with a life insurance company. Life Insurance Corporation of India and some other private life insurers have introduced a Group Insurance Scheme in lieu of EDLIS approved by the Central Provident Fund Commissioner. However, employers have to make individual applications for exemption. These schemes provide either differential covers or a uniform cover to all employees. One of the conditions for approval of the scheme is that all employees including part-time employees should be covered under the scheme. In case of uniform cover scheme the minimum cover should be 60,000/-.

5 EMPLOYEES' PENSION SCHEME 1995 (EPS' 95)

5.1 Employees' Pension Scheme, 1995 (EPS) has been introduced with effect from 16.11.1995. Prior to this, Employees' Family Pension Scheme, 1971 was in operation since April, 1971. Under EFP Scheme, the employer, employees and the Government each was contributing at the rate of 1.16% of the wages of the employees. EFPS provided for limited pension coverage for the widow/minor children in the event of employee's death

while in service only. In case of retirement/resignation of the employee, a lump sum benefit was payable. The benefits available were life insurance benefit and the dependant's pension. EPS has replaced EFP Scheme. The Scheme applies to all those establishments to whom Employees' Provident Fund and Miscellaneous Provisions Act, 1952 is applicable.

5.2 Eligibility for membership:

The membership of EPS is mandatory for existing employees who were members of the ceased EFPS as also new employees who become members of EPF (including exempt provident funds) on or after 16.11.1995.

5.3 Contributions:

8.33% of employee's wages are contributed by the employer towards this Scheme out of the total contribution of employer to EPF of 10% or 12%, as the case may be. In addition 1.16% of employee's wages are paid by the Central Government. The wages for contribution purpose are restricted to a maximum of ` 6,500/-. A member may make contribution to EPS without the ceiling of ` 6,500/- in which case this ceiling will not apply to his benefits also. However, such option to contribute above the ceiling is applicable only to those whose salary was above the ceiling of ` 6,500/- at the time of introduction of the scheme and who have been contributing to the scheme without the ceiling from that date itself.

5.4 Benefits:

A member shall be entitled to a:

- i. Superannuation Pension – if he has rendered the eligible service of 10 years or more and retires on attaining the age of 58 years,

- ii. Early Pension – if he has rendered eligible service of 10 years or more and retires or otherwise ceases to be in employment before attaining the age of 58 years.

5.5 Computation of Pension:

- 5.5.1 In case of a new entrant, the amount of monthly superannuation pension or early pension, as the case may be, shall be computed in accordance with the following formula:

$$\text{Monthly member' pension} = \frac{\text{Pensionable Salary} \times \text{Pensionable Service}}{70}$$

Where pensionable service shall mean the service for which contributions are received in respect of the employee in the Employees' Pension Fund and pensionable salary is the average of last 12 months' salary during the contribution period of service. Where the pensionable service is 20 years or more and the member superannuates on attaining the age of 58 years, a credit of 2 years is given in the Pensionable service.

- 5.5.2 In case of existing members, the superannuation or early pension shall be the aggregate of the monthly pension calculated as per above formula and the past service benefit depending upon the years of past service and the date of commencement of pension subject to a certain minimum amount.
- 5.5.3 Normally the pension is payable after attainment of 58 years irrespective of employer's policy of retirement age. However, a reduced pension after completing the age of 50 years may be paid in which case the amount of pension shall be reduced at the rate of 4% p.a. compounding for which the age falls short of 58 years. Prior to September 2008 such reduction was at the rate of 6% p. a. subject to a maximum reduction of 25%.

- 5.6 If a member ceases to be in employment by way of retirement or otherwise earlier than the age of superannuation, he may either be paid a pension on attaining the age exceeding 50 years or he may be issued a Scheme certificate indicating the pensionable service, pensionable salary and the amount of pension due on the date of exit from employment. If such member is subsequently employed, he will be entitled for the pension earned by him with the old employer as well as with the new employer for fresh spell of pensionable service.

5.7 Leaving before rendering eligible service of 10 years:

If a member does not render the eligible service of 10 years, he is entitled to a withdrawal benefit as per Table "D" or may opt for the Scheme certificate. Further existing members

shall receive an additional amount for their contribution under Employees' Family Pension Scheme, 1971 computed as Table 'A' multiplied by the factors given in Table 'B'. The tables A, B, C & D are given at the end of the Scheme notified by the Government.

5.8 Permanent and Total Disablement:

A member on permanent and total disablement is entitled to an immediate pension without any reduction from the date following the date of disablement subject to a minimum pension of ` 250/- per month provided at least one month's contribution has been made to the Pension Fund..

5.9 Family Pension:

5.9.1 In case of death of a member while in service, the monthly widow/widower pension will be worked out as if the member had retired on the date of death subject to a minimum pension of ` 450/-. Where death of the member takes place after commencement of pension to the member, the widow/widower pension will be equal to 50% of member's pension subject to a minimum pension of ` 250/- per month. The widow/widower's pension is payable till her/his death or remarriage, whichever is earlier.

5.9.2 The monthly children pension for each child (maximum two children at a time) shall be equal to 25% of the amount of widow/widower's pension subject to a minimum of ` 150/-per month. It will be payable till 25 years of age of the child. The eligibility of children will be decided according to their seniority by age. Thus if there are more than two children, the pension will first be paid to two eldest of them. When pension for one of them is stopped (either due to death or on attaining 25 years age (or marriage in case of female child), the next eldest child becomes eligible for family pension and so on. However, in case of disabled children, the pension admissibility remains for life and without restriction of linking to two children at a time.

5.9.3 The Scheme provides for widow/widower and children pension concurrently. If widow/widower dies or remarries, each child's pension is increased to 75% of widow pension. Such pension is then called orphan pension. In case of death of a member who is unmarried or is not having any eligible family member the pension will be paid to the nominee/dependent parent for his/her life time.

5.9.4 If a member dies leaving behind no spouse and/or an eligible Child, the widow pension shall be paid to the nominee or dependent father or dependent mother, as the case may be. If the pension is paid to the dependent father, then on father's death widow pension would be payable to dependent mother so long she survives.

5.10 Valuation:

5.10.1 The Scheme has a provision of annual valuation by a valuer as per Para 32 of the scheme. As a result of valuation the Central Government may either alter the rate of contribution payable or the scale of benefits admissible under the Scheme or the period for which such benefit may be paid. The first valuation was made as at April, 1997 as a result of which pension increase of 4% was permitted. After that one more increase of 4% has been allowed in the year 2000. These increases have been made effective for pensions in payment, i.e. after vestment. Subsequent valuations of scheme have not revealed any actuarial surplus therefore no further increases have been allowed thereafter.

5.10.2 The Central Government appointed an Expert Committee on the Scheme under the Chairmanship of Additional Secretary, Labour and Employment. The Committee has submitted its report on 15 August 2010 recommending either the introduction of a Provident Fund- cum- Pension Annuity Scheme or modifications in the existing scheme. The Government is examining the report for taking further steps.

5.11 Exemption from EPS:

5.11.1. As per Para 39 of the scheme the Central Government may grant exemption to any establishment or class of establishments from EPS if the employees of the establishment/s are either members of any pension Scheme or are proposed to be the members of a pension Scheme wherein the pension benefits are at par or more favourable than the benefits available under EPS. One of the conditions for exemption from the scheme is that all employees including the part-time employees should be covered under the scheme.

