

PF judgement: What should employers do next?

This article lays down some of the proactive steps that employers can consider in light of the PF Judgment and the measures taken by the PF authorities.



It has been over 3 months since the Hon. Supreme Court of India (SC) pronounced its landmark judgment on provident fund (PF) contributions (PF Judgment). It is unfortunate and somewhat ironic that the SC's attempt to finally clarify and put to rest the 'basic wages' conundrum has resulted in considerable confusion and anxiety across all industries. Many employers have been left clueless and are unsure about what actions they need to take basis the PF Judgment.

Soon after the PF Judgment, the Employees' Provident Fund Organization (EPFO) issued a circular on 20 March 2019 advising the PF authorities to utilize the PF Judgment while defending cases and taking necessary action. Adding to the woes of employers, PF Commissioners have started issuing notices to employers making references to the PF Judgment and directing employers to furnish copies of attendance registers and wage registers of employees to determine if there has been any subterfuge of wages. Post-scrutiny of this data, the PF authorities are likely to quantify the liabilities and issue Section 7A notices and initiate proceedings against defaulting employers.

This article lays down some of the proactive steps that employers can consider in light of the PF Judgment and the measures taken by the PF authorities.

Step# 1: Review of CTC structure

The PF Judgment reminds us that allowances that are universally, ordinarily and necessarily paid to employees across the board are to be included for the purposes of determining the PF contributions. Accordingly,

employers should review the cost-to-company (CTC) break-up of their employees and identify the components which need to be included while calculating PF contribution. For instance, employers who were historically excluding special allowance from the ambit of basic wages' should now include it.

Compliance with the ratio involves an analysis of law and fact. Each employer will need to understand the intricacies and nature of each type of allowance mentioned in the CTC break-up to determine whether it should be included as part of 'basic wages'. This step is particularly urgent and important for those employees whose PF contributions are made on wages of less than Rs. 15,000 per month.

Step# 2: Identify your International Workers

The impact of the PF Judgment is perhaps most significant on organizations employing international workers ("IWs"). Unlike domestic employees, there is no cap on the amount of PF contributions which need to be paid by the employer with respect to its IWs, a category introduced in 2008.

IWs are employees holding foreign passports who work for an establishment in India to which the PF Act applies or Indian employees working abroad in a country with which India has signed a reciprocal Social Security Agreement and are eligible to avail benefits under the social security programme of that country. IWs who are from treaty countries or countries which have bilateral comprehensive economic agreement with India and who are contributing to social security in their home jurisdiction, are considered 'excluded employees' and are not required to make PF contributions in India if they hold a Certificate of Coverage from their home country.

Step # 3: Quantify risks from past non-compliances

It should hopefully be clear by now that the PF Judgment has retrospective effect. Given that the law does not stipulate any limitation period, employers will remain exposed to any past non-compliances, unless the EPFO clarifies its position.

In that respect, it must be known that the current contributory wage cap of Rs. 15,000 per month was effective from September 2014 - previously, it was Rs. 6,500 per month. In case of IWs, the liability could start from either November 2008 (when the concept of IWs was introduced prior to which they would be subjected to the wage cap) or from the day on which the IW joined the organization, whichever is later.

As per the PF Scheme, the employer could become liable to pay arrears with respect to both the employer's contributions as well as employee's contributions. In addition, the employer would be liable to pay interest at 12% per annum along with damages of up to 25% per annum (limited to 100% of the shortfall), besides the administrative charges, fines and the potential imprisonment risk.

In situations where the cases are ongoing or notices have been received, employers will need to reconsider their defense strategy in light of the PF Judgement. In other cases and where PF audits have not been closed as yet, employers should work with their finance and payroll consultants to calculate the potential financial liability arising out of historic non-compliance. While most employers prefer to wait and watch, some may wish to be proactive in rectifying past non-compliances, which remains a judgemental call. However, the latter approach does not eliminate the risk of receiving an automated notice from the EPFO to pay the interest as per Section 7Q and/or damages as per Section 14B of the PF Act.

Step #4: Document compensation policies including allowances

One of the most important takeaways from the PF Judgment is the importance of organizational policies that an employer should have in place. In case of the PF Judgement where five cases were clubbed together, a critical observation was made by Hon. Justice Navin Shah that "no material has been placed by the establishments to demonstrate that the allowances in question being paid to its employees were either variable or were linked to any incentive for production resulting in greater output by an employee and that the allowances in question were not paid across the board to all employees in a particular category or were being paid especially to those who avail the opportunity".

In case of any inspection or scrutiny, employers need to be prepared with their justification. Essentially, the employer should be able to justify that the excluded allowances are not universally, necessarily and ordinarily paid to all employees across the board and are only paid to certain employees who avail a particular opportunity and that such payment is made by way of a special incentive to those employees. To the extent the need and purpose of the allowances forming part of CTC components are well documented, it could help provide a defense to employers, not just for the purposes of the PF Act but for the other labour laws as well.

The way forward?

While the EPFO has initiated action for past non-compliances, it would be interesting to see how the courts interpret the doctrine of legitimate expectations in the event of any PF litigation arising out of retrospective effect of the PF Judgment. The doctrine of legitimate expectations is a principle of administrative law which protects individuals from arbitrary actions taken by public authorities. As per this doctrine, an individual may have a reasonable or legitimate expectation of being treated in a certain way by the administrative authorities owing to some consistent practice in the past.

Implementing the PF Judgment prospectively could potentially undermine the government's efforts towards ease of doing business - an agenda that the Modi government will continue to actively focus on during the next five years. The PF Judgment is also likely to impose immense financial burden on the industry, especially start-ups and MSMEs.

A review petition has already been filed by the management of Surya Roshni against the PF Judgment before the Supreme Court and accordingly the matter remains sub-judice. Representations have been made to the EPFO by leading industry bodies for a prospective implementation. Unfortunately, the EPFO has responded to certain representations affirming that the PF Judgment is self-explanatory and needs no further clarification from the EPFO. Given the current state of affairs, the time is ripe for the EPFO to consider introducing an amnesty scheme to allow employers to proactively rectify their past non-compliances, without bearing the burden of paying interest and/or damages. In the past, the EPFO gave opportunity to employers by way of the Employees' Enrolment Campaign, 2017 to rectify non-compliances. Employers who participated in the campaign were also to be granted certain concessions such as waiving employee's share of contribution, restricting damages to nominal amounts, absolving employers from legal actions, etc.

The Draft Labour Code on Social Security and Welfare ("Code") proposes to overhaul the extant social security structure by doing away with the centralized social security system and introducing state-specific social security funds. It also introduces the harmonized definition of "wages" which is different from the definition of "basic wages" as per the PF Judgment. With revised rates of contributions, new rules for computation, new regulatory bodies and wider coverage, the extent of PF contributions will need to be reviewed by employers once the Code is enacted.

Sources:

1. *The Regional Provident Fund Commissioner (II) West Bengal vs. Vivekananda Vidyamandir and Ors* AIR2019SC1240
2. *India has currently executed SSAs with 18 countries.*
3. *India has signed a bilateral comprehensive economic agreement with Singapore.*
4. *Surya Roshni Ltd. was one of the appellants in the PF Judgment.*
5. *These industry bodies include*

Views are personal.

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