

# Special allowance to form part of basic wage for provident fund contribution: SC

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## Summary

The Hon'ble Supreme Court (SC) has, in a recent decision<sup>1</sup>, ruled that various allowances like conveyance allowance, special allowance, education allowance, medical allowance etc., paid uniformly and universally by an employer to its employees would form part of basic wages for computing the provident fund (PF) contribution.

The SC held that it was not demonstrated that the various allowances including special allowance paid by employer to its employees are variable in nature or linked to production incentive, and not paid across the board to all employees. The SC observed that grant of such special allowances is a camouflage to reduce basic wage and consequently avoid a higher PF contribution.

## Facts of the case

- The appellants are the covered establishments under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 (EPF Act), and were making certain payments to the employees in the nature of special allowances like travel allowance, canteen allowance, special allowance, management allowance, conveyance allowance, education allowance, medical allowance etc., under the employment contract.
- These establishments did not contribute PF on such special allowances paid to the employees, on the basis<sup>2</sup> that it should not be considered as basic wage for PF contribution.

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<sup>1</sup> Civil appeal no.(s) 6221 of 2011, 3965-3966 of 2013, 3969-3970 of 2013, 3967-3968 of 2013, transfer case no.(s) 19 of 2019

<sup>2</sup> As excluded from the definition of basic wage under section 2(b) of the PF Act

- However, the PF authorities alleged that such special allowances are camouflaged basic wages liable for PF contribution. The authorities, after relying on the earlier decision of the Apex Court in the case of Bridge and Roof Co. (India) Ltd.<sup>3</sup>, argued that the allowances which are earned by all the employees and form part of the salary break-up with no nexus to extra output produced, would fall within the definition of basic wages.
- The dispute reached before the SC wherein a common question of law arose regarding the inclusion of the special allowances paid by an establishment to its employees within the expression 'basic wages' under Section 2(b)(ii) read with Section 6 of the PF Act for the purposes of PF contribution.

## SC's decision

- The SC ruled that the crucial test to determine the applicability of PF contribution on any component of salary is universality, i.e. the component must not have a specific access and linkage to the production and should be commonly payable to all the employees.
- In the present case, no material has been placed by the establishments to demonstrate that the allowances in question were either variable or were linked to any production incentive resulting in a greater output by the employee.
- Also, no evidence was made available to demonstrate that the allowances in question were being paid specifically to certain eligible employees and not being paid across the board to all employees.
- Accordingly, the SC held that the special allowances shall be included for the purposes of calculating PF contribution.

## Our comments

This ruling provides finality to the varied interpretations being taken by the establishments by structuring basic salary into various allowances to escape PF contribution. It is likely to have an impact on the PF contribution for the employees receiving various allowances and drawing basic wages up to INR 15,000 per month. Employees drawing basic salary above INR 15,000 per month can continue to contribute at minimum PF threshold, thus may not get impacted. Also, international workers would have to make higher PF contribution as minimum PF threshold does not

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<sup>3</sup> Bridge & Roof Co. (India) Ltd. v. Union of India 1963 AIR 1474 (SC)

apply to them. Finally, one would also need to evaluate impact of this ruling in determining the term 'basic salary' for income-tax purposes.

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