5.11.2. Where exemption is granted to any establishment/s, the withdrawal benefits available to the credit of the employees of such establishment/s under ceased Family Pension Scheme shall be paid, subject to the consent of the employees concerned.

5.11.3. Due to a number of complexities, hardly two–three establishments sought exemption from the scheme.

6. PUBLIC PROVIDENT FUND (PPF):

- 6.1 The PPF scheme started with effect from 1.7.1968 under the provisions of the Public Provident Fund Act, 1968. The objective of the scheme is to provide unorganised sector workers & self-employed a vehicle for accumulation of their small savings for old age income security.
- 6.2 It is a voluntary scheme and any individual (including organised sector employees contributing to EPF) can open a PPF account. The account may be opened by the individual in his/her own name or in the name of his/her spouse or as a guardian on behalf of a minor. The account may also be opened by Karta or a member of HUF or an association of persons or a body of individuals. Non-resident accounts can also be opened subject to certain conditions. No person can open two or more accounts in his or her name.
- 6.3 The Scheme is operative at all Head Post Offices of the country, at branches of State Bank of India and its Associate Banks and at selected branches of the nationalised banks. The minimum and maximum contribution that can be made in a financial year are ` 500/- and ` 70,000/- respectively. There are some other restrictions such as contributions can be made in the multiple of ` 5/- and not more than 12 contributions can be made in a financial year (More than one installment can be accepted in a month).
- 6.4 A PPF account matures in 15 years period irrespective of the age of the contributor. The term can, however, be extended thereafter by a block period of 5 years i.e. to 20, 25 years and so on. For extension of the period the subscriber has to exercise renewal option within one year of the expiry period. The scheme allows partial withdrawals every year after sixth year onwards. The facility of loan is also available under the scheme from third year onwards.
- 6.5 The contributor gets tax rebate on contributions under Section 80C of Income-Tax Act. Further, accumulations (under section 10 (11) and withdrawals (including the partial withdrawals) are fully tax exempt. The amount standing to the credit of the account is exempt from wealth tax. The interest earned is totally exempt from income tax under Section 10 (25) (ii) of the I T Act. Further, all the balance accumulates over time is exempt from Wealth Tax.
- 6.6 The rate of interest declared from 1.3.2003 is 8% p.a. compounded annually.

7. GRATUITY:

7.1 The word “Gratuity” has probably been derived from the word gratuitous as originally it was considered to be a parting gift. The payment was entirely voluntary in nature and only good, progressive minded and prosperous employers used to pay this benefit. Not all employees used to get it as it was generally paid to the loyal employees in recognition of their long and faithful service.

7.2 Earlier, there was no basis to determine the quantum of gratuity. However, with the passage of time, employers started to pay gratuity having regard to the salary and service rendered by the employees. As more and more employers paid gratuity to their employees, it gradually acquired a force of convention and employees began to regard it as a price for cessation of service.

7.3 Time passed by but all the employers were still not paying gratuity gracefully. Labour Unions started to demand for it. India has a long history of labour unrest, industrial disputes and legal battles before the “Gratuity” shed its gratuitous character and acquired the legal force. The states of Kerala and West Bengal passed State Acts in 1970 and 1971 respectively after which the Central Government enacted the Payment of Gratuity Act, 1972 (Gratuity Act) which has come into force with effect from 16 September 1972. It was with the object of providing a uniform scheme of payment of gratuity to industrial workers through out the country.

7.4 Gratuity Act applies to nearly all employers who employ (or had employed on any day preceding 12 months) ten or more employees. It becomes obligatory on the part of such employers to pay gratuity to their employees. Earlier there used to be a ceiling on salary which from 1994 has been removed. Now the gratuity payable as per the Gratuity Act (Act Gratuity) is a statutory benefit for all employees irrespective of their salary.

7.5 Benefits:

7.5.1 As per Gratuity Act, the gratuity is computed at the rate of 15 days' wages for each year of service. For this purpose a month's wages are treated as 26 days' wages and hence the benefit accrues at the rate of 15/26 of monthly wages for each year of service. The Act gratuity is thus calculated as under:

$$\text{Act Gratuity} = \frac{15}{26} * \text{Service in years} * \text{monthly wages}$$

A part of service in excess of six months is taken as one year and wages are the last drawn monthly wages of the employee concerned. Further, in case of seasonal workers the gratuity is calculated at the rate of 7 days' wages instead of 15 days' wages.

7.5.2 Gratuity is payable immediately on the "termination" of employment of the employee after he has rendered a continuous service of not less than five years:

- a. on his superannuation; or
- b. on his retirement; or resignation; or
- c. on his death; or disablement due to accident or disease.

The completion of continuous service of five years is not necessary in case of death/disablement.

7.5.3 As per the Act, the amount of gratuity shall not exceed ` **ten lacs**. This ceiling has been revised from time to time. Present ceiling on gratuity amount is applicable with effect from 24 May 2010. Earlier to it the ceiling was ` **3.50 lacs**. The Gratuity Act however does not deny the right of an employee to receive better terms of gratuity under any award or agreement or contract with the employer. An employer may therefore pay gratuity at a rate of more than fifteen days' wages (e.g. one month wages) for each year of service with or without any ceiling. The Act merely prescribes a minimum gratuity and therefore no employer can provide less than the Act benefit.

7.6 Taxation Aspects:

7.6.1 The gratuity as and when paid by the employer to his employee, is deductible from his income under section 37(1) of Income Tax Act, 1961. It is because in terms of Section 17(1) (iii) of the Act, gratuity is a variant of salary and hence for the employer it is a necessary business expense. For the recipient (i.e. employee) it is taxable under Section 15 of the Act. However, as per Section 10(10) (ii) of IT Act any gratuity received under the Gratuity Act is not taxable. Also as per Section 10(10) (iii) of IT Act any gratuity which does not exceed one-half month salary for each year of completed service, subject to such limit as notified by the Central Government is not taxable.

7.6.2 The Government has encouraged the employers to fund their gratuity liability by providing a number of tax-incentives. Such tax benefits are available to Gratuity Funds provided they are approved by the Commissioner of Income Tax under Part C of Fourth Schedule of Income Tax Act, 1961 and Part XIV of Income Tax Rules, 1962. The conditions to be satisfied by a scheme to qualify for approval are set out in Rule 3 of the said Schedule. The main conditions include that the Scheme should be run by the Trustees, the trust should be irrevocable in nature, the employer should be contributor to the fund, funding of gratuity should be the sole purpose of the fund, contributions should not exceed 8.33% of salary etc.

7.6.3 An approved Gratuity Fund is entitled to following Tax reliefs:

- i. As per Section 36(1) (V) of IT Act contributions paid by the employer are treated as business expenses of management.
- ii. As per Central Board of Direct Taxes (CBDT) circular No. 14 dated 23.4.1969, if the past service liability is funded by the employer in a single installment or in maximum five installments, the whole of the contribution made by the employer will be treated as business expense in the year of payment.

