

Analysis of PAYMENT OF GRATUITY ACT 1972

- FMSF Research Team

1. INTRODUCTION:

Gratuity is an important form of social security benefit. It is a lump-sum payment made by an employer as a mark of appreciation for the services rendered by his employee. Gratuity is a defined benefit plan and is one of the many retirement benefits offered by the employer to the employee upon leaving his job. It is payable at the end of the employment (by way of retirement, death, termination or resignation). The law which governs Gratuity in India is the Payment of Gratuity Act, 1972.

2. APPLICABILITY:

The Gratuity Act applies to the following categories:

- Every factory, mine, oil plantation, port and Railway Company
- Every shop or establishment – if it employs 10 or more persons in the preceding 1 year.
- To any other establishment – employing 10 or more persons, in which ten or more persons are employed, or were employed, on any day of the

preceding twelve months. In addition, once this Act is applied to a shop or establishment it shall continue to be governed by this Act even if the number of persons employed gets reduced at a later date.

Gratuity is a terminal benefit payable to an employee after continuous service of *not less than 5 years*. There are three types of condition when it is payable:

- Superannuation
- Retirement or resignation
- Death due to accident or disease (5 years continuous service is not required for this).

Earlier the terminal benefit was considered as ex-gratia but now the Central Government made it obligatory on the employer by the Payment of Gratuity Act, 1972.

3. EMPLOYEES NOT ENTITLED TO GRATUITY:

Under following circumstances employees are not entitled to gratuity

- If an employee is dismissed because of willfully or negligently causing damage to,

loss of or destruction of property belonging to the employer, then his/ her gratuity will be forfeited to the extent of the damage or loss so caused.

- If an employee is dismissed for any act of moral turpitude committed in the course of his/ her employment, then the gratuity shall be wholly forfeited.
- If an employee is dismissed for riotous or disorderly conduct or violence, then his/ her gratuity shall be wholly forfeited.

4. METHODS OF FUNDING FOR GRATUITY:

There are two methods in which funding for gratuity can be done-

4.1 Funding by employer

- In this method the employer has to estimate the gratuity liability and set apart a sum every year towards gratuity.
- This fund shall be designated as a Gratuity Fund and be invested specifically for this purpose.
- As and when the gratuity is payable, the investment is en-cashed and paid to the employee.

4.2 Constitution of an Irrevocable Gratuity Trust

Employer has option to fund the liabilities for payment of gratuity by setting up an irrevocable Trust and making contributions to the Trust Fund. The other option is to purchase a gratuity policy with LIC or any other insurance company. In such case the insurance company creates a irrevocable trust in the name of the organization.

In order to estimate the gratuity liability in a scientific manner there is an

authority called an actuary who will certify the gratuity liability.

Organizations have to provide details like the period of service, salary drawn with its break up, date of birth, etc. Based on these particulars the actuary prepares a report on a scientific basis and provides a certificate. Every year the employer should estimate the gratuity liability and contribute the same into the trust based on an actuary's certificate.

For administering such a trust similar steps as for operation of PF through an employee's "Irrevocable Trust" must be followed like –

- Recognition under the Income Tax Act
- Maintenance of accounts
- Audit
- Filing of returns to the Income Tax Department
- Meeting of Board of Trustees

In case the organization has its own gratuity trust funds, the same can be invested as per the Ministry of Finance notified Pattern of Investment which is to be followed by non Government Provident Funds, Superannuation Funds and Gratuity Funds.

5. PAYMENT OF GRATUITY:

The employer shall arrange to pay the amount of gratuity within thirty days from the date it becomes payable. If not paid within the period stipulated above, the employer is liable to pay interest for the delayed payment. If the delay was caused due to the fault of the employee and the employer has obtained permission in writing from the controlling authority for the delayed payment, on this ground the interest is not payable.

Instruments	% of Investment
i. Central Government securities and/or units of such mutual funds set up as dedicated funds for investment in Government securities and regulated by SEBI; ii. (a) Government securities created and issued by any State Government; and/or units of mutual funds set up as dedicated funds for investment in Government securities and regulated by the SEBI/or (b) Any other negotiable securities the principal whereof and interest whereon is fully and unconditionally guaranteed by the Central Government or any State Government or multilateral funding agencies(World Bank, ADB) (c) The Trustees, subject to their assessment of the risk-return prospects, may, if they so decide, divide the total portfolio under categories (i) and (ii)(a) above into tradable and non tradable categories. At least 25% of the total portfolio at the end of the preceding financial year can be treated as tradable and may be used for active management:	35%
iii. (a) Bonds/Securities of 'Public Financial Institutions' "public sector companies" including public sector banks; and/or (b) Term Deposit Receipts up to three years issued by public/private banks. (c) Collateral Borrowing and Lending Obligation (CBLO) issued by Clearing Corporation of India Limited and approved by the Reserve Bank of India. (d) Schemes of Mutual Funds primarily investing in money market instruments, regulated by SEBI. (e) Rupee Bonds issued by Multilateral agencies (World Bank, ADB)	25%
iv. To be invested in any of the above five categories as decided by their Trustees.	30%
v. Shares of companies that have an investment grade debt rating from at least one credit rating agency/ Shares of companies figuring in BSE Sensex and /or NSE NIFTY 50 and / or in equity linked schemes of mutual funds regulated by SEBI.	Upto 10%

while in service and the right to receive on death. An employee may in his nomination, distribute the amount of gratuity payable to him, under this Act amongst more than one nominee.

If an employee has a family at the time of nomination, the nomination shall be made in favor of one or more members of his family, and any nomination made by such employee in favor of a person who is not a member of his

6. RATE OF GRATUITY:

For every completed year of service or part thereof in excess of six months, the employer shall pay gratuity to an employee at the rate of fifteen days' wages based on the rate of wages last drawn by the employee concerned. Fifteen days wages is calculated by dividing the monthly rate of wages by twenty six.

Gratuity = Monthly rate of wage last drawn X 15

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7. MAXIMUM LIMIT ON GRATUITY:

The amount of gratuity payable to an employee shall not exceed ten lakhs rupees (Rs.10, 00,000). However, the employer can also structure a gratuity benefit that is higher than statutory requirements in the form of an award, agreement or contract.

8. NOMINATION:

The employee, who is entitled to the gratuity, has to make a nomination conferring on one or more persons the right to receive the gratuity in the event of death

family, shall be void.

If at the time of making a nomination the employee has no family, the nomination may be made in favor of any person but if the employee subsequently acquires a family (Form 'G'), such nomination shall become invalid.

A nomination may, be modified by an employee at any time, after giving to his employer a written notice in such form and in such manner as may be prescribed, of his intention to do so. Form 'H'

Every nomination, fresh nomination or alteration of nomination, as the case may be, shall be sent by the employee to his employer, who shall keep the same in his safe custody.

9. CONCLUSION:

Non-Profit Organizations are encouraged to provide this very important social security benefit to their staff so that there is recognition to the hard work put in by them in the cause of social change.
