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PROVIDENT FUND CONTRIBUTION ON ALLOWANCES

1) EMPLOYER'S OBLIGATION TO PAY STATUTORY CONTRIBUTIONS:

1.1) Employees State Insurance Act, 1948 (ESI Act) & The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (PF Act) are two social security statutes available to employees working in India. The Funds established under the ESI Act & PF Act are contributory in nature. The employer & all eligible employees, in the factories or establishments amenable to the said acts, are required to contribute at the specified percentage of the "Wages"/"Basic Wages" drawn by the employee to the said funds established under the ESI Act/ PF Act.

1.2) An employer is charged with the duty to pay his contribution (referred to as the 'Employer's Contribution') in respect of every covered employee and deduct contribution at a specific rate, from wages payable to the employee (referred to as the 'Employee's Contribution'), and deposit the total amount of contributions with the fund constituted under the respective act, on or before the due date.

1.3) The vexed question as to which are the elements of Salary/Wages included in the term "Wages" under ESI Act (*referred to as 'ESI Wages'*)[1] or expression "Basic Wages" under PF Act (*referred to as 'PF Wages'*)[2].

1.4) Employers have been paying various cash allowances to employees. Allowances were not being considered by Employers as ESI wages or PF wages and consequently not factored for statutory contributions. The employer would justify exclusion, contending that the allowance/s is/are in the nature of bonus or Inam, or are paid to enable the employee to defray expenses entailed on account of his duty and hence, not to be reckoned for computation of contributions. This stand of the employer was disputed by the authorities constituted under the respective statutes. The Authorities would contend that in the garb of a nomenclature of 'special allowance' the employers were evading to pay contributions due under the said Acts.

1.5) This dispute has been subject matter of several decisions rendered by tribunals, established under the said acts, various High Courts and the Supreme Court. However, a clear answer to the question remained elusive.

1.6) The skirmish regarding which elements of salary would come within the amplitude of the word "wages" defined by Section 2 (22) of the ESI Act was nebulous till the Supreme Court interpreted and explained the said term in the case of *Harihar Polyfibres vs The Regional Director, ESI*[3].

1.7) Thirty Five years later the controversy as to what type of allowances paid by employers as emoluments to their employees will come within the scope of the expression *"basic wages"* under PF Act seems to have been finally settled with decision of the Supreme Court in the case of ***The Regional Provident Fund Commissioner (II) West Bengal vs. Vivekananda Vidyamandir & Ors.***[4]

1.8) This post traces the landmark judgements delivered by the Supreme Court conceptually evolving the content of the phrase "basic wages" defined under PF Act.

2) JUDICIAL VERDICT REGARDING "ESI WAGES"

2.1) In the case of *Harihar Polyfibres (Supra)* the issue was whether 'House Rent Allowance', 'Heat, Gas & Dust Allowance' and 'Incentive Allowance' paid by an employer to the employees and 'Night Shift Allowance', paid to those employees who are obliged to work in the night shift, came within the ambit of the expression 'wages', defined by Section 2(22) of the ESI Act.

2.2) Justice O. Chinnappa Reddy, the eminent jurist, delivering the verdict set the tone by a germinal observation inter-alia that:

> "***The Employees State Insurance Act is welfare legislation and the definition of 'wages' is designedly wide. Any ambiguous expression is, or course, bound to receive a beneficent construction at our hands too***."

2.3) The aforesaid profound interpretation of a social beneficial legislation, grounded in Directive Principles ingrained in our Constitution, discloses a coherent vision of constitutional socialism.

2.4) The Learned Judge dissected the three parts of the term 'wages' defined in Section 2(22) of ESI Act as under;

> "***Now, under the definition <u>first,</u> whatever remuneration is paid or payable to an employee under the terms of the contract of the employment, express or implied is wages; thus if remuneration is paid in terms of the original contract of employment or in terms of a settlement arrived at between the employer and the employees which by necessary***

implication becomes part of the contract of employment it is wages: second, whatever payment is made to an employee in respect of any period of authorised leave, lock out, strike which is not illegal or lay-off is wages; and third, other additional remuneration, if any paid at intervals not exceeding two months is also wages; this is unqualified by any requirement that it should be pursuant to any term of the contract of employment, express or implied. However, 'wages' does not include any contribution paid by the employer to any pension fund or provident fund, or under the Act, any travelling allowance or the value of any travelling concession, any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment and any gratuity payable on discharge". (*Emphasis Supplied****).***

With the above simple and lucid analysis of the term 'wages' the Court held that:

"Therefore wages as defined includes remuneration paid or payable under the terms of the contract of employment, express or implied but further extends to other additional remuneration, if any, paid at intervals not exceeding two months, though outside the terms of employment. Thus, remuneration paid under the terms of the contract of the employment (express or implied) or otherwise if paid at intervals not exceeding two months is wages. The interposition of the clause 'and includes any payment to an employee in respect of any period of authorised leave, lock out, strike which is not illegal or lay off' between the first clause, 'all remuneration paid or payable in cash to an employee, if the terms of the contract of employment, express of implied, was fulfilled' and the third clause, 'other additional remuneration, if any, paid at intervals not exceeding two months, 'makes it abundantly clear that while 'remuneration' under the first clause has, to be under a contract of employment, express or implied, 'remuneration' under the third clause need not be under the contract of employment but may be any 'additional remuneration' outside the contract of employment. So, there appears to our mind no reason to exclude 'House Rent Allowance', Night Shift Allowance', Incentive Allowance' and 'Heat, Gas and Dust Allowance' from the definition of 'wages'."

