PF JUDGMENT: 5 IMPORTANT LESSONS

The keenly awaited SC judgment should lay to rest the prevailing confusion and ambiguity in the industry while interpreting basic wages…

Vikram Shroff
Leader - HR Law
Nishith Desai Associates

In the recent provident fund (PF) judgment, the Hon. Supreme Court (SC) upheld the test of 'universality'. However, that did not seem to create any new jurisprudence - it basically and correctly reiterated the position taken in some of the previous case laws on this issue, including as far back as 1963.

Hopefully, the PF judgment, which was keenly awaited, should lay to rest the prevailing confusion and ambiguity in the industry while interpreting basic wages. It should now be abundantly clear as to salary components on which employers need to contribute PF. Unfortunately, there were higher expectations, given the potential impact an adverse decision would have had on all industry sectors covering a majority of India's working population.

Analyzing the PF judgment has in a way helped all of us learn several important lessons, some of which are indicated below:

a. Lesson # 1: The EPF Act is a beneficial social welfare legislation.

While it may seem obvious, the very fact that the SC makes a mention of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 (EPF Act) being a beneficial social welfare legislation and that it must be interpreted as such, serves as a reminder for us. This reference is often and unfortunately overlooked while interpreting some of the labor laws, as a result of which, employers end up taking decisions that may be disadvantageous to employees, especially in relation to matters concerning their salary, benefits and social security.

It is expected that more judgments will follow where the overall object of providing legitimate statutory benefits to the employees will be applied by various courts.

b. Lesson # 2: Basic wages = all cash emoluments except the exclusions.

The EPF Act is the only labour law that contains a specific definition of 'basic wages'. Based on the PF judgment, it is reconfirmed that basic wages of an employee are indeed "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 him." To that extent, employers must bear in mind that in general, only those allowances which are specifically excluded from the definition of basic wages, such as house-rent allowance, overtime allowance, bonus and commission, may not be subjected to PF contributions.

What constitutes 'basic wages' is not only a question of law but also a question of facts. As such, it is the substantive nature and not only the form or description

of the salary component, which is relevant. Allowances that form part of the CTC structure and are universally, necessarily and ordinarily paid to all across the board, must be considered as part of basic wages. Accordingly, whatever is payable in all concerns and earned by all the permanent employees, needs to be considered for the purposes of determining PF contributions.

c. Lesson # 3: There is nothing special about special allowance.

In several CTC structures, 'special allowance' is usually nothing but a balancing or residual figure. Once a certain percentage of basic salary is determined and the rest of the allowances are calculated, the remaining amount is referred to as special allowance. Some employers use broader terminologies such as flexi-allowance, flexi-benefit, basket of allowances, etc. all of which should continue to have similar considerations.

The PF judgment should lay to rest the prevailing confusion and ambiguity in the industry while interpreting basic wages

For any payment or allowance to be truly special and be excluded for the purposes of attracting PF contributions:

a. The payment should be specifically made to those employees who avail of an opportunity.

b. The payment should be made as a special incentive for work.

c. The payment must be based upon certain contingencies or uncertainties.

d. Lesson # 4: Tax structuring is independent of PF contributions.

Employers have historically and in all good faith provided their employees with the most favorable CTC structure in order to ensure a higher take-home pay. As such, it seems perfectly legal to split salary in a way to help reduce the tax burden in the hands of the employees. The SC decision once again enlightens us all that any such tax structuring is independent of and unconnected with, statutory benefits that employees are entitled to under applicable labor laws.

To that extent, the finance team should constantly work with the HR, compensation and benefits experts to ensure that while employees are not subjected to higher tax burden, their benefits including social security, are not compromised.

e. Lesson # 5: Can the PF judgment turn out to be a double-edged sword?

The PF judgment was in relation to five cases that were clubbed together since they all dealt with a common question of law. The judgment arrived at a factual conclusion that the allowances in question were essentially a part of the basic wages camouflaged as part of an allowance so as to avoid deduction and contribution to the PF account of the employees.

The same judgment can also possibly be applied in cases for determining whether an employee is eligible to PF benefits at the time of joining. As per the EPF Act, eligible employees are those who earn up to ₹15,000 per month as their basic wages, dearness allowance, retaining allowance and cash value of any food concession. The rest of the employees who are above this limit at the time of joining are not covered by the EPF Act, unless they continue to hold a PF membership basis their previous employment or they are categorised as international workers. Several employers continue to cover all employees for PF contributions given that it is one of the best savings instruments available to their employees. However, if PF eligibility limits are increased in the future, the stakes may be relatively higher.

The regional PF offices, who are now armed with this SC decision, are likely to increase their inspections and audits in order to recover the shortfall in the PF contributions along with interest and damages for delayed contribution. In cases of subterfuge of splitting of wages by employers to reduce the PF contribution, the EPFO's action could be retrospective given that the EPF Act does not provide for a limitation period.

Given its potential impact, leading industry associations have already stepped up their efforts to request the EPFO to consider March 1, 2019 as the date of implementation of the PF judgment. This may be the right time for the EPFO to clarify its position and consider introducing an amnesty scheme to allow employers to rectify their past non-compliances in good faith and avoid payment of interest and/or damages for the delayed PF contribution.

Disclaimer – The views are personal.