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Tax alert: Karnataka HC strikes down international worker provisions under provident fund, pension schemes on principle of equality

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The Karnataka High Court ('HC') has struck down the provisions introduced for International Workers ('IWs'), vide para 83 of the Employees' Provident Funds Scheme, 1952 ('EPF Scheme') and para 43A of Employees' Pension Scheme, 1995 ('EPS'). It has held that introduction of such provisions was unconstitutional and arbitrary. The Court has further ruled that all orders passed against which the writ petitions were filed and covered in the judgement, are unenforceable.

In a nutshell

The Ministry of Labour and Employment ('the Ministry') had amended the Provident Funds Scheme in October 2008 extending its applicability to IWs effective 1 November 2008. Unlike domestic workers, where the statutory wage ceiling of INR 15,000 pm was applicable, IWs were mandatorily required to contribute to PF on total wages irrespective of their salary levels. IWs were eligible to withdraw the PF balances only upon retirement at the age of 58 unless they were covered under a Social Security Agreement ('SSA').

India currently has social security agreements with 20 countries, which enable covered employees to avoid dual social security contributions. Indian employees who were deputed to countries covered by such SSA, are exempt from contributing to the overseas social security regime.

Several writ petitions were filed by employers and employees challenging the IW provisions on the grounds of them being discriminatory, arbitrary, not aligned with the intent of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, ('EPF Act').

Essentially the provisions were challenged on the grounds that they are discriminatory in nature and in violation of Article 14 of the Constitution of India.

The Karnataka High Court in its recent ruling has held that the classification made for IWs is unreasonable and has defeated the intent and parameter of the EPF Act. Accordingly, the Court has held that the IW provisions under EPF scheme and EPS, violate Article 14 of the Constitution of India and should be struck down. Further, orders made pursuant to such IW scheme are unenforceable.

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Facts of the case:

GOI had amended the PF regulations in October 2008 introducing the concept of IWs to bring foreign nationals working with establishments covered by the PF regulations, within the PF ambit. Further, Indian passport holders travelling to a country with which India has an effective SSA, were to be categorized as IWs, subject to conditions and covered by the amended regulations.

Essentially, IWs were mandatorily required to contribute to PF in India, irrespective of the wage ceiling. There are also restrictions on withdrawal of accumulated balances for IWs. Further, the contribution is required to be made on all the components of salary except those specifically excluded as per definition of basic wages under the EPF Act, irrespective of whether the salary was paid in India or outside India.

This led to higher contributions for foreign nationals working for Indian establishments both by employer and employee. The non-compliance with such rules, were specifically being questioned during PF inspections/ audits resulting in significant interest and penalties for the employers. Aggrieved by the same, several petitions were filed for relief from such provisions on the basis that the intent of PF and pension laws in India is to protect the interests of weaker sections of society and not for individuals who earn huge salaries. Further, such provisions lead to inequality for individuals working in India who are equal at all levels.

Under this background, the writ petitions were filed to strike down para 83 of the EPF Scheme and para 43-A of EPS on the basis that these provisions are ultra vires Article 14 of Constitution of India and illegal, being opposed to the objective of PF laws in India.

Highlights of this judgement:

