



Provident Fund applicability on allowances

Supreme Court Ruling

March 2019

Presenters

Subject matter experts



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Background

Why this discussion

Supreme Court rules allowances in question are subject to PF

Impact on the industry – far reaching and significant

What we propose to cover

- What is basic wages under PF Act
- Judicial history
- Outcome of the ruling
- Impact on the industry

01

Review and revisit positions adopted for course correction

02

Remediation for the past

03

Increased notices from PF authorities

Definition of Basic Wages

Challenges

Definition of Basic Wages as per EPF Act

The term “basic wages” has been defined in clause (b) of section 2 of the Act as below:
...“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 employment and which are paid or payable in cash to him, but does not include:

- the cash value of any food concession;
- 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;
- any presents made by the employer

Section 2(b) read with section 6 of the Provident Fund Act provides that contributions are required to be paid on:

- basic wages
- dearness allowance (including cash value of any food concession)
- retaining allowance.



Lack of clarity on “any other similar allowance” and hence litigative

Issues

The phrase "or any other similar allowance"

- Has not been defined in the PF Act or the Scheme
- Is open to interpretation
- And hence has been the cause of litigation for several years

PF Department Circulars



- The PF authorities issued a circular in November 2012, which inter alia indicated that the term "any other allowance of a similar nature" which is to be excluded for PF computation refers only to an allowance akin to a commission.
- However subsequently this circular has been kept in abeyance indicating lack of clarity on the definition of the term basic wages
- August 2014 - Regional offices were required to inspect establishments where PF contribution has been deducted on 50% or less of total wages.

Supreme Court decisions



- The Apex Court in its earlier rulings has examined the definition of basic wages and laid down principles for interpretation.
- The term special allowance has not been dealt with in the earlier Supreme court rulings.

High Court decisions



- Several High Courts have examined specific allowances individually and provided their decisions basis some reasoning.
- The conclusions were not uniform.
- The question of whether special allowance forms part of pay for the purposes of PF was pending at Supreme Court.

Supreme Court Ruling

Understanding the facts

Issue under consideration by the SC

Understanding the facts

- Should allowances be treated as wages for PF purposes?
- The SC has considered multiple appeals, given the commonality of issues
- Employers were paying various cash allowances but were not including the same for PF wages, which was disputed by the PF authorities.
- A Special Leave Petition was filed before the SC against the decisions of lower Courts to decide what constitutes PF wages.
- The PF department also preferred an appeal where the Calcutta High Court which had given relief to the establishment from applicability of PF on such allowances.
- Decisions covered in the SC ruling
 - RPFCL in the case of Vivekananda Vidya Mandir and others
 - Surya Roshni Ltd
 - U-Flex Ltd
 - Montage Enterprises Pvt Ltd
 - Saint Gobain Glass India Ltd



Understanding the facts

Earlier decisions appealed against

Decision	Issue	Ruling of the High Court which was the subject of SC decision
The RPFC West Bengal v/s Vivekananda Vidyamandir and Others Kolkata High Court	Whether special allowance by way of incentive to teaching and non-teaching staff is covered within the meaning of 'basic wages' for the purpose of calculating provident fund contribution?	Special allowance was not linked to the consumer price index and not in the nature of dearness allowance and hence did not fall within the definition of basic wage. RPFC went on appeal
Surya Roshni Ltd. vs. Employees Provident Fund and others Madhya Pradesh High Court	Whether Transport allowance, HRA, Attendance incentive, Special allowance, Canteen allowance and Lunch allowance paid by the employer is covered under "basic wages" for the purpose of calculating provident fund contribution? The authority conceded that Washing allowance was not liable to PF	These allowances are universally necessarily and ordinarily paid to the employees across the board and hence form part of basic wage. Only where the payment is specially paid to those who avail of the opportunity is not the basic wages. Canteen allowance which is paid to workers who are required to remain on machines during lunch period could not be included in basic wages Rest of the allowances paid by the employer should be included under the 'basic wages'.

