

FAQ on GRATUITY ACT, 1972

Meaning: Gratuity is a lump sum payment to employee when he retires or leaves service. It is retirement benefit to an employee

Objectives: The Payment of Gratuity Act, 1972 envisages to provide a retirement benefit to the workmen who have rendered long and meritorious services to the employer.

Applicability: Every factory (as defined in Factories Act), mine, oilfield, plantation, port and railway, Every shop or establishment to which Shops & Establishment Act of a State applies in which 10 or more persons are employed on any day of the preceding twelve months.

Any establishment employing 10 or more persons on any day of the preceding twelve months as may be notified by the Central Government.

Once Act applies, it continues to apply even if employment strength falls below 10.

Applicability – Exemption: The Appropriate Government has power to exempt the Employer or any employee or class of Employees from applicability of this Act,

If in its opinion, the employee is in receipt of gratuity or pensionary benefits not less favourable than the benefits conferred under this Act. Such exemption may be issued retrospectively.

Eligibility: Any person employed on wages/salary should have rendered continuous service of not less than five years, Gratuity is payable at the time of, Retirement or Resignation, or on superannuation, or In case of death or disablement, the gratuity is payable, even if he has not completed 5 years of service.

To whom is Gratuity Payable? Gratuity is normally payable to the employee himself, in the case of death of the employee, it shall be paid to his nominee or if nomination has not been made, to his legal heirs.

In case the nominee/heir is a minor, his share shall be deposited with the controlling authority who shall invest the same for benefit of the minor, until he/she attains majority.

Benefits: For every completed year of service or part thereof in excess of Six Months, the employer shall pay gratuity to an Employee at the rate of 15 Days Wages based on the rate of wages last drawn by the Employee concerned.

Calculation of Gratuity: Amount of Gratuity for Monthly rated Employee,

=15 Days' Wage x Number of years of Service

Wage = (Basic + DA) as per Last drawn Salary, 15 Days' Wage = Last drawn Monthly Wage x 15 / 26.

Maximum Amount of Gratuity: The amount of Gratuity payable to an employee shall not exceed Ten Lakh Rupees.

In case where higher benefit of gratuity is available under any gratuity scheme of the Company, the employee will be entitled to such higher benefit.

Gratuity Trust: Not mandatory to create a Gratuity Trust. However to get benefit of Tax exemption and also to start a Gratuity Insurance, the Trust is mandatory.

Gratuity Trust is not a public trust. It has to be approved by Income Tax commissioner of your circle under whose jurisdiction it falls.

The Company should nominate 3 trustees who should not be directors of the company or its family members.

A) Privately Managed Trust: Investment of funds will have to be done as per Income-Tax Act by the trustees and entire administration of the Trust including Actuarial Valuation will be the responsibility of the Trustees.

B) Trust managed by Insurance Company: Investment and actuarial valuation are taken over by the Insurance Company free of charge and in addition, interest is paid by the Corporation on the accumulated funds.

Gratuity Trust – Procedures for Formation: Board resolution to be passed, Appoint the Trustees, To Draft and execute the trust deed and rules in consultation with the Insurance company, Create a Fund,

Apply to Commissioner of Income tax for approval, To forward to the Insurance Company, a copy of trust deed and rules, Approval from concerned income tax

commissioner is required for every changes in the trust deed.

Gratuity – Few Important Forms / Format:

- *Notice of Opening*
- *Notice of Closure Nomination*
- *Application for Gratuity by an Employee*
- *Notice for Payment of Gratuity*
- *Application for Direction*
- *Notice for Payment of Gratuity*

Insurance of Gratuity liability: Section 4A provides that every employer must obtain insurance of his gratuity liability with LIC.

However

Forfeiture of Gratuity: When service has been terminated for any act or willfull omission or negligence causing, Any damage or loss to, or Destruction of, property belonging to the employer, Gratuity shall be forfeited to the extent of the damage or loss caused this section is not in force as the date from which this section comes into effect has not yet been notified.

Gratuity shall be wholly or partially forfeited: If the services of such employee have been terminated for his riotous or disorderly conduct, or any other act of violence on his part, or If the service of such employee have been terminated for any act which constitutes an offense involving moral turpitude committed by him in the course of his Employment.

Other important provisions...

Section 8 - If Gratuity is not paid within the prescribed time, the aggrieved person may apply to Controlling Authority. He shall after giving opportunity of being heard to the Employer, authorise the Collector to recover the same together with compound interest as arrears of land revenue.

Sec13 - Gratuity payable cannot be attached in execution of any decree or order of any civil, revenue or criminal court.

Sec 14 – This Act or any rule made there under overrides any enactment other than this Act or in any Instrument or Contract having effect by virtue of any enactment other than this Act.

Do You Know About Your Gratuity's Treatment While Filing Your IT Return?

Gratuity usually refers to a lump sum payment made by the employer in compensation of past services. It is one of the retirement benefits granted by an employer to his employees. Employees covered by the Payment of Gratuity Act, 1972 are entitled to gratuity as per the rules provided in section 4(2) and 4(3) of the said act. All other employees are entitled to gratuity as per terms of contract of employment.

Tax treatment of gratuity: Gratuity is taxable as salary as per section 17(1) (iii) subject to exemption as provided in section 10(10) as follows:

Tax treatment of gratuity depends on the status of the employees. Status of the employee and tax treatment of gratuity in different situations are discussed below:

Gratuity received by government employees and employees of local authority: Any death-cum-retirement gratuity received by a Central government or a State government employee or an employee of local authority is wholly exempt from tax under section 10(10) (i).

Gratuity received by a non-Government employee covered under the Payment of Gratuity Act, 1972: Any gratuity received by a non-Government employee covered under the Payment of Gratuity Act, 1972 is exempt from tax under section 10(10) (ii) to the extent of the least of the following:

Meaning of wages: Wages mean all cash emoluments including dearness allowance but excluding any bonus, commission, house rent allowance, overtime wages and any other allowance. In simple word it means the basic wages and dearness allowance.

15 days wages- how to calculate: Fifteen days wages shall be calculated by dividing the monthly wages last drawn by him by 26 and multiplying the quotient by 15.

Completed year of service: Any service in excess of six months will be reckoned as one complete year. Thus, service for a period of 32 and 7 months shall be reckoned as 33 years and service for a period of 32 years and 5 months shall be reckoned as 32 years.

General considerations: Relief under section 89: An employee can claim relief under section 89 in respect of gratuity included in his total income.

Gratuity due in one previous year but received in another year: As per section 15, read with section 17(1), gratuity is taxable on due or payment, whichever is earlier. It means that if gratuity becomes due in the previous year 2009-10, the same is taxable in that year whether or not such gratuity is received by the employee in that year. According to section 10(10), exemption is allowed when gratuity is received. Thus, if gratuity becomes due in the previous year 2009-10 but received in previous year 2010-11, such gratuity is fully taxable in the previous year 2009-10, no exemption under section 10(10) is allowed. Moreover, as the total income of the employee for the previous year 2010-11 does not include gratuity, no exemption under section 10(10) will be allowed. Relief under section 89 is also allowed in the year in which gratuity is received.