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Demystifying Pay in India: How to Structure Compensation for Local Practices

Compensation planning in India requires knowledge of local market practices. Following these tips will guide you to creating an effective pay plan in the country.

The India rewards market is unique. Look no further than the special terms and acronyms that exist only in this complex market: basic salaries, HRA, LTA, conveyance, EPF and gratuity. These terms are all common features of a rewards package in India that don't exist in the same way elsewhere. Due to the complexity and distinctive characteristics of India pay, it is sometimes challenging to establish or communicate compensation packages to employees in India as well as business leaders outside of the country.

For rewards professionals, it is essential to know how various pay elements align to outside markets in order to make an accurate cross-country comparison of relative pay levels and truly understand human capital expenditures in India.

In this article we break down the components of a common pay package in India so you can better understand, structure and manage your India rewards package.

Compensation Elements

India rewards packages begin with the "Cost to Company" (CTC) measurement. This includes all costs incurred by the company on behalf of the employee, both monetary and non-monetary before taxes. In short, CTC consists of fixed compensation, variable cash incentives and benefits. Importantly, the value of stock awards is typically outside of, and in addition to, the CTC.

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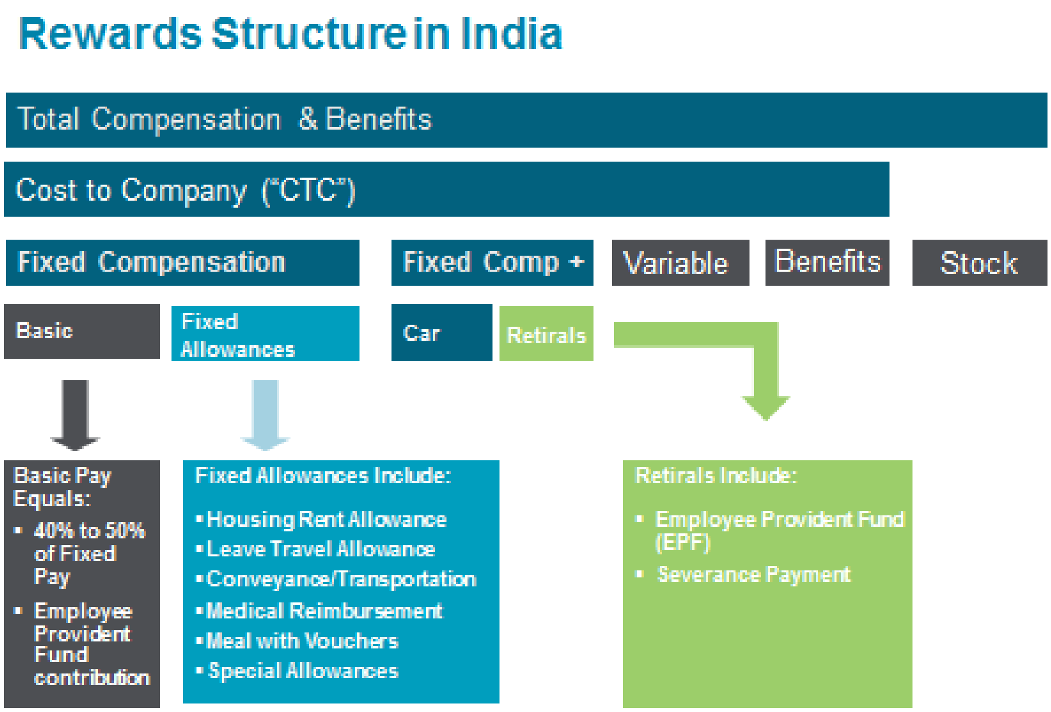
Figure 1

An Overview of Rewards Packages in India



Fixed compensation, also sometimes referred to as "gross salary" in India, is the equivalent of "base salary" in other geographies. Fixed compensation and CTC are the most widely used external competitive pay benchmarks, with fixed compensation often the foundation for creating pay ranges. Fixed compensation is designed to maximize tax advantages for the employee and to minimize the tax liability of the employer. As shown in Figure 1, there is more than base salary involved in fixed compensation; it includes a basket of allowances. Instead of building up compensation elements, rewards packages in India are designed by starting with the targeted fixed compensation amount and then backing into the various components.