- The key arguments raised by the petitioners for striking down the provident fund and pension provisions for IWs are as under:
  - Provisions are violative of Article 14 of the Constitution of India which provides for equality for all and is also illegal being opposed to the object of the EPF and MP Act, 1952. Non-citizen employees working in India and employees who are citizens of India when working in India are equal but are being treated differently.
  - The intent of the legislature is to benefit the weaker sections of the workers working in industrial undertakings and the intent is not to cover high-ranking officials. Thus, introduction of such a scheme for foreign workers is not within the framework of statutory provisions of the Act.
  - There is no cap on the salary on which PF contribution is payable, unlike INR 15,000/- for domestic workers. This results in additional cost burden to the employer.
  - The SSA is a bilateral instrument to protect the social security interest of the workers posted in another country and overall, as on date, 20 countries are covered which is a small set of the population. Majority of the domestic workers are excluded from the purview of the Act at the entry level itself with the prescription of a wage ceiling (INR 15,000 p.m.)
- The key counter arguments of the Union of India/ PF department in support of the introduction of IW scheme are as under:
  - The State has the power to determine who should be regarded as a class for the purpose of legislation and in relation to law enacted on a particular subject.
  - The main intention behind introducing stringent provision for IWs was to be able to negotiate the bilateral agreement with foreign countries to provide relief to Indian nationals who are deputed outside India for shorter period. Such individuals made contribution to the foreign social security and were unable to reap the benefit as most of the benefits required 10 years of contribution / benefits being available on retirement.
  - Thus, a specific classification was carried out considering IWs which had a rational basis with a specific objective to be achieved i.e. availability of benefit to Indians on the principle of reciprocity. Given these principles were on rational basis and for a specific class, the scheme is neither arbitrary nor discriminatory on

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the constitutional validity of the Act, based on Article 14.

- The Karnataka HC after considering the rival submissions, observed as below:
  - The Centre has the due powers as per Section 7 of the EPF Act to amend the EPF Scheme, power to create a specific class and frame specific rules as it did for category of journalists and cine workers.
  - The intent of institution of PF is to encourage the stabilization of a steady labour force in the industrial centers. It is a social welfare legislation meant for the protection of industrial workers to enable them to have an alternative to the pension when they retire.
  - Inclusion of IWs within the purview of PF requires huge contribution by the employer for the high income earning IWs. The provisions have imposed heavy cost in terms of interest and damages in case of non-compliance.
  - An Indian employee moving to a country with which India has an effective SSA, is entitled to the wage ceiling of INR 15,000 p.m., beyond which contributions are optional. However, IWs coming to India from a country with which India does not have an SSA, have to contribute on full salary without any threshold. Thus, there is discrimination between international workers of Indian and foreign origin.
  - India has SSAs only with 20 countries although para 83 was introduced sixteen years ago.
  - It is clear from the above analysis that there is discrimination between the Indian employees working in a non-SSA country (who are not international workers as per definition) and foreign employees from a non-SSA country working in India who are classified as international workers. For such cases, there is neither a rational basis for this classification nor is there reciprocity.

  The Honourable Court considered that non-citizen employees working in India and employees who are citizens of India are treated as two different classes but when working in India they are equal but treated differently. That being so, it is violation of Article 14 of the Constitution of India. Further, such provisions also fail to defeat the very intent of the Act which is to uplift and maintain the rights of the lower/ weaker sections and not for the riche.

  On these grounds, the High Court struck down the validity of the provisions of the IW scheme.

Our comments:

This ruling can have significant ramifications, considering PF contributions are made on full wages (i.e. the contributions towards the EPF Scheme and EPS is payable on gross wages subject to the exclusions called out under the definition of “basic wages”) for IWs and the statutory wage ceiling of INR 15,000 p.m. is not applicable on them. Further, IWs from countries with which India does not have an effective SSA in force, are only allowed to withdraw their PF contributions upon attaining the age of 58 years or superannuation, whichever is later.

Few key challenges arising on account of this ruling are:

1. What would be the status of past PF/ pension contributions / on-going contributions to be made by IWs?
2. What would be the sanctity of SSAs signed by India and the status of exemptions provided to Indian outbounds under the same?
3. What would happen to the taxes paid by IWs on PF withdrawals made earlier?

This judgement could jeopardize the effort of the Indian government of negotiating for a SSA on a reciprocity basis and could dissuade other countries from signing new SSAs with India.

At an international level, this ruling could weaken India’s position to negotiate social security agreements, as the current agreements with India have been based on the principle of reciprocity. Given the current judgement has been pronounced by a single judge bench, it is anticipated that the EPFO would file an appeal before the divisional bench of the Karnataka High Court or before the SC for quashing the order. Hence, it is advisable for employers to closely watch the developments before initiating any policy changes.

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