Chapter 16

DEFINED CONTRIBUTION PLANS

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16 DEFINED CONTRIBUTION PLANS

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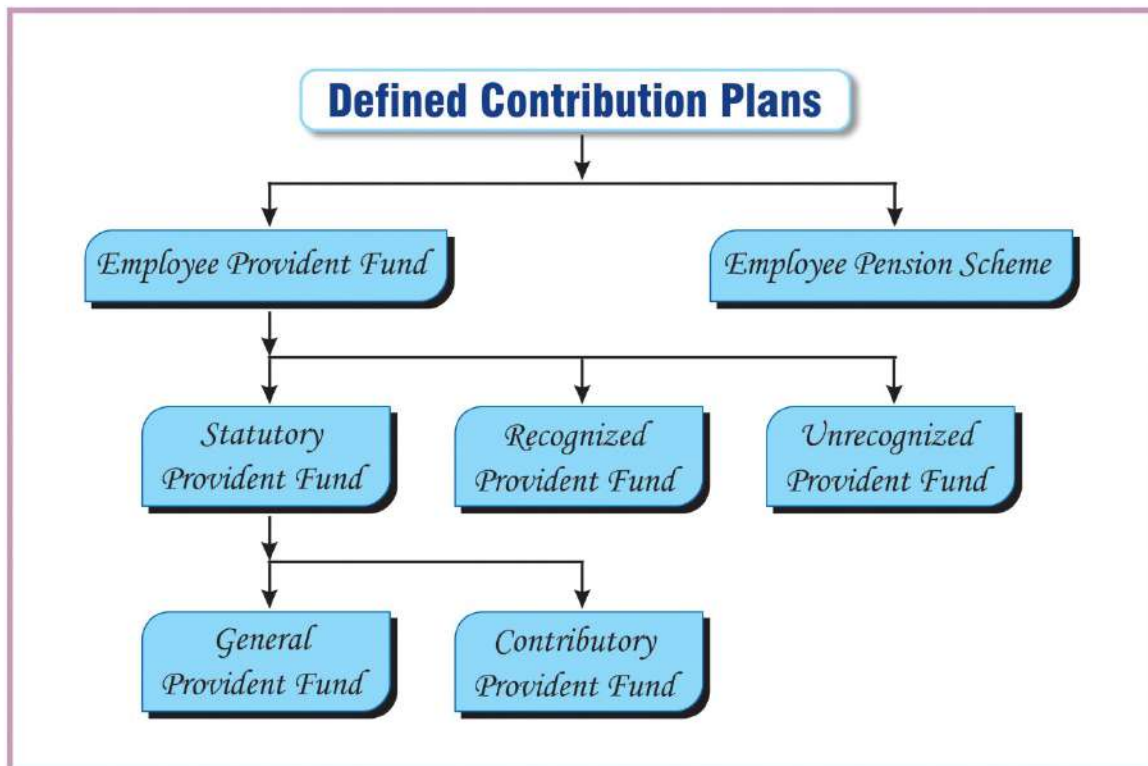
Defined Contribution Plans, in this type of plan contributions, are usually expressed as a percentage of salary or total earnings. The rate of contributions could be a flat rate or could be tiered by some other consideration like the length of service or seniority etc. But the final benefit payout is never fixed and would be based on the accumulation of the contributions made.



Defined Contribution Plans

Types of Defined Contribution Plans

- Employee Provident Fund
- Employee Pension Scheme

EMPLOYEE PROVIDENT FUND

Provident Fund (PF) or EPF is also called the Employee Provident Fund Scheme. It is one where the employees contribute a small portion of their Salary i.e. 12% of their basic pay every month. A matching amount is contributed by the employer. Such a contribution together forms a corpus. This is to be used to fund the employee's retirement. EPF withdrawal by employees can, however, be done earlier itself i.e. during their employment.

A Provident fund scheme is a welfare scheme for the benefit of the employees. The balance keeps accu-

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mulating year after year. At the time of retirement/resignation, the accumulated amount is paid to the employee. In the case of the death of the employee, the accumulated balance is paid to his legal heirs.