- iii. The contributions (or premium in case of an insured Scheme) will not be treated as income in the hands of the employees and hence will not be taxed in their hands. This is as per a directive by the CBDT in which a ruling was given that the premia or the amounts payable by the Trustees of an approved Gratuity Fund to a life insurer or life insurers for obtaining a Group Gratuity Scheme will not be regarded as taxable perquisites under Section 17(2) (V) of Income-tax Act in the hands of the employees.
- iv. Income (whether interest or capital gains) out of the investments of the Trust is not taxable as per Section 10(25) (iv) of IT Act.

7.7 Disclosure of Gratuity Liability in Company Accounts:

7.7.1 Gratuity is a deferred benefit accruing with every year of service completed by the employee and grant of every increment in salary. It however, becomes due on cessation of service. The benefit is thus of the nature of deferred wages. Therefore, if the company does not provide for this liability or does not disclose its quantum by way of a note, the accounts of the company cannot be regarded as giving the true picture of state of affairs of the company. It is thus necessary, as per Schedule VI of the Companies' Act, 1956 that the company should get the gratuity liability assessed in accordance with the normally accepted methods and a suitable provision for the liability is made in the books of Accounts of the company.

7.7.2 The council of the Institute of Chartered Accountants of India (ICAI) issued Accounting Standard (AS) 15 which deals with the accounting for retirement benefits in the financial statement of employers. It came into effect in respect of accounting periods commencing on or after 1.4.1995. AS 15 has been revised subsequent to its introduction and presently AS 15 (Revised 2005) is applicable on or after 1 April 2006.

7.7.3 As 15 rev. 2005 is mandatory in nature. It provides for the following accounting treatment in respect of gratuity (and other defined benefit) schemes:

- i. If the employer is paying gratuity on pay-as-you-go basis, then accruing liability will be computed actuarially and an appropriate charge shall be made to the profit and loss account of the employer. In case of a small employer employing less than 50 employees the accrued liability (if not material) may be computed using some other rational method.
- ii. The actuarial valuation (whether funded or unfunded scheme) should be conducted at least once in three years. In case valuation is made less frequently- say annually, the annual contribution as certified by the actuary should be made by the employer during the inter valuation period. Further, in an accounting year, if fund of the scheme falls short of the value of accrued benefit, such shortfall should be made good by the employer during that year. In case of insured schemes the insurer may get the valuation done by an actuary and actuarial certificate signed by the actuary may be provided by the insurer.
- iii. Where the contribution paid by the employer is less than the amount determined as per (ii) above, the shortfall will be charged to the statement of profit and loss for the year. On the other hand, if excess contribution is made, then such excess will be treated as a prepayment.
- iv. AS 15 had neither prescribed for any actuarial method nor any actuarial assumptions. GN 11 issued by the Institute of Actuaries of India (IAI) had, therefore recommended for Projected Unit Method with one-year control period. Further, GN12 prescribed caps for values of actuarial assumptions keeping in view the economic scenario prevailing at the valuation date. These caps prescribed for discount rate, salary escalation, annuity rate and escalation rate for index linked pension.
- v. AS 15 (Revised) has specified Projected Unit Credit Method to be used to determine the present value of the defined benefit obligations and the related current service cost and, where applicable, past service cost. The discount rate should be determined by reference to market yields at the balance sheet date

on government bonds. Estimates of future salary increases should take into account the inflation, seniority, promotion and other relevant factors. Other actuarial assumptions, whether demographic and financial, should be unbiased and mutually compatible.

vi. Generally a shortfall/excess of the fund found in the year of valuation is to be accounted for in that very year itself. However, if such shortfall/excess arises due to alterations in the benefits or as a result of change in the actuarial assumptions (actuarial gains and losses), the same should be accounted for as per AS-5 treating it as arising as a result of the change in accounting policy of the employer. Such extraordinary items will have to be disclosed.

vii. AS15 did not specify the method by which assets, if any, will be valued. Revised AS15 has specified assets to be valued at fair value.

viii. The AS15 (Revised) has also introduced a lot of disclosures in respect of the following:

- o Accounting policy for recognizing actuarial gains and losses
- o Description of the type of plan
- o Reconciliation of the assets and liabilities recognized in the balance sheet
- o A reconciliation showing the movements during the period in the net liability (or asset) recognized in the balance sheet
- o Bifurcation of total expense for the employee benefits
- o Actual return on plan assets
- o Principal actuarial assumptions

ix. The revised AS15 treats insured schemes as an investment vehicle. The earlier AS15 seems to assume as if they cover the liabilities fully.

7.8 For some time during early 1970s, the employers used to claim tax relief simply by making accounting provision towards the gratuity liability. The IT Act was then amended with effect from 1.4.1973 and a new section 40A (7) was introduced. As per this section, any provision made by a company for the payment of gratuity to its employees as a deduction may not be allowed unless such provision is for the purpose of making payment of contribution towards an Approved Gratuity Fund or for the purpose of payment of gratuity that has become due. Further as per another section 43(B) to the IT Act introduced with effect from 1.4.1983, the provisions made in the accounts towards payment of contribution to an Approved Gratuity Fund will no longer be allowed as a deduction. For claiming it as a deductible expense, the contribution has actually to be paid.

7.9 These developments and the availability of tax benefits in funding gratuity liability have encouraged the employers to set up approved Gratuity Trust Funds.

7.10 Approved Gratuity Trust Funds are irrevocable in nature where the employer does not have the proprietary control over the funds. The gratuity rights of the employees become independent of the fortunes of the business as they are invested outside the business. These Schemes are managed by the Trustees who look after the interest of the members and have control over the funds.

7.11 The Trustees may either invest the funds themselves (in which case the scheme is called privately (or self) managed Scheme) or may adopt a gratuity scheme of a life insurance company. In case of a privately managed Scheme the funds are to be invested as per the pattern prescribed under Rule 101 of the IT Rules (present pattern given in the Annexure-II to this paper). The Trustees have to set up machinery to deal with day-to-day administration such as investment of funds, collection of interest and maturity proceeds, maintenance of records and books of accounts, sale of securities, and payment of benefits to members etc. They have also to arrange for periodical actuarial valuation and annual audit of accounts of the Trust. The scheme, whether it is self-managed or insurer administered, has to be got approved by the Commissioner of Income tax in order to avail tax benefits.

7.12 Under the Gratuity Scheme offered by life insurers the funding is offered under a deposit administration contract or a unit-linked plan. The funding under deposit administration plan is made for cash and a running account of the Scheme is maintained to which contributions are credited, benefit payments are debited and interest is credited as at 31st March every year. The interest under this plan is not guaranteed except for a period of one year or so from the introduction of the Scheme. Interest rates applicable under this plan are declared every year depending on the yield earned (or likely to be earned) by

it on pooled funds of all its Gratuity Schemes. The interest rates may vary according to size of the fund of schemes and may be either gross or net of expenses i.e. no explicit charges are made for expenses.

7.13 Prior to 1981 the funding under Gratuity Schemes as practiced by LIC of India was done under Pure Endowment (PE) Plan where premiums are calculated individually for the Pure Endowment sum assured payable at normal retirement date (NRD). The sum assured here is equal to member's total service gratuity based on current salary. If the employee dies or resigns (or retires) before NRD, individual surrender value is payable which is the return of all premiums paid by the trustees for that particular employee along with interest (currently 9.5% p.a. compounding yearly). Now-a-days PE plan is not offered as it requires individual calculations and hence a lot of administrative work for the insurer.

