

HR Law Hotline

August 30, 2019

INDIA'S PROVIDENT FUND LAW: PROPOSED AMENDMENTS AND NEW CIRCULAR HELPS EMPLOYERS SEE LIGHT AT THE TUNNEL'S END

- Definition of 'wages' to be aligned with the Code on Wages, 2019
- Flexibility to be provided to fix varying rates of provident fund contributions for different classes of employees
- Proposal to introduce limitation period of 5 years for initiation of inquiry for non-compliance
- Employees to be given flexibility to opt between National Pension Scheme and the Employees' Pension Scheme
- New circular by EPFO should help reduce questions in relation to the retrospective period

The recent Supreme Court ruling on 'basic wages' for provident fund (social security) has led to considerable concerns and confusion across the employer community in India. The government has taken note of the same and accordingly proposed the Employees Provident Fund & Miscellaneous Provisions (Amendment) Bill, 2019 ("EPF Bill, 2019") to amend the Employees' Provident Fund & Miscellaneous Provisions Act, 1952 ("EPF Act").

Once enacted and made effective, the EPF Bill, 2019 shall amend the EPF Act in respect of the following significant aspects:

- Replace the definition of 'basic wages' with 'wages' in line with the definition provided under the Code on Wages, 2019
- Allow the government to fix varying rates of contributions for different classes of employees based on select factors
- Introduce a 5-year limitation period for initiation of an inquiry for non-compliance under the EPF Act, commonly known as a section 7-A inquiry
- Enable employees to opt for National Pension Scheme in lieu of pension benefits under the EPF Act and
- Significantly higher monetary penalties may be imposed in case of a non-compliance of the EPF Act by the employer.

Subsequently, the Employees Provident Fund Organization ("EPFO") has issued an inter-departmental circular dated August 28, 2019¹ **restricting its officers from engaging in inspections in the absence of any *prima facie* evidence of any illegal practice by an employer** of avoiding its provident fund ("PF") liability by splitting the basic wages.

These developments will considerably benefit the employer community in general across all industry sectors and is expected to significantly uplift the business morale.

BACKGROUND

The EPF Act is one of India's most important social security legislations for employees. It applies to every establishment having at least 20 employees ("Covered Establishments").

As per the EPF Act, PF contributions are required to be made in respect of (a) all domestic employees of Covered Establishments who draw Contributory Wages (*defined below*) up to Rs. 15,000 per month (approx. US\$ 250)² and (b) employees who continue to hold a PF account based on their previous employment, irrespective of the Contributory Wages that they draw and (c) employees who fall under the category of International Workers under the EPF Act ("Eligible Employees").

As per the EPF Act, Covered Establishments are required to make PF contributions for all Eligible Employees, at the rate of 12% of the employee's monthly 'basic wages', dearness allowance, retaining allowance and cash value of any food concession ("Contributory Wages"), subject to a maximum cap of Rs. 1800 per month (approx. US\$ 25) for domestic employees³.

What constitutes 'basic wages' for the purpose of PF contributions has been a highly litigated subject in India. In this respect, the Supreme Court of India ("SC") passed a landmark ruling on February 28, 2019 ("2019 PF Judgement") clarifying its position in relation to various allowances forming part of the Contributory Wages. Please refer to our legal alert on the 2019 PF Judgement, available [here](#). Although a review petition was filed with respect to the 2019 PF Judgement, the same has been dismissed by the Hon. Supreme Court of India on August 28, 2019.

Given the confusion surrounding the look-back period for compliance after the 2019 PF Judgement, the Ministry of Labour and Employment has released a notification dated August 23, 2019 containing a preliminary draft of the EPF Bill, 2019 proposing to make certain significant changes to the EPF Act.