The interest rate on Provident Fund deposits increased to 8.65% from 8.55% for the Financial Year 2018-19.

The interest rate on Provident Fund deposits decreased to 8.50% from 8.65% for the Financial Year 2019-20.

There are three types of Provident Funds:

- Statutory Provident Fund (SPF)
- Recognized Provident Fund (RPF)
- Unrecognized Provident Fund (URPF)

Statutory Provident Fund (SPF)

The provident fund legislation in India dates back to the year 1919, it was first framed u/s 96-B of the Government of India Act. Later, the provident fund Act, 1925 was enacted to amend and consolidate the laws relating to both government and other provident funds.

A Statutory Provident Fund is set up under the provisions of the Provident Fund Act, 1925. This fund is maintained by the government, semi-government organizations, local authorities, railways, universities, and recognized educational institutions.

Statutory Provident Fund is further classified under two heads:

(a) General Provident Fund

(b) Contributory Provident Fund

Taxability:

Employee's contribution: eligible for rebate u/s 80C

Employer's contribution: Fully exempt from tax.

Interest on PF: fully exempt from tax

Repayment: fully exempt from tax u/s 10(11)

General Provident Fund (GPF)

The government provident fund introduced for the government employees is controlled by The Ministry of Finance.

Eligibility

(i) Permanent government servants

(ii) Re-employed pensioners

(iii) Temporary government employees after continuous service of 1 year.

Contribution: A sum as fixed by the employee, subject to a minimum of 6% of emoluments and not more than the employee's total emoluments.

Emolument = Basic pay + leave salary + any remuneration of the nature of pay received in Foreign Service (D.A. is not to be included)

The contribution may be increased twice and/or reduced once at any time during the year.

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Contributory Provident Fund (CPF)

The Contributory Provident Fund Rules (India), 1962 apply to every non-pensionable servant of the Government belonging to any of the services under the control of the President. A subscriber, at the time of joining the Fund, is required to make a nomination in the prescribed Form conferring on one or more persons the right to receive the amount that may stand to his credit in the Fund in the event of his death, before that amount has become payable or having become payable has not been paid.

A subscriber shall subscribe monthly to the Fund when on duty or Foreign Service but not during the period of suspension. Contributions are done by both employee & employer. The minimum contribution by the employee is 1% of the salary (Basic + DA) and maximum full salary. Government Contribution is the matching amount of employee contribution and will contribute a maximum of 10% of salary on 31st March of each year. If for any period the employee doesn't contribute, there will be no contribution from the government. Government contribution will be rounded off to the nearest whole rupee.

Advances and Withdrawals: 3 month's pay or half the amount of contribution and interest thereon at credit, whichever is less in case of normal advances/withdrawal. No such limit in case of special advance/withdrawal. Recovery is not more than 24 equal monthly installments if within 3 month's pay and 36 installments if it exceeds 3 month's pay.

All other rules for GPF and CPF are the same. Both GPF & CPF funds were established under the PF Act, 1925 controlled by the Ministry of Finance. The rules for GPF & CPF are the same except for the following differences:

- Every government servant not eligible for pension has to compulsorily subscribe to the fund.
- Employees can contribute any amount as fixed by them subject to a minimum of 1% of emoluments and not more than his total emoluments.
- Contribution by the government is matching employee contribution but a maximum of 10%. For any period, if the employee does not contribute, there will be no contribution by the government also.

Recognized Provident Fund

As defined in Section 2(38) of the Income-tax Act, "Recognized Provident fund means a provident fund which has been and continues to be recognized by the chief commissioner following the rules contained in Part A of the Schedule IV and includes a provident fund established under a scheme framed under the Employees provident fund and Miscellaneous provision Act, 1952". According to this Act, any person who employs 20 or more employees is under an obligation to register himself under the PF Act, 1952, and start a provident fund scheme in his organization after 3 years of its establishment.

However, there is no such restriction if the employer wants to start a scheme even if the numbers of employees are less than 20 or even from its commencement.