2.5) The Learned Judge took notice of the decisions rendered by the Full Bench of the Andhra Pradesh High Court in E.S.I. Corpn., Hyderabad v. A. P. Paper Mills Ltd[5] and the Full Bench of the Karnataka High Court in N.G.E.F. Bangalore v. Deputy Regional Director, E.S.I.C., Bangalore[6] and the conflicting opinion in the judgment of a learned Single judge of the Calcutta High Court in Bengal Potteries Ltd. v. Regional Director,

W. Bengal Region, Employees, State Insurance Corporation[7] and remarked

> "***We express our respectful agreement with what has been said by the Full Bench of the Andhra Pradesh High Court in the above extracted passage and their dissent from the view expressed by the learned Single Judge of the Calcutta High Court***".

Concurring with the logical interpretation Justice Amarendra Nath Sen reiterated;

> ***"The Employees' State Insurance Act is a piece of social welfare legislation enacted for the benefit of the employees. The Act has to be necessarily so construed as will serve its purpose and objects.***
>
> ***I entirely agree with my learned brother that on a proper interpretation of the term 'wages' the legislative intent is made manifestly clear that the term 'wages' as used in the Act will include House Rent Allowance Night Shift Allowance, Heat, Gas and Dust Allowance and Incentive Allowance. The definition, to my mind, on its plain reading is clear and unambiguous. Even if any ambiguity could have been suggested, the expression must be given a liberal interpretation beneficial to the interests of the employees for whose benefit the Employees State Insurance Act has been passed.***
>
> ***All other aspects including the various decisions of the High Courts on this question have been considered by my learned brother in his judgment. I entirely agree with the views of my learned brother and I have nothing more to add."***

2.6) This clear, cogent and unanimous decision put to rest the controversy as to what constitutes wages for purpose of contribution under the ESI Act.

2.7) It is also worthwhile to note that ESI Corporation on its website[8] has set out various allowances (which are ordinarily paid by employers to workers) which constitutes "wages" under ESI Act or not. This is a commendable step in transparency. This has also gone long way in guiding Employers and has definitely assisted Lawyers & Labour Laws Consultant in tendering proper advice to their clients.

3) UPHEAVAL REGARDING PF WAGES

However, besides basic wages & Dearness Allowance (DA) whether emoluments paid under different nomenclature constitutes "basic wages" under PF Act remained a controversial issue. Unfortunately, Judgements of the EPFAT, High Courts & Supreme Court instead of solving the issue confounded it. This is basically because the definition of the phrase 'basic wages' was a legal nightmare.

4) ANALYSIS OF THE EXPRESSION "BASIC WAGES" r/w SECTION 6 OF PF ACT

4.1) Section 6 of PF Act is the charging section. It provides that contributions are required to be paid on:

- basic wages
- dearness allowance (including cash value of any food concession)
- retaining allowance.

4.2) The term "basic wages" defined in clause (b) of section 2 of PF Act means <u>all emoluments</u> which are earned by an employee while on duty or on leave with wages in accordance with the terms of the contract of employment and which are paid or payable in cash.

- By using the word "means" the Legislature, intended that what follows speaks exhaustively. It is a "hard-and-fast" definition and no meaning other than that which is put in the definition can be assigned to the same. Going by interpretation of statutes it is an exhaustive definition and *all emoluments earned by an employee in accordance with the terms of the contract of employment* would be "basic wages."

- If there were no exceptions to this definition, there would have been no difficulty in holding that payment of any incentive or allowance, whatever is its nomenclature or nature, as a part of wages would be included within the phrase "basic wages".

- The difficulty, however, arises because the definition also provides that certain components which ordinarily forms part of wage packet will not be included in the term "basic wages", and these are contained in three clauses.

    - The first clause mentions the cash value of any food concession. Though the main definition includes ***"all***

emoluments" which are paid or payable in cash, the exception excludes the cash value of any food concession, which in any case is not payable in cash.

- The second clause excludes dearness allowance, house-rent allowance, overtime allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment.
- The third clause excludes any presents made by the employer shows that though the definition mentions "***all emoluments which are earned in accordance with the terms of the contract of employment***". The Legislature took care to exclude presents which would ordinarily not be earned in accordance with the terms of the contract of employment.

- The exception contained in the second clause suggests that even though the main part of the definition includes all emoluments which are earned in accordance with the terms of the contract of employment, certain payments which are in fact the price of labour and earned in accordance with the terms of the contract of employment are excluded from the main part of the definition of "basic wages".

- The Legislature having excluded "dearness allowance" from the definition of "basic wages"- included dearness allowance for purposes of contribution in section 6 of the Act.

- The exceptions therefore do not seem to follow any logical pattern which would be in consonance with the main definition.

- The phraseology *"or any other similar allowance"* in clause (ii) has given rise to many a legal controversy as to which allowances, other than those specifically excluded, would come within the ambit of the expression "basic wages".

5) PF CIRCULARS

5.1) The PF authorities issued a circular dated 20th November 2012 (First Circular)[9], which inter alia indicated that the term "any other similar allowance" in the definition of 'basic wages' provided under PF Act, was to be read in conjunction with the word 'commission' and that all allowances such as conveyance, special allowance, etc., are to be

treated as a part of basic wages since these are paid ordinarily, necessarily and uniformly to employees. Therefore, barring the specific exclusions set out under Section 2(b) of the Act, all additional allowances payable to an employee were to be treated as part of the 'basic wage' component.

5.2) However due to stiff opposition from employers and also employees, who resisted because such a view would shrink their take home pay, the PF Authorities by circular dated 18th December 2012 (Second Circular)[10] decided to keep their first circular in abeyance until further orders indicating lack of clarity on the part of the department as to what constitutes "basic wages" as per PF Act.

