

Social Security Alert

Introduction

This alert briefly summarises a recent ruling of the Supreme Court of India on social security regulations.

In the ruling, the Supreme Court has made observations and laid down principles for salary components to be considered under the definition of 'basic wages'.

Background

The Indian social security regulations are governed by The Employees' Provident Fund and Miscellaneous Provisions Act, 1952 along with the schemes enacted thereunder.

The regulations provide that social security contributions would be calculated at the rate of 24 percent of basic wages with equal contributions from the employer and employee at the rate of 12 percent each.

As such, basic wages has been defined as all emoluments paid or payable in cash to an employee in accordance with the terms of the employment contract with the following prescribed exclusions:

- The cash value of any food concession.
- Any dearness 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.
- Any presents made by the employer.

For domestic employees, many employers follow a pay structure where the employees' gross salary is divided into various components, basic salary being one of them. Traditionally, employers only consider the component of basic salary for calculating the Indian social security contributions even though there are other fixed components like special allowance that are payable to the employees as part of the gross salary.

Key observations

The Supreme Court observed, *as such*, that there is no doubt that all emoluments paid to the employee should be considered for the purpose of calculating the contributions. Payments that are universally, necessarily and ordinarily paid across all employees should be included in basic wages.

However, it is important to analyse whether any payment falls within the prescribed exclusions as defined by law.

These exclusions need to be evaluated keeping the following principles in mind:

- To be eligible for exclusion, the amount paid to the employee should be ascertainable that it was paid for work over and above the normal wage for additional efforts.
- Allowances that are essentially a part of the basic wage cannot be camouflaged as part of an allowance to avoid deduction and necessary contribution.
- If any payment is to be excluded from basic wages, then the payment must have direct linkage of not being common to all.

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- Allowances that are variable, or incentives provided, based on the efficiency and diligence of the employee, should be excluded from basic wages.

Conclusion

Based on the ruling, where employees are eligible to fixed salary components as part of their salary structure and these are not linked to any special efforts or performance, they should be included as basic wages and social security calculated accordingly.

The Supreme Court addresses a much debated topic and employers should take note of the ruling and not merely follow the industry practice of considering only the basic salary component for the purpose of calculating Indian social security contributions.

In the event that that EPF authorities increase their inspections as a result of this ruling, employers could face a recovery claim with interest and damages. Simultaneously, should employers chose to amend their social security practices to include more components, it would result in reduction of net-take home for the employees.

For International Workers, based on the FAQ document issued by the social security authorities, employers have generally been considering gross salary for calculating the contributions. Therefore, we don't foresee an impact towards the inbound expatriate assignee population.

Next Steps

Employers should review their social security practices to determine the impact of the ruling.

Broadening Horizons is a specialty services company providing expatriate tax, social security, immigration and exchange control advisory and compliance services.

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