The establishment has a choice between the following two alternatives:

a. They may join the government scheme set up by the provident fund commissioner under the provident fund act; this scheme is already recognized by the Commissioner of Income Tax. This is known by the name EPF (Employee Provident Fund).

b. They may start their PF Scheme on their own by creating a trust. After creating such trust they have to get it approved by the commissioner of provident fund and also require getting it recognized from the Commissioner of Income Tax.

U/s -2(38) of Income Tax Act, 1961 recognized Provident Fund is at par with the Statutory Provident fund only condition in case of withdrawal before 5 years the entire amount is fully taxable.

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Definition of 'Basic Wages' and 'Pay'

"Basic wages" means all emoluments which are earned by an employee while on duty or leave or on holidays with wages in either case following the terms of the contract of employment and which are paid or payable in cash to him, but does not include

(i) The cash value of any food concession;

(ii) Any dearness allowance (that is to say, all cash payments by whatever name called paid to an employee on account of a rise in the cost of living), house-rent allowance, overtime allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or work done in such employment;

(iii) Any presents made by the employer.

Salary = Basic wage + D.A. (forming part of retirement benefit) +
Retaining allowance + cash value of food concessions.

Excluded Employee

An employee whose pay exceeds Rs. 15,000 or having been a member of the fund has withdrawn the full amount of accumulation in the fund on retirement from service after attaining the age of 55 years.

The withdrawal facility is available for the following purpose:

a. Medical Care

b. Housing

c. Family Obligation

d. Retirement

e. Education

f. Insurance

The employees covered under the EPF act automatically get three statutory benefits namely:

1. Provident Fund
2. Pension, under "Employees' Pension Scheme, 1995"
3. Term Life Insurance Cover Linked to Provident Fund, under "Employees Deposit Linked Insurance Scheme, 1972.

Contribution for EPF Scheme

Employee's Contribution 12% of salary

Employer's Contribution 12% of salary (matching contribution)

Salary = Basic Wages + D.A. + Retaining Allowance + Cash Value of Food Concessions.

But the employer's contribution is bifurcated in two parts:

- 8.33% of the salary is deposited towards Employees' pension scheme, 1995
- The balance (i.e. 3.67%) is deposited in PF a/c

Contribution	PF	Pension
Employee	12%	Nil
Employer	3.67%	8.33%
Government	Nil	1.16%

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Administration Charges of 1.10% of emoluments towards PF & 0.01% towards the EDLI Scheme, 1976 are payable by the employer under the EPF Act.

Un-recognized Provident Fund

A scheme started by the employer and employees in an establishment, whether approved by the commissioner of Provident fund or not, but not approved by the Commissioner of Income-tax is called an unrecognized Provident fund.

Self-Administrated Provident Fund (Private)

If a self-administered provident fund is created, then the other 2 benefits of Employees Provident Fund and Miscellaneous Provisions Act, 1995, and Employees Deposit Linked Insurance, 1972 are not available to the employees.

The Commissioner of Income Tax under Section IV of the Act may approve such a provident fund. If the income tax authorities approve it, then it is termed as "Recognized Provident Fund Trust". If not, it is called "Unrecognized Provident Fund Trust".

Tax Implication

Recognized Provident Fund: Under a recognized provident fund, all the tax benefits are the same as in the case of the EPF Act. On withdrawal of money before an employee has put in service of a minimum of 5 years, the provident fund amount is taxable. But, it is not taxable if his services are terminated because of

- His illness
- Discontinuation of the employer's business
- For a cause beyond the control of the employee

If he gets the provident fund and transfers to another recognized provident fund trust in joining a new service, total service with all the employers as provident fund member has to be counted for tax benefit.

Unrecognized Provident Fund: Contributions by the employer to a recognized or unrecognized provident fund trust are deductible expenses and are not perquisites for the employees. The income of the unrecognized trust is subject to tax. Receipts from the unrecognized trust by the employee on exit are treated as under.