Understanding the facts

Earlier decisions appealed against

Decision	Issue	Held
The Management of Saint-Gobain Glass India Limited v/s The RPFC, EPFO Madras High Court	Whether conveyance, educational allowance, food concessions, medical, special holidays, night shift incentives, city compensatory allowances were within the meaning of 'basic wages'?	<ul style="list-style-type: none">• These allowances are universally necessarily and ordinarily paid to the employees and form part of the contract of employment hence should be treated as basic wages
Montage Enterprises Pvt. Ltd. v/s EPF and another Madhya Pradesh High Court	Whether HRA, special allowance, management allowance, and conveyance, were within the meaning of 'basic wages'?	<ul style="list-style-type: none">• These allowances are universally necessarily and ordinarily paid to all employees and form part basic wages
U-Flex Ltd v/s EPF and another	Whether HRA, special allowance, management allowance, and conveyance allowance, were within the meaning of 'basic wages'?	<ul style="list-style-type: none">• These allowances should form part of basic wages.

Industry practice has been to consider Basic Salary as PF wages. Special allowances and other specific allowances were excluded

Supreme Court Ruling

Reliance on earlier decisions

Supreme Court Ruling on PF wages

Basis for conclusions

01

The SC held that the allowances in question are covered under the definition of basic wages for calculation of PF

02

SC ruled that there is no occasion to interfere on the factual conclusion of the Provident Fund authority and hence there is no merit in appeals by the employers. Further, the appeal by the RPFC in the case of Vivekananda Vidya Mandir is allowed.

03

While disposing the Special Leave Petitions, the SC placed reliance on the principles laid down on the same matter under various earlier rulings.

04

It is relevant to understand the earlier rulings and the principles arising from the same, and see how these have been applied in the current ruling.

Supreme Court Ruling

Reliance on earlier decisions

Decision	Issue	Held
Bridge and Roof (SC)	Whether production bonus is to be included as wages for the purpose of computation of PF	<p>The basis for exclusion of certain specified components seems to be “all that is not earned in all concerns, or by all employees of a concern seems to be excluded”.</p> <p>In view of the above and the specific exclusion for bonus, it was held that “production bonus” was not to be included as wages for the purpose of computation of PF.</p>
Manipal Academy (Supreme Court)	Whether payment towards leave encashment would be considered as basic wages for the purpose of computation of PF	<p>Following the decision of the SC in the case of Bridge & Roof, it was held that</p> <ul style="list-style-type: none"> • Where the wage (component) is universally, necessarily and ordinarily paid to all across all levels such emoluments are basic wages. • Where the payment is payable specially for those who avail of the opportunity is not basic wages. • Any payment by way of a special incentive or work is not basic wages. • Payment of leave encashment is contingent upon the claim from the employee and hence does not meet the test of universality.

Supreme Court Ruling

Reliance on earlier decisions

Decision	Issue	Held
<p>Muir Mills Co. Ltd. Vs. Its Workmen</p> <p>(SC ruling in context of Industrial Dispute Act)</p>	<p>Whether the employers have wrongfully reduced the wages of their employees by discontinuing payment of production bonus?</p>	<p>It was held that the production bonus is not part of basic wages</p> <p>Any variable earning which may vary from individual to individual according to their efficiency and diligence will be excluded from the definition of basic wages.</p>
<p>Kichha Sugar Company Limited through General Manager vs. Tarai Chini Mill Majdoor Union, Uttarakhand</p> <p>(SC)</p>	<p>Where the hill development allowance was paid as a percentage of basic wages, whether basic wages should include overtime wages and leave encashment?</p>	<p>The dictionary meaning of basic wages is a rate of pay for a standard work period exclusive of such additional payments as bonuses and overtime.</p> <p>Overtime wages and leave encashment may be available to each employee but may vary from one employee to another. The extra bonus depends upon the extra hour of work done by the employee whereas leave encashment depends upon number of days of leave available to the employee. Hence these will not form part of basic wages</p>
<p>The Daily Partap vs. The Regional Provident Fund Commissioner, Punjab, Haryana, Himachal Pradesh and Union Territory, Chandigarh (SC)</p>	<p>Whether production bonus should form part of basic wages?</p>	<p>Provident Fund Act is a beneficial social welfare legislation and must be interpreted as such. The production bonus was not paid as per a genuine production bonus scheme and hence production bonus will form part of basic wages</p>

