

Rödl & Partner

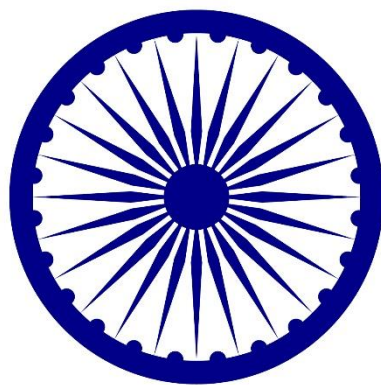
NEWSFLASH INDIA

ADDING VALUE

Issue:
April
2019

Latest news on compliance, tax and business in India

www.roedl.de/indien | www.roedl.com/india



Rödl & Partner

NEWSFLASH INDIA

ADDING VALUE

Issue:
April
2019

Read in this issue:

→ THE HON'BLE SUPREME COURT CLARIFIES THE INCLUSION OF 'SPECIAL ALLOWANCE' FOR CONTRIBUTION UNDER THE EMPLOYEES' PROVIDENT FUND (EPF)

→ THE HON'BLE SUPREME COURT CLARIFIES THE INCLUSION OF 'SPECIAL ALLOWANCE' FOR CONTRIBUTION UNDER THE EMPLOYEES' PROVIDENT FUND (EPF)

The Hon'ble Supreme Court of India on 28th February 2019 while hearing a matter between *'The Regional Provident Fund Commissioner (II) West Bengal v. Vivekananda Vidyamandir and Others'*¹ has clarified its position on 'special allowance' for contribution under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 (EPF Act) and held that special allowance or any allowance which is universally and ordinarily paid by various employers to all the employees without any connection to the quantum of efforts put in by them or the quantum of the output, shall take the form of basic salary/dearness allowance and hence must always be factored in for the purpose of computing contribution towards the Employees' Provident Fund (EPF).

This present judgement arises from several appeals and transferred cases jointly heard and disposed by the Hon'ble Supreme Court, all facing a common question of law "Whether special allowances paid by an establishment to its employees would fall within the expression of 'basic wages' under Section 2(b)(ii) read with Section 6 of the Act for computation of deduction towards the Employees' Provident Fund?"

Key highlights of Supreme Court's decision are as under:

FACTS

In the case of *Regional Provident Fund Commissioner (II) West Bengal v. Vivekananda*

Vidyamandir and Others' an unaided school had been giving 'special allowance' by way of an incentive to their teaching and non-teaching staff pursuant to an agreement between the staff and the management. Wherein such incentive was also reviewed from time to time. The adjudication authority under the EPF Act as per their interpretation held that the special allowance made, was to be included in the basic wages for deduction for making contribution towards the EPF. Accordingly an appeal was brought with the Hon'ble Supreme Court against such decision of the EPF authority clubbed along with other similar matters

WHAT DOES THE LAW SAY

–The EPF Act defines the "basic wage" under Section 2(b)(ii) as all emoluments paid in cash to an employee in accordance with the terms of his contract of employment. The definition of "basic wage" explicitly excludes cash value of food concessions, dearness allowance, house-rent allowance, overtime allowance, bonus, commission, presents made by the employer.

–However section 6 of EPF Act categorically provides that the EPF contribution shall be payable on monthly basis upon basic wages, dearness allowance and retaining allowance (if any) payable to each of the employee wherein each employee is required to contribute at the rate of 12 per cent of basic wages, dearness allowance and retaining allowance (if any). The employers also have to make a matching contribution of 12 per cent as the employee contribution along with 0.5 per cent towards Employee Deposit Linked Insurance Scheme (EDLI), 0.5 per cent as EPF administrative charges.

