

How to restructure your salary to make it tax friendly under the new Wage Code

Synopsis

The new Wage Code has spurred companies to restructure the pay packages of employees. Find out how to optimise your salary.

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Feedback

The **new Wage Code**, which comes into effect from 1 April, will have a far-reaching effect on **salary** structures in the organised sector. Under the new rules, wages should be at least 50% of the total remuneration of the employee. Wages includes basic salary, dearness allowance and retaining allowance. If the allowances and other benefits exceed 50% of the total income of the individual, the amount above 50% will be treated as part of the wages.

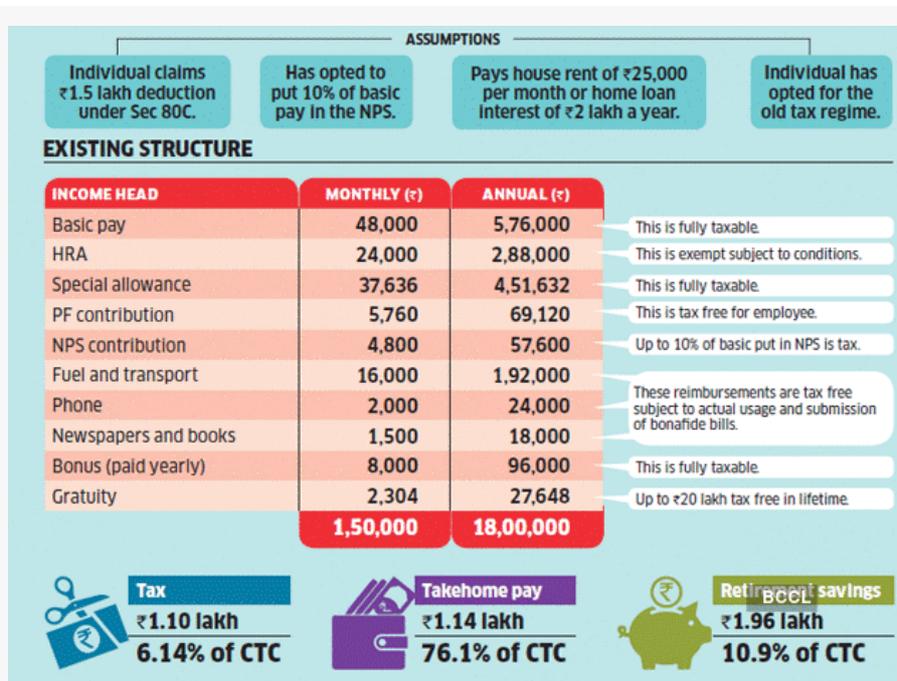
In other words, basic component of the salary has to be at least 50% of the total pay. Since house rent allowance is usually 40-50% of the basic, it would account for another 20-25% of the total remuneration. That leaves a considerably smaller window of 25-30% for all other perks, allowances and benefits to fit in.

It is feared that reducing this component of the remuneration, which is packed with tax-free allowances and also includes the company's contribution to the **Provident Fund**, will push up the tax liability of the employee. The fears are not entirely unfounded, though the tax will go up only marginally. We looked at the typical salary structure and how the changes brought about by the new Wage Code will impact the tax, take-home pay and retirement savings of the individual. The individual's total cost-to-company (CTC) is assumed to be Rs 1.5 lakh a month (Rs 18 lakh per year). She claims the maximum Rs 1.5 lakh deduction under Section 80C, pays a rent of Rs 25,000 per month and has opted for the NPS benefit offered by her company under Sec 80CCD(2). Under this, 10% of basic contributed by the employer to the NPS on her behalf is tax-free.

In the existing structure, the basic salary is 32% of the CTC and the tax is 6.14% of the CTC. The bigger impact is on the takehome pay of the employee, which reduces from 76% to a little over 70% when the basic salary is raised to 50% of CTC in compliance with the Wage Code. At the same time, her retirement savings shoot up from 11% of the CTC to 17%. This is because the retirement savings are linked to the basic salary and any hike in this component will accordingly increase their allocation in the salary structure. The contribution to the Provident Fund, for instance, is 12% of the basic pay. Many companies are known to have compensation structures with low basic salaries to keep their Provident Fund liability as low as possible. The NPS contribution also goes up with the increase in the basic salary.

Choose the best pay structure

Compensation packages under the New Wage Code could enhance your retirement savings, reduce your take home or hike your tax.



