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Tax Flash News

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EPFO issues circular on utilization of reserves and surplus for exempted Provident Fund trusts

Executive summary

Employees' Provident Fund Organisation (EPFO) has issued a circular dated 07 October 2024, addressing the utilization of reserves and surplus for crediting interest to Trust beneficiaries.

The circular advises that upon the cancellation or surrender of exemption for Exempted Provident Fund (PF) Trusts, all accumulated funds, including undistributed interest on investments, must be transferred to the EPFO. Additionally, a compliance audit will be conducted to identify any instances of non-compliance or improper use of reserves and surplus.

Background

- In 1952, the Government of India introduced a mandatory savings scheme for non-government employees, known as the Employees' Provident Funds Scheme (EPFS). The Government also allowed employers to establish and manage their own in-house Provident Fund (PF) trusts, provided they comply with the conditions set forth in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act) and the Income Tax Act, 1961 (IT Act). These establishments are referred to as **exempted establishments**.
- The exempted establishments at the time of surrender/ cancellation are required to transfer the accumulations credited to each employee to the Employees' Provident Fund Organisation (EPFO).
- Section 17(5) of the EPF Act, if any exemption is cancelled/ surrendered, the accumulations in the Provident, Pension or Insurance Fund along with any forfeited employer contributions, must be transferred to the respective funds within the specified time and manner.
- Paragraph 28 of the EPFS outlines the transfer process, requiring authorities to submit a statement of credits and advances, transfer accumulations in cash or securities within specified timeframes and provide all relevant documents to the EPFO.

Circular[1] issued in October 2024

- EPFO had observed instances where exempted establishments have requested permission from Regional Offices to utilize the balance in their Trusts' reserves and surplus to credit interest to current beneficiaries at rates significantly higher than those declared by the EPFO for its members. These actions were either proposed at the time of surrendering their exemption or just prior to initiating the surrender process.
- To clarify the utilization of surplus reserves, recently EPFO has issued a new circular.

Key Points of the circular

- Exempted establishments have been seeking permission to use the balance in Trusts reserves and surplus to credit interests at higher rates than those declared by EPFO.

[1] EPFO Circular Source - https://www.epfindia.gov.in/site_docs/PDFs/Circulars/Y2024-2025/circular_exemption_11102024.pdf

Accessed on 15 October 2024

- These actions are proposed either during the surrender of exemption or just before initiating the surrender process. This issue and its legal consequences have been carefully considered, resulting in the following points:
    - An inflated surplus in the Trust's Balance Sheet indicates that earnings from previous years were not proportionately distributed among beneficiaries. Higher earnings in previous years should have been distributed as higher interest to beneficiaries.
    - Interest must be credited to beneficiary accounts on a monthly running balance basis, effective from the last day of each year. No interest is allowed for broken periods of a year.
    - The interest rate for beneficiaries of Exempted Trusts should match the Fund's earnings.
    - Overdrawal of reserves and surplus is not permitted at any time.
- The circular further states that the legal considerations regarding the use of reserves and surplus for crediting higher interest rates are clear and stringent. Such practices are illegal under Para 60 of the EPF Scheme and violate the provisions of Indian Trusts Act.
- The EPFO circular mandates that requests from exempted establishments to use reserves and surplus for crediting higher interest rates cannot be approved and will be identified during compliance audits.
- It is essential that all trust fund accumulations, including undistributed interest, be transferred to the EPFO upon cancellation or surrender of exemption as per provision of the EPF Scheme.
- This circular supersedes previous circulars dated October 20, 2010[2], and March 17, 2011[3].

Our comments

These changes mandate that all accumulated funds including undistributed interest should be transferred to the EPFO at the time of cancellation or surrender of exemption of the Private PF Trusts.

Exempted trusts should carefully consider these guidelines while distributing their yearly surplus.

[2] EPFO Circular Source - https://www.epfindia.gov.in/site_docs/PDFs/Circulars/Y2010-2011/CompAudit43789.PDF

[3] EPFO Circular Source - https://www.epfindia.gov.in/site_docs/PDFs/Circulars/Y2010-2011/Ex_CompAudit_104919.pdf

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