- His contributions are tax-free
- Interest on employees own contributions are treated as 'income from other sources'
- Employer's contribution and interest thereon is treated as 'profits instead of salary'

Summarized Treatment for Income Tax Purpose

	SPF	RPF	URPF
Employee's Contribution	Deduction u/s 80C	Deduction u/s 80C	No deduction u/s 80C
Employer's Contribution	Fully exempt	Exempt up to 12% of salary, excess of 12% of salary is included in gross salary	Not exempt, but not also taxable for every year, deductible expenses for the employer and not a prerequisite for the employee

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Interest	Fully exempted from tax	Exempt U/s 10 up to 9.5% p.a. interest credited more than 9.5% p.a. is included in Gross Salary	Not exempt but not also taxable for every year
Repayment of lump sum amount on Retirement / Resignation / Termination	Fully exempt from tax u/s 10(11)	**Exempt Subject to:**	
		i. Minimum 5 years of service, or	i. Accumulated staff contribution tax free
		Ii a.Terminated for illness b. Discontinuance of business c. For a cause beyond the control of employee	ii. Accumulated interest in staff contribution is taxed as income from other sources
		iii. PF amount is transferred to another RPF by joining new services	iii. Accumulated employer's contribution plus interest on this taxable as profit instead of salary

EMPLOYEE PENSION SCHEME

Earlier to EPS-95, the employees were covered by Family Pension Schemes 1971. The main features of the old FPS, 1971 were

- • If a member was alive, no pension
- • If a member was not alive, pension to a spouse only
- • Pension amount was very small, as the contribution collected to the scheme was 3.34% (1.67% ´ 2) of the wages.
- • This scheme ceased when the EPS, 95 came into existence.

Employee's Pension scheme was introduced in the exercise of the powers given by Section 6A of Employees Provident Funds and Miscellaneous Provisions Act, 1952. This scheme has come into force on 16th November 1995. Under this scheme, a relaxation was also given to those who were not members of the ceased FPS, between the periods from 01/04/1993 to 15/11/1995. Subject to the provisions of this Scheme the employees have an option to become the members of the Scheme with effect from the 1st April 1993.

The main features and contributions of the new scheme are:

- If a member is alive, the pension is available to him/her (member)
- If a member is not alive, the pension is to spouse and children below 25 years of age
- The scheme applies to all members who joined EPF after15/11/1995.
- 8.33% of wages is contributed by the employer and shall be remitted by the employer to the Employee's Pension Fund within 15 days of the close of every month by a separate bank draft or cheque on account of the Employee's Pension Fund contribution in such manner as may be specified in this behalf by the Commissioner. The cost of remittance if any shall be borne by the employer.
- 1.16% of wages is contributed by the government, to this welfare scheme and credit the contribution to the Employee's Pension Fund.

If you have not yet opted for pension Scheme

You cannot be a Pension Scheme Member if:

1. You settled your EPF Account before 16.11.1995
2. You were not a member of Old Family Pension Scheme-1971

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You can be a Pension Scheme Member if:

You were a member of the Old Family Pension Scheme-1971.

Four Situations when Pension can be applied for

1. On Superannuation • Age 58 years or more and • At least ten years of service	The member can continue in service while receiving this pension. On attaining 58 years of age, an EPF member ceases to be a member of EPS automatically
2. Before Superannuation/Early Pension • Age between 50 and 58 years and • At least ten years of service	The member should not be in service Retires or otherwise ceases to be in the employment before attaining the age of 58 years To draw an early pension from a date earlier than 58 years of age but not earlier than 50 years of age, the amount of pension shall be reduced at the rate of 4% for every year the age falls short of 58 years.
3. Death of the Member	Death while in service or Death while not in service
4. Permanent Disability	Permanently and unfit for the employment which the member was doing at the time of such disablement.

Calculation of Pension

A. Those who joined after 15/11/1995.

$$\text{Monthly member's pension} = \frac{\text{Pensionable salary} \times \text{Pensionable service}}{70}$$

The maximum service for the calculation of service is 35 years. Average salary means pensionable salary; it is calculated by considering the average contributing salary preceding 12 months from the date of exit. A company can maximum contribute Rs. 1250/- for any employee in this scheme, as it is restricted up to 8.33% on Rs. 15,000/- p.m. salary.

