HR Law Hotline

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INDIA'S PAYMENT OF GRATUITY ACT: EMPLOYERS' INCREASED OBLIGATION TO EXPRESS THEIR GRATITUDE!

INTRODUCTION

The Indian government has finally decided to increase the limit of gratuity to INR 1,000,000 (approx USD 22,250) from the existing limit of INR 350,000 (approx USD 7,750). While the notification for change to the Payment of Gratuity Act, 1972 ("**POGA**") is still awaited, this announcement has already brought cheers to the large employee community in the country. As a result of this decision, an employer will be required to pay up to INR 1,000,000 (which amount shall be tax-free in the hands of the employee) to eligible employees, upon retirement, resignation or termination of employment.

Background

The POGA applies to all factories and to establishments that have at least 10 employees. As per the POGA, every employee who has rendered continuous service for a minimum of five years (except in certain cases), is eligible to receive gratuity from his employer, upon termination of employment. The rate for payment of gratuity under POGA is 15 days' salary (wages) for every completed year of service or part thereof in excess of six months. In order to limit the employer's liability, the gratuity amount has been capped at INR 350,000, which amount was increased from INR 100,000 in the year 1998. At the same time, employees serving the federal or the state government were eligible to receiving gratuity up to INR 1,000,000.

As per the Indian accounting standards[1], gratuity can be paid by the employer through a trust fund created for the purpose or alternatively arrangements can be negotiated with an insurance company such as the Life Insurance Corporation of India (LIC) or any other prescribed insurer, so that the annual contributions towards gratuity, calculated actuarially, can be made each year.

ANALYSIS

The amendment seems to emanate from the deliberations between the government officials and the state labour authorities on this subject, which discussions have been ongoing for some time. The amendment is in the right direction as it seeks to bridge the inequalities between the government employees and those working for private employers. Further, the current gratuity limit of INR 350,000 seems fairly low especially in recent times where India is witnessing escalating salary numbers. Several employees, especially those receiving high salaries, failed to truly benefit from POGA in view of the lower limit of gratuity. Also, POGA needed to keep pace with the steady increase in the eligibility limits (in terms of salaries) under some of the other federal labour laws. The increase in gratuity limit may further incentivize junior and mid level employees to stay with the current employer longer to reap the benefits.

However, once notified, the amendment would significantly increase the obligations of the private sector companies' towards gratuity. Some of the leading organisations follow the HR and retention strategy of calculation of the gratuity amount which is arrived at based on the prescribed formula but without being constrained to the statutory limit. At the same time, several other companies continue to limit their gratuity exposure as per the provisions of the POGA. These companies, predominantly small to mid-size, may need to rework their financials to reflect the higher gratuity obligation. Also, in view of the current scenario where hiring conditions have significantly revived in several sectors, senior level employees (ie, those who have already completed 5 years and reached the new gratuity ceiling), may prefer to cash in on the higher limit by considering alternative employment opportunities.

- Harshita Srivastava & Vikram Shroff

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1 Accounting Standard-15 issued in 1995 titled "Accounting for retirement benefits in the financial statements of employers"

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