5.3) In August 2014, Regional Provident Fund offices were directed to inspect establishments and ascertain establishments wherein PF contribution deducted is 50% or less of total monthly wages. This was with the object to detect evasion by splitting & allocating disproportionately amounts under various allowances.

5.4) The term "basic wages" was initially defined in the Act in 1952, when the structure of wages was such which entailed allowances calculated and given on the basis of the Basic wages. Subsequently, the definition of wages was amended in 1988 by inserting a phrase 'on leave or on holidays with wages in either case' rest remained the same and the wage structure remained the same.

5.5) The expression "***basic wages"*** defined under PF Act came to be considered by the Supreme Court in following cases prior to *Vivekanand Vidyamandir* case (Supra).

A. BRIDGE & ROOF CO. (INDIA) LTD VS UNION OF INDIA[11]

The question was whether production bonus (formulated by the company under two schemes) could be taken into account in calculating the contribution under Section 6 of the Act.

The Supreme Court analysing Section 2(b) of the PF Act observed:

- The basis of inclusion in Section 6 and exclusion in cl. (ii) is that whatever is payable in all concerns' and is earned by all permanent employees is included for the purpose, of contribution under Section 6, but whatever is not payable by all concerns or may not be earned by all employees of a concern is excluded for the purpose of contribution.

- Dearness allowance, for example, is payable in all concerns either as an addition to basic wages or as a part of consolidated wages

where a concern does not have separate dearness allowance and basic wage.

- Similarly, retaining allowance is payable to all permanent employees in all seasonal factories like sugar factories and is therefore included in Section 6;

- but house-rent allowance is not paid in many concerns and sometimes in the same concern it is paid to some employees, but not to others, for the theory is that house- rent is included in the payment of basic wages plus dearness allowance or consolidated wages. Therefore, house-rent allowance which may not be payable to all employees of a concern and which is certainly not paid by all concern is taken out of the definition of "basic wages", even though the basis of payment of house rent allowance where it is paid is the contract of employment.

- Similarly, overtime allowance though it is generally in force in all concerns is not earned by all employees of a concern. It is also earned in accordance with the terms of the contract of employment; but because it may not be earned by all employees of a concern it is excluded from, “basic wages".

- Similarly, commission or any other similar allowance is excluded from the definition of "basic wages" for commission and other allowances are not necessarily to be found in all concerns; nor are they necessarily earned by all employees of the same concern, though where they exist they are earned in accordance with the terms of the contract of employment.

- The basis for the exclusion in cl. (ii) of the exceptions in s. 2 (b) is that all that is not earned in all concerns or by all employees of concern is excluded from basic wages. To this the exclusion of dearness allowance in cl. (ii) is an, exception. But that exception has been corrected by including dearness allowance in s. 6 for the purpose of contribution.

- Dearness allowance which is an exception in, the definition of "basic wages", is included for the purpose of contribution by Section 6 and the real exceptions therefore in cl. (ii) are the other exceptions beside dearness allowance, which has been included through Section 6.

- The ***basis for exclusion*** of certain specified components seems to be “***all that is not earned in all concerns, or by all employees of a concern seems to be excluded***”.

- In view of the above and the specific exclusion for bonus, it was held that “production bonus” was not to be included as wages for the purpose of computation of PF Contributions.

B. JAY ENGINEERING WORKS LTD VS THE UNION OF INDIA AND OTHERS[12]

FACTS:

Wages were fixed by Engineering awards. The company and its workmen entered into an agreement whereby a scheme was established. Under this scheme a certain proportion of the production was taken to correspond to the minimum basic wages and dearness allowance fixed by the awards and this was termed as quota'. The production above the quota was paid at piece rates. But there was a 'norm' also fixed which was much higher than quota. Every workman who failed to produce the 'norm' would be considered guilty of misconduct and would be liable to be dismissed.

The Company contented that the entire payment for production above the quota was payment of production bonus and therefore could not be taken into account for the purposes of provident fund in view of the decision in Bridge and Roof Co. Ltd. v. Union of India. It was further contended that even if the payment for production between quota and norm was not production bonus which can be taken out of the definition of basic wages in the Act it should be treated as payment in the nature of 'other similar allowances' appearing in S.2(b) (ii) of the PF Act.

CONCLUSION:

- Payment for work done between the quota and the norm cannot be treated as any other similar allowance". The allowances mentioned in the relevant clause are dearness allowance, house-rent allowance, overtime allowance, bonus and commission or any "other similar allowance", must be of the same kind.

- The payment for production between the quota and the norm has nothing of the nature of an allowance, it is a straight payment for the daily work and must be included in the words defining basic wage i.e., "all emoluments which are earned by an employee while on duty or on leave with wages in accordance with terms of the contract of employment".

- The portion of the payment which is made by the petitioner for production above the "norm" would be production bonus and would be covered by the judgment of Bridge and Roof Company, but that portion of the payment which is made by petitioner for

production up to the quota as well as production between the "quota" and the " norm" is basic wage within the meaning of that term in the Act.

C. THE DAILY PARTAP VS THE REGIONAL PROVIDENT FUND[13]

FACTS:

The Production Bonus scheme under consideration read as under:

"Production Bonus is paid for the following reasons:-

1. *Less than the normal number of people doing the normal work of a working shift, in which case the Production Bonus is paid according to the deficiency in the numerical strength of the staff.*

2. *Extra output given by any workmen in any shift. Output of compositors and distributors is measured in terms of column inches of type, that of machine men in terms of the speed of the machines and of the process section in terms of plates and negatives. Allowance is made for delays caused by factors beyond the control of the workmen.*

   Production Bonus in 1.5 times the normal daily wage. It may be reduced or increased on account of special reasons at the discretion of the management. It is variable from month to month and is apart from the basic wage of the workmen".