Here are the components of fixed compensation and how they are typically designed:

- Basic salary is generally set at 40% to 50% of fixed compensation, depending on the metro location. It is the largest component of fixed compensation fully taxable to the employee. The mandatory Employer Provident Fund contributions and Gratuity are calculated based on basic salary.

- House rent allowance (HRA) can be claimed by employees as a tax exemption (up to 50% of basic salary in a metro city or up to 40% in a non-metro city) if the employee is living in rented housing.

- Leave travel allowance (LTA) is for holiday travel within India. An employee can claim tax benefits for the fare expenses paid for his/her family when they take a holiday, subject to certain restrictions.

- Conveyance Allowance is for travel expenses between home and work. The maximum tax-free amount was 19,600 INR per year. (If the company has arrangements to transport employees to and from work, then the conveyance allowance cannot be claimed for tax benefits). However, this benefit was withdrawn by the government under the new tax regime effective April 1, 2018.

- Medical Allowance is a reimbursement for medical expenses incurred by employees, tax deductible up to 15,000 INR a year. To claim tax benefits, employees must submit proof of their medical expenses. However, this benefit was withdrawn by the government under the new tax regime effective April 1, 2018.

- Meal Allowance is tax free with vouchers with a median value of 22,000 INR.

- Special Allowance is the balancing component and is the amount left over after basic and the fixed allowances above are deducted from fixed compensation. Employees are taxed on this component of pay.

The table below shows an example of how each pay component described above is calculated for a job with a targeted fixed compensation amount of 1,500,000 INR.

Figure 2

Setting Fixed Compensation in India

	Component	Indian Rupee (annual pay)	Calculation	Description
Starting Point:	Fixed Compensation	1,500,000		Target Amount
Step 1:	Basic Pay	600,000	40%	40% to 50% of Fixed Compensation
Step 2:	Specific Allowances:			
	Housing Rent Allowance	300,000	50%	40% to 50% of Basic Pay
	Medical Allowance	0	N/A	Tax deductibility withdrawn April 1, 2018
	Conveyance Allowance	0	N/A	Tax deductibility withdrawn April 1, 2018
	Leave Travel Allowance	40,000	10%	Varies
	Meal Allowance	22,000	Fixed	Median Amount
Step 3:	Special Allowance	538,000	Balance Amount	Fixed Comp minus Basic and Specific Allowances

Beyond Fixed Compensation

In addition to the standard items included in fixed compensation, there are other pay elements included in the CTC measurement, including a car or car allowance (often only for employees at a certain job level) and retirals, which are company contributions to the Employee Provident Fund (for retirement) and the employer accrual towards the gratuity obligation. Gratuity is a formulaic amount paid as severance to employees who are terminated and meet minimum service requirements.

The Employee Provident Fund (EPF) is typically calculated at 12% of basic pay and is contributed by both the employee and the employer. However, only the employer’s contribution is included as part of the CTC. Gratuity is accrued at 4.81% of basic pay. Typically, employers do not include gratuity as part of the CTC. Meanwhile, the National Pension Scheme is an optional retirement vehicle where an employee can contribute up to 10% of basic pay.

Other pay elements outside of fixed compensation include the variable annual cash incentive, benefits (i.e., retirement, medical, life insurance and disability), and stock (an important part of many rewards packages but outside of the Cost to Company calculation).

Next Steps

Structuring rewards packages in India may seem particularly daunting for compensation professionals new to the market. What's more, explaining the structure of India rewards packages to business leaders at multinational companies is difficult when pay terms don't always mean the same thing. However, taking a broad view of how pay is structured can break down these complexities. In order to design competitive and fair rewards packages, HR and compensation professionals must first understand each component and what they are intended to provide to the employee.

Furthermore, new tax laws that went into effect on April 1, 2018, make it even more important to stay up-to-date on what each component of compensation costs employees and employers in taxes.

If you have questions about the India rewards market and want to speak with a member of our compensation consulting group, please write to consulting@radford.com. To learn more about participating in a Radford survey, please contact our team.

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