HR Law Hotline

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SHOULD SOCIAL SECURITY CONTRIBUTIONS BE BASED ON MINIMUM WAGES?

The Employees Provident Fund Organisation of India ("**EPFO**"), which manages India's largest social security fund for employees, has recently clarified to its officers that employers are required to make provident fund ("**PF**") contributions on the minimum wages.

The EPFO has issued an inter-department clarification on May 23, 2011 ("**Clarification**") indicating that splitting of minimum wages for the purposes of PF contributions is not permissible. This Clarification, which has been issued in view of the lack of a uniform approach followed by the PF authorities in different states, seems to be an attempt by the labour department to settle the ongoing ambiguity with respect to the calculation of provident fund ("**PF**") contributions.

BACKGROUND

According to the extant provisions of law, to the extent the Employees Provident Fund and Miscellaneous Provisions Act, 1952 ("**EPF Act**") applies to an establishment, the employer is required to make PF contributions for its eligible employees (whether employed directly or through a contractor) on the amount of basic wages (base salary), dearness allowance (which is like a cash allowance paid to an employee on account of inflation) and retaining allowance. While the EPF Act defines 'basic wages', it does not stipulate that basic wages need to be equivalent to the minimum wages under the Minimum Wages Act, 1948 ("**MWA**"). Further, it is a common practice to structure the compensation package to include several allowances and perquisites, some of which provide tax benefits. As a result, for employees drawing minimum wages, the basic wages would typically be an amount lower than the minimum wage rates prescribed by the government under the MWA. This would therefore reduce the PF and pension contributions by the employer as they are linked to the amount of basic wages.

The Clarification states that the minimum wage is the lowest permitted wage legally required to be paid by an employer to its worker and therefore 'basic wages' (for the purpose of PF calculation) should not be lower than the minimum wage (under the MWA). As per the Clarification, employers who do not pay minimum wages to their employees but claim to pay certain additional allowances to them, may be liable for punishment under the EPF Act as well as under the Indian Penal Code. Further, the Clarification also states that any employment contract between the employer and the employee which contains a stipulation to the effect that the minimum wages paid or payable to an employee is bifurcated to reduce the liability of the employer under the EPF Act shall be treated as *void ab initio*. Since the minimum wage is calculated by the state governments after due consideration of the prevailing market conditions and other prescribed factors, splitting, segregation or re-classification of the minimum wage should not be permissible.

The Clarification places reliance[1] on the judgment of the Division Bench of the Karnataka High Court, in the case of *M/s Group 4 Securities Guarding Ltd., Bangalore Vs. Regional Provident Fund Commissioner and Others*[2] (reported as 2004 LIC, Page 2075), which specifies that the PF Commissioner may exercise his powers to enquire whether the wages fixed are a subterfuge to avoid its contribution to the PF. The court took the view in that case that employers splitting up basic wages under several heads and allowances would amount to a subterfuge to avoid PF contribution. However, it is pertinent to note that while the MWA provides for a definition of wages, it does not contain a definition of basic wages.

ANALYSIS

The Clarification seems to be in the interest of the employee community in general, since it is intended to ensure that the employer makes a certain level of PF contributions for its eligible employees and provide necessary social security. The contributions would help ensure adequate amounts in the employees' provident fund account and provide sufficient pension benefits to the employees and their family members. The Clarification should help curb the malpractices adopted by some employers who make a very low amount of PF contribution as a result of the low basic salary, which also affects the benefits under certain other labour laws where the benefits are linked to the basic salary.

However, the stand taken by the EPFO and the position stated in the Clarification, does not appear to be consistent with law and may be tested in a court of law, leading to more litigation on this issue. This is in view of some of the points as mentioned below:

a. The EPF Act, being a standalone law, does not prescribe that the basic wages should be equal to the minimum wages. Moreover, if that was indeed the intention of the legislature, instead of providing a separate definition of basic wages under the EPF Act, it would have cross referred to the definition of wages under the MWA, since the EPF Act was enacted much after enactment of the MWA.

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b. The EPF Act is silent on the issue with regard to the percentage of the salary that may be deemed to be basic wages. As a matter of fact, there is no statute in India that prescribes the percentage of basic wages and/or of any allowance. Accordingly, an employer can under the employment contract indicate the amount of basic wages (besides the other allowances) that shall be payable, as long as the employer ensures that the employee receives at least the minimum amount of wages as prescribed under the MWA.

c. The MWA does not contain a separate definition of basic wages. Infact, while the definition of wages under the MWA includes House Rent Allowance ("**HRA**"), the definition of basic wages under EPF Act specifically excludes HRA - therefore there does not appear to be any co-relation between 'wages' under the MWA and 'basic wages' under the EPF Act.

d. The latest judgement on this subject, being that on the Punjab and Haryana High Court in the case of *Assistant Provident Fund Commissioner, Gurgaon vs. G4S Security Services (India) Ltd & Anr. (2011 LLR 316 (P&H HC)* has permitted the employer to split the minimum wages for the purposes of PF contributions. Unless another court decision in the future overturns this judgement, this judgement shall continue to be the law on this subject. This judgement also makes necessary references to some of the earlier judgments as have been referred in the Clarification. It is surprising to note that this judgment has not been referred to in the Clarification.

Unless there is a further clarity issued by the EPFO on this issue or unless this matter is settled by the courts, this Clarification is likely to lead to more labour law litigation in India since the PF authorities, relying on the Clarification, are likely to take an aggressive stand.

- Harshita Srivastava & Vikram Shroff

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1 The Clarification refers to the following judgments: (i) the RPFC, Punjab vs. Shibu Metal Works 1965 (1) LLJ 473, (ii) Crown Aluminum Works vs. Workers Union (1958) Vol. I LLJ, Page 1, (iii) Unichoyi vs. State of Kerala (1961 Vol.I Page 631), (iv) Kamani Metals & Allys Ltd. vs. Their Work Men (1967 Vol. II-55.

2 The Appellant Company had bifurcated the wages into several allowances and that the basic pay component was a fraction of the statutory minimum wage stipulated.

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