HR Law Hotline

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SOCIAL SECURITY IN INDIA - EMPLOYERS SHOULD CONTRIBUTE PROVIDENT FUND ON UNIVERSAL ALLOWANCES

- The Supreme Court of India has ruled that special allowances that form part of wages shall be subject to provident fund contributions
- Allowances that are universally, ordinarily and necessarily paid to employees across the board unless they are specifically excluded by law are to be included for provident fund contributions
- The judgment has analyzed if certain components of overall salary paid by the employer would attract provident fund contributions

This judgement is possibly one of the most keenly awaited and a landmark labour law ruling! The Supreme Court of India ("**SC**") has finally clarified the position (and resolved the confusion!) with respect to provident fund ("**PF**") contributions on employees' wages.

The SC has confirmed that the special allowances are part of basic wages (or dearness allowance, as the case may be) and accordingly should attract PF contributions. By upholding the universality principle laid down in the Bridge and Roof Case (*discussed subsequently*), the SC has concluded that *"the allowances in question were essentially a part of the basic wage camouflaged as part of an allowance so as to avoid deduction and contribution accordingly to the provident fund account of the employees."*

BACKGROUND

The Employees' Provident Funds & Miscellaneous Provisions Act, 1952 ("**EPF Act**") along with the schemes thereunder govern the employers' provident fund (social security) contributions on behalf of their eligible employees. The law is applicable to the establishments employing at least 20 employees. Mandatory contributions need to be made with respect to eligible employees at the rate of 12% of basic wages, dearness allowance and retaining allowance. The employees are required to make an equal and matching contribution. Eligible employees are those who (a) earn basic wages up to INR 15,000 (approx. US$215) per month, (b) continue to hold PF account based on their previous employment, or (c) international workers (as defined in the EPF Act).

"Basic wages" means "*all emoluments which are earned by an employee while on duty or (on leave or on holidays with wages in either case) in accordance with the terms of the contract of employment and which are paid, or payable in cash to* 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 of work done in such employment*** *and*

(iii) any presents made by the employer."

Given that it is a common practice for employers to split the total salary (base salary) into basic salary and allowances from a tax structuring standpoint, the term 'basic wages' for the purposes of PF contributions has been subjected to extensive litigation across the country with varying judgements.

IMPORTANT CASE LAWS - 'BASIC WAGES'

In the past, several cases have come before challenging various components of salary like special allowance, conveyance allowance, canteen allowance, bonus allowance, etc. for the purpose of making PF contributions (besides other labour laws). The issue whether production bonus is part of basic wages was brought before the SC in year 1962 in the case of *Bridge & Roof Co. (India) Ltd. v. Union of India*[1] ("**Bridge and Roof Case**"). Since the component of production bonus was incentive wage eligible to be paid to employees for producing beyond the normal standards and was not payable to all employees of concern, the court held that it cannot be part of basic wages. Basis this legal position, the SC reiterated in the case of *Manipal Academy of Higher Education v. Provident Fund Commissioner,*[2] ("**Manipal Academy Case**") the principle of universality, stating that *"(a)where the wage is universally, necessarily and ordinarily paid to all, across the board such emoluments are basic wages; (b)where the payment is available to be specially paid to those who avail of the opportunity is not basic wages; and (c)conversely, any payment by way of special incentive or work is not basic wages."*

Long after the above judgment, another issue came before the Madhya Pradesh High Court to determine whether special allowances like lunch allowance, conveyance allowance, etc. would attract PF contributions. In the case

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of *Surya Roshni Ltd. v. Employees' Provident Fund and Anr.*,[3] ("**Surya Roshni Case**"), the petitioner was deducting provident fund contributions on basic wages and variable dearness allowance. However, the employees' salary included other components like house rent allowance ("**HRA**"), attendance incentive, special allowance, lunch incentive, canteen allowance, and conveyance allowance. The petitioner admitted that conveyance allowance (like other allowances) was paid to all the employees, however, it was not the same with respect to lunch allowance, which was paid to only those employees who volunteered to work for the extra time during lunch so that the production does not stop. Therefore, the court relied upon the SC's ruling in the matter of Manipal Academy Case to hold that lunch allowance is not to be included within basic wages, but the other allowances form part of basic wages. Aggrieved by the ruling of the Madhya Pradesh High Court, the petitioner (Surya Roshni) appealed before the SC in 2013.

