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Employment law advisory

Special allowances under the EPF Act need to be special

On February 28, 2019, the Supreme Court of India passed a landmark order on whether special allowances fall within the scope and meaning of “basic wages” under the Employees Provident Fund and Miscellaneous Provisions Act, 1952 (the “**EPF Act**”). Under the EPF Act, provident fund contributions of 12% need to be paid by an employer and employee on the employee’s basic wages, dearness allowance and any retaining allowance. The definition of basic wages excluded specific categories including overtime allowance, house rent allowance, bonus and the category of “any other allowance payable to the employee in respect of his employment or work done in such employment”. Companies typically treat the said carve-out as a ‘special allowance’, which is not subject to provident fund contributions. While structuring the salary components, special allowance was often 30-40% of an employee’s salary, on which they would not remit provident fund contributions.

Through this Supreme Court order, allowances which are universally and ordinarily paid to all employees across the board have to be held as basic wages rather than special allowances. Allowances which are paid out to an employee as an incentive or for work performed beyond the regular work requirement can be excluded from the scope of basic wages, not otherwise. All universal allowances thus now need to be treated as part of “basic wages” and subject to provident fund contributions.

This issue had come up several times previously before the courts, including the Supreme Court and the new order makes it effectively clear that an employer cannot create an allowance structure from an employee’s compensation just to avoid paying the required provident fund contributions.

While the Employees Provident Funds Organisation has long maintained that special allowances are part of the basic wages and subject to provident fund contributions, several companies had challenged this issue. With the current Supreme Court order, employers should ensure that they are making provident fund contributions on the required components of basic wages, dearness allowance and retaining allowance under the EPF Act and are excluding only statutorily permitted allowances such as house rent allowance, overtime allowance or a bonus.

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ABOUT KOCHHAR & CO.

Kochhar & Co. is a leading full service commercial law firm with the best national presence among all law firms in India. The firm mostly represents international companies doing business in India and offers a high quality, business oriented service to its clients. The firm takes great pride in its client servicing approach which is focused on clarity, accessibility and providing business solutions. The firm has the largest national presence in India with offices at Delhi, Gurgaon, Mumbai, Bangalore, Chennai and Hyderabad.

EMPLOYMENT LAW PRACTICE

Kochhar & Co. has the leading employment law practice in the country, assisting companies on a wide range of issues including employment contracts, stock options, termination aspects, employment

related litigation, employee generated intellectual property, statutory benefits and tax issues.

We are Legal 500 Top Tier (Rank 1) for Employment.

Kochhar & Co. is cited as being known for: "deep expertise in advising multinational corporations on all aspects of Indian employment law, including benefit schemes, employment terms and conditions and HR policies. Large-scale employee terminations and whistle-blower cases are also key strengths."

Kochhar & Co. was adjudged a winner by the Indian Business Law Journal for Employment and Industrial Relations.

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