B. In the case of the member who superannuates on attaining the age of 58 years, and/or who has rendered at least 20 years of pensionable service:

$$\text{Monthly Pension} = \frac{\text{Pensionable Salary} \times (\text{Pensionable Service} + 2)}{70}$$

C. Those who joined before 15/11/1995 regarding age as on 16/11/1995.

For these employees are divided into three categories:

X: Those who have not attained 48 years

Y: Those who have attained 48 years but less than 53 years

Z: Those who have attained 53 years or more.

Formula for Calculation

Past service benefit + Pensionable service benefit- proportionate reduction subjectto minimum pension specified for each group. (X = Rs. 800, Y = Rs. 600, and Z = Rs. 500)

Note: The maximum pensionable salary shall be limited to rupees fifteen thousand per month: provided that if at the option of the employer and employee, the contribution paid on salary exceeding rupees fifteen thousand per month from the date of commencement of this Scheme or the date salary exceeds rupees fifteen thousand whichever is later and 8.33 percent share of the employers

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thereof is remitted into the Pension Fund, pensionable salary shall be based on such higher salary.

If no wages are earned for a certain period, that period is to be deducted from the services (as there will be no contribution to the pension fund).

Two pension capitalizing options are available:

1. Commutation: One can opt for commutation of pension on completion of 3 years from the commencement of this scheme Maximum percentage of commutation is 33.33%. In this case, the pension will be reduced by 33.33% and you get 100 times the monthly pension so commuted as the commuted value of the pension.

2. Return of Capital: A member eligible to a pension may opt to draw reduced pension and avail some return of capital under any one of the three alternatives given below:

Alternatives Available to avail Return of Capital

S.no.	Alternatives	Revised Pension Payable	Annual Payable as Return of Capital
1.	Revised pension during the lifetime of the member with the return of capital on his death	90% of the original monthly pension	100 times the original monthly pension on death of a member to the nominee
2.	Revised pension during the lifetime of the member, further reduced pension during the lifetime of a widow or her remarriage whichever is earlier and return of capital on widows death/ remarriage	90% of the original monthly pension to the member. On his death 80% of the original monthly pension to the widow.	90 times the original monthly pension on death of widow/remarriage to the nominee
3.	Pension for a fixed period of 20 years notwithstanding whether the member lives for that period or not.	87.5% of the original monthly pension for a fixed period of 20 years. The pension will cease there-after	100 times the original monthly pension at the end of 20 years from the date of commencement of pension to the member if he is alive, other-wise to his nominee.

Concept of EDLI

Introducing the Employees' Provident Fund Act in Parliament in 1952, the then Labor Minister Jagjivan Ram had said: "What we need is a pension scheme, but because we don't have the resources (for it), for the time being, we are putting in a provident fund system.

The pension scheme which Jagjivan Ram talked about was finally launched in 1971 as the Family Pension Scheme. Yet, neither the provident fund nor the pension scheme dealt adequately with the problems arising from the early death of an employee. So, in 1976, the EPF Act was amended to introduce a scheme that would provide insurance cover to employees without them having to pay any premium. And the Employees' Deposit Linked Insurance (EDLI) scheme came into effect from 1 August 1976. But even today, the scheme is far from providing the cover it was originally meant to provide.

As the name suggests, the cover paid to an employee's survivors is linked to the balance in the employee's PF account. Currently, survivors get the average PF balance of the previous 12 months or that for the entire membership period, whichever is lesser. Now, the average balance during the

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entire membership period is usually lesser than the last 12 months' balance, unless a member has withdrawn the account in the previous year.

Concepts like Eligibility, Contributions, and Benefits of EDLI

Eligibility: Employees Deposit Linked Insurance Scheme applies to all establishments covered under the Employees Provident Fund and Miscellaneous Provisions Act, 1952. It provides an automatic life insurance term cover to all members of the Employees Provident Fund Scheme. This scheme provides for an insurance cover to an employee linked to his average balance in the provident fund account over the last 12 months before death, so the cover is variable. This scheme does not apply to tea factories in the state of Assam. A nominee or legal heir of an active member of EPFO gets a lump sum payment of up to Rs. 6 Lakhs in case of the death of the member during the service period.

