



Tax alert: Inter-company transfer not an impediment for gratuity entitlement

31 May 2024

The Hon'ble Bombay High Court, in its ruling dated 15 January 2024, has held that mere transfer of employment between two companies under same management, does not result in discontinuation of services of the employee. Accordingly, gratuity needs to be computed based on last drawn wages for the entire period of service across all concerned entities.

In a nutshell



The Hon'ble Bombay High Court (the Court) has pronounced a judgement on gratuity entitlement for an employee who was on a long-term overseas transfer to an entity under the same management. In its ruling favouring the employee, the Court has directed that the foreign assignment tenure has to be considered as continuous service period as per Section 2A of The Payment of Gratuity Act, 1972 (POGA). Further, the quantum must be computed based on 'wages' last drawn before cessation of employment.



The Court relied on its earlier ruling wherein the view was that when an employee working with an educational institution was transferred to another legally independent and distinct education institution, managed, and controlled by the same management, '*there is continuity of service between the two spells*'.

The Court placed reliance on the relieving letter and documents on record for arriving at this opinion.



Where it is established that the services in two spells/entities remain continuous as per Section 2A of the PoGA, employee to get the benefit of gratuity for such continuous service.

In such cases, gratuity to be computed based on last drawn 'wages' further defined in Section 2(s) read with Section 4 of the POGA.



Overseas long-term transfer policy, documentation in place and the case specific facts play a crucial role in establishing "continuity of service" in instances where employment is transferred between companies in the same management / group.



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Facts of the case:

- Mr. Noshir Nani Desai (“Mr. X”) was in service with home entity or ‘MB’ during the period 1996 to 2004.
- Effective 01 March 2004, he was sent on an overseas assignment with MB’s group entity ‘host entity’ or ‘DAG’ as per the assignment agreement (“contract”) executed between MB and Mr. X. On 05 April 2012, Mr. X resigned from services and his last working day with DAG was 25 June 2012.
- It was agreed in the contract that the terms of the existing employment agreement with MB shall continue to apply unless the contract provided otherwise. Further, as per the contract, at the end of the assignment with DAG, