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HOW THE NEW WAGE CODE WILL AFFECT YOUR SALARY

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The government has come out with new compensation rules which may result in your company changing your salary structure if it is not in line with the new wage code.

As per the Wage Code Bill 2019, also known as the Code of Wages 2019, the definition of ‘wage’ will change. In simple terms, as per the new definition, wage has to comprise at least 50% of total salary that the employee is getting. This may result in a change in the basic pay which, in turn, will result in a change in the other components such as provident fund contribution, gratuity, whose calculation is based on the definition of basic wages.

The restructuring may result in lesser take home and higher contributions to retirement benefits. Let’s understand how the change in definition of wages is likely to impact your salary structure and your tax liability:

The cost-to-company (CTC) of an employee typically comprises three-to-four components. The basic wage, house rent allowance (HRA), retirement benefits (provident fund, or PF, gratuity accruals, National Pension System) and flexible tax-friendly allowances such as leave travel allowance and entertainment allowance.

The wage code has defined inclusions and exclusions to be considered while calculating wages. “All existing elements that constitute the wage need to be looked at as per the inclusions and exclusions, which means that companies would need to make sure that the exclusions as defined in the new wage code do not exceed 50% of the total remuneration," said Preeti Chandrashekhar, India business leader, health and wealth, Mercer. So, if a person’s salary per month is 1 lakh, the exclusions mentioned can’t be more than 50% of the salary; therefore, the basic wage will have to be 50,000. Companies may have to cut down certain allowances to meet the 50% limit for basic wage. “Allowances will be come down for most employees as the basic salary may go up from an average 30% as per our experience to 50% as per law," said Sudhir Kaushik, chief executive, Taxspanner.com.

“This new definition will affect statutory payments like PF and gratuity as they are linked to wages, which on one hand will entail additional cost to and, on the other hand, reduce take-home for employees," said Raunak Singh, founding partner, Avitr Legal, a law firm.

The change in basic wage will result in a change in contribution towards PF in cases where the employer is contributing towards PF on the actual basic salary rather than the minimum required contribution of 12% of 15,000 (the minimum wage for PF contributions). A higher PF contribution will lead to a lower in-hand pay.

Say, if a person’s salary is 1 lakh and the current basic wage is 40,000, then at 12% each, the employee and employer would be contributing 4,800 each towards PF. The in-hand salary would then be 90,400. But if the basic wage rises to 50,000 after complying with the definition of the New Wage Code, then the take-home will reduce to 88,000, that is 2,400 less. The gratuity will also go up if there is any change in basic wage. Organizations have to pay gratuity as an amount equalling 15 days of last drawn basic wage for each year of service. So, an increase in basic wage will result in an increase in gratuity paid.

The impact of salary restructuring on tax liability will have to be assessed individually. “In general, those in a higher salary bracket will pay more tax as the tax planning option would be limited to 50% of cost-to-company (CTC), whereas those in a lower bracket will be safeguarded through higher contributions for retirement and lower taxes too," said Kaushik. As contributions towards PF may go up, one would be able to claim higher deduction. “Increase in statutory contributions like PF may lead to a reduction in tax liability, subject to the overall limit of 1.5 lakh prescribed under Section 80C," said Rituparna Chakraborty,co-founder and executive vice-president, TeamLease, a staffing firm.

Also, as the basic pay will go up, the tax deduction to be claimed under house rent allowance (HRA) may also go down in some cases as HRA can be claimed as the minimum of three—actual received, actual rent paid minus 10% of the basic salary or 50% of the basic in case of metro cities and 40% in case of non-metro.

Employers will have to be flexibille in deciding pay structures. “Employers can offer flexibility in CTC as per current tax laws, hence, the 50% allowances should have all exempt options like HRA, LTC, and perquisites i.e. car lease, meal coupon, etc. This will help staff choose as per their family and financial needs," said Kaushik.

To limit increase in PF contributions, employers may cap the contribution at 12% of 15,000, the statutory wage ceiling for PF contributions. In case the salary exceeds 15,000, it is not mandatory to contribute to PF. “One would possibly see many companies taking a relook at the practice of deducting PF on full basic in the backdrop of the statutory wage ceiling of 15,000 for PF deduction. This may however, involve seeking employee consent and communicating to PF authorities, but would help balance employer costs and employee take-home," said Chandrashekhar.

It would be prudent to consult a professional to understand the pay structure and plan your investments accordingly once your company restructures after salary provisions.

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