7.14 Life insurers offer life insurance cover under their Gratuity Schemes with the result the gratuity payable in case of death of employee is more than the gratuity payable based on accrued service. The life cover is provided on renewable basis under One Year Renewable Group Term Assurance (OYRGTA) Plan for which an explicit premium is additionally charged.

7.15 Some of the life insurance companies are also offering schemes to companies for funding of gratuity benefit of their employees under a unit linked plan. Companies pay contributions into the unitized fund or funds which are converted into units after deduction of expenses and other charges, if any. The insurer buys assets and the price if the unit moves to reflect the value of the underlying investments. These schemes either offer no guarantees or offer very low-level guarantees. However, explicit expenses, low or nil surrender charges and investment choices are some of the features of the schemes.

8. SUPERANNUATION BENEFITS:

8.1 Provident Fund and Gratuity are statutory lump sum benefits payable on retirement, cessation of service or earlier death of the employee. It is quite possible that the monies available from these benefits may be utilised to repay certain loans (such as housing or vehicle loans) or in the higher education of children or may be frittered away in expenses like marriage of children etc. Even if invested, the investments may not be made wisely with the result that those who survive, particularly for a longer period after retirement may be left with nothing to live on.

8.2 Prior to independence, certain British Companies transacting business in India and some big Indian companies used to superannuate their employees on attainment of a specified age. Some even introduced pension Schemes for senior employees which, in the beginning, were unfunded i.e. the pension was paid out of current revenue of the company. The introduction of Chapters IX A and IX B in the Indian Income Tax Act, 1922 (subsequently replaced by Part 'A' and Part 'B' respectively of Fourth Schedule of Income Tax Act, 1961) encouraged these companies to fund retirement benefits in order to avail tax relief. Some of these funded Schemes were administered by insurance companies (such as Gresham, Norwich Union, Hindustan Insurance etc.) which were taken over by LIC of India at the time of nationalisation of life insurance business in India.

8.3 Although it is not mandatory to provide pension to their employees, the tax incentives offered by the Government have played a great role in the steady growth of superannuation schemes in India. Many progressive employers have also recognised, particularly during eighties and nineties of last century that they have a responsibility towards their employees far beyond the payment of salaries in return for the services availed. One of the objectives for introduction of superannuation benefits is also to attract and retain talented employees.

8.4 The Payment of Bonus Act, 1965 gave a fillip to the development of superannuation schemes. The high salaried senior employees and executives became ineligible for bonus. As these persons were important for the growth and prosperity of business, employers found superannuation schemes as an alternative medium to compensate these executives.

8.5 Taxation Aspects:

8.5.1 The Government offered attractive tax incentives for providing superannuation benefits. However, such incentives are available if benefits are funded through a superannuation scheme approved by the Commissioner of Income-tax under Part B of Fourth Schedule of Income-Tax Act and Part XIII of Income-tax Rules. The main conditions to be satisfied to qualify for approval are that the scheme should be run by the trustees and the trust should be irrevocable in nature, i.e. no moneys belonging to the trust shall be receivable by the employer under any circumstances. The employer should be a contributor to the fund and its sole purpose should be to provide for annuities to the employees on their retirement on or after a specified age or on their becoming incapacitated prior to such retirement or for their widows, children or dependants on death.

8.5.2 There used to be a restriction on the rate of contribution to be made by the employer which together with employer's contribution to P.F. would not exceed 27% of salary of the employee. Prior to 21.9.1997 this limit was 25% instead of 27%. The employer could also make contribution in respect of past service of the employees either in lump sum or in installments (Rule 87 and 88 of Income-tax Rules). Presently contribution made by an employer up to one lac is not treated as income in the hands of the employee. Any contribution over and above this sum for an employee is taxable income for that employee Under Section 17 (2) (vii) of IT Act.

8.5.3 As per rule 89(ii) of Income-tax Rules, it is obligatory on the part of trustees to purchase annuities from life Insurers. However, till the pension comes into payment the trustees may accumulate contributions in which case they have to be invested as per Rule 85 (Present pattern given in the Annexure- II to this paper).

8.5.4 There is also restriction for a Director of the company to be admitted to the benefits of the fund. Only those directors may get benefit under the scheme who are whole time bonafide employees of the company and do not own more than five percent voting power shares of the company. Thus members of Business Firms, Members of Co-operative societies and self-employed persons cannot become members of approved superannuation schemes.

8.6 The ceiling on contributions to be made by the employer has encouraged setting up of defined contribution schemes. Further where a scheme is set up in lieu of bonus then it is the bonus which is being rearranged as a contribution. As the bonus is payable as a proportion of salary the scheme is usually set up as a defined contribution scheme.

8.7 In case of insured schemes insurers offer funding under Deposit Administration Plan or Unit Linked Plan, details of which are given in Para 7.12 and 7.15 of this paper. Earlier the funding was done under Group Deferred Annuity Plan. Decreasing term insurance cover equal to 2 month's salary for each year of outstanding service (subject to a maximum amount which generally depends upon the membership size) is also offered. The insurance cover helps in augmenting family pension benefits.

8.8. Tax Benefits:

The Government encouraged funding of Superannuation benefits by way of tax incentives for approved Superannuation Schemes which are given as follows:

- i) Section 36(1) (iv) of Income-tax Act allows the ordinary annual contribution paid by an employer as a deductible expense from his income for the purpose of computation of profits and gains of the business.
- ii) As per Notification No.100(F-44A)/8/64 I.T. dated 21.10.1965 issued by the Central Board of Direct Taxes (CBDT), 80% of the actual contributions made by the employer in respect of past service contributions is allowed as business expense spread equally over a period of five assessment years of the employer. Whether an employer should get partial or full tax rebate on past service contributions is a contentious issue. The Hon'ble Supreme Court of India in a case of 1999 between CIT Vs. Sirpur Paper Mills held that the deduction of 100% must be granted in the year of payment. Similar rulings were earlier given by Andhra Pradesh High Court and the Calcutta High Court in two different cases.
- iii) Income of the Fund (both interest and capital gains) is exempt from Income-tax under Section 10(25) (iii) of Income-Tax Act.
- iv) Employee's contributions are deductible from taxable income of the individual under section 80C along with other tax eligible investments (such as premium for life insurance and annuity policies, contributions to PF etc.).
- v) Contributions made by the employer are treated as income in the hands of the employee according to Section 17 (2) (vii) of Income-Tax Act to the extent they exceed **one lac.**
- vi) Pension is treated as "Salary" income under Section 17(1) (ii) of Income-tax Act and thus annuities payable to employees from Approved Superannuation Funds are taxable in their hands as salary. However, commuted value received on retirement at or after a specified age or on his becoming incapacitated prior to such retirement is tax free under Section 10(13)(ii). As per Rule 90 of Income-tax Rules the maximum commutation allowed is one-third of annuity, if the employee is entitled to receive gratuity, or one-half, in other cases.

