

Compulsory Gratuity Benefit Insurance & Approved Gratuity Trust Formation Process

An Article on requirement of Compulsory Insurance for Gratuity Benefits and Process of Formation of Approved Gratuity Trust

Gratuity being an important retirement benefit to employees in the Indian context, is relevant for all organizations (i.e. MNC's, Schools and Other business entities) having more than 10 employees . Since an employee sacrifices prime time of his life for the development, prosperity and betterment of his employer, employer pays his employee gratuity as a graciousness or gift to him, when he no longer serves him.

Gratuity Benefit falls in the category of "Defined Benefits" & amount of Gratuity payable to an employee on his exit from service, according to " **Payment of Gratuity Act 1972**", in force at present, is :-

$(\text{Wages of the employee at the time of exit}) \times (15/26) \times (\text{Number of Years of Service at the time of exit})$

This is subject to a ceiling limit of 20,00,000/-.

Gratuity is payable to an employee on exit from service after he has rendered continuous service for not less than five years:

- (a) On his superannuation
- (b) On his resignation
- (c) On his death or disablement due to employment injury or disease.

In case of (c) vesting condition of 5 years does not apply.

Gratuity is a statutory right of employee whoever completes 5 years in the same organization and the cost of Gratuity is to be borne by the Organization and not by an employee. Gratuity is a defined benefit nature and it Increases with the increase/changes in following:-

- (a) Past Service of Employee,
- (b) Increase in wages of Employee,
- (c) Change in Benefit Formula of the Gratuity Benefit due to the amendment in Act,
- (d) Change in Ceiling Limit on Gratuity Benefits due to the amendment in the Act &
- (e) Change in Vesting Condition for eligibility of Gratuity Benefits due to the amendment in the Act.
- (f) Change in applicability of compulsory insurance for Gratuity by State Governments due amendment in the act.

(State of Andhra Pradesh notified about the compulsory insurance for Gratuity under **Andhra Pradesh Compulsory Gratuity Insurance Rules, 2011** vide Lr.No. M1/8842/2010, dated: 04.12.2010 from the Commissioner of Labour, Andhra Pradesh and remains un-notified for rest of India).

Applicability of compulsory insurance for Gratuity can be notified by the other State Governments because compulsory insurance of gratuity secures the gratuity benefits of employee even in case of bankruptcy of the company.

For the purpose of Accounting of gratuity benefits, Companies makes provision of Gratuity on accrual basis in their balance sheet to comply with the requirement of Accounting Standards issued by the Institute of Chartered Accountants of India. Compliance of these standards (i.e. AS 15 Revised 2005 and IndAS 19) is mandatory in nature. Generally services of an Actuary is taken for preparation of actuarial report under Gratuity Plan for compliance of AS 15 Revised 2005 and Ind AS 19 by the company's annual basis at the end of each financial year.

Gratuity provision made in the balance sheet only suffice the requirement for compliance of Accounting Standard 15 (Revised 2005) but it is not allowed as **deduction (Refer Section 47A (7) of Income Tax Act 1961)**

For achieving the tax benefits under **Section 36(1)(v)** for contribution of gratuity equivalent to gratuity provision in the balance sheet based on actuarial report (**Refer Circular : No. 30(XLVII-18), dated 30-11-1964 for clarification for Rule 103 for Initial Contribution of Income Tax Rules 1962**), companies requires to create an Approved Gratuity Trust in terms of Part C of The Fourth Schedule of Income Tax Act, 1961

Section 36(1)(v) of Income Tax Act, 1961 reads as under :-

“any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust”

An approved gratuity trust investment is either “Self Managed by the Trustee” or “Managed by the Insurance Company”.

A brief about the Steps involved in Formation of Trust for Gratuity Fund. The different steps for Formation of Retirement Benefit Trust are as under :-

1. Assessment of Gratuity Liability – The process of formation of Gratuity Fund starts with assessment of gratuity liability on actuarial basis by taking as actuarial valuation certificate from An Actuary. Inputs for Actuarial Valuation is prepared by the HR Department of the Organization. It normally takes 2 to 3 days to complete this exercise.

2. Board Resolution for an Approved Gratuity Trust – Once the actuarial valuation certificate for accrued liability of gratuity is received from the Actuary. Management or Society of Organization with consultation of Gratuity Trust Fund Consultant can decide the Corpus of Investment into the Gratuity Fund of an Approved Gratuity Trust & A board resolution is passed by the Management of the Organization to form a Irrevocable Trust for Gratuity Fund.

3. Registration of Trust Deed – Indian Trusts Act, 1882 regulates and administers the private trusts in India, whereas the Public Trusts Direct the functioning of the public trusts except in the state of Maharashtra and Gujarat where public trusts are governed by Bombay Public Trust Act, 1950 :-

I. Trust Deed/Trust Rules is executed on a Non Judicial Stamp Paper.

II. Next Step is to Seek an appointment with the Sub Registrar office having jurisdiction based on the registered office of the Trust, and the Government Registration fee is to paid after that.

III. On appointment Date the Trust Deed is presented before the sub registrar where all trustees need to be present along with 2 witnesses

IV. The registration process is undertaken by the office of the sub-registrar, and the registered deed can be collected after a week.

V. Once the Registered Deed is received then apply for PAN & TAN of the Trust and open a Bank Account in a Scheduled Bank as listed in for the Trust. It may take 30 Days.

VI. Once the Bank Account in a Scheduled Bank is opened then Organization Transfer the funds into Trust Bank Account.

4. Investment Decision – Once the Gratuity Fund is received from the organization into the Trust then the next step for the Trustees is to make decision for Investment of Gratuity Fund either by themselves or they can approach Insurance Company.

5. Application for Approval of Gratuity Trust – Once the Investment is done then organization needs to submit an application to their Zone Income Tax Commissioner for Approval of Gratuity Trust with a Copy of Trust Deed/Trust Rules, Investment details and other relevant documents.

The establishment of Gratuity Trust requires in-depth knowledge of various rules/regulations and expertise. We have a team-leading Professionals, Litigation Partners, Chartered Accountants, Company Secretaries & Heads of Insurance Companies having decades of experience in providing their services to our clients spread in all sectors of the Indian Economy, in the Public & Private Sectors which covers areas of Manufacturing, Software, Technology, Electricity, Electronics, Call Centers, Banks, Educational Institutes, Schools, Universities, Hotels, Hospitals, Hospitality Companies, etc. etc.

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