

HR Law Hotline

March 30, 2018

EMPLOYEE SEVERANCE LIMIT DOUBLED: A GRATUITOUS ACT BY THE INDIAN GOVERNMENT!

- The Payment of Gratuity Act, 1972 provides for payment of severance in the form of gratuity upon employment termination.
- As a result of the amendment, the Indian government now has the flexibility to determine the maximum gratuity payable to employees, thereby eliminating the need to amend the law every time.
- Similar to government employees, gratuity limit for private sector employees has been doubled to INR 2 million (approx. US\$ 30,000).
- The maternity leave period for computation of 'continuous service' has been increased to 26 weeks.

Gratuity limit for employees has been doubled from the previous limit of INR 1 million (approx. US\$ 15,000) to INR 2 million (approx. USD 30,000). Gratuity payable as per the Payment of Gratuity Act, 1972 of India ("**Gratuity Act**"), is considered as one of the important social security benefit.

The Gratuity Act provides for payment of gratuity upon employment termination, if the employee has been employed for at least 5 years. The calculation of gratuity is based on a formula prescribed by law and is linked to the last drawn wages and the number of years of 'continuous service'. The amount of gratuity is however subject to a monetary limit. Gratuity, if paid as per the terms of the Gratuity Act, is tax free for the employee.

The Payment of Gratuity (Amendment) Act, 2018 has come into effect on March 29, 2018. As a result of the amendment, the government now has the power to determine and revise the gratuity limit, keeping in mind the inflation and wage increase trends in India. The government has issued additional notifications specifying (a) the gratuity limit as INR 2 million and (b) the period of maternity leave (for the purpose of computation of 'continuous service' under the Gratuity Act) as 26 weeks.

KEY CHANGES:

1. **Revision in gratuity limit:** The maximum gratuity payable upon employment termination was previously INR 1 million, a threshold that was fixed in 2010. The law has now been amended to enable the government to fix the maximum amount by way of a notification, thereby doing away with the need to amend the law each time the limit is proposed to be revised. A separate notification specifies the limit of gratuity to an amount not exceeding INR 2 million.

The provisions with respect to gratuity under the Gratuity Act are similar to the Central Civil Services (Pension)

Rules, 1972 for Central Government employees. After implementation of the 7th Central Pay Commission in 2016, the gratuity limit for Central Government employees was enhanced to INR 2 million from the pre-existing limit of INR 1 million. In the past, the gratuity limit under the Gratuity Act (as applicable to private sector employees) has been revised from time to time based on the Central Pay Commission recommendations.

Accordingly, the gratuity payable to private sector employees has now been doubled to INR 2 million bringing the private sector employees at par with their counterparts in the government sector.

2. **Maternity leave period for determining 'continuous service':** Previously, the Gratuity Act specified that the period of maternity leave of 12 weeks shall be taken into consideration for computing the 'continuous service' of an employee for determining an employee's eligibility to receive gratuity. The 12 weeks of maternity leaves prescribed thereunder was based on the maternity benefits then available to female employees as per the Maternity Benefit Act, 1961 ("**MBA**"). However, post the 2017 amendments to the MBA, the maternity leave available to female employees has been increased to 26 weeks. Please refer to our legal alert on this development: [click here](#).

With the objective of aligning the provisions of the Gratuity Act with the amended MBA (in terms of the period of statutory maternity leave period) and in order to avoid a situation where the Gratuity Act needs to be amended every time to bring it in line with the MBA, the provision relating to calculation of "continuous service" in case of female employees who have been on maternity leave has been amended. The amended provision now removes the reference to 12 weeks of maternity leaves and enables the government to notify the period of paid maternity leave for computing "continuous service" by publishing a notification in the Official Gazette. Further, the government has issued a separate notification specifying the maternity leave period to be 26 weeks.

ANALYSIS:

In terms of the legislative history, the gratuity limit which was INR 350,000 in 1997, was increased to INR 1 million in 2010. Employees and trade union representatives have been of the view that the threshold under the Gratuity Act

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has failed to keep pace with the changing economic scenario in India and have demanded that the limit be removed altogether¹. While that demand has not been accepted by the government, the current amendment enables the government to revise the gratuity limit from time to time without going through the procedural and time-consuming hassles of amending a legislation. This would enable the government to take quicker actions in terms of revising the limit in the future.

For quite some time now, private sector employees have been hopeful of a revision in the gratuity limit which would bring them at par with their counterparts in the government sector. The wait has finally come to an end. It may just be a double benefit for employees for FY 2018-19 given the recent increase in standard deduction for salary income as per the tax laws. Increased gratuity limits may also help employers from an employee retention perspective, given that the amount of gratuity payable increases with every year of service. In fact, there are already certain progressive companies that pay out the entire gratuity based on the formula without any monetary cap - they will not be affected by this change. The rest of the employers will need to rework their financials (and gratuity policies) to account for a significantly increased liability.

Given that the national elections are on the horizon, the large employee community in India will surely give a thumbs up to the government.

– **Preetha S & Vikram Shroff**

You can direct your queries or comments to the authors

¹ <https://www.moneylife.in/article/lc-passes-bill-to-hike-gratuity-ceiling-to-rs10-lakh/5172.html>

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