13 FAQs on Gratuity Benefit Amount & Tax Implications

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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 *(Cost to Company)* or 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.

In this post, let us understand about – 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? …

13 FAQs (Frequently Asked Questions) on Gratuity Benefit Amount

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 the most frequently asked question 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 Gratuity Benefit Amount Calculated? (For the employees who are covered under Gratuity Act)

How to calculate my gratuity amount, is also one the Frequently asked questions. It is calculated based on simple formula as below; (This formula is applicable 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 comprises 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 is in excess of 6 months is considered as one year. *(Sixmonths 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 maximum amount that I can receive as Gratuity Benefit?

Yes, there is a ceiling of Rs  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 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 .

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.