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# The EPFO's Circular Dated 7 October 2024: A Paradigm Shift or an Overreach?

## OVERVIEW

The Employees' Provident Fund and Miscellaneous Provisions Act, 1952, (EPF Act) is a socio-beneficial legislation that was enacted to benefit an employee, and his dependants post his retirement. Under the EPF Act, all eligible employees are required to contribute 12% of their monthly pay (which includes basic wages, dearness allowance, retaining allowances and other regularly payable allowances), up to INR 15,000. The establishments covered under the EPF Act also make an equal contribution for each eligible employee. While the employee's entire contribution goes directly to the provident fund, only 3.67% of the employer's contribution is allocated to the provident fund, with the remaining 8.33% directed to the Employees' Pension Fund.

Section 17 of the EPF Act empowers the appropriate government to exempt an establishment covered under the EPF Act from the operation of all or any of the provisions the Employees' Provident Fund Scheme, 1952 (EPF Scheme). Such exempted establishments maintain their own trust. and both the establishment as well as the employee remit their respective contribution to the trust instead of the Employees' Provident Fund Organisation (EPFO). The only pre-condition for seeking an exemption under Section 17 of the EPF Act is that the benefits provided by the establishment to its employees should not be less favourable than the benefits envisaged under the EPF Act. Once an establishment is granted exemption from the operation of all or any of the provisions of the EPF Scheme, the establishment has to comply with the exemption conditions provided under Appendix-A to Paragraph 27AA of the EPF Scheme (Exemption Conditions).

## EXEMPTION: FROM BOON TO BANE?

In the past, a growing number of establishments sought exemption under Section 17 of the EPF Act in view of the perceived advantages that such exemptions were believed to provide. One of the primary reasons for seeking exemption was the assumption that exempted establishments would have the autonomy to make their own investment decisions. It was thought that this autonomy would allow them to manage provident fund contributions based on their own research, with the potential to achieve higher returns.

Another perceived advantage was the faster processing of claims and disbursements. With the EPFO, the withdrawal process can be bureaucratic and slow, often involving extensive paperwork and longer processing times. This can be frustrating for employees who need quick access to their funds in cases such as retirement, resignation or emergencies. Exempted establishments, on the other hand, are able to manage and disburse funds more efficiently.

Due to these attractive benefits, many establishments applied for exemption under Section 17 of the EPF Act. The establishments viewed such exemptions as an opportunity to offer better financial returns and benefits to employees, which in turn allowed them to position themselves as preferred employers in the market.

However, over the past few years, numerous establishments have surrendered their exemption and transferred their corpus to the statutory fund managed by the EPFO. Over the last 2 years, 27 establishments have surrendered their exemption, comprising of approximately 30,000 employees and an amount of INR 1,688.82 crore to the fund managed by the EPFO.

A key factor prompting this shift is the lack of autonomy available to exempted establishments to manage their trust (including the surplus / reserves accumulated in the trust over a period of time). On one hand, the exemption conditions mandate employers to compensate for any losses resulting from theft, misappropriation or poor investment decisions, and to cover any discrepancy between the provident fund trust's declared interest rate and the statutory rate. On the other hand, the EPFO disallows exempted establishments from using their accumulated 'Reserves and Surplus' to set off such losses.

Moreover, many exempted establishments have faced significant financial setbacks due

to investments in bonds issued by Companies now in bankruptcy, thereby making exemption a less lucrative option.

EPFO Circular No E.III/10(122)/2024/Circular/Exemption/5435 dated 7 October 2024: Adding to the woes?

Further adding to the woes of exempted establishments, the EPFO recently issued a circular dated 7 October 2024 (bearing reference number E.III/10(122)/2024/Circular/Exemption/5435) (Circular) regarding the utilisation of reserves and surplus by an exempted establishment. *Vide* the said Circular, the EPFO has issued the following guidelines with respect to utilisation of reserves and surplus:

(a) A large surplus indicates non-distributed past earnings, suggesting that beneficiaries should have received higher interest. Such earnings should have been distributed as higher interest for the beneficiaries.

(b) Interest should be credited monthly, with no interest for broken periods within a year.

(c) The interest rate for beneficiaries should correspond with the Fund's earnings.

(d) Overdrawing from reserves and surplus is not allowed.