CONCLUSION:

- As far as the first category of cases envisaged by the Scheme is concerned, it contemplates a situation where at a given point of time the required number of staff may not be available with the likelihood that the production for the day might fall and in order to ensure maintenance of the same level of production other workmen available in the given shift may be required to carry on the extra work than what is normally required to be done by them.

- In such cases, an extra amount is contemplated to be offered to the remaining employees who are present and who take extra load of work which otherwise would have been discharged by their absentee colleagues.

- The category of cases contemplated by the first part of the Scheme necessarily indicates that any extra effort undertaken by the workmen discharging extra load of work over and above the usual

work expected of them normally is to ensure maintenance of the requisite normal level of production.

- This situation is entirely different from the one wherein more than normally expected out-turn of work is being made available by the workmen who would get Production Bonus by way of incentive to valid total production beyond its normal level.

- Consequently, the first category of cases contemplated by the Scheme cannot be said to be introduction any Production Bonus scheme in the real sense of the term. It in substance is a scheme of insurance against shortfall in normal production per shift due to shortage of available staff at a given point of time.

- As regards the second category of cases, it is true that it envisages extra payment as an incentive to any workman in any shift who puts in extra output by his own effects.

- So far as compositors and distributors are concerned, their output will be measured in terms of column inches of type, and if their output goes beyond the normal output expected of them under the contract of service, then they would be eligible for getting the benefit of the Production Bonus Scheme envisaged by category 2.

- Similarly, for machine men to the extent speed of the machines handled by them per shift is beyond the normally expected speed of machine handled by machine men would show the eligibility of the machine men for such extra payment.

- So far as the workers working in the processing section are concerned their eligibility for earning extra payment would depend upon the additional work which they would be said to have put in per shift in items of the plates and negatives normally to be handled by them.

- It is, therefore, obvious that the extra output given by the concerned workmen in any shift will depend upon the basic norm fixed for the output which will have to be given by the concerned workmen during the shift and if it is found that any extra output is put up by them beyond the requisite norms of work-load then only the same would make them eligible to get benefit of the Production Bonus as envisaged by category 2.

- However, the payment of Production Bonus as envisaged in category 2 cases under the scheme is not directly linked up with the amount of extra output furnished by the workmen.

- Consequently, the aforesaid scheme said to be granting Production Bonus to the employees is in substance not a scheme which is directly linked up with extra production nor it is commensurate with the extra production workman-wise or even establishment-wise.

- It only carves out a category of more efficient workmen or more enthusiastic workmen for being given a flat rate of extra remuneration for discharging their duties more efficiently under the contract of employment.

- It offers in substance an instantaneous superior daily wage scheme for more efficient workmen.

- Consequently the definition of the term "basic wages" as found in first part of Section 2(b) will squarely get attracted as 1.5 times of normal wages which will be given to workmen under category 2 of the scheme will be excess emoluments earned by them while on duty in accordance with the terms of the contract of employment.

- This amount uniformly paid to them having on direct nexus with the amount of the extra output put up by them, strictly speaking is not a Production Bonus.

- It is not a scheme of sliding scale bonus having real nexus with the amount of extra output furnished by the concerned workmen either individually or collectively.

- Under any scheme bonus is to be paid on piece rate basis for the extra output given by him beyond the norms prescribed for such work, the extra amount payable to him will have a direct linkage with the extra output furnished by him. More extra output more payment; less extra output less payment. Such a scheme would be a genuine Production Bonus scheme.

- The scheme relied on by the appellants does not fulfil this legal test it does not attract the exception (ii) to Section 2(b). It remains in the realm of basic extra wage, attracting contributions.

- This decision concludes that Provident Fund Act is beneficial social welfare legislation and must be interpreted as such. As production bonus was not paid as per a genuine production bonus scheme, production bonus will form part of basic wages.

D. TI CYCLES OF INDIA, AMBATTUR vs. M.K. GURUMANI[14]

ISSUE:

Whether the amount received as incentive wages would be "Wages" as per Section 2(s) of payment of Gratuity Act & ought to be considered while computing Gratuity under section 4(2) of the Act.

FACTS:

The scheme under the settlements provided;

> "..that the objective of the scheme is to ensure optimum production of high quality, promote safety and cost consciousness and maintain a high level of productivity. Incentive payment was based on two components:
> (i) Group performance index and
> (ii) Individual/sectional performance index
> (iii) No incentive will be payable to workmen on leave, absent, away from duty or on holidays.
> (iv) The minimum performance level is indicated in each sectional incentive table and below which no incentive will be paid for any reason whatsoever.
> (v) If a person works for more than one group during the month, he will be awarded incentive as per the performance of each group in the respective periods.
> (vi) Clause 9.1 also sets out incentive payment payable under the scheme will not be regarded as wages and, therefore, the payment shall not be taken into account for the purpose of leave wages, overtime wages, wages in lieu of notice, provident fund contributions, bonus, gratuity or any other allowance. However, this clause is subject to review in case of statutory amendments, if any".

CONCLUSION:

Comparing definition of 'wages' defined in Section 2(s) of Gratuity Act & 'basic Wage' in Section 2(b) of PF Act the Court observed that comparison between these two provisions will make it clear that there is no basic difference between the two expressions used in these two enactments insofar as the exclusion of bonus from the emoluments is concerned. The distinction between expression " basic wages" used in the PF Act while the term "wages" used in Gratuity Act will not be of any impact, if the manner in which the two terms are defined in the respective Acts. The nomenclature of the two

expressions will not alter the contents of the two terms. The definition in both enactments cover all emoluments while on duty but exclude any bonus, commission, HRA, overtime wages and any other allowance. Incentive wages paid in respect of extra work done does not come within ambit of 2(s) of Gratuity Act as they have a direct nexus and linkage with the amount of extra output & is to be excluded from computation of Gratuity.