KEY AMENDMENTS PROPOSED & RELATED ANALYSIS – EPF BILL, 2019

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1. Definition of 'Wages': The EPF Bill, 2019 proposes to replace the definition of 'basic wages'⁴ with 'wages'⁵, bringing it in line with the definition of 'wages' under the Code on Wages, 2019⁶. Please refer to our legal alert on this subject [here](#).
Unlike the definition of 'basic wages' under the EPF Act, the definition of 'wages' under the EPF Bill, 2019 sets out an elaborate list of items that would be excluded from the definition of 'wages' such as statutory bonus, house rent allowance, conveyance allowance, overtime allowance, any commission paid to an employee, gratuity, retrenchment compensation etc. However, in the event that the quantum of the excluded components exceeds 50% (or such other percentage as prescribed by the Central Government) of the total remuneration of the employee, the amount which exceeds the one-half or such percentage as notified, will be deemed as 'wages' for the purpose of the EPF Act. In other words, the Contributory Wages of an employee for the purpose of PF contributions is unlikely to be less than one-half of the total monthly remuneration of an employee. Previously, while dearness allowance and retaining allowance were covered separately as part of Contributory Wages, these items have now been included within the definition of 'wages' itself.
2. Varying rates of 'employee' PF contribution: While the EPF Act enabled employees to make higher contributions (if they so desired), the EPF Bill, 2019 introduces a new provision⁷ which enables the Central Government to specify the rate of employee contributions (which maybe lesser than 12%) and the period for which such contribution rates would apply for any class of employees, after making such inquiry as it deems fit, by way of a notification in the Official Gazette.

In the Union Budget 2015-16⁸, there was a recommendation from the Hon. Finance Minister to allow employees below a certain threshold of monthly income an option to decide whether to make PF contributions or not, without affecting or reducing the employer's contribution. In line with the above recommendation, flexibility has been proposed under the EPF Bill, 2019 to prescribe different rates of PF contribution for such periods and such classes of employees as specified.
3. Limitation period and timeframe for inquiry: The PF inspectors are currently permitted to conduct an inquiry as necessary to (a) determine the applicability of the EPF Act to an establishment and (b) determine any amounts due from employers under the EPF Act or the schemes framed thereunder. The EPF Act does not provide for a limitation period. This essentially means that they can go back and conduct audits for a retrospective period, without any limit on the look-back period.

The EPF Bill, 2019 proposes to introduce a **5-year limitation period**⁹, from the date on which the dispute referred to in (3)(a) above is alleged to have arisen or the amount referred to in Clause (3)(b) above is alleged to have become due from the employer. The EPF Bill, 2019 also requires the PF authorities to complete/conclude such inquiries within a maximum timeframe of 2 years¹⁰, unless for reasons to be recorded in writing, to the Central Provident Fund Commissioner (**CPFC**) or such other authorized officer.
4. Enhanced monetary penalties & composition of offences: The EPF Bill, 2019 proposes to significantly enhance the monetary penalties for non-compliance of the EPF Act. For example, an employer who fails to make appropriate PF contributions shall be punishable with imprisonment extending up to 3 years and a monetary fine of Rs. 50,000 (approx. US\$ 700), which is currently set at Rs. 5,000 (approx. US\$ 70). Similarly, the EPF Bill, 2019 stipulates a monetary penalty of Rs. 100,000 (approx. US\$ 1,400) besides imprisonment in cases where the employer has deducted the PF contributions from the employee's wages but not deposited the same, whereas the monetary penalty for this offence under the EPF Act is currently Rs. 10,000 (approx. US\$ 140). It is interesting to note that the penalty amounts have not been revised since 1988 and accordingly the ten times increase from the previous amount.

Interestingly, the EPF Bill, 2019 also provides for composition of certain minor offences doing away with the need to undergo a complete trial for disposition of such offences. Accordingly, these defaults can be resolved by paying up the compounding amounts as specified.
5. National Pension Scheme: The EPF Bill, 2019 proposes to introduce certain new provisions¹¹ under the EPF Act which will enable the members (employees) to opt for National Pension Scheme in lieu of the benefits available to them under the EPF Act. This requires the members to make an application in this respect to the CPFC or such other authorized officer and the central government shall by way of a notification on the official gazette, specify the manner in which the contributions shall be made to the NPS. An employee who joins the NPS shall be deemed to have exited from the Employees' Pension Scheme under the EPF Act, although such member shall have the ability to join back the Employees' Pension Scheme subject to certain conditions. The manner and method to exercise this option and transfer the accumulated amounts from one scheme to the other will be as prescribed by the Central Government.

EPFO'S INTER-DEPARTMENTAL NOTICE (AUGUST 28, 2019)

As a result of the 2019 PF judgment, several employers started receiving inspection notices specifically quoting the 2019 PF judgment. The employer's PF contributions for the past 3 - 5 years were questioned by the regional PF officers, in order to ascertain if any allowances were omitted by employers for the purposes of PF contributions. In light of the same, the EPFO has issued an inter-departmental circular dated August 28, 2019.