8.10 Defined Benefit Scheme and the contribution ceiling:

As per rule 87 & 88 of Income-tax Rules the Ordinary Annual contribution and Initial contribution together with employer's contribution to the P.F. should not exceed one lac (earlier 27% of each employee's salary). Under Defined contribution schemes it is straight-forward to allocate each member's contribution to his account. The defined benefit schemes, on the other hand, are funded on a pool basis where cost of the benefit is not known with certainty. The cost also differs from employee to employee. The employer may, however, pay contribution for each employee up to the ceiling and the trustees can reallocate the contribution so that benefits for all members are fully funded. Some employees may thus avail contribution in excess of the ceiling depending upon their age, scale of benefit, salary rises etc. So long as the total cost of the scheme remains within the ceiling the tax authorities may not object, otherwise benefits may need to be reduced.

8.11 Contribution during extended service:

If an employee's service is extended beyond his normal retirement age, the employer may continue to contribute during the extended service period of such employee. However, such contribution is permitted up to a maximum period of five years. This is as per the administrative instructions issued by the CBDT. The reason given here is that the member would have already earned more than sufficient pension by that time and any further concession will be at the cost of revenue of the State.

8.12 Unapproved Superannuation Schemes:

An employer may also introduce an unapproved superannuation scheme. The premiums paid, though, will be allowed as business expenses of the employer under Section 37(1) of Income-tax Act; the same will be treated as perquisites in the hands of the employees as they will form part of salary and taxed. In this case employees will get income-tax rebate under Section 80 (C) of Income-Tax Act. Further the employees may avail tax-free sum assured or cash option in lump sum. However, if an annuity is payable, the same will be treated as salary and taxed.

8.13.1 Different types of annuity i.e. payable for life, payable for a period certain (which may be 5, 10, 15 or 20 years) and for life thereafter, Joint life last survivor (with full or part reversion for the spouse), payable for a period certain and thereafter so long as either the member or his spouse survives etc. are provided by LIC and some other life insurers. Annuities where the pension amount is linked to an index are not provided, probably because index-linked investments are not available in India. LIC and some other life insurers however, provide increasing annuities where amount of pension increases at a pre-fixed rate either on a simple or compound basis. Wherever pension funds provide index-linked pension the schemes purchase additional amount of annuities whenever the index goes up. The administration of such schemes is thus very complex.

8.13.2 In 1987-88 LIC introduced a special annuity plan known as Annuity Payable for Life with Return of Capital on Death. This plan is a combination of two components – life annuity and whole life assurance with sum assured equivalent to purchase price. This annuity is very popular in India as the member gets pension so long as he survives and on his death the family gets the lump sum equal to the capital sum invested in the purchase of annuity. Many life insurers have introduced this annuity.

9. LIFE, HEALTH & DISABILITY INSURANCE BENEFITS:

9.1 These are the benefits which an employer can provide to its employees. They are not mandatory benefits except to the extent of EDLI covered in Section 4 of this paper. They can be provided as part of other employee benefits such as gratuity, superannuation etc. Schemes providing stand alone life and health insurance benefits to the employees can be introduced. Optional Riders such as Critical Illness, Disability, and Accident Benefit may also be offered.

9.2 Initially pure term insurance cover was not popular in India and there was no demand from employee unions either. Its progress, therefore, has been very slow. During early seventies Central Government and many State Governments introduced Group Insurance Schemes covering their employees. These schemes cover lacs of employees and provide survival benefit also. The contribution under these schemes has got two parts – risk part to provide term insurance cover and savings part which accumulates at a certain rate of interest. These schemes are generally contributory, though major part of the contribution comes from employees themselves and only a portion of the risk part is contributed by the Government. Initially some such schemes were administered by LIC of India. Now almost all the schemes covering government employees are administered by the respective governments.

9.3 Looking to the popularity of savings-linked group insurance schemes of the Government, LIC of India introduced Group Savings Linked Insurance (GSLI) Scheme in 1982. This is generally on the lines of government schemes. Entire contribution is usually made by the employees themselves and the role of the employer here is just that of a facilitator.

9.4 LIC of India and a number of private life insurers offer Group Insurance (GI) Schemes providing pure term insurance cover to the employees of an organisation. Generally entire contribution under these schemes is made by the employer as the term insurance is a low cost benefit. The insurance cover under such schemes is offered by insurers on an annual renewable basis. The terms offered by various companies are very competitive. There is sometimes a provision of profit sharing also. IRDA, with the objective of adopting a standard market practice in respect of profit sharing, came out with guidelines vide its circular no. IRDA/ACTL/FUP/Ver A/Aug.2003 dated 2.9.2003. The summary of these guidelines is as under:

- a) Minimum number of life years covered under a Group Master Policy should not be less than 1000 for considering profit sharing. Where for a scheme year the

available experience is less than 1000 life years; profit sharing arrangement shall be deferred until the end of the scheme year in which the minimum number of life years of 1000 in scheme is reached on cumulative basis prospectively.

- b) Profit sharing shall not be allowed other than on a scheme year basis.
- c) Whether to carry forward losses or not shall be decided by the Appointed Actuary having regard to related factors like pricing basis, percentage of profit sharing formula and assumptions for profit sharing etc.
- d) Profit sharing percentage shall not exceed 75% (seventy-five percent) if number of life years for a scheme is less than one lac and shall not exceed 90% (ninety percent) if the number of life years is one lac and more for a scheme.
- e) Mortality assumption for this purpose shall not be lighter than 60% of the rates under the standard mortality table prescribed for the pricing assumptions i.e. currently LIC (94-96) ultimate mortality experience.
- f) The experience rating profit sharing formula and related assumptions should be furnished at the time of filing the product with the authority.

9.5 During last few decades Group Health Insurance or Group Medi-claim policies have become very popular. These policies cover expenses arising out of illness or accidental bodily injury or maternity. Policies provide for hospitalization expenses which include room charges, doctors' fees, operation theatre charges, ICU, drugs and medicines, diagnostic tests etc. Pre and post hospitalization expenses are also covered up to certain number of days. Medi-claim policies cover the spouse, children and even the dependent parents. These covers are provided with certain exclusions and there are waiting periods for some of covers which may be different. This benefit is offered by General Insurance Companies. Some companies take help of Third Party Administrators (TPAs) in claims management which are also registered with IRDA. Cashless medical facility is also offered up to a limit in some of the cases if treatment is taken in certain hospitals with which either the insurer or the TPA has arrangement.

9.6 Individuals, whether employed or self-employed can also buy life insurance cover with or without savings. Optional riders of critical illness, accidental death, disability etc. are also offered by life insurance companies. General Insurers offer these on stand alone basis also. Further Health Insurance covers are offered by life, general and stand alone health insurance companies.

9.7 Tax Aspects:

9.7.1 Ordinarily any premium paid by an employer under a Scheme of Insurance to effect life on the life of employees and health insurance on the life of employees and their family members will be allowed as deductible expense in the income-tax assessment of the employer. But the premiums paid by the employer will be treated as perquisite in the hands of employees under Section 17(2) (v) of Income-tax Act if such policies do not form part of the Recognised Provident Fund or Approved Superannuation Funds. Further, the employees will get income-tax rebate under Section 80 (C) and 80 (D) of Income Tax Act for life and health insurance covers respectively on the premiums paid by them.

