



## Blog by Paku Kalyanarama Sastry CEO – THE HUB / Career HUB

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**Structuring Salaries** is an important assignment for any HR and Payroll professional. Despite the importance of the activity, professionals are often uninformed of the technical and best practices of drafting a complete and efficient salary structure.

**Structuring the salary** is done to benefit both: -

✚ **For the Employee It should be tax efficient**

The Salary structure should give employees the opportunity to save as much tax as possible.

✚ **For the Employer – it should reduce the employer's liability**

The salary structure should reduce the liability of the employer. The employer's contribution to PF, Gratuity etc. should be kept as low as possible, to ensure statutory compliance and to control the CTC cost.

✚ **Statutory Compliance**

The salary structure should comply with the statutory requirements as per the prevailing laws applicable to each of the categories of employees and industry.

## Components of Salary

The salary consists of various components which are dependent on the statutory compliance norms and the Income Tax and the exemption limit on each of these components. While some components are fully taxable, others can be claimed as tax-exempt if you meet certain conditions.

The various components are:-

- ✚ Basic Salary
- ✚ House Rent Allowance
- ✚ Leave Travel Allowance
- ✚ Special Allowance
- ✚ Reimbursements
- ✚ Contributions
- ✚ And others



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### Basic Salary (Basic + Dearness Allowance)

The Basic component is the primary component of the salary structure and the base income of the employee. A basic salary is determined based on the designation of the employee and the industry in which he or she works. It is the fixed amount paid prior to any reduction or increase due to any other component or statutory compliance.

It is usually the largest component of the CTC, making up for 50-60% of the total CTC. Most of the other components are based on the basic salary. The basic salary is considered in defining the salary as other components like Provident Fund, Gratuity and ESIC are dependent on it.

Dearness Allowance (DA) was introduced as part of the salary to reduce the burden of inflation on salaried employees. This amount is notified by the government every year for each of the categories of employees based on the industry and location they work. It is fixed by the government based on the Cost-of-Living Index.

In general, when we speak of Basic Salary it includes Basic + DA

- ✚ The Minimum Wages Act controls the basic salary payable to each category of employee and it is based on the Cost-of-Living Index
- ✚ Basic salary is fully taxable
- ✚ In most of the cases – Basic Salary is included along with the Dearness Allowance as per the Minimum Wages Act

#### If the Basic Salary is too high

- ✚ It will increase the tax liability of the employee since this component is fully taxable
- ✚ It also affects the liability of the employer since higher contributions would be required for PF, ESIC etc.

#### If the Basic Salary is too low

- ✚ You may not be able to meet the Minimum Wage norms set
- ✚ As per the PF Act – the basic should be @ 60% of the Gross Salary for all salaries less than or equal to Rs.15,000/-
- ✚ You would run the risk of falling below the recommended wage limit which attracts penalty

**“Golden thumb rule - It is always recommended to keep 60% of the Gross Salary as Basic Salary”**

### House Rent Allowance (HRA)



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HRA or House Rent Allowance is an amount paid out to employees by companies for expenses related to rented accommodation. It offers tax benefits to the employees for the sum that they pay towards their accommodation every year. Salaried individuals residing in rented homes can claim this exemption and reduce their tax liability.

The amount that you can claim as tax deduction under HRA cannot be more than 50% of your basic in a metro or 40% of your basic in a non-metro. Hence, depending on where your workplace is located, this salary component will usually be set at 40% or 50% of the basic salary.

### **HRA received is not fully exempt from tax**

HRA received during the financial year **can claim the lowest** of the following:

- ✚ The total amount received as the HRA from the employer in the financial year
- ✚ Actual rent paid in the year less 10% of the basic salary in the year
- ✚ 50% of the annual basic salary if staying in a metro city or 40% of the annual basic salary if staying in a non-metro city

**“Golden thumb rule - It is always recommended to keep 50% of the Basic Salary as HRA”**

## **Special Allowance**

Special allowance is the balancing component of the salary structure. It is usually used by organisation as the leftover of the CTC when the rest of the components have been paid out. This component is fully taxable and is also considered for the calculation of Provident Fund.

## **Reimbursements**

Occasionally, employees are entitled to several reimbursements like books and periodicals, phone bills, newspaper bills, etc. The amount is not received in the salary, but on submission of the bills, reimbursement is given. Generally, there is an upper limit for every category of reimbursement.

## **Leave Travel Allowance (LTA)**



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LTA is the amount provided by the company to cover domestic travel expenses of an employee, when he or she is on leave from work. It does not include the expenses for food, accommodation, etc. during the trip.