The above case dealt with issue of additional payment made in the name of Bonus of different kinds, before & even after passing of the Payment of Bonus Act,1965. The supreme court in each of the above decided cases found that what was being paid in addition to basic wages was in the nature of the bonus. Bonus is specifically excluded by clause (II) of Sub-section (b) of Section 2 of PF Act. However applying the ratio *in Bridge & Roofs Case (Supra)* several other additional payments were held not to be "basic wages" under the PF Act

E. MANIPAL ACADEMY OF HIGHER EDUCATION VS PROVIDENT FUND COMMISSIONER[15]

ISSUE:

Whether the amount received by encashing the earned leave is a part of "basic wage" under Section 2(b) of the PF Act requiring pro rata employer's contribution.

FACTS:

The RPFC held that the amount received on encashment of earned leave has to be reckoned as 'basic wage' for the purpose of Section 2(b) of the Act.

CONCLUSION:

I. The basic principles as laid down in Bridge Roof's case (supra) on a combined reading of Sections 2(b) and 6 are as follows:

   a) Where the wage is universally, necessarily and ordinarily paid to all across the board such emoluments are basic wages.

   b) Where the payment is available to be specially paid to those who avail of the opportunity is not basic wages. By way of example it was held that overtime allowance, though it is generally in force in all concerns is not earned by all employees of a concern. It is also earned in accordance with the terms of the contract of

employment but because it may not be earned by all employees of a concern, it is excluded from basic wages.

c) Conversely, any payment by way of a special incentive or work is not basic wages.

The Supreme Court in this case observed that in many cases the employees do not take leave and encash it at the time of retirement or same is encashed after his death which can be said to be uncertainties and contingencies. Though provisions have been made for such contingencies unless the contingency of encashing the leave is there, the question of actual payment to the workman does not take place. Any amount of contribution cannot be based on different contingencies and uncertainties. The test is one of universality. In the case of encashment of leave the option may be available to all the employees but some may avail and some may not avail. That does not satisfy the test of universality. Thus the foundation of "test of universality' was read in the ratio laid down in the case of *Bridge & Roofs (Supra)*

F. KICHHA SUGAR COMPANY LIMITED THROUGH GENERAL MANAGER VS. TARAI CHINI MILL MAJDOOR UNION, UTTARAKHAND[16]

FACTS:

The Government of Uttar Pradesh, by directed for payment of Hill Development Allowance to its employees working at specified hill areas at the rate of **15% of the basic wage**.

The workmen demanded calculation of 15% of the said allowance by taking into account the amount paid as overtime, leave encashment and all other allowances.

The dispute was referred to Industrial Tribunal for adjudication. The order of reference read

> ***"Whether the exclusion of payment of overtime, leave encashment, bonus and retaining allowance while calculating the Hill Development Allowance by the Employer is legal and justified? If not, to what relief, the workmen concerned are entitled to get?***
> ***Where the hill development allowance was paid as a percentage of basic wages, whether basic wages should include overtime wages and leave encashment?"***

The Industrial Tribunal made an Award to "give Hill Development Allowance to their permanent and regular workers on the amount received regarding leave encashment and overtime wages." However, the Tribunal observed that "Hill Development Allowance shall not be payable on bonus and retaining allowance or on any other allowances." Writ Petition challenging the Award was summarily rejected.

The Supreme Court noted that the expression “basic wages” is not defined; one can take into account the definition given to such expression in a statute as also the dictionary meaning. The SC considered the definition of the expression “basic wages” in Section 2(b) of PF Act & dictionary meaning of the said expression.

CONCLUSION:

> ***“..Wages which are universally, necessarily and ordinarily paid to all the employees across the board are basic wage. Where the payment is available to those who avail the opportunity more than others, the amount paid for that cannot be included in the basic wage. As for example, the overtime allowance, though it is generally enforced across the board but not earned by all employees equally. Overtime wages or for that matter, leave encashment may be available to each workman but it may vary from one workman to other. The extra bonus depends upon the extra hour of work done by the workman whereas leave encashment shall depend upon the number of days of leave available to workman. Both are variable. In view of what we have observed above, we are of the opinion that the amount received as leave encashment and overtime wages is not fit to be included for calculating 15% of the Hill Development Allowance.***

The aforesaid decision once again, on the facts, held that Hill Development Allowance paid to certain employees was in the nature of bonus and was not ***universally, necessarily and ordinarily paid to all the employees.***

The above decisions however did not resolve the issue as to which type or category of additional payments which were being regularly paid to all employees in the shape of ‘allowance’ with varied prefix would fall outside the gamut of specific exemptions listed under Section 2(b)(ii) of the PF Act.

6) DECISION OF HIGH COURT APROPOS VARIOUS SPECIAL ALLOWANCES

PF Authorities took a stand that Employers were engaging in subterfuge by paying various cash allowances as part of emoluments earned by the employee but under the head of 'Allowance' so as to evade & avoid paying PF contribution on the portion shown as allowance. Alleging evasion the RPFC demanded PF contribution on all allowances except what was specifically excluded by clause (ii) of Sub Section (b) of Section 2 of PF Act.

Delhi High Court

i) In the matter of *Whirlpool of India Limited v Regional Provident Fund Commissioner*[17], the held that 'canteen allowance' was very much a part of an employee's basic wages. It observed that the use of the words 'any other similar allowances' in the definition of basic wages provided under the Act, had to be read in conjunction with the word 'commission'. Hence, canteen allowances would not fall under the gamut of specific exemptions listed under Section 2(b) of the Act. Argument, placing reliance on the Second Circular, that the authorities themselves had kept the demand on 'other Allowances' in abeyance was summarily rejected by the Delhi High Court holding that the provisions of the Second Circular cannot override the statutory interpretation of the Act.