9.7.2 The Central Board of Direct Taxes (CBDT) has, however, allowed a special concession to promote term insurance and health insurance covers as employee welfare measures. The concessions have been allowed in following respects:

- i) Premiums paid by the employer will be allowed as deductible expenditure in his income-tax assessment.
- ii) The premiums paid by the employer will not be treated as perquisite in the hands of the employee.
- iii) If the scheme is contributory, the employee's contribution will be eligible for income-tax relief under Section 80 (C) and 80 (D) of Income Tax Act as the case may be.
- iv) The benefits, if and when paid, will not be taxed in the hands of the dependants.
- v) The employer will not claim any tax relief on the death benefits paid under the scheme.

9.7.3 The above concessions are subject to the condition that the employer should not receive any amount under the scheme by way of surrender value or return of premium, otherwise such amounts will be taxed in the employer's hands. A term or health insurance policy does not ordinarily have any paid-up or surrender value. However, sometimes profit-sharing is available under bigger schemes, if claim experience is favourable. The profit sharing, however, does not constitute return of premium as this merely reduces the employer's next year's cost of the scheme and hence the tax relief. The condition imposed by CBDT is thus satisfied.

- 9.8 The term insurance cover on group basis can be availed by self-employed persons also. These schemes are administered through Associations, Co-operatives, and Welfare Funds etc. and are generally granted on occupation basis. Nearly all types of occupation may be covered such as professionals (Doctors, lawyers, Accountants, Pilots, and Engineers etc.) Craftsmen, Shop-keepers etc.
- 9.9 The Central Government has set up a Social Security Fund (SSF) in 1987-88 to provide term insurance cover to weaker sections of society on subsidised basis. A new scheme known as 'Janashree Bima Yojana' (JBY) has been launched from 10 August 2000 where people below and around poverty line are provided insurance cover of ` 30,000/- (with an additional accidental cover of ` 45,000/-). Earlier the cover available was ` 20,000/-. Fifty percent of the premium under this scheme will be subsidised from SSF. JBY and some other Social Security Insurance schemes of Government of India are administered by LIC of India. Similarly, some other social security schemes are administered by public sector general insurance companies also for which a separate SSF has been created by the Government.

10. LEAVE ENCASHMENT:

10.1 Most of the employers these days provide leave encashment facility to their employees. Such facility is generally provided for un-availed Earned (or Privilege) leave. Some employers, however, provide encashment of Medical (or Sick) leave also. Employees earn and accumulate leave during their service period. The rules for accrual and accumulation differ from employer to employer. EL/PL is normally earned at the rate of 1/11 or 1/20 (or 1/21) (and there is usually a ceiling up to which the EL can accumulate, say 180 or 240 days. In some companies there may not be any ceiling. The encashment is generally provided while in service as well as at the time of cessation of service. The object of leave encashment benefit is to discourage employees to avail leave, particularly of small durations as and when required by them. When availing encashment while in service one may have to take certain minimum number of days' leave (say, 15). The employees are thus encouraged not to avail EL too frequently than otherwise.

10.2 After amendment in the Companies Act, 1956 (vide the Companies {Amendment} Act, 1988) and issuance of AS-15 (Revised), the employers are required to ascertain accrued liability in respect of accumulated leave on an appropriate basis and to provide for the same in the Statement of Profit & Loss of the employer. The accounting is to be done regardless of whether the same is allowed as a deduction in the computation of taxable profit or not. Here the liability for benefit payable at the time of separation from the employer is to be accounted for in accordance with AS 15 (rev.2005). The employers thus have to get their leave encashment liability assessed by an actuary. Such valuation has certain peculiarities which are discussed in Para 9 of GN11 of IAI. The GN also provides guidance how to deal with such peculiarities.

10.3 In terms of Section 17(1) (va) of Income-Tax Act salary includes any payment received by an employee in respect of any period of leave not availed of him. Thus the cash equivalent of the leave salary as and when paid by the employer to his employees is deductible from his income under Section 37(1) of Income-Tax Act. For the recipient (i.e. employees) leave encashment benefit is taxable under Section 15 of the Act. However, Section 10(10AA) of Income-Tax Act provides relief where the benefit is received by the employee at his retirement (whether on superannuation or otherwise). Such relief shall be limited to eight months leave and such amount as may be specified by the Central Government from time to time, whichever is lower.

10.4 Some life insurance companies offer funding of Leave Encashment Benefit under their Group Leave Encashment Scheme (GLES). The funding is offered under Deposit Administration Plan or under a Unit-Linked Plan. Brief details of these plans are given in Para 7.11 and 7.15 respectively. The Scheme also provides an insurance cover which may be flat or equal to maximum en-cashable months' salary subject to a ceiling. In the absence of specific tax incentives not many employers are encouraged for funding of leave encashment benefit.

11. VOLUNTARY RETIREMENT:

11.1 Technological changes, economic reforms and restructuring of the economy compelled a number of organisations, whether in public or private sector, to make their operations viable and competitive. In many organisations, particularly where the salary cost has been disproportionately high, companies wanted to downsize their workforce. They offer incentives to encourage their employees to retire voluntarily. This kept the morale of their employees high.

11.2 The company designs a voluntary retirement scheme and offers the same to its eligible employees. If the scheme is designed fulfilling the requirements of Income-Tax Act, then employees are entitled to income-tax relief of any sum received at the time of voluntary retirement subject to a maximum of Rs.5,00,000/-. This relief is available under Section 10(10C) of Income-Tax Act.

11.3 The main requirements of Income-Tax Act are as under:

- i) It applies to an employee who has completed ten years of service or completed 40 years of age. This condition is not applicable in case of amount received by an employee of a public sector company under scheme of voluntary separation framed by the said company.
- ii) It applies to all employees including workers and executives of the company/authority/co-operative society excepting directors of the company/co-operative society.
- iii) The scheme of voluntary retirement has been drawn to result purpose in overall reduction in the existing strength of the employees.
- iv) The vacancies caused by voluntary retirement are not to be filled up, nor are the existing employees to be employed in another company or concern belonging to the same management.
- v) The amount received on account of voluntary retirement does not exceed the amount equivalent to three months' salary for each completed year of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement or superannuation.

- 11.4 The companies generally offer annuities certain payable up to normal retirement age. If the employee dies during the period certain, annuities continue to be paid at the original rate. In some cases the annuities may reduce to, say 50% during the remaining period on death. Other types of annuity such as payable for life with or without return of capital or increasing annuities (increasing at a flat rate) are also offered. Life insurance covers up to notional normal retirement age, lump sum benefit or periodical payments in the form of medical benefits are also sometimes offered.
- 11.5 LIC of India introduced a VRS Plan in 1992 to cater the needs of various companies. As the benefits offered by companies under VRS vary widely it has been a flexible plan of LIC having different components. Some other life insurers also offered attractive annuity schemes. Now-a-days VRS is not very popular among companies.