Contributions: Employees do not have to pay anything towards this scheme.

Contribution @ 0.5 % of the salaries per month is paid by the employer. Salary exceeding Rs. 15000/- is not accounted for. The maximum contribution is Rs. 75/- (Rs. 15000´0.50%). Administrative costs @ 0.01 % (0.01 paisa per Rs. 100/-) of the wage bill up to Rs. 15000/- (0.5 paise) per employee per month is also paid by the employer. A minimum amount of Rs. 2/- have to be deposited by the employer even if the employee base is less than four.

Salary = Basic Wage + D.A. + Retaining Allowance + Cash Value of Food Concessions.

Benefits: It is a life insurance term cover so long as the employee is a member of the EPF. So the employee does not get to enjoy the cash or maturity benefit. The benefit will be paid to the person whom an individual nominated to receive his/her provident fund. The insurance cover is variable. The amount of insurance cover depends on the average balance in PF over the last 12 months before death.

Salient Features of EDLI

The insurance benefits can be availed by the family members, legal heirs, or nominees of the member.

Members of EPFO are automatically enrolled for EDLI.

An EPFO member is only covered by the EDLI scheme as long as he/she is an active member of the EPF. His family/heirs/nominees cannot claim it after he leaves service with an EPF registered company.

There is no minimum service period for availing EDLI benefits

The employer has to contribute EDLI and no fee can be deducted from the employee's salary

The claim amount under ELDI is 30 times the average monthly salary in the past 12 months subject to a maximum of 6 lakh (4.5 lakh basic + 1.5 lakh bonus).

The average monthly salary is calculated as the Basic + Dearness Allowance of the employee

A bonus of Rs. 1.5 Lakhs is also applicable under this scheme

The employer can opt-out of the scheme in case he takes a higher paying life insurance scheme for employees under Section 17 (2A)

EDLI Calculation:

The insurance amount that the heirs of a deceased member get is calculated as 30 times the average monthly salary in the last 12 months of employment.

The maximum average monthly salary of an employee is capped at Rs. 15,000

So, 30 times the salary comes to be around to be 30 x Rs. 15,000 = Rs. 4,50,000

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A bonus amount of up to Rs. 1,50,000 is also paid to the claimant under this scheme

Thus, the total amount payable under this scheme to the beneficiary is Rs. 6,00,000

Summarized Format of Contributions

Scheme	Employee's Contribution	Employer's Contribution	Central Government's Contribution	Administrative Costs (Contributed by Employer)
PF	12%	03.67%	0.00%	1.10%
EPS	0%	08.33%	1.16%	0.00%
EDLI	0%	00.50%	0.00%	0.01%
Total	12%	12.50%	1.16%	1.11%

It may be noted that an employer may be exempted from consulting to this scheme if he/she has provided for better insurance benefits through an alternative scheme.

NATIONAL PENSION SYSTEM

The National Pension System is a social security initiative by the Central Government. This pension program is open to employees from the public, private, and even the unorganized sectors except those from the armed forces. The scheme encourages people to invest in a pension account at regular intervals during their employment. After retirement, the subscribers can take out a certain percentage of the corpus. As an NPS account holder, you will receive the remaining amount as monthly pensions post your retirement.

Earlier, the NPS scheme covered only the Central Government employees. Now, however, the PFRDA has made it open to all Indian citizens voluntarily. NPS scheme holds immense value for anyone who works in the private sector and requires a regular pension after retirement. The scheme is portable across jobs and locations, with tax benefits under Section 80C and Section 80CCD

Types of NPS Account

The two primary account types under the NPS are tier I and tier II. The former is the default account while the latter is a voluntary addition. The table below explains the two account types in detail.