### **Leave travel allowance is eligible for tax exemption**

The amount paid as leave travel allowance is exempt from tax under Section 10(5) of Income Tax Act, 1961. Leave travel allowance only covers domestic travel, and the mode of travel needs to be air, railway or public transport.

### **Leave encashment**

Leave encashment policy is a subject matter of company HR policy and may differ from company to company. The company's policy may allow individuals to carry forward their unused leaves to the next year or may require the employees to utilize their leaves in same year. In certain cases, company may allow an individual to encash the unused leaves up to a certain limit at different points of employment including:

- ✚ **At the time of retirement (including VRS)**

Separation of the employee from the organization on account of resignation or termination

- ✚ **During the period of employment**

Tax treatment of encashment of unused leave differs for government and non-government employees under Section 10 (10AA) of Income Tax Act.

### **Tax on leave encashment**

- ✚ **Leave encashment during the period of employment**

Leave encashment received during continuation of service is taxable in the year of such encashment irrespective of whether the employee is a government employee or not.

- ✚ **Leave encashment at the time of retirement – Govt. Employees**

Leave encashment of accumulated leave at the time of retirement is fully tax exempted in case of government employees.

- ✚ **Leave encashment at the time of retirement – Private Employees**

However, in the case of non-government employees, leave encashment of accumulated leaves at the time of retirement is exempted from tax up to a certain limit under section 10 (10AA) of the Income Tax Act of 1961.

### **Child Education Allowance**



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This component is paid out towards tuition fees of employees' children and is tax deductible up to Rs. 100 every month for a maximum of two children. Hence, this amount is usually set to not more than Rs. 2,400 a year for an employee.

### Gratuity

Gratuity is a lump sum benefit paid by employers to those employees who are retiring from the organization. This is only payable to those who have completed 5 or more years with the company. The gratuity amount is paid in gratitude for the services rendered by the individual during the period of employment. According to the Payment of Gratuity Act, 1972,

- + As per the **Payment of Gratuity Act of 1971**, Gratuity is payable to the employees during the exit upon due completion of 5 or more years of uninterrupted services.
- + It forms part of the Salary cost and taken as a notional amount to find the CTC Salary of the employee. Gratuity is calculated as 4.81% of the basic pay
- + Maximum cap for Gratuity is Rs.10,00,000/-
  
- + **Gratuity = [ (Basic monthly salary + D.A) x 15 days x No. of years of service] / 26**
- + Here, basic monthly salary is the last month's basic pay at the time of leaving.

### Income Tax applicable on Gratuity payment

The amount of gratuity one receives from his employer is the part of the salary component of the employees and it is shown in their salary slip.

### Taxability of Gratuity in case of government employees

Gratuity received by a government employee is tax **exempted** under Section 10 (10)(i) of Income Tax Act. However, employees of statutory corporations are not included in this category and are not eligible for tax exemption under this category.

### Taxability of Gratuity in case of non- government employees

Is different for two categories of employees.

- + Exemption of gratuity in case of employees covered by the Payment of Gratuity Act, 1972
- + Exemption of gratuity in case of employees not covered by the Payment of Gratuity Act, 1972

### Bonus



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As per The Payment of Bonus Act, 1965 provides for the payment of bonuses to people employed in certain establishments, employing 20 or more people based on profits or based on production or productivity and matters connected there with.

- ✓ The minimum bonus of 8.33% is payable by every industry and establishment.
- ✓ The maximum bonus including productivity linked bonus that can be paid in any accounting year shall not exceed 20% of the salary/wage of an employee.
- ✓ Eligibility limit for Bonus for employees drawing salary up to Rs. 21,000/- per month.
- ✓ Minimum Bonus is fixed at Rs. 7000 Or the minimum wage for scheduled employment, as fixed by the appropriate Government, whichever is higher.

## The Minimum Wages Act of 1948

The Minimum Wages Act controls the minimum wages / salary payable to each of the category employees based on the Cost-of-Living Index for each of the categories of location of work. There are State and Central Minimum Wages rates which are published every year by the Department of Labor for each of the location, category of work and the category of Industry. Every employer must comply with the rates specified for each of the categories and pay the Basic Pay along with the applicable Dearness Allowance mentioned.

**Sometimes the salary is also called with various names – CTC Salary, Gross Salary and Net Salary. Let's understand the meaning of each of these names.**

### Gross Salary

Gross Salary is the basis on which the monthly salary of every employee is calculated. The deductions if any like Provident Fund, ESIC, Professional Tax, Income Tax, Loans and Advances and others are deducted from Gross Salary.