In the Circular, it is explicitly stated by the EPFO that utilising the reserves / surplus, which have accumulated over time from the contributions of both past and present beneficiaries, to benefit only the current beneficiaries, would result in unjust enrichment for a few at the expense of others. The EPFO has clarified that such a practice violates paragraph 60 of the EPF Scheme and contravenes Section 17 of the Indian Trusts Act, 1882, which mandates trustees to act impartially. The EPFO further directed that on surrender or cancellation of the exemption, all fund accumulations (including undistributed interest) must be transferred to the Central Board of Trustees.

The said Circular has been issued by the EPFO in suppression of all the existing Circulars on the utilisation of surplus / reserves by exempted establishments.

The Circular dated 07 October 2024 is contrary to the prior Circulars issued by the EPFO:

The stance taken by the EPFO in the Circular is in complete deviation from the position adopted by the EPFO in its previous circulars issued from time to time:

(a) In the circular (bearing No. C-Ex./Misc./Comp./Audit/2009/43799) dated 21 October 2010 (2010 Circular), it was stated by the EPFO that the reserves and surplus accumulated by an exempted establishment over time should be used to provide additional benefits to members through enhanced interest payments. The relevant contents of the 2010 Circular are set out hereinbelow for ready reference:

    *"2. […] the reserves and surplus are created over a period of time out of the yield of investments of the contributions of the members, hence the same has to be utilized for extending benefits to the members in the form of enhanced interest of payments."*

    *"3. The Board of Trustees and the employer may accordingly be advised to make judicious utilisation of the funds lying in the reserves and surplus of the trust for the overall benefit of the members keeping in view the provisions of the Act and Scheme."*

    Thus, the 2010 Circular only emphasised regarding judicious utilisation of funds lying in the reserves and surplus of the trust for the overall benefit of the members of the trust. In other words, the 2010 Circular did not prohibit the employer from utilizing the reserves to meet the statutory interest rate in subsequent years.

(b) In continuation of the 2010 Circular, the EPFO issued another Circular dated 17 March 2011, (bearing no. Ex/Misc/Comp.Audit/2009/104919) (2011 Circular). *Vide* the 2011 Circular, the EPFO again only clarified that exempted establishments can use the amount in

reserves for the purpose of granting interest at statutory rates or even higher than statutory rates. However, even in the 2011 Circular, it was nowhere specified by the EPFO that the reserves and surplus could only be used to declare interest at statutory or higher rates in that particular year itself. Consequently, exempted establishments were carrying forwarding any reserves or surplus for declaring interest at statutory or higher rates in future years.

## THE IMPLICATION OF THE CIRCULAR DATED 7 OCTOBER 2024

However, in complete deviation from the prior circulars, the EPFO issued the Circular whereby it has prohibited the employer from carrying forward the surplus / reserves for future years to fill in gap in statutory rate of interest. *Vide* the Circular, the EPFO has made it mandatory to distribute the surplus / reserves in the trust by crediting higher interest to the beneficiaries.

At this juncture, it is pertinent to highlight that neither the EPF Act nor the EPF Scheme provides that the surplus / reserves accumulated in the trust has to be distributed to the beneficiaries by providing a higher rate of interest on monthly basis. The EPF Act and the Scheme thereunder simply stipulate that the interest rate offered by such exempted establishments cannot be lower than the statutory rate of interest. Thus, the Circular appears to overreach the scope and ambit of the EPF Act and the EPF Scheme. This raises concerns about its legality and appropriateness and underscores the need for careful judicial scrutiny.

## CONCLUDING REMARKS

To enforce compliance with the Circular, provident fund authorities may initiate inquiries under Section 7-A against exempted establishments for prior periods, given that the EPF Act does not impose a time limitation for such inquiries. However, any such action taken under Section 7-A would lack legal justification, as it is well-established that a circular cannot be applied retrospectively without legislative authority from the issuing body (in this case, the EPFO) *[Bharat Sanchar Nigam Limited & Ors v M/s Tata Communications Limited, Civil Appeal No. 1699-1723/2015]*.

Moreover, the Circular's directive that, upon cancellation or surrender of exemption, all fund accumulations (including undistributed interest) must be transferred to the Central Board of Trustees contradicts the objectives of the EPF Act. The EPF Act is not akin to a tax legislation that empowers authorities to demand an amount from the establishment. Transferring these amounts to the EPFO would not benefit the employees but would instead deprive them of the additional financial advantages that could have been derived from the surplus. In essence, the Circular undermines the core purpose of the EPF Act, which is to strengthen the financial security of its members.

Given these concerns, it is essential for the EPFO to reconsider the Circular to ensure that it aligns with the true intent and objectives of the EPF Act and continues to serve the best interests of the employees.

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