Particulars	NPS Tier-I Account	NPS Tier-II Account
Status	Default	Voluntary
Withdrawals	Not permitted	Permitted
Tax exemption	Up to Rs 2 lakh p.a.(Under 80C and 80CCD)	None
Minimum NPS contribution	Rs 500 or Rs 1,000 p.a.	Rs 250
Maximum NPS contribution	No limit	No limit

Atal Pension Yojana

1. Atal Pension Yojana (APY) is open to all bank account holders. The Central Government would also co-contribute 50% of the total contribution or Rs. 1000 per annum, whichever is lower, to each eligible subscriber, for 5 years, i.e., from Financial Year 2015-16 to 2019-20, who join the APY before 31st December 2015, and who are not members of any statutory social security scheme and who are not income taxpayers. Therefore, APY will be focussed on all citizens in the unorganized sector.
2. Under APY, the monthly pension would be available to the subscriber, and after him to his spouse and after their death, the pension corpus, as accumulated at age 60 of the subscriber, would be returned to the nominee of the subscriber.

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3. Under the APY, the subscribers would receive the fixed minimum pension of Rs. 1000 per month, Rs. 2000 per month, Rs. 3000 per month, Rs. 4000 per month, Rs. 5000 per month, at the age of 60 years, depending on their contributions, which itself would be based on the age of joining the APY. Therefore, the benefit of minimum pension would be guaranteed by the Government. However, if higher investment returns are received on the contributions of subscribers of APY, the higher pension would be paid to the subscribers.

4. A subscriber joining the scheme of Rs. 1,000 monthly pension at the age of 18 years would be required to contribute Rs. 42 per month. However, if he joins at age 40, he has to contribute Rs. 291 per month. Similarly, a subscriber joining the scheme of Rs. 5,000 monthly pension at the age of 18 years would be required to contribute Rs. 210 per month. However, if he joins at age 40, he has to contribute Rs. 1,454 per month.

   Therefore, it is better to join early in the Scheme. The contribution levels, the age of entry, and the pension amounts are available in a table given in frequently asked questions (FAQs) on APY, which is available on www.jansuraksha.gov.in.

5. The minimum age of joining APY is 18 years and the maximum age is 40 years. Therefore, the minimum period of contribution by any subscriber under APY would be 20 years or more.

Pradhan Mantri Shram Yogi Mandhan Pension Yojana (PMSYM)

PMSYM for Unorganized Workers

People working in the government and organized sectors don't have to worry about financial security once they retire. But the same is not true for the laborers, who work in the unorganized sector. The central government has come out with a scheme that offers such individuals with a regular pension after they attain a certain age. Pradhan Mantri Shram Yogi Mandhan is primarily a pension scheme for the labors, associated in the unorganized sector

Key features of the Pradhan Mantri Shram Yogi Mandhan Yojana:

1. Financial Security – The primary objective of the scheme is to offer financial security to the people with no economic backup facilities.
2. Pension Scheme for Applicants – Under this scheme, people working in the unorganized will be able to open their pension accounts and deposit money regularly.
3. Monthly Pension Amount – Once the scheme matures, the person will be entitled to attain a monthly pension of Rs. 3000 without fail. It will help the pension holders to meet the financial requirements without any issues.
4. Amount to be paid by the individual – The scheme highlights that the interested candidates will have to deposit a certain amount in the pension account. Applicants, who join the scheme at the age of 18 years, will have to make monthly contributions of Rs. 55 till they attain the age of 60 years.
5. Government's Contribution – Along with the amount given by the worker in the pension chart, an equal amount will be contributed by the central government. The pension amount will be given after they reach the age of 60.
6. Total Beneficiary – The central government estimate suggests that the successful implementation of this mega pension scheme will offer financial support to around 10 crore individuals, who earn their livelihood from the unorganized sector.
7. Age Limit for Contribution – The scheme highlights that any interested applicant, who has attained the age of 18 years will be able to deposit money in the scheme till 40 years.
8. Pension Available from – Once the applicants reaches the age of 60 years; he/she will be able to

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reap the benefits of the scheme. Each month, a fixed pension amount will be deposited in the pension account of the individuals.

9. Budgetary Allocations – The minister also highlighted that the central government has already set aside a mammoth amount of Rs. 500 crore for the implementation of this scheme.

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