12. PFRDA PENSION SCHEME FOR THE UNORGANISED SECTOR:

12.1 An expert committee on Project OASIS was set up in 1998 under the Chairmanship of Dr. S.A. Dave to devise a Pension System for organized and unorganized sector in India. The Committee submitted its report in January, 2000. Following are some of the main features of the proposed pension scheme for Indian workers:

- i) The individuals will open an account known as Individual Retirement Account (IRA). The account will have a distinctive number which will remain the same irrespective of transfer from one place to another.
- ii) The account may be opened with any designated Branch of a Bank or a Post Office who will be called the Points of Presence (PoPs)
- iii) The minimum amount per contribution will be Rs.100/-. The minimum amount per annum will be Rs.500/-.
- iv) The scheme will be voluntary.
- v) The system envisages centralised record keeping through a Depository.
- vi) The funds of the scheme shall be managed by Professional Fund Managers who will be known as Pension Fund Managers (PFMs). The committee has suggested maximum number of such managers as six.
- vii) Each Fund Manager will operate three styles of scheme known as “Safe Income”, “Balanced Income” and “Growth Scheme”. The Committee has also suggested following investment pattern for these schemes:

	Safe Income	Balanced Income	Growth Scheme
Government Paper	>50%	>30%	>25%
Corporate Bonds	>30%	>30%	>25%
Equity	<10%	<30%*	<50%*

* Of which less than 10% may be international equity

- viii) The individual will choose a Fund Manager as well as the type of scheme. The Fund Manager as well as scheme style may be changed subsequently.
- ix) The system will have Retirement Advisors (RAs) who will educate the individuals about various schemes. They will also guide and advise the contributors about the suitability of different styles of schemes according to needs of the contributors. The information will also be provided about the performance of various Fund Managers. The RAs will work on commission basis. The commission will be paid by the Pension Fund Managers.
- x) The system will work under a Regulatory Agency known as the Indian Pensions Authority (IPA). Its main function will be the registration and supervision of POPs, Depository, and PFMs & RAs. The authority will also oversee the functioning and growth of all aspects of India's Pension Sector.
- xi) The committee has recommended tax-free accumulation of funds with the Fund Managers. The tax benefit on contribution will be available under Section 88 of Income-Tax Act. No separate or specific tax incentive has been suggested by the Committee on contribution under the scheme.
- xii) The retirement age under the scheme will be 60. Individuals will not have freedom to withdraw from the fund prior to this age except in case of death or disablement. At retirement also the individuals may not be paid any lump sum unless the accumulated fund of the member exceeds 2,00,000/-.
- xiii) At age 60, the individuals will have to purchase annuity from an Annuity Provider (AP). The annuities may be provided by insurance companies or banks.

12.2 The committee had also suggested certain reforms under existing schemes. The main suggestions in this regard were as under:

a) Employees Provident Fund:

- i) Premature withdrawals should not be permitted except in the event of permanent disability.

- ii) EPF contributors should be given a choice either to contribute to PF or to switch over to the new proposed pension scheme.
- iii) Exempted PF schemes should discontinue. The employees participating under such schemes should become members of the proposed scheme compulsorily.

b) Employees' Pension Scheme:

- i) The contribution of 1.16% by Central Government should be discontinued.
- ii) The EPS funds should be professionally managed.
- iii) The contribution should be raised from present level of 8.33% to 10%.
- iv) Investment guidelines for EPS funds should be amended. They may be made on the lines suggested for the schemes of this report.
- v) The actuarial valuation should be made every year

c) Public Provident Fund:

- i) No fresh contributions should be allowed under existing PPF scheme. A new PPF Scheme should be introduced.
- ii) No withdrawals should be permitted before age 60 years except on death or permanent disability.
- iii) Funds of new PPF scheme should be professionally managed.

12.3 The Committee had also recommended the following safety net measures:

i) **“Relative Returns Guarantee for “Safe Income” Style :**

In the “Safe Income” style, PFMs would have to provide a guarantee that they would not under perform the weighted average returns of all managers in that style by worse than 2 percentage points in a year. For example, if a PFM under performs the weighted average returns under the “safe income” style by 5% in a year, he would be required to make good the 3% shortfall in returns to the individual subscribers”; and

ii) **“Contribution Protection Insurance :**

An additional safety net in the pension system should be that if, for any reason, the final pension assets of a participant are smaller than the sum total of all contributions, and then the insurance cover would reimburse this difference. This would be applicable only for individuals who have contributed for at least ten years.

12.4 The Central Government considered the recommendations/suggestions of the Committee. In the budget speech of 2001, the Finance Minister advised the IRDA to study the various aspects and furnish a report by October 2001. The IRDA constituted a Committee which submitted its report in October 2001. The IRDA Committee advocated **TEE** approach in respect of pension benefit instead of **EET**. Further in respect of investment guarantees its observations were as under:

“Investment returns are not envisaged to be guaranteed under the proposed system. To build in guarantees would add costs and would deny people, the higher returns they could achieve from certain investments. It is envisaged, however, that the regulator should ensure that the returns to the subscribers do not fall below the level of the bank rate plus. This could be fixed by the regulator. This provision, which is deemed to be necessary in order to instill confidence among the various stakeholders would be reviewed as the market develops. Another option that the regulator could evaluate in this regard is that of creation of a reserve fund into which a portion of the surpluses generated are credited and any shortfalls debited from”.

12.5 In December 2002, IRDA constituted another Committee under the Chairmanship of Mr. N K Shinkar, Actuary, to suggest a standard simple pension plan with a uniform technical structure to be sold by all life insurance companies to the public. The Committee submitted its report suggesting a standard plan. However, the suggested plan could not be implemented.

12.6 The government, ultimately, on 23rd August 2003 set up an interim regulatory authority viz. Pension Fund Regulatory and Development Authority (PFRDA) to regulate and supervise pension funds and also to develop pensions in India. The Government also introduced PFRDA Bill, 2005 which has not resulted into an Act. Pending passage of the Bill, the Government has, through an executive order dated 10 October 2003, mandated PFRDA to act as a Regulator and develop the Pension Sector in India.

12.7 The New Pension Scheme (NPS) will be voluntary in general but is compulsory for Central Government employees who join service on or after 1 January 2004. Twenty two State/ UT Governments have also issued notification to opt for the NPS for their new

employees. During 2007-08 the interim PFRDA appointed three fund managers in public sector (State Bank of India, Unit Trust of India and Life Insurance Corporation of India) to manage the funds pertaining to Central Government employees (who joined on or after 1.1.2004) for whom the scheme is compulsory. Since 1 April 2008 the pension contributions of Central Government Employees covered by NPS are being invested by these fund managers.

12.8 Presently following seven Pension Fund Managers have been appointed by PFRDA for NPS:

- L I C Pension Fund Ltd.
- S B I Pension Funds Pvt. Ltd.
- U T I Retirement Solutions Ltd.
- I D F C Pension Fund Management Co. Ltd.
- I C I C I Prudential Pension Funds Management Co. Ltd.
- Kotak Mahindra Pension Fund Ltd.
- Reliance Capital Pension Fund Ltd.

12.9 Government has announced that NPS would be available to every citizen from 1 April 2009 on a voluntary basis. PFRDA has set up a Trust under the Indian Trusts Act, 1882 to oversee the functions of PFMs. Further a scheme known as Swavalamban Scheme has been introduced for the unorganized sector of India for

those who are not Government or Semi-Government employees and are not covered under EPF Act. The Government will be contributing ` 1,000/- per annum for three years to their account provided such people contribute at least ` 1000/- and at the maximum ` 12,000/- per annum. This has been done in order to encourage people in unorganized sector to contribute for their old age.

12.10 In spite of the above efforts made by the Government, NPS has not got popularity to the desired level. The Government has now constituted a Committee on 10 August 2010 under the Chairmanship of Mr. G. N. Bajpai to review implementation of Informal Sector Pension. The other members are Mr. Deepak Satwalekar, Professor Abhinandan Jain, Dr. Nachiket Mor and Mr. P. K. Tiwari.