CIRCULAR CLARIFYING THE POSITION OF 'BASIC WAGES'

In the interim, the Employees' Provident Fund Organisation ("**EPFO**") clarified by notifying through a circular dated November 20, 2012 that all allowances which are ordinarily, necessarily and uniformly paid to employees are to be considered as basic wages, barring the specific exclusions under the law.[4] However, this notification was criticised by employers and employees, since it was not a settled position of law. The EPFO notified another circular soon thereafter to put the earlier circular in abeyance until further orders.[5]

THE CURRENT (LANDMARK) JUDGMENT OF THE SC

On February 28, 2019, SC has delivered the judgment in the much awaited Surya Roshni Case which was on appeal since 2013. Along with Surya Roshni Case, certain other cases were clubbed, raising the common question of law on whether the special allowances paid by an establishment to its employees would form part of basic wages and accordingly attract PF contributions.

The SC has held that "*in order that the amount goes beyond the basic wages, it has to be shown that the workman concerned had become eligible to get this extra amount beyond the normal work which he was otherwise required to put in*." It further said that "*the wage structure and the components of salary have been examined on facts, both by the authority and the appellate authority under the [EPF] Act, who have arrived at a factual conclusion that the allowances in question were essentially a part of the basic wage camouflaged as part of an allowance so as to avoid deduction and contribution accordingly to the provident fund account of the employees.*"

As a result of this judgment, special allowance and other similar allowances, which are part of wages shall be considered as basic wages and accordingly attract PF contributions. The petitioners were unable to prove that the allowances are variable or linked to any incentive for production of greater output by an employee, beyond the normal work performed.

Thus, the SC has upheld the universality principle laid down in the Bridge and Roof Case to state that *"only such allowances not payable by all concerns or may not be earned by all employees of the concern, that would stand excluded from deduction."* To that extent, it has categorised various components in question under the other appeals clubbed together on whether they are to be included within 'basic wages' for PF contributions.

The SC also analysed dearness allowance and retaining allowance which, as such are already part of the PF contribution, by virtue of Section 6 of the EPF Act. It also made reference to HRA which as such is not paid universally and hence excluded from the definition of 'basic wages'. Similarly, overtime allowance is not earned by all employees even though it is applicable to employees in all concerns, if eligible. To that extent, only those emoluments earned in accordance with terms of employment would qualify as basic wage and not other discretionary allowances which are not in accordance with the terms of employment. Further, attendance incentive was not paid to employees in terms of the contract of employment nor was it legally enforceable by an employee. Similarly, transport or conveyance allowance and canteen allowance is not paid universally, ordinarily and necessarily to all employees.

ANALYSIS

The SC has finally clarified the legal position on whether an allowance paid to employees as part of total salary, base salary or cost-to-company, would be subjected to PF contributions. As a result, employers may need to review their existing compensation structure and determine any increased PF liabilities for domestic employees as well as their international workers (expats) in India. For domestic employees (including contract labourers), the employer's liability to make PF contributions would not extend beyond the current limit of 12% of Rs. 15,000 (approx. US$ 215) per month (until such time the limit is increased), although this monetary limit does not apply to international workers and hence the risks for that category may be higher.

On a practical note, the PF authorities, who are now armed with this SC decision, are likely to increase their inspections and audits in order to recover the additional PF contributions along with interest and damages for delayed contribution. The action would most likely be retrospective given that the EPF Act does not provide for a limitation period.

Overall, this SC judgement is likely to increase the employees' PF contributions, which in turn would decrease their current take-home pay but eventually increase their retirement savings. For employers, the cost of doing business in India will be higher!

– Archita Mohapatra & Vikram Shroff
You can direct your queries or comments to the authors

[1] AIR 1963 SC 1474
[2] (2008) 5 SCC 428
[3] 2011 (2) MPLJ 601
[4] Available at https://taxguru.in/wp-content/uploads/2012/12/CirQJA_345.pdf
[5] Available at http://asklabourproblem.info/wp-content/uploads/2012/11/EPFO%20Circular%20keeping%20earlier%20circular%20in%20abeyance.pdf

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