

# India: Supreme Court test to exclude salary allowances when determining PF contributions

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## In brief

In a recent ruling, the Supreme Court of India (SC) laid down principles to exclude a particular allowance/payment from salary for the purpose of calculating Indian social security (PF) contributions. According to this ruling, an allowance/payment may be excluded from salary if it is variable or incentive in nature and is not paid across the board to all employees in a particular category, or is paid specially to those who availed the opportunity.

## In detail

### Facts of various appeals

Several appeals have been filed on a common question of law, i.e., whether the special allowance paid by an establishment to its employees would qualify as salary for purposes of the PF contribution. The brief facts of each appeal are summarized below.

- **Civil Appeal No. 6221 of 2011** (the Regional Provident Fund Commissioner( II), West Bengal vs Vivekananda Vidyamandir and Others). In this case, the respondent school was paying a special allowance as an incentive for teaching and non-teaching staff, per an agreement between the staff and

management. The PF authorities took a view that the special allowance constituted salary for purposes of the PF contribution. The Division Bench held that the special allowance is not linked to the consumer price index. Hence, it is not a dearness allowance to fall within the definition of salary, and is thus not subject to PF contributions.

- **Civil Appeal Nos. 3965-3966 of 2013** (Surya Roshni Ltd. vs Employees Provident Fund and others). The appellant employer company was paying various allowances to employees. While contributing to the PF, the employer excluded

special allowances from salary for this purpose. The PF authorities held that only the washing allowance was to be excluded. The High Court partially allowed the writ petition by excluding the lunch incentive. A review petition against the same also was dismissed.

- **Civil Appeal No 3969–3970 of 2013** (U Flex Ltd. vs Employees Provident Fund and Another). In the case, the appellant employer company was not deducting PF contribution on house rent allowances, special allowances, management allowances, and conveyance allowances.

The PF authorities contended that these allowances had to be taken into account for the purpose of PF contributions. The High Court dismissed the writ and the review petition filed by the appellant company.

- **Civil Appeal No 3967–3968 of 2013** (Montage Enterprises Pvt. Ltd. vs Employees Provident Fund and Another). The facts of this case were similar to the above case, in which the appellant employer company was not deducting PF contributions on house rent allowances, special allowances, management allowances, and conveyance allowances. The PF authorities held that these allowances should form part of the basic wages and accordingly are subject to PF contributions. The High Court dismissed the writ and the review petition filed by the appellant employer company.
- **Transfer case (C) No 19 of 2019** (The Management of Saint Gobain Glass India Ltd. vs The Regional Provident Fund Commissioner). In this case, the appellant employer company got a 'show cause' notice from the PF authorities calling for records maintained to determine if the conveyance allowances, education allowances, food concessions, medical allowances, special holidays, night shift incentives, and city compensatory allowances formed part of the salary for PF contribution purposes. The employer company filed a writ with the High Court, which was dismissed.

### Contentions of the PF authorities

- The special allowance paid was a camouflaged dearness allowance, which is subject to PF contributions. The PF authorities also contended that similar to a dearness allowance, the special allowance was subject to increment contributions on a time-scale basis.
- The Provident Fund and Miscellaneous Provisions Act, 1952 (PF Act) is social welfare legislation intended to protect the less fortunate sections of society and therefore should be interpreted in a manner that seeks to advance the purpose of the legislation.
- By referring to the SC ruling in the case of Bridge and Roof Co. (India) Ltd vs Union of India, the PF authorities contended that whatever is payable by all concerns or earned by all permanent employees had to be included in salary for PF contribution purposes. However, what an employee produces beyond the base standard would not be a salary for PF contribution purposes, but rather a production bonus or incentive payment. Accordingly, it would fall outside the purview of PF contributions.

Based on the above, the authorities contended that the special allowance was a part of the salary breakup payable to all employees; it did not have any nexus with the output produced and should be included in salary for the purpose of PF contributions.

### Contentions of the employers

- Salary subject to PF contributions, as defined under the PF Act, contains few exceptions and should include only those components that are paid ordinarily per the terms of employment. It should not include discretionary allowances that are not pursuant to the employment agreement.
- A transport/conveyance allowance is similar to a house rent allowance, as employees claim reimbursement. Since such payments are not universally, ordinarily, and necessarily paid to all the employees, they should be excluded from the ambit of PF contributions.
- Canteen allowances, being optional and paid only to some employees, should not be included for PF contribution purposes.

### The SC's observations and ruling

Under the PF Act, salary for PF contribution purposes includes all the cash emoluments paid to an employee in accordance with the terms of employment. The SC noted that the crucial test for excluding any payment from salary for PF contributions is universality. In other words, the payment of such special allowance must not be common to all.

Relying on various judgments, the SC laid down the following tests to exclude an allowance/payment from salary for the purpose of PF contributions:

- The allowance/payment should be either variable in nature or linked to any incentive for production resulting in greater output by an employee; and

- The same is not paid across the board to all employees in a particular category or is paid especially to those who avail the opportunity.

The SC also observed that no material demonstrates that the allowances in question were either variable or linked to any incentive, and that the allowances were not paid across the board to all the employees in a particular category.

The salary structure and the components of the salary have been examined, both by the authority and the appellate authority under the PF Act, who have arrived at a factual conclusion that the allowances in questions should be treated as salary for PF contribution purposes (i.e., camouflaged as part of an allowance.) It is not possible in the given case to ascertain whether the extra amount paid has exceeded the normal output prescribed.

Accordingly, the SC ruled in favour of the PF authorities stating that there is no reason for them to interfere with the conclusion of facts.

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### The takeaway

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Although the SC in this judgment did not analyse the individual components of salary for PF contribution purposes, it nevertheless laid down an important test that must be fulfilled for an allowance to be excluded from the definition of salary for PF contribution purposes.

If the salary for PF purposes exceeds Rs. 15000 per month, are the employers required to contribute on this higher amount? This ruling did not address this aspect.

Interestingly, in another SC ruling in the case of Marathwada Gramin Bank, it was held that employers cannot be compelled to contribute beyond their statutory liability. PF authorities did not file the review petition in that case and issued instructions to their field officers in May 2014 that they should not force employers to contribute over and above the statutory salary ceiling (i.e., Rs. 15,000).

In view of this, employers still have the option to contribute PF on the

statutory salary ceiling of Rs. 15,000 per month (statutory obligation) unless they voluntarily agree to contribute PF on a salary higher than Rs. 15,000. If PF authorities expect employers to contribute on the higher salary, they will need to withdraw their earlier instructions, but these can then be applied prospectively only. Nevertheless, in view of the Marathwada Gramin Bank ruling, the issue still may be challenged in a court of law.

For foreign nationals qualifying to be International Workers (IWs), the situation is not the same, as the wage ceiling of Rs. 15,000 is not applicable to them, and they are required to contribute PF on the full salary. Accordingly, by virtue of this ruling, where any allowances are included in the salary for PF contribution, the employer's liability to contribute to the PF will increase, and such IWs also will need to contribute more.

Employers should take note of the above ruling and review the salary structure of their employees, particularly those of IWs, to avoid any default relating to PF compliance.

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## Let's talk

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For a deeper discussion of how this issue might affect your business, please contact your Global Mobility Services engagement team or one of the following professionals from PwC India:

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