13. DIRECT TAX CODE- EMPLOYEE RETIREMENT BENEFITS:

13.1 The Government introduced Direct Tax Code Bill, 2010 which is expected to come into force from 1 April 2012. The tax incentives for savings under the code have been rationalised so as to encourage net savings and the code has proposed to introduce the EET method of taxation of savings.

13.2 The intention and logic of taxing employee benefits is rational as the intention of the Government is to tax income at one stage- either at the time of receipt or at the time of payout.

13.3 Under EET system one has to consider the effect of inflation particularly in the long term savings such as savings by employees for their retirement. It is because the inflation erodes the money values. It is expected that the new tax code would evolve a suitable system to address the inflationary effect.

NOTIFICATION
Investment Pattern
July 9, 2003
As amended by notification September 10, 2008

Government of India/ Bharat Sarkar
Ministry of Labour/ Shram Mantralaya, New Delhi

S.O. - In exercise of the powers conferred by Sub-paragraph (1) of Paragraph 52 of the employees' Provident Funds Scheme, 1952 and in super session of the notification of the government of India in the Ministry of Labour No. S.O.1398 dated 11th July, 1998 (dated 19.6.1998 published in the Gazette of India) the Central Government hereby directs that all incremental accretions belonging to the fund shall be invested in accordance with the following pattern, namely :

	INVESTMENT PATTERN	Percentage amount to be invested
i	Central Government Securities	Twenty Five percent
ii	(a) Government securities as defined in Section 2 of the) Public Debt Act, 1944 (18of 1944) created and issued) by any State Government; and/) (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)	Fifteen percent
iii	(a) Bonds/Securities of 'Public Financial institutions' as) specified under Section 4(I) of the Companies Act ;) "Public sector companies" as defined in Section 2(26-A)) of the Income Tax Act, 1961 including public sector) banks; and/or) (b) Short duration (less than a year) Term Deposit Receipts) issued by public sector banks)and/or (c) CBLO issued by CCI Ltd. and approved by RBI)	Thirty percent
iv	To be invested in any of the above three categories as) decided by the Trustees)	Thirty percent

v.	The Trustees, subject to their assessment of risk-return prospects, may invest up to 1/3 rd of the (iv) above, in private sector bonds/ securities, which have an investment grade rating from at least two credit Rating agencies.	
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2. Any moneys received on the maturity of earlier investments, reduced by obligatory outgoings, shall be invested in accordance with the investment pattern prescribed in this notification.

3. In case of any instruments mentioned above being rated and their rating falling below investment grade and the same rating has been confirmed by two credit rating agencies then the option of exit can be exercised.

4. The investment pattern as envisaged in the above paragraphs may be achieved by the end of a financial year and shall come into force with immediate effect.

(D. S. Poonia)

Joint Secretary to the Govt.

**INCOME-TAX (FIFTH AMENDMENT) RULES, 2009 - AMENDMENT IN
RULE 67**

NOTIFICATION NO. 24/2009, DATED 12-3-2009

In exercise of the powers conferred by sub-section (1) of section 295 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income tax Rules, 1962, namely:-

1. (1) These rules may be called the Income-tax (Fifth Amendment) Rules, 2009.
(2) They shall come into force with effect from the first day of April, 2009.
2. In the Income-tax Rules, 1962, in rule 67, for sub-rule (2) the following shall be substituted, namely:-

"(2) The manner of investment referred to in sub-rule (1) shall be in accordance with the following Table, namely:-

**TABLE
INVESTMENT PATTERN**

Sl. No.	Investment	Maximum percentage amount to be nvested in items referred to in column (2)
(1)	(2)	(3)
(i)	(a) in Government securities; (b) Other securities, as defined in section 2(h) of the Securities Contract (Regulation) Act, 1956, the principal whereof and interest whereon is fully and unconditionally guaranteed by the Central Government, or any State Government, except those covered under clause (ii)(a) below: and/or (c) units of mutual funds set up as dedicated funds for investment in	Fifty five per cent.
	Government securities and regulated by the securities and Exchange Board of India.	

(ii)	(a) Debt securities with maturity of not less than three years tenure issued by Bodies Corporate, including banks and public financial institutions;	Forty per cent
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Provided that any moneys received on the maturity of investments made prior to the 1st day of April, 2009, reduced by obligatory outgoings, shall be invested in accordance with the manner of investment specified in this sub-rule:

Provided further that the investment pattern specified in this sub-rule may be achieved by the end of the previous year; so however that at no time during the year investment in any category should exceed by more than ten per cent of the limit prescribed:

Provided also that, irrespective of the proportion of investments stated in clauses (i) of the said Table, exposure of a trust to any individual mutual fund, under sub-clause (c) of the said clause, which has been set up as a dedicated fund for investment in Government securities, shall not exceed five per cent of its total portfolio at any point of time:

Provided also that the trustees shall invest at least 75 per cent of the amount invested under sub-clause (a) of clause (ii) of the said table in instruments having an investment grade rating from at least one credit rating agency registered under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992):

(ii)	<p>b) Term Deposit Receipts of not less than one year duration issued by scheduled commercial banks fulfilling all the following criteria:</p> <p>(i) it has made profit continuously for immediately preceding three years;</p> <p>(ii) it is maintaining a minimum Capital to Risk Weighted Assets Ratio of 9 per cent;</p> <p>(iii) it is having net non-performing assets of not more than 2 per cent. of the net advances; and</p> <p>(iv) it is having a minimum net worth of not less than rupees 200 crore; and/or</p> <p>(c) Rupee Bond having an outstanding maturity of at least three years issued by institutions of the</p>	
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	International Bank for Reconstruction and Development, International Finance Corporation and the Asian Development Bank.	
(iii)	Money market instruments including units of money market mutual funds	Five per cent
(iv)	Shares of companies on which derivatives are available in Bombay Stock Exchange or National Stock Exchange or equity linked schemes of mutual funds regulated by the Securities and Exchange Board of India.	Fifteen per cent

Provided also that in the event of the rating of any instruments mentioned in this sub-rule for being rated and their rating falling below the investment grade, as certified by one credit rating agencies registered under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), then the option of exit from such instruments can be exercised and the released funds shall be invested in accordance with the manner provided in the Table of this sub-rule:

Provided also that the turnover ratio, being the value of securities traded in the year divided by the average value of the portfolio at beginning of the year and the end of the year, should not exceed two.

Explanation 1.- The manner of investment specified in this sub-rule shall apply to the aggregate amount of investible moneys with the fund in the previous year.

Explanation 2.- For the purposes of this sub-rule,-

(i) the expression "Government securities" shall have the meaning assigned to in clause (b) of section 2 of the Securities Contracts (Regulation) Act, 1956:

(ii) the expression "public financial institutions" shall have the meaning assigned to it in section 4A of the Companies Act, 1956 (1 of 1956);

(iii) the expression "public sector company" shall have the meaning assigned to it in clause (36A) of section 2 of the Income-tax Act;

(iv) the expression "public sector bank" shall have the meaning assigned to it in clause (23D) of section 10 of the Income-tax Act; and

(v) the expression "securities" shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956."

[Notification No. 24. F.No. 142/13/2008-TPL]