

Gratuity Benefit Amount & Tax Implications

The general meaning of Gratuity is 'a favor or gift, usually in the form of money, given in return for service.' In employment terms, **Gratuity Benefit amount** is similar to a bonus, *meaning* that it is a portion of your salary provided to you, by your employer, for the services rendered on the company's behalf. Gratuity is a reward for your long and meritorious service.

Gratuity is a **defined benefit plan** and is one of your retirement benefits offered by your employer. You can generally find Gratuity eligibility details in your CTC Company's offer letter.

*(Meaning of **Defined Benefit Scheme** is – A plan/scheme in which a certain amount or percentage of money is set aside each year by a company for the benefit of the employee. Gratuity is a defined benefit plan.)*



Earlier, it was not compulsory for an employer to reward his employee at the time of his retirement or resignation. But in 1972 the Government passed the Payment of Gratuity Act and made it mandatory for all the employers with more than 10 employees to pay gratuity.

What is gratuity?

- How to calculate the gratuity benefit due amount?
- What is the formula to calculate?
- Is gratuity amount taxable?
- What is the applicable tax exemption limit on gratuity benefits?
- How to calculate the gratuity amount online?
- What are the income tax implications?

FAQ 1 – Am I eligible to receive Employees Gratuity Benefit Amount?

After completing five years of continuous service with the same company, you are eligible to receive the gratuity benefit. Gratuity shall be payable to 'you' (employee) on the termination of your employment after rendering continuous service for not less than **five years**.

FAQ 2 – When is Gratuity Amount paid?

It is payable.

- On Superannuation (or) Retirement.
- On your Resignation (or) Termination.
- On death or Disablement due to accident or disease.
- On Retrenchment (or) Layoff.
- VRS (Voluntary Retirement Scheme).

(You can check your 'Full & Final Settlement' papers to know if you have received the gratuity amount or not.)

FAQ 3 – Is five years continuous service rule applicable to all the above events?

The condition of five years of continuous service is **not applicable** if employee's service is terminated due to **death or disablement**. Your nominee or legal heir can receive your gratuity amount (in the event of death of the employee).

FAQ 4 – Are Temporary staff or Contract workers eligible to receive Gratuity amount?

Temporary staff, contract workers etc., are all eligible (except 'apprentice') for the gratuity amount, as long as they are considered as employees of the organization.

FAQ 5 – Is 4 years 10 months (any period above 4.5 years of service) considered as 5 years?

This is one of the most frequently asked questions and there are various conflicting views available on this one.

In one of the court cases, Madras High Court has held that an employee who has completed 4 years and 240 working days in 5th year will be entitled for gratuity i.e. 4 years 10 months and 11 days.

This judgment may or may not be applicable to you (it depends on the place of your establishment). It is better to contact your HR (Human Resource) personnel to get more clarity regarding this point.

FAQ 6 – How is the Gratuity Benefit Amount be Calculated? (For the employees who are covered under Gratuity Act)

How to calculate my gratuity amount, is also one of the frequently asked questions. It is calculated based on simple formula as below; **(This formula applies to all the employees who are covered under the Payment of Gratuity Act, 1972.)**

Gratuity = Last drawn salary * 15/26 * No. of completed years of service.

In the above gratuity calculation formula, **the definition of 'last drawn salary'** means, it includes your Basic Salary + DA (Dearness Allowance if any).

How to treat number of months for the purpose of gratuity calculation after completion of 5 years? **Any service which more than 6 months is considered as one year.** (*Six months and above means even 1 day extra after six months, you are eligible for 1-year gratuity. This is applicable only if you have completed 5 years of service*) (Also note that service period calculation is not dependent on '5 days or 6 days' in a week work rule.)

For example – If you have put in 11 years and seven months in an organization, your service period will be taken to be 12 years. But if your service tenure is 11 years and five months, then for the purpose of this calculation your tenure will be taken to be 11 years only.

FAQ 7 – How is Gratuity Benefit Amount Calculated? (For the employees who are not covered under Gratuity Act)

For non-government employees (*private company employees*), who are not covered under the Gratuity Act, the formula for the calculation of gratuity amount is as below;

Gratuity = Average salary * ½ * No. of years of service

In the above gratuity calculation formula, **the definition of 'Average salary'** means, it comprises, your Basic Salary + DA (Dearness Allowance) + commission (as a percentage of turnover achieved by you, if any). To compute 'Average Salary,' you have to consider the average of last 10 months **salary** (Basic + DA + Commission) preceding the month of your retirement/resignation.

Kindly note that in this case, **your service period will not be rounded off to the nearest full year.** For instance, if you have a total service of 21 years and 10 months, only 21 years will be considered in the calculation.

FAQ 8 – What is the largest amount that I can receive as Gratuity Benefit?