Supreme Court Ruling Conclusions

Supreme Court Ruling

Understanding the outcome



Principles laid down for allowances to be excluded

- Allowances which are variable in nature;
- Allowances which are linked to any incentive for production resulting in greater output by an employee; or
- Allowances which are not paid across the board to all employees in a particular category; or
- Allowance which are paid especially to those who avail the opportunity.

Principles varying from the earlier decision

- Including " all employees in a particular category"

Conclusion

- All allowances under question are PF wages
- The salary structure and components of salary were examined on facts by the authorities who have arrived at a conclusion that the allowances in question were essentially a part of the basic wage, camouflaged as part of the allowance to avoid PF contributions.
- There was no material placed on record by the employers to demonstrate the above
- SC relied on the findings of the RPFC
- Appeals by companies dismissed, Appeals by RPFC allowed

Supreme Court Ruling

Analysing the impact

Supreme Court Ruling

Understanding the impact

Contributions being made on basic salary – impact on allowances

Identify the impacted population

Domestic workers - PF wages are lower than statutory wage ceiling i.e. INR 15,000 effective September 2014 and INR 6,500 pm earlier

International Workers effective November 2008 – includes expats, foreign nationals locally hired and OCI card holders.

Revisit past positions for IWs covered by SSA

Contracted employees

Principal employer liable for PF contributions relating to contract employees.

Exposure where employees basic salary < INR 15,000 pm

Companies hiring manpower are not able to pass on interest/damages

To be reviewed for the past. There is no limitation period under the EPF Act.

Domestic workers - Excluded employee



**Domestic worker
Excluded employee**

A domestic employee whose pay at the time he is otherwise entitled to be a member of the fund exceeds INR 15,000 per month (INR 6,500 per month prior to 1 September 2014) may not get impacted due to this ruling where PF wages exceed the statutory wage ceiling under the PF Act.

Reliance in this regard is placed on SC ruling in case of Marathwada Gramin Bank and PF departments internal circular not to force employers to contribute over and above statutory wage ceiling

Domestic workers with wages exceeding the wage ceiling not impacted

Potential Exposure and implications

Remediation for past non-compliance – Employer to bear both employer and employee contributions

Interest @ 12% per annum due on delayed payments and is mandatory in nature
Prescribed rate for levy of damages

Period of default	Damages - % of arrears per annum
Less than 2 months	5%
2 months to 4 months	10%
4 Months to 6 months	15%
6 months and above	25%

Damages to be restricted to amount in default
Trigger of prosecution – low in case of suo moto declarations

Considerations for the industry

Past remediation

- Ballooning liability on account of employer and employee contributions being non-recoverable from employee for the past
- Employee contribution met by employer – tax / gross up implications
- Clock on interest liability continues to tick
- Exposure to damages – limited to amount of default/delay

Course corrections to be adopted

- Realignment of the compensation structure and deposit of PF on correct amount
- Impact on net take home of the employee – additional payment may be made to the employee
- Timing to be aligned with increments?
- Contract employees – push back by principal employer

Considerations for the industry

Wider stakeholder involvement

- Significant impact on employer cash flow / bottom line
- Employee communications on salary impact
- Potential corporate tax implications on retrospective contributions
- Transfer pricing implications – determining cost base?
- Discussions with auditors on provisioning / accounting

Key considerations

- Identify impacted population
- Review salary structure and determine gaps in compliance
- Quantify impact – including interest and potential damages
- Consider past risks and ballooning impact





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