**Gross Salary = Basic Salary + HRA + Other Allowances**

### Net Salary or Take-Home Salary



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Net Salary is the amount paid to each employee as salary and gets credited to their bank account. The net amount after deduction of all the above Provident Fund, ESIC, Professional Tax, Income Tax, Loans and Advances and others is called the Net Salary.

Particulars	Monthly	Annual	Monthly	Annual	Monthly	Annual
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Basic Salary	15,000	180,000	15,000	180,000	50,000	600,000
House Rent Allowance (HRA)	5,000	60,000	7,500	90,000	25,000	300,000
Allowances	-	-	2,500	30,000	25,000	300,000
<b>GROSS SALARY</b>	<b>20,000</b>	<b>240,000</b>	<b>25,000</b>	<b>300,000</b>	<b>100,000</b>	<b>1,200,000</b>
		-		-		-
Provident Fund	1,800	21,600	1,800	21,600	6,000	72,000
ESIC	350	4,200	-	-	-	-
Professional Tax	208	2,500	208	2,500	208	2,500
Income Tax	-	-	-	-	10,000	120,000
Loans & Advances	-	-	-	-	-	-
Canteen Deduction	-	-	-	-	-	-
Other Deductions	-	-	-	-	-	-
<b>Total Deductions</b>	<b>2,358</b>	<b>28,300</b>	<b>2,008</b>	<b>24,100</b>	<b>16,208</b>	<b>194,500</b>
<b>NET SALARY</b>	<b>17,642</b>	<b>211,700</b>	<b>22,992</b>	<b>275,900</b>	<b>83,792</b>	<b>1,005,500</b>

## CTC Salary – Cost to Company Salary

CTC or Cost to Company is the total amount that any organisation spends (directly or indirectly) to engage an employee. It refers to the total salary package of the employee. CTC is inclusive of



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monthly components and annual components; cost of benefits provided to the employee. It also includes the fixed and variable pay components.

There are certain components of salary which are not paid along with the monthly salary, they include employee reimbursements, employee benefits, annual components and variable components like Bonus, etc.

The CTC Salary is the total of your Gross Salary+ Annual Components + Employee Benefits + Variable Pay. **“CTC Salary is the notional amount for the purpose of calculating the cost of engaging an employee and never the actual amount which is received by the employee”.**

Particulars	Monthly Rs.	Annual Rs.	Monthly Rs.	Annual Rs.	Monthly Rs.	Annual Rs.
Basic Salary	15,000	180,000	15,000	180,000	50,000	600,000
House Rent Allowance (HRA)	5,000	60,000	7,500	90,000	25,000	300,000
Allowances	-	-	2,500	30,000	25,000	300,000
<b>GROSS SALARY</b>	<b>20,000</b>	<b>240,000</b>	<b>25,000</b>	<b>300,000</b>	<b>100,000</b>	<b>1,200,000</b>
Provident Fund Contribution	1,800	21,600	1,800	21,600	6,000	72,000
ESIC Contribution	950	11,400	-	-	-	-
Canteen Contribution	1,000	12,000	1,000	12,000	1,000	12,000
Transport Contribution	1,000	12,000	1,000	12,000	1,000	12,000
<b>Total of Monthly Benefits</b>	<b>4,750</b>	<b>57,000</b>	<b>3,800</b>	<b>45,600</b>	<b>8,000</b>	<b>96,000</b>
Variable Salary	2,500	30,000	5,000	60,000	15,000	180,000
Bonus	1,667	20,000	2,083	25,000	8,333	100,000
Gratuity	833	10,000	1,042	12,500	4,167	50,000
Leave Encashment	833	10,000	1,042	12,500	4,167	50,000
Leave Travel Allowance	500	6,000	1,000	12,000	2,500	30,000
Medical Insurance	833	10,000	833	10,000	2,083	25,000
<b>Total of Annual Benefits</b>	<b>7,167</b>	<b>86,000</b>	<b>11,000</b>	<b>132,000</b>	<b>36,250</b>	<b>435,000</b>
<b>Cost to Company (CTC Salary)</b>	<b>31,917</b>	<b>383,000</b>	<b>39,800</b>	<b>477,600</b>	<b>144,250</b>	<b>1,731,000</b>