Yes, there is a ceiling of Rs 20 Lakh as the maximum gratuity amount that you can receive. As per the above calculations, if you are eligible to get more than Rs 20 Lakh as gratuity, your company is bound to pay only Rs 20 Lakh. (*In case your company wants to pay more than 20 L then they can pay it as performance bonus or ex Gratia 😊*)

The ceiling of Rs. 20 lakh applies to the aggregate of gratuity received from one or more employers in the same or different years.

FAQ 9 – How to calculate my Gratuity Benefit amount online?

If you are not comfortable in calculating your gratuity due amount using the above formulas, there are lot of online gratuity calculators that are available. You may consider using the below ones;

FAQ 10 – Is Nomination facility available?

Yes, you can give your nomination by filling **Form "F"** at the time of joining your company (during new joined formalities). Employee can nominate one or more members of his/her family to receive the gratuity amount in the event of the death of the employee.

FAQ 11 – My company is not paying gratuity due to financial Loss; can it refuse to pay?

Even if your company is not doing financially well, your company is bound to pay gratuity amount. They cannot cite their 'financial losses' as the reason for the refusal.

But, an employer can refuse to pay the gratuity amount, if the services of an employee have been terminated for his/her riotous or disorderly conduct or any other act of violence on his part, during his/her employment. Employers can also deduct the cost of damages (if any) from the gratuity amount.

FAQ 12 – Is my Gratuity Amount Taxable in India? Does Employees Gratuity Benefit have any tax exemption?

Gratuity is considered as your retirement benefit and is tax exempted subject to certain conditions of Income Tax Act. For the intent of taxation on gratuity, employees are divided into two categories:

- Government Employees &
- Private Sector Employees

Any gratuity amount received by an employee (Govt or Private employee) during his service is taxable. But when gratuity is received by the employee at the time of his retirement, death or superannuation then tax exemption rules for government employees differs from private employees.

In case of Government Employees, the entire gratuity amount that he/she receives on retirement or on death is exempted from paying any Income tax.

In case, when private employees covered under the payment of Gratuity Act of 1972, any gratuity received is tax exempted to the extent of **least of the following**:

1. Statutory limit of Rs Rs 20 Lakh . (Maximum limit / Govt notified amount)
2. Last drawn salary * 15/26 * No. of completed years of service. (**Refer FAQ 6**)
3. Actual Gratuity received by you.

If the gratuity exceeds the limit mentioned above, then it becomes taxable.

Example: *Let us understand the above tax exemption rule with an example. Mr Sundaram receives Rs 9 Lakh as gratuity benefit from his employer. As per the Gratuity Act calculation, he is eligible to receive, let's say Rs 5.5 Lakh. The maximum notified limit is Rs 20 Lakh. Out of these, Rs 5.5 Lakh is the least one. So, the tax exemption is limited to the extent of Rs 5.5 Lakh only. Mr Sundaram has to pay income tax on Rs 3.5 Lakh (Actual gratuity received – Tax exempted gratuity amount.)*

For private employees not covered under the payment of Gratuity Act of 1972, any gratuity received is tax exempted to the extent least of the following:

1. Statutory limit of Rs. Rs 20 Lakh.
2. Gratuity = Average salary x $\frac{1}{2}$ x No. of years of service. (**Refer FAQ 7**)
3. Actual gratuity received by you.

(Where the gratuity was received in any one or more earlier previous years also and any exemption was allowed for the same, then the exemption to be allowed during the year gets reduced to the extent of exemption already allowed, the overall limit being Rs. 20 Lakh.)

FAQ 13 – Gratuity received by Employee/nominee/legal heir: Taxable under what 'head' of income tax?

Gratuity received by you on your retirement (or) during your service period is taxable under the head “Salary.” It should be shown under the head of “Salaries” while computing your ITR. This is applicable for both Government as well as Private employees.

Whereas, gratuity received by the **legal heir (or) nominee is not taxable** if the gratuity becomes due/sanctioned after the death of the employee. If the gratuity amount becomes due and paid before the death of the employee, then it is taxable under the head ‘Income from Other Sources.’ The nominee / legal heir has to show it in ITR (Income Tax Returns).

So, gratuity benefit amount is not fully exempted from income tax. Be extra cautious while calculating the tax exemption limit that is applicable on your gratuity amount.

Latest update: The 7th CPC (Central Pay Commission) increased Gratuity Ceiling limit from Rs 10 Lakh to Rs 20 Lakh w.e.f 01-Jan-2016.

Latest News (25-02-2017): The Central Govt has agreed to raise the ceiling limit of Gratuity amount for Private Sector (organized) employees also, from Rs 10 Lakh to Rs 20 Lakh. The Union Labor Ministry is expected to bring a formal amendment to the Payment of Gratuity Act to implement the change.

Latest update (22-March-2018): The Parliament has passed the Payment of Gratuity (Amendment) bill which will increase the ceiling limit amount to Rs 20 Lakh from the exiting Rs 10 Lakh. This is applicable for central govt employees and also private sector employees (organised sectors).

Latest News (29-Mar-2018) : The President has given his assent to the Payment of Gratuity (Amendment) Act, 2018 and this Act would now be effective from 29th March, 2018.