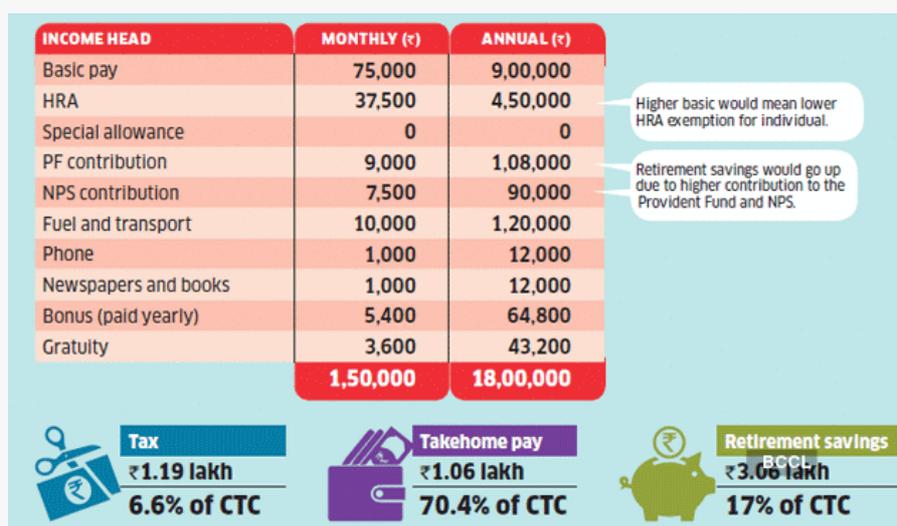
HRA up, but exemption down

Paradoxically, while the increase in the basic salary will also increase the HRA of the individual, the HRA exemption claimed by the taxpayer might come down. Under tax rules, the HRA exemption is the least of the following three: actual HRA; 50% of basic salary (40% in non-metros) and actual rent paid minus 10% basic salary. In our example, although her HRA is Rs 2.88 lakh, she can claim tax exemption for only Rs 2.42 lakh. This is because Rs 3 lakh minus Rs 57,600 (10% of basic) was the least of the three calculations.

Now that the basic will go up to Rs 9 lakh, the HRA exemption will further reduce to Rs 2.1 lakh (Rs 3 lakh minus 10% basic), which means a higher tax liability for the taxpayer. The annual tax outgo increases marginally from Rs 1.10 lakh (6.1% of CTC) to Rs 1.19 lakh (6.6% of CTC).

OPTION I: Increase the basic to 50% of income

Higher basic pay would increase retirement savings but reduce the takehome salary



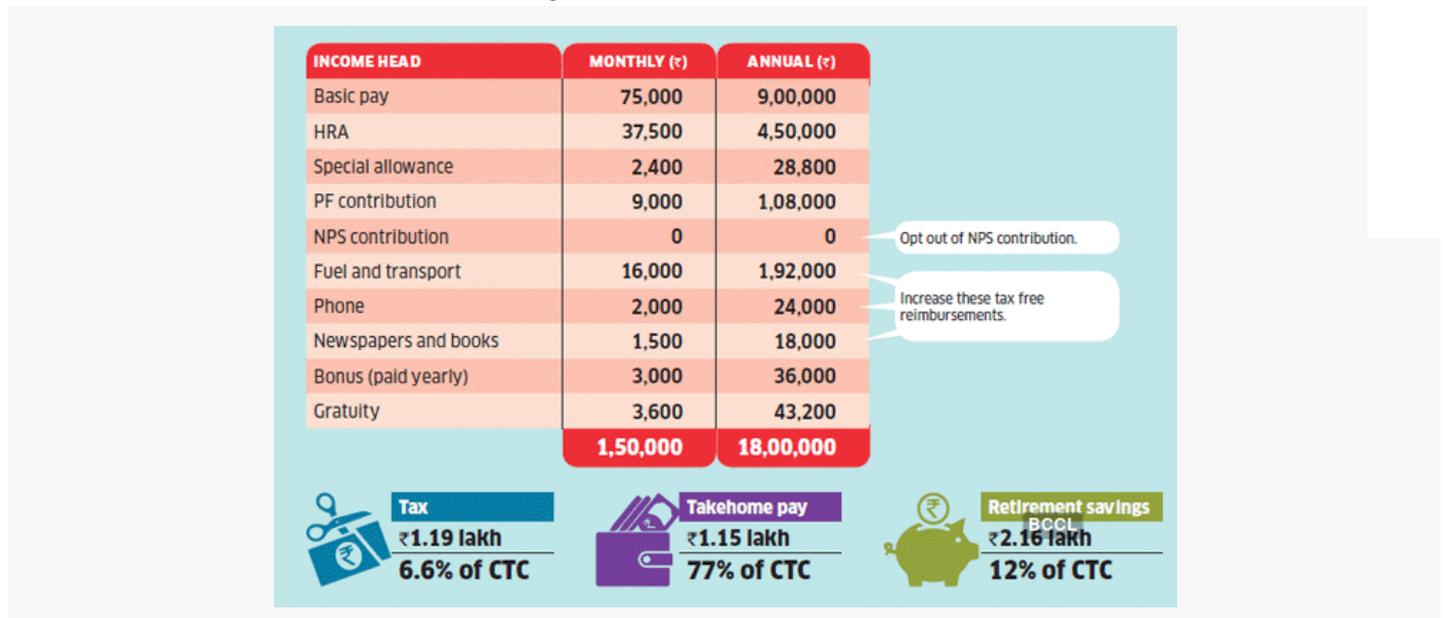
Retirement can wait

A lower takehome pay can be a problem, especially when it comes after a year of pay cuts. But there is very little room for adjustment here. In our example, the individual can push up her takehome salary by reducing her contribution to

retirement savings. While the contribution of 12% of basic salary to the Provident Fund is mandatory, the NPS benefit under Section 80CCD(2) is a voluntary contribution. If the individual stops the contribution to the NPS and her reimbursements are increased by the same amount, her takehome salary will rise to 77% of the CTC while the tax will remain at 6.6% of CTC.

