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AMENDMENTS TO THE EMPLOYEE PROVIDENT FUND SCHEME, 1952 (INTEREST TO BE PAID ON INOPERATIVE EMPLOYEE PROVIDENT FUND ACCOUNT)

Background:

The Employees Provident Fund Scheme, 1952 (**"EPF Scheme"**) has been recently amended, *vide* the Employees' Provident Fund (Sixth Amendment) Scheme, 2016, to allow the crediting of interest on inoperative accounts. The ministry of labour and employment has issued a notification dated November 11th, 2016[1] (**"Notification"**) diluting the definition of an inoperative account with the objective of allowing interest on amounts in the employee provident fund account (**"EPF Account"**). Per the terms of this amendment, if an EPF Account lies idle for 36 (Thirty Six) months or more, it will not be automatically treated as inoperative, but will continue to accrue interest.

This amendment marks a noticeable shift in the policy of the labour and employment ministry to a more worker friendly scheme. From April 1st, 2011 the central government had disallowed interest to accrue on such inoperative EPF Accounts. This was primarily because the then central government wanted to dissuade workers from making their EPF Accounts inactive and encourage them to transfer their EPF Account any time they switched their jobs. This five year old decision has now been reversed by the employees' provident fund organisation's (**"EPFO"**) top decision making body - the central board of trustees. Accordingly, with effect from November 11th, 2016 the central government has relaxed the definition of inoperative account, thereby allowing employees to park their funds in such EPF Accounts and still receive interest. However, the Notification will not apply retrospectively.

Position before the issuance of the Notification:

Prior to the issuance of the Notification, the EPF Scheme laid down that any amount due to a member as a result of either:

1. Accumulation in respect of any member who has either ceased to be employed or died, and no application for withdrawal or transfer of such amount has

[1] Notification no G.S.R 1065 (E) dated November 11th, 2016

been made within a period of thirty-six months from the date on which it becomes payable; or

2. If any amount remitted to a person is received back undelivered, and is not claimed again within a period of thirty six months from the date it becomes payable shall be transferred to an account called the inoperative account (**"Inoperative Account"**)[2].

In other words, accounts were deemed inoperative when there was no contribution for 36 (Thirty Six) months. In most cases, accounts turned inoperative due to the tedious procedure of transferring the account for employees who switched their jobs. Most organizations preferred to open new EPF Accounts rather than facilitate the transfer of the existing EPF Account.

The EPF Scheme also stated that interest shall not be credited to the account of the member from the date on which it becomes an Inoperative Account in terms of the abovementioned provision[3]. Hence, since April 1st 2011 and until the introduction of the Notification on November 11th, 2016, an idle EPF Account did not attract any interest. Therefore, any employee who resigned from employment or took up employment with an employer who does not fall under the EPF Scheme bracket and did not transfer his EPF Account to the new employer would not receive interest on the funds lying idle in the account.

Changes brought about by the Notification:

Prior to the issuance of the Notification, the EPFO had issued another notification dated February 10th, 2016[4] (**"Notification dated February 10th, 2016"**) wherein the withdrawal of the entire provident fund corpus was barred until the employees had reached the age of 58 (Fifty Eight) years. One of the many amendments brought about by the Notification dated February 10th, 2016 was that the age limit of the provident fund withdrawal was increased from 55 (Fifty Five) years of age to 58 (Fifty Eight) years of age. Per the revised provisions, employees could withdraw the full amount standing to their credit only after retirement from service after attaining 58 (Fifty Eight) years of age. In effect, employees could not withdraw the provident fund corpus even if they were unemployed or were no longer in the employee provident fund net. With this in mind, the EPFO also decided to undertake a review of the rules regarding Inoperative Accounts and subsequently allowed the crediting of interest due to the fact that withdrawal rules had been tightened. However, due to the controversial nature of the notification dated February 10th, 2016, the central

[2] Para 72 (6) of the EPF Scheme

[3] Para 60 (6) of the EPF Scheme

[4] notification no G.S.R 158(E) dated February 10th, 2016

government later decided to rollback this provision and hence a circular dated April 19th, 2016[5] was issued withdrawing the Notification dated February 10th, 2016.

Despite the rollback of the earlier provision restricting withdrawal of the provident fund, the Notification has now been issued diluting the definition of Inoperative Account with the intent of providing interest on EPF Accounts. Accordingly, the Notification has removed the words 'ceased to be employed' from Paragraph 72 (6) of the EPF Scheme. Now, an EPF Account will become an Inoperative Account only with respect to any amount becoming due to a member as a result of:

1. accumulation in respect of any member who has retired from service after attaining the age of 55 (Fifty Five) years but no application for withdrawal has been preferred within a period of thirty-six months from the date on which it becomes payable; or

2. accumulation in respect of any member who has migrated abroad permanently but no application for withdrawal has been preferred within a period of thirty-six months from the date on which it becomes payable; or

3. accumulation in respect of any member who has died, but no application for withdrawal or transfer of such amount has been made within a period of thirty-six months from the date on which it becomes payable; or

4. if any amount remitted to a person is received back undelivered, and is not claimed again within a period of thirty six months from the date it becomes payable.

Therefore, merely because the employment has ceased, the funds shall not be transferred to an Inoperative Account. This amendment has in effect created a new investment option for account holders. For instance, the Notification will benefit various people who leave their employment to take up self-employment or who take up employment with smaller employers who are not covered under the EPF Scheme or who have ceased employment altogether in pursuance of other options.

Conclusion:

Prior to the issuance of the Notification, an Inoperative Account was generally considered a burden to the account holder. The process of transferring an EPF Account with the switching of jobs is a cumbersome process and therefore much of the savings in such an EPF Account could not be accessed by the member. Furthermore, the savings in the EPF Account did not accrue any interest which meant that the investment was static and not growing. The introduction of the Notification has solved certain aspects of this problem to a great extent. As long as the account is not inoperative by reason of retirement after the age of 55 (Fifty Five),

[5] Circular No. Coord/3(1)2015/Amendment Scheme dated April 19th, 2016

permanently migrating abroad, death etc, the member is entitled to receive interest on the amount even if there are no contributions.

The review of the rule was initiated only as a result of the government's initial decision to curb EPF withdrawal. This decision to curb withdrawal was later removed due to protests from various sectors but the decision to credit interest on the inoperative accounts remained. With this move of the central government, a member would not lose money due to his inability to transfer his account. However, as a good practice a member should still transfer his / her EPF Account on switching jobs as it has many other benefits. For instance, monitoring of one EPF Account is much easier than monitoring multiple EPF Accounts. Another point to be kept in mind is that an EPF withdrawal before the service of 5 (Five) years is taxable. Each time a new EPF Account is created, the account holder has to wait 5 (Five) years from the date of creation of the EPF Account before he / she can withdraw the amount, in order to avoid a tax burden. However, on transferring the EPF Account, the employee can add the service period of the previous employment and hence avoid tax on withdrawal.

Perhaps the rationale behind such a move is that as long as the members' money is invested somewhere by the EPFO, there is no reason why interest must not accrue. In conclusion, the Notification has been hailed as a move that creates a secure investment opportunity for members who can now park their funds safely and attain interest on the same. It acts as a social security scheme with far reaching effects as millions of organised sector employees will start receiving interest income with effect from November 11th, 2016.

This is an update for general information purposes only and does not constitute legal advice. Please contact us if you require further clarifications on this subject.

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