By this new circular, the EPFO has directed its officers / inspectors to not initiate any PF inspection unless there is *prima facie* evidence to support such action. Accordingly to the EPFO, "there is no reason or justification to initiate roving inquiries into the wage structure" as a result of the SC Judgement. Accordingly, the regional PF offices have been directed by the EPFO as follows:

- a. In cases where notices have already been issued by the PF department to employers without any *prima facie* evidence of arbitrary bifurcation of wages with the intent to avoid PF liability, such notices should not be pursued further; and
- b. Any inspections or investigations should be carried out by the regional PF inspectors only after it receives the permission of Central Analysis and Intelligence Unit (CAIU) constituted by the EPFO and following the administrative guidelines and policy **only** in those cases where there is credible basis for forming a view that the employer has *prima facie* indulged in illegal practice of avoiding PF liability by splitting basic wages.

ADDITIONAL ANALYSIS:

The Indian government continues its thrust towards ease of doing business in India by introducing progressive

labour reforms. The biggest take-away and relief for employers once the EPF Bill, 2019 is enacted would be the introduction of a much-needed limitation period under the EPF Act. Although it has time and again been argued that whenever a statute does not provide for a period of limitation, action by the authorities must be taken within a 'reasonable' period of time, there have been situations in the past where (section 7A) inquiries for PF non-compliances have been initiated against employers for extended periods, making it a nightmare for employers to produce relevant records.

After the 2019 PF Judgment, the financial liability for employers (for retrospective periods) especially in the case of international workers has been a matter of grave concern. While the liability for the past non-compliances will not be eliminated, the EPF Bill, 2019 will at least help bring about some method in the madness by introducing a fixed limitation period. The EPFO inter-departmental notice of August 28, 2019 is expected to go a long way in ensuring that employers are not subjected to any undue harassment in genuine cases. It is also hoped that the PF authorities consider introducing amnesty schemes which will provide employers an opportunity to rectify any past non-compliances without incurring significant monetary liabilities in the form of interest and damages. The introduction of a fixed timeframe for concluding the inquiry will also help ensure that the power vested with the authorities is not abused.

The alignment of the definition of 'wages' with that of the Code on Wages, 2019 is also a prudent step from the perspective of ensuring consistency amongst various labour laws. However, the new definition of 'wages' is likely to continue posing challenges in terms of what allowances would be subjected to PF contributions. This question would become more pertinent especially in situations where the allowances are such that they have not been specifically included or excluded under the new definition. For example, items such as production bonus, presents given by an employer etc. (which were earlier excluded under the definition of 'basic wages') are not covered under the exclusions in the EPF Bill, 2019 and to that extent, could lead to continuing confusion as to whether such items would continue to stand excluded, although the limit of 50% of wages for PF contributions would come in handy. Given that some employers have already revamped their current practices in relation to the manner of making PF contributions in light of the 2019 PF Judgment, employers may need to re-analyze their CTC structure and wage components in light of the new definition once the EPF Bill, 2019 becomes law.

The option to enable employees to choose between the NPS and the employees' pension scheme under the EPF Act is also a progressive step which will enable employees to make independent decisions with respect to their retirement savings keeping in mind the benefits that each of these schemes offer. It could indirectly lead to a healthy competition between the EPF and the NPS authorities to provide more competitive service for attracting and retaining their 'clientele'!

Given that the EPF Act is expected to eventually be subsumed by the Code on Social Security, the government would be looking to quickly implement the proposed changes by way of the EPF Bill, 2019. In any case, the EPFO inter-departmental notice of August 28, 2019 has already provided a huge relief to employers.

– Preetha S & Vikram Shroff

You can direct your queries or comments to the authors

¹ https://www.epfindia.gov.in/site_docs/PDFs/Circulars/Y2019-2020/Vivekanand_Vidyamandir_717.pdf

² This limit was revised from INR 6500 to INR 15,000 in September, 2014

³ No such cap for International Workers

⁴ Section 2 (b) of the EPF Act

⁵ To be inserted as Section 2 (n) of the EPF Act

⁶ Published in the Official Gazette on Aug 8, 2019

⁷ Proviso of new Section 6

⁸ Para 62 of the Budget Speech

⁹ Proviso to Section 7A

¹⁰ Proviso to Sub-section 1(A) of 7A

¹¹ By inserting Sections 16B and 16C

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