OPTION II: I Keep takehome pay high

This reduces contribution to retirement savings but won't hike the tax



On the flip side, her retirement goal will get pushed further as the retirement savings will drop to 12% of the CTC. “The new Wage Code will enhance the contribution to retirement savings. But young people want to spend more than they want to save. Retirement savings often get sacrificed,” rues Sudhir Kaushik, co-founder of tax filing portal Taxspanner.com.

Some companies provide employees the option to choose the allowances they want based on their requirements and circumstances. “For instance, the HRA would not be of any use to a person who lives in her own house and hence she would not enjoy a tax deduction for the same,” says Aarti Raote, Partner, Deloitte India.

Will the Code plug tax leaks?

It is argued that by restricting the perks and allowances to 25-30% of the remuneration, the new Wage Code could fix the problem of tax avoidance. In our example, only 13% of the total emoluments of the individual were tax-free reimbursements. But some companies give far more than 13%, packing the CTC with all kinds of emoluments and reimbursements. “Individuals whose salaries have a very high proportion of perks and allowances will see a bigger impact on their tax liability after the new Wage Code comes into force,” says Kapil Rana, Founder & Chairman of HostBooks.

Though transport allowance and medical allowance were made taxable two years ago, there are a host of other perks that are tax free. The expenses on vacation travel, fuel, driver salary, telephone, newspapers and books, uniform and even children’s education are reimbursed if the individual submits actual bills and supporting documents. “In developed economies, the pay structure is not very complicated with multiple components. In India, we see such an elaborate pay structure with so many allowances, perquisites and reimbursements because there are several tax breaks linked to specific components,” says Raote of Deloitte India.

Some companies also offer benefits that are taxed differently. For instance, an employee can purchase moveable assets (computers, laptops, white and brown goods and even furniture) in the name of the company and gets reimbursed the

amount. Under Section 17(2), the employee is taxed for 10% of the value of the asset. So, if you bought an air conditioner worth Rs 50,000, you will be taxed for only Rs 5,000. In about five years, the book value of the item depreciates to nearly zero and the company sells it to the employee for a nominal sum (usually Rs 1). “Many IT companies have been offering this to employees for years. Now others should also consider this,” says Archit Gupta, CEO of tax filing portal Cleartax.com.

But this arrangement can be tricky if the employee is not planning to stick around for five years or more. Unlike other perks, the moveable asset belongs to the company. If an employee decides to leave, he will have to return the depreciated value of the item to the company. Even so, the provision of moveable assets to employees is a tax-efficient allowance.

Similarly, a leased car from the company may sound very tax-efficient on paper but could be a costlier proposition for someone who wants to use the vehicle for more than five years. The monthly lease amount going from your salary will not get taxed, so there is a tax benefit. You also need not pay for maintenance or insurance. But at the end of the lease, the car is not yours. Instead, if you buy the car out of post-tax income, you own the car and can get a resale value of the vehicle.

Besides the math, companies are not very excited about this perk. “The car benefit may appear tax-friendly but many companies are getting out of this arrangement on account of the administrative challenge it poses for a company,” says Raote.

You won't need bills to claim reimbursements

Like millions of salaried employees, do you also struggle to keep records of expenses and claim the reimbursements and other benefits offered by your company? The Sodexo Multi-Benefit Pass could be your one-stop solution to this tedious problem. It's a chip-based card that helps organisations deliver benefits like meal coupons, fuel reimbursements and telecom bills to their employees. Sodexo, one of the oldest meal coupon companies in India, has tied up with Zeta to offer this to the estimated three million employees of the 12,000-odd companies it caters to in India.

The Sodexo Zeta smart card and app help categorise the spends according to the nature of the expense. Swipe it at a petrol pump and it will pay money out of the fuel wallet. If used for paying a telephone bill or recharging a mobile, the money goes out of the telecom wallet. The user can even take a picture of the bill and upload it through the app if his company insists on bills. “It is a seamless way to claim all reimbursements through one single platform,” says Anish Sarkar, CEO of Sodexo BRS India.

Meal coupons are tax-free up to Rs 50 per meal, which works out to around Rs 2,200 per month. If this limit sounds low, it's because it was set decades ago and has not been revised till now. Though companies have been offering this benefit for years, there are still some grey areas. In some cases, the meal coupon benefit may be part of the pay package and therefore within the definition of remuneration under the Wage Code. In others, it may not be part of the CTC but as an additional benefit to the employee. “Strictly speaking, the monetary value of any benefit should be part of the individual's income and taxed accordingly unless specifically exempted,” says Aarti Raote, Partner, Deloitte India.