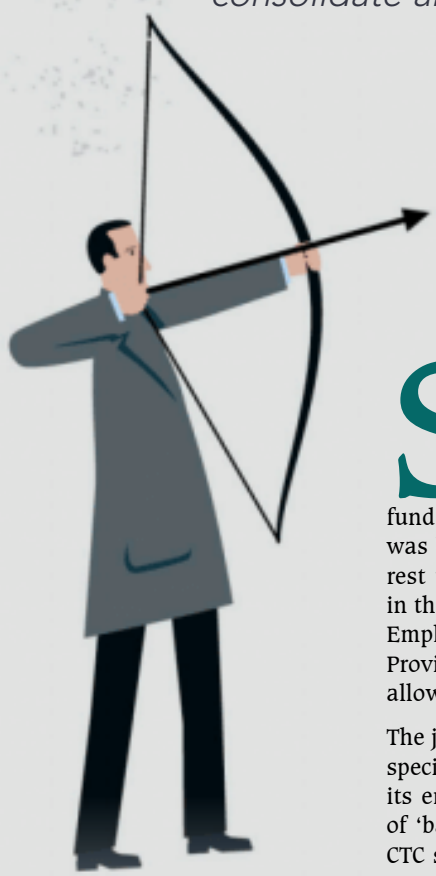
PF JUDGMENT
A MISSED OPPORTUNITY?

As one of the most-awaited judgments of the SC on labor laws, the Court could have gone a step ahead to direct the government to consolidate and redefine wages across various labor laws to make it easier to do business in India



Special allowance is no longer 'special' - at least that is abundantly clear from the recent judgment of the Hon. Supreme Court (SC) of February 28, 2019, in relation to provident fund (PF) contributions. This judgment, which was keenly awaited since 2013, finally lays to rest the prevailing confusion and ambiguities in the interpretation of 'basic wages' under the Employees' Provident Funds & Miscellaneous Provisions Act, 1952 (EPF Act) and on what allowances the employers must contribute PF.

The judgment delves into the question whether special allowance paid by an establishment to its employees would fall within the definition of 'basic wages' under the EPF Act. In several CTC structures, special allowance was nothing more than a balancing figure and was taxed accordingly.

In its judgment, the SC basically reconfirmed the principle of universality in terms of making the determination - as to whether an allowance or salary component forms part of 'basic wages'. This principle may now be applied as the thumb rule, not just for PF contributions but also possibly under other labor laws which contain their own definition of 'wages'. This is in view of the fact that just like the EPF Act, other labor laws are also 'beneficial social welfare legislations'. Luckily, wages can currently be capped at INR 15,000 per month (approx. US$215) for PF contributions, although this limitation does not apply to 'international workers'.

For excluding any allowance from PF contributions, it will remain critical for employers to demonstrate that it has a direct nexus and linkage with extra output and/or a variable amount which is not paid across the board to all employees. For example, an allowance that is being paid by employers over and above the regular work may only be exempted from PF contributions. While there is no restriction on splitting of wages from a CTC or tax structuring standpoint to allow an employee higher take home pay, any subterfuge of wages meant to reduce PF contributions is unlikely to be accepted by the Employees' Provident Fund Organization (EPFO).

In a way, the judgment does not create any new jurisprudence. The SC has basically reiterated its previous position in the case of Bridge and Roof Co. which judgment was delivered way back in 1963. Unfortunately, there continued to remain ambiguities leading to significant litigations across the country. Whether this judgment would put an end to the existing litigation, remains to be seen, since employers have been innovative with their compensation structures.

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Unfortunately, I see this as a missed opportunity for the country. Given that this was one of the most-awaited judgments of the SC on labor laws and has significant implications, the Court could have gone a step ahead to direct the government to consolidate and redefine wages across various labor laws to bring in necessary consistency, at least until the labor laws are consolidated into codes. In a country where we have 44 laws at the federal level and almost 100 laws at the state level governing labor and employment matters, it continues to remain a nightmare for employers to understand and interpret the laws.

As part of the Indian government's continuing focus on ease of doing business and improve our ranking in the annual World Bank survey, it is not enough to only consolidate the labor law forms and compliances. It is time we moved from form over substance and harmonized 'wages' under all the labor laws, since the same principles should apply to other labor laws. Some efforts were made previously in that direction but no result. Hopefully, the proposed labor codes should be taken up by the new government after the elections and that could help eliminate this issue going forward.

In the interim and in light of this judgment, employers may do well to review their salary structures across different employee segments and determine their correct PF liability. It is hoped by the industry that the EPFO applies the judgment only prospectively, given that the EPF Act does not contain a limitation period. Any retrospective implementation of the judgment will lead to significant legal and practical challenges for employers, especially in cases where there are no UAN, employees have left the organization, trying to deduct from subsequent salary of employees, etc., besides proving to be costly given the extent of interest and damages that can be levied by the EPFO.

A review petition has already been filed in the SC on the judgment. Additionally, there have been certain representations to the EPFO to consider March 1, 2019 as the effective date to implement the decision, which date also coincides with the beginning of the new year for the EPFO. May be there was a reason why the SC announced the judgment on 28th February!