¹CIVIL APPEAL NO(s). 6221 OF 2011

WHAT WAS HELD BY THE HON'BLE SUPREME COURT

- The Hon'ble Supreme Court by applying the 'universality test' has concluded that those allowances whether titled as 'special allowance' or any other which are universally and ordinarily payable to all the employees without any reference to direct nexus and linkage with the amount of extra output essentially, forms a part of the 'basic salary'. Such additional payments are in fact camouflaged by employers as allowance so as to avoid deduction towards contribution under EPF.
- However, the Hon'ble Supreme Court further clarified that certain allowances are excluded by law for the EPF contribution purpose which are variable or linked to any incentive for production of greater output by an employee. For instance overtime allowance, bonus, commission, transport/conveyance allowance, house rent allowance or other similar allowance which are not necessarily to be found to be paid in all the establishments nor are they necessarily earned by all the employees hence, shall specifically stand excluded from the EPF contributions. Likewise any variable earning which may vary between individual according to their efficiency and diligence will stand excluded from the term "basic wages".
- Therefore under this case the petitioners were unable to prove that the allowances i.e. special allowances paid were variable or linked to any incentive for production of greater output by the employee beyond the normal work performed. Hence accordingly the Supreme Court held that such special allowances to form a part towards basic salary for EPF contribution.
- In addition the present Supreme Court's decision would result in to significant increase with respect to amount of contribution to be deducted from employees' salary resulting in decrease in their salary in hand but at the same time shall increase in the accumulation towards their EPF contribution for the benefit of such employees. Also this will increase the cost of employers as they will have to put in equal contribution towards the EPF. For instance, for an eligible establishment and the employee to whom the EPF Act is applicable, if on a monthly basis employee's basic salary is INR. 10,000/- and he also gets a dearness allowance of INR. 3,000/- and a special allowances of INR. 3,000/-, therefore unlike earlier where the employer/s were making deduction towards EPF only on basic salary and dearness allowance i.e., only INR. 13,000/-, under this case if such special allowance are not justified as per test laid down by the Supreme Court, then such applicable deductions under the EPF would be calculated on a combined sum of basic salary, dearness allowance and special allowance i.e., on INR. 16,000/- per month.
- It is pertinent to note that the increase in the amount for making contribution in case of employees and employers would still be currently limited to 12 per cent of INR. 15,000 per month because of maximum wage ceiling limit. However the risk of higher contribution is seen to be considerable in respect of employees qualifying as the 'International Workers'. This is since maximum wage ceiling limit is not applicable towards the International Workers, hence such International Workers will have to contribute towards the EPF at 12 per cent on full basic salary, dearness allowance, and special allowance (if any) and the employer would also be required to make an equal contribution along with additional administrative costs as applicable. Therefore this is likely to even further increase the expatriate assignment costs for establishments covered under the EPF. Further the Supreme Court in this order was silent with regard to the applicability of such a decision.

IMPLICATIONS

- The present Supreme Court's decision has clarified and put a stop on a common practice undertaken by the employers while preparing salary split into various components of deliberately demonstrating a lesser amount under 'basic wages' and segregating/adding certain additional amounts payable to employees under a category of certain allowances often titled as 'special allowance' or any 'other allowance'. This was generally done with a view to have a lower deduction and contribution towards EPF account.
- The conservative approach in the present Supreme Court's decision is merely a clarification on the current position of law and therefore it is likely to have a retrospective effect which shall have an increased risk of inspection by the EPF authorities to track down non-compliances amongst employers who have

adopted such a practice of knowingly or unknowingly lowering down the basic salary and segregating additional wages under 'special allowance' or in any other name in order to have an advantage of lower deduction and contribution to the EPF. The EPF authorities may also take appropriate actions in order to recover the additional EPF contributions along with interest and damages for such delayed contribution. The present Supreme Court's decision also calls for attention of companies to review the salary structure of their employees and evaluate any increased liabilities towards their employees for making the EPF contribution in order to avoid any penalties/damages in future.

CONTACT FOR FURTHER INFORMATION



Abhisharan Singh
abhisharan.singh@roedl.com



Apoorva Singh
apoorva.singh@roedl.com

Imprint

Rödl & Partner Consulting Pvt Ltd
Lunkad Sky Cruise, Wing-B
Survey No 210/3, Viman Nagar
Pune -411014
T +91 0 2066 2571 00
www.roedl.de | www.roedl.com

Responsible for the content:
Abhisharan Singh
Abhisharan.singh@roedl.com

and

Apoorva Singh
Apoorva.singh@roedl.com

Layout/Type:
Karuna Advani
Karuna.advani@roedl.com

This Newsletter offers non-binding information and is intended for general information purposes only. It is not intended as legal, tax or business administration advice and cannot be relied upon as individual advice. When compiling this News-letter and the information included herein, Rödl & Partner used every endeavor to observe due diligence as best as possible, nevertheless Rödl & Partner cannot be held liable for the correctness, up-to-date content or completeness of the presented information.

The information included herein does not relate to any specific case of an individual or a legal entity, therefore, it is advised that professional advice on individual cases is always sought. Rödl & Partner assumes no responsibility for decisions made by the reader based on this Newsletter. Should you have further questions please contact Rödl & Partner contact persons.