## Deductions on Salary



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Deductions	How is it calculated?	Whom does it apply to?
<b>Provident Fund</b>	Employer and Employee each contribute Contribution 12% of Basic + DA + Special	Companies that have more than 20 or more employees. It is mandatory for employees who's Basic+DA + Special is less than Rs. 15,000 a month
<b>ESIC</b>	Employer Contribution is 4.75% of Gross Salary; Employee Contribution is 1.75% of Gross Salary	If a company has 20 or more employees who have a gross salary of less than Rs. 21,000 a month, then it is applicable to all those employees
<b>Professional Tax</b>	Varies from state to state	All employees of applicable states
<b>Labour Welfare Fund</b>	Varies from state to state	All employees of applicable states, that might depend on designation

### Provident Fund (PF)

Employee Provident Fund is an employee benefit scheme where investments are made by both the employer and the employee each month. It is a savings platform that aids employees to save a portion of their salary each month, from which withdrawals can be made following a month from the date of cessation of service or upon retirement. At least 12% of an employee's basic salary is automatically deducted and goes to the Employee Provident Fund every month. The contributions are maintained by the Employees Provident Fund Organization (EPFO).

Provident fund is an investment both by the employer and the employee each month, the lump sum amount of which acts as an employee's retirement benefits scheme.

### Provident Fund Employees Provident Funds and Miscellaneous Provisions Act, 1952



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- ✓ Social security for the employees towards compulsory savings for retirement is controlled by the above PF Act.
  - ✓ Every employee shall contribute 12% of his / her - Basic Salary (Basic+DA)
  - ✓ Every Employer must contribute towards the Provident Fund 12% of the Basic Salary (Basic+DA)
  - ✓ It is mandatory for every employer to deduct and contribute towards the Provident Fund for employees, in case the number of employees engaged at any given point of time is more than 10.
  - ✓ Organisations with less than 10 employees it is voluntary to contribute and comply with the PF Act.
  - ✓ The threshold amount for the Basic Salary for Provident Fund Contribution at present is Rs.15,000/- per month.

### Employees State Insurance Corporation (ESIC)

Deductions on ESIC are mandatory for employees whose gross salary is not more than Rs. 21,000. It is only applicable in companies where there are 20 or more employees within the Rs.21,000 gross salary bracket. Employees must contribute 1.75% of the gross salary and employers have to contribute of 4.75% of the gross salary.

#### Employee's State Insurance Act of 1948

- ✓ Social security for the employees towards medical assistance is provided in ESIC Act
- ✓ Every employee shall contribute 1.75% of his / her Gross Salary every month
- ✓ Every Employer must contribute towards ESIC 4.75% of Gross Salary
- ✓ It is mandatory for every employer to deduct and contribute towards ESIC for employees, in case the number of employees engaged at any given point of time is more than 20.
- ✓ The threshold amount for the Basic Salary for Provident Fund Contribution at present is Rs.21,000/- per month.

### Professional tax



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Professional tax is the tax charged by the state government to let an individual practice a certain profession. It depends on one's monthly salary and on the state in which one works. The professional tax levied varies from state to state in India.

### **Labour Welfare Fund**

The Labour Welfare Fund, as the name suggests, is a contribution made by salaried employees for the benefit of the labour class.

The contribution amount varies from state to state and is relatively small. The employer and the employee both make contributions, and the employer pays approximately twice the employee contribution. The payments are made semi-annually in the months of June and December.

Like Professional Tax, Labour Welfare Fund contributions also vary from state to state where they are applicable.

## **Income Tax deductions & exemptions available for Salary income**



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SECTION	NATURE	LIMIT
80C	Basic deductions from total income	Rs. 1,50,000
80 TTA	Interest from deposits	Rs. 10,000 on interest, available to an individual and HUF, deduction allowed on interest earned from a savings account with a bank
80 G	Donations to charity	50% of the donation made is allowed to be deducted from the taxable income. However, if the amount is more than 10% of the gross total income, the excess will be ignored.
80 E	Educational loan	deduction allowed on total EMI part, no limit
80 EE	Home loan interest	Allowed interest paid on home loan up to maximum Rs 50,000 per financial year.
80 D	Medical insurance premium	For self and family- Rs 25,000, For self and family and parents- Rs. 55,000, For self and family and senior citizen parents- Rs. 80000

**Conclusions: -**

This is an effort to highlight some of the critical points on structuring the salary. Structuring of the salary for the employees depends on the business dynamics, industry, and the income tax benefit for each of the employees. I sincerely request you to send in your specific requirement so that we can work on it and take it forward.