

The Applicability and Calculation of Gratuity in India

In 2016, the government considered the proposal to increase the tax-free gratuity US\$15,350 (Rs 1 million) cap to US\$30,700 (Rs 2 million) for the private sector; this is already available to government employees under the Sixth Pay Commission. (US\$1=Rs 65.14).

- The Payment of Gratuity (Amendment) Act, 2018 subsequently received the presidential assent on March 28, and was officially notified on March 29.
- The Gratuity Amendment Act will now enable the government to raise the limit of tax-free gratuity. It will also fix the period of maternity leave so that it will qualify as a continuous service period.
- The change can be made through an executive order by the prime minister.

In this article, we discuss India's gratuity rules in terms of:

- Applicability;
- Calculation;
- Tax exemption;
- Payment; and
- Forfeiture.

Applicability

The Payment of Gratuity Act, 1972 (the Gratuity Act) is applicable to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments with ten or more employees. **Gratuity is fully paid by the employer, and no part comes from an employee's salary.**

To be eligible for gratuity under the Gratuity Act, an employee needs to have at least five full years of service with the current employer, except if an employee passes away or is rendered disabled due to accident or illness, in which case gratuity must be paid.

Gratuity is paid when an employee:

- Is eligible for superannuation;
- Retires;
- Resigns; or
- Dies or is rendered disabled due to accident or illness (if an employee passes away, gratuity will be paid to the employee's nominee).

Gratuity Calculation Formula

Gratuity in India is calculated using the formula:

$$\text{Gratuity} = \text{Last Drawn Salary} \times 15/26 \times \text{No. of Years of Service}$$

Notes:

- The ratio 15/26 represents 15 days out of 26 working days in a month.
- Last drawn salary = Basic Salary + Dearness Allowance.
- Years of Service are rounded down to the nearest full year. For example, if the employee has a total service of 20 years, 10 months and 25 days, 21 years will be factored into the calculation.

Tax Exemption

Gratuity received under the Gratuity Act is exempt from taxation to the extent that it does not exceed 15 days' salary for every completed year of service calculated on the last drawn salary (to US\$30,700 (Rs 2 million)).

Any other gratuity is exempt to the extent that it does not exceed one half-month salary for each year of completed service calculated on the basis of average salary for 10 immediately preceding months (subject to a maximum of US\$15,430). The upper limit of US\$30,700 (Rs 2 Million) applies to the aggregate of gratuity received from one or more employers in the same or different years.

India's income tax department has put out a taxable gratuity calculator, which can be accessed