Madhya Pradesh High Court

i) In the case of *Surya Roshni Limited v Employees Provident Fund*[18], the Division Bench of the High Court took the view that *On combined reading of Section 2(b) and Section 6 of the Act, the wages' which is universally, necessarily and ordinarily paid to all across the board, such emoluments are 'basic wages' and where the payment is available to be specially paid to those who avail of the opportunity is not the 'basic wages'".* On the aforesaid principle the Court held that conveyance allowance, attendance incentives, lunch allowances and other similar allowances would all form part of the 'basic wage' component, as said allowances were being paid ordinarily, uniformly, and necessarily to employees.

ii) Similarly, the said Division Bench on the same day, delivering separate judgments, in Montage Enterprises Private Limited v Employees' Provident Fund and U Flex Ltd. v EPF held that conveyance allowance, transportation allowance, and special

allowances are part of basic wages under the provisions of the Act and directed that provident fund contributions should be remitted on such allowances.

Karnataka High Court

i) In analysing the permissibility of an employer to structure an employee's wages under various components, in the case of Group 4 Securities Guarding Limited v Regional Provident Fund Commissioner[19] held that: "*... any agreement entered into between the employer and its employees for splitting of the amount payable by the employer to its employees for the service rendered by them, cannot take away the power of the Commissioner under Section 7A of the Act to look into the nature of the contract entered into between the employer and its employees and decide that splitting up of the pay payable to the employees under several heads is only subterfuge to avoid payment of contribution by the employer to the provident fund. It was open to the Commissioner to lift the veil and read between the lines to find out the pay structure fixed by the employer to its employees and to decide the question whether the splitting up of the pay has been made only as a subterfuge to avoid its contribution to the provident fund.*"

Kolkatta High Court

In *RPFC West Bengal v/s Vivekananda Vidyamandir*[20] the Court held that Special allowance being paid to teaching & non-teaching staff members of unaided school was not linked to the consumer price index and not in the nature of dearness allowance and hence did not fall within the definition of basic wage.

Madras High Court

A batch of Writ Petitions, the lead petition titled as Management of Reynolds Pens India Pvt. Ltd. Kancheepuram and others V. Regional Provident Fund Commissioner Chennai[21] , came to be decided by a common judgement. Affirming the concurrent orders of the 7A authority & EPFAT holding that that various allowances paid by the petitioners to their employees under different heads, such as conveyance, educational allowances, food concessions, medical, special holidays, night shift incentives, city compensatory allowances were wages within the

meaning of the term 'basic wage' as per Section 2(b) of the PF Act and covered for deductions towards Provident Fund.

7) VERDICT OF SUPREME COURT:

RPFC & the Establishment filed Special Leave Petitions impugning the judgements of some of the High Courts as set out in table below. The Hon'ble Supreme Court decided the SLP's by a common order dated 28.02.2019 titled as '***The Regional Provident Fund Commissioner (II) West Bengal vs. Vivekananda Vidyamandir &Ors*** (supra)

SR. NO.	PARTIES/ HIGH COURT	ISSUE	VERDICT OF HIGH COURT
1)	The RPFC West Bengal v/s Vivekananda Vidyamandir and Others Kolkata High Court	Whether special allowance by way of incentive to teaching and nonteaching staff is covered within the meaning of 'basic wages' for the purpose of calculating provident fund contribution?	Special allowance was not linked to the consumer price index and not in the nature of dearness allowance and hence did not fall within the definition of basic wage.
2)	Surya Roshni Ltd. vs. EP Fund and others Madhya Pradesh High Court	Whether Transport allowance, HRA, Attendance incentive, Special allowance, Canteen allowance and Lunch allowance paid by the employer is covered under "basic wages" for the purpose of calculating provident fund contribution? The authority conceded that Washing allowance was not liable to PF	These allowances are universally necessarily and ordinarily paid to the employees across the board and hence form part of basic wage. Only where the payment is specially paid to those who avail of the opportunity is not the basic wages. Canteen allowance which is paid to workers who are required to remain on machines during lunch period could not be included in basic wages Rest of the allowances paid by the employer should be included under the 'basic wages'.
3)	The Management of Saint-Gobain Glass India Ltd. Vs The RPFC, EPFO	Whether conveyance, educational allowance, food concessions medical, special holidays, night shifts	These allowances are universally necessarily and ordinarily paid to the employees and form part of the contract of employment

	Madras High Court	incentives, city compensatory allowances were within the meaning of 'basic wages'?	hence should be treated as basic wages
4)	Montage Enterprises Pvt. Ltd. Vs EPF & another Madhya Pradesh H.C.	Whether HRA, special allowance, management allowance, and conveyance, were within the meaning of 'basic wages	These allowances are universally necessarily and ordinarily paid to all employees and form part basic wages
5)	U-Flex Ltd. Vs EPF & another Madhya Pradesh H.C.	Whether HRA, special allowance, management allowance, and conveyance allowance, were within the meaning of 'basic wages'?	These allowances should form part of basic wages

8) TEST OF UNIVERSALITY

8.1) The Supreme Court held that all allowances which are universally and ordinarily paid to all employees across the board, irrespective of quantum of efforts put in or the quantum of the output, shall deemed to be considered as part of "basic salary" for the purpose of computing contribution towards Provident Fund (PF)**.**

8.2) The Supreme Court affirmed that allowances which are variable in nature and linked to any incentive for production resulting in greater output by an employee; or Allowances which are not paid across the board to all employees in a particular category; or Allowance which are paid especially to those who avail the opportunity will stand excluded from "basic salary" for the purpose of computing contribution towards Provident Fund (PF).

8.3) Considering the decisions rendered *Muir Mills Co. Ltd., Kanpur v. Its Workmen*[22], & Kichha Sugars (supra), the Supreme Court in the present case concluded that none of the establishments demonstrated that the allowances being paid to their employees were variable or were linked to any incentive resulting in greater output by an employee. The material on record did not show that allowances were paid only to a few employees in a particular category and not across the board to all employees. In order to exclude an allowance from "basic wages" it has to be shown that the workman concerned had become eligible to get

extra amount beyond the normal work which he was required to as per contract of employment.

8.4) The Supreme Court concurred with the Regional PF Commissioners, who had concluded in each of the instances concerned, that the allowances were essentially part of basic wages and had been camouflaged as allowance to avoid deduction of PF contribution.

8.5) The Supreme Court explained that applying the ***test of universality***, in each of the above tabulated cases the allowances paid formed part of the basic wage and had to be factored in while making PF contribution.

9) CONSEQUENCES OF SUPREME COURT DECISION

9.1) The Supreme Court has now clarified the legal position that an allowance paid to employees as part of total salary, base salary or cost-to-company, would be subjected to PF deduction & contribution**.** The Supreme Court decision is interpretation of an existing law. The interpretation of the provision becomes effective from the date of enactment of the provision. In M*.A. Murthy v. State of Karnataka*[23], it was held that the law declared by the Supreme Court is normally assumed to be the law from inception. There is no period of limitation prescribed by statute for invoking power to assess past PF contributions. However, when a power is conferred without mentioning the period within which it could be invoked, the same has to be done within reasonable period, as all powers must be exercised reasonably, and exercise of the same within reasonable period would be a facet of reasonableness. (See R.P.F. Commr vs K.T. Rolling Mills Pvt. Ltd[24])

9.2) The said judgement has opened floodgates of inspection notices and inquiries by the PF authorities to establishments for tracking down non-compliances. The PF authorities requisitioned records of past three to five years to ascertain wage structure from several establishments to determine if any allowances which were supposed to have been a part of "basic wages" have been deliberately omitted from the ambit of "basic wages". This is to ascertain whether the salary packet has been split into different components such as basic, DA & various allowance with a view to have an advantage of lower deduction and contribution to the PF.

9.3) The EPFO vide circular dated 28th August 2019 stated that no inquiries should be initiated into the salary structure of the complying establishment merely on speculation that certain allowances forming a part of basic wages have been excluded for paying PF contributions. Further, EPFO has directed its officers not to pursue any of such

notices which have been issued unless there is any prima facie evidence of arbitrary bifurcation of wages with the intention to avoid PF liability and that such inquires on the part of EPF authorities are impermissible in law.

9.4) However, this does not prohibit the Enforcement Officer to call for information & records if the EO is of the opinion that the employer has prima facie indulged in illegal practice of avoiding EPF liability by splitting the wages. The EPF authorities in such a case may proceed with such inquiries/investigations subject to the prior permission from the Central Analysis Intelligence Unit (CAIU) constituted by EPFO.

10) IMPACT OF THE SUPREME COURT DECISION

10.1) The burden to prove that an allowance paid to an employee is excluded from deduction and contribution to the PF is upon the company. The direct impact of the judgement will be the liability of employers who had not considered various allowances paid for deduction & contribution to PF. The extent of liability will depend upon the period of enquiry. Pay Roll Managers will now have to consider revisiting / reviewing contributions omitted to be made by them under the assumption that allowances do not attract PF Contributions. The review will of course have to factor the period & category of employee.

10.2) For the purpose of this post the phrase "domestic workers" is used to distinguish nationals from International Workers (IW). In respect of an enquiry, for the period from 1st June 2001 to 31st August 2014, the ruling will impact domestic workers who were in receipt of monthly salary up to Rs 6,500 (Statutory Wage Ceiling). For such employees, if total monthly wages included allowances but Provident Fund contributions were made only on basic wages, DA & Retaining Allowance (if any) then the employer will be liable to pay additional contributions on all allowances paid during the said period.

10.3) For the period on or after 1 September 2014, the ruling will have an impact for domestic workers drawing salary (Basic+ DA + Retaining Allowance) up to Rs 15,000 per month (Statutory Wage Ceiling). For such employees, if Provident Fund contributions were made only on basic wages, DA & Retaining Allowance (excluding all other allowances) then the employer will be liable to pay contributions on all allowances paid during the said period but not considered for deduction & contribution.

10.4) It may be noted that if the total emoluments of an employee on the date of joining exceeds the extant Statutory Wage Ceiling then such an employee will be considered as "excluded employee" vide Paragraph 2(f)(ii) read with Paragraph 26 of the EPF scheme. In Marathwada

Gramin Bank Karamchari Sanghatana versus Marathwada Gramin Bank[25] the Supreme Court observed that,

> "***The respondent bank is under an obligation to pay provident fund to its employees in accordance with the provisions of statutory Scheme."***

10.5) The PF Act is applicable to International Workers (IW) on & from 1st November 2008(Paragraph 83 of the Scheme). IW includes expats, foreign nationals locally hired and OCI card holders (Paragraph 2(ja) of the Scheme). There is no Statutory Wage Ceiling on which contributions payable in respect of wages paid to IW. The PF contribution, at specified rate, is calculated on full salary of the IW irrespective of whether the salary is paid in India or outside India, split payroll, or multiple country sources.

10.6) In case any amount of contribution is found to be payable the employer on allowances which were excluded the Employer will have to pay both contributions i.e. Employer's & Employee's along with statutory interest @ prescribed in Section 7Q of the PF Act.

10.7) Apart from the above a defaulting employer may be liable to pay damages at rates specified in Paragraph 32 A of the Scheme.

10.8) As far as the department is concerned the judgment will have an effect on the pension payable under The Employees' Pension Scheme (EPS) due to the definition therein of "pay" in Section 2(xiii) which includes "basic wages" and Section 12 which relates to the determination of pensionable salary. The claims of several employees/heirs that were settled may have to be reopened & reviewed due to the inevitable retrospective operation of the decision.

11) COURSE CORRECTION

11.1) Pay Roll Managers will now have to ensure deduction & payment of PF Contributions on all Allowances which are paid to all employees across the board.

11.2) Allowance/s paid which is/are:

- variable in nature and linked to any incentive for production resulting in greater output by an employee; or
- not paid across the board to all employees but only to some employees in a particular category; or

- Allowance is paid specially to those employees who avail the opportunity to perform additional work beyond the terms of contract or norms or quota, and allowances specifically excluded vide Section 2(b)(ii) of the Act will not be considered as "basic wages" under PF Act & need not be factored for deduction & contribution to Provident Fund.

12) LABOUR LAW CODES

12.1) As a measure of labour reforms, the Labour Ministry has decided to amalgamate 44 Labour laws into four Codes – Wages, Industrial Relations, Social Security (ESI, PF, etc.) and Safety, Health & Working conditions.

12.2) The consolidation, rationalisation and simplification of Labour laws has commenced with the Parliament passing the **Code on Wages, 2019** (referred to as ***"Wages Code"***). This Code has consolidated four labour laws, viz. Payment of Wages Act, 1936, Minimum Wages Act, 1948, Payment of Bonus Act, 1965 and Equal Remuneration Act, 1976 under one single Code. The Wages Code will be applicable to employees in both organised and unorganised sectors. It has received the Presidential assent on 8th August 2019. The Central Government has to notify in the official gazette the date on which the Wages Code (or different provisions of the Code) shall come into force.

12.3) Section 2(y) of Wages Code defines the term "wages" exhaustively. It takes within its definition all remuneration, whether called salary, allowances or by any other nomenclature and specifically excludes components enumerated in clauses (a) to (k). The proviso to the said definition clarifies that if component of salary mentioned from clauses (a) to (i) (which are remuneration by an employee as per contract of employment) exceeds one half (or such percentage as may be specified) of the aggregate remuneration then such amount which exceeds the specified percentage shall be deemed as remuneration and shall be accordingly added and treated as wages. The aforesaid definition of wages under the code should now be considered as the basis for the purpose of contribution to funds established under diverse labour laws.

12.4) The Central Government is also proposing to replace the existing definition of "basic wage" in the PF Act with that of wages as provided in the Code. The employer, therefore, should also analyse and work out PF contributions from the said perspective, especially in respect of resident employees whose basic salary is presently less than the statutory wage ceiling. The HR Personnel will have to re-work labour contracts and terms of service to ensure that they are compliant with the provisions of Wages Code.

12.5) The consolidation of various labour laws into four Codes is a much-needed measure. Such measure will go a long way in reducing legal disputes especially as to which components or elements of the total remuneration paid to an employee constitutes 'wages' as per law. The consolidation of various labour laws will avoid the chaotic condition which now prevails in the field of labour laws. The uniform definition of words, phrases & expression used in the four Codes will simplify labour law and give way for greater transparency and legal compliance.

(S. C. Naidu)

Advocate

Dated 28th April, 2020

[1] "2.Definitions
In this Act, unless there is anything repugnant in the subject or context,-
XXXX
(22) "wages" means all remuneration paid or payable, in cash to an employee, if the terms of the contract of employment, express or implied, were fulfilled and includes any payment to an employee in respect of any period of authorised leave, lock-out, strike which is not illegal or lay -off and] other additional remuneration, if any, paid at intervals not exceeding two months, but does not include-
(a) any contribution paid by the employer to any pension fund or provident fund, or under this Act;
(b) any travelling allowance or the value of any travelling concession;
(c) any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment; or
(d) any gratuity payable on discharge."

[2] "2. Definitions. - In this Act, unless the context otherwise requires,-
(a)Xxxx
(b)"Basic wages" means 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, but does not include -
(i) The cash value of any food concession;

(ii) Any dearness allowance (that is to say, all cash payments by whatever name called paid to an employees on account of a rise in the cost of living), house-rent allowance, overtime allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment;

(iii) any presents made by the employer;"

[3] AIR 1984 SC 1680

[4] 2019 LLR 339.

[5] 1978- I- LLJ 469

[6] [1980] LAB. I.C.431

[7] [1973] LAB.I.C.1328

[8] https://www.esic.nic.in/wages

[9] *Ref*: 7(1)2012/RCs Review Meeting/345.

[10] *Ref*: 7(1)2012/RCs Review Meeting/21224

[11] AIR 1963 SC 1474

[12] AIR 1963 SC 1480

[13] 1998 (8) SCC 90

[14] 2001 (7) SCC 204

[15] (2008) 5 SCC 428

[16] (2014) 4 SCC 37

[17] W.P.(C) 7729/1999, Per Vipin Sanghi J

[18] 2011 (3) MPLJ 491

[19] 2004-II LLJ 1142

[20] 2005-II-LLJ-721

[21] 2011 LLR 876

[22] AIR 1960 SC 985

[23] (2003) 7 SCC 517

[24] AIR 1995 SC 943

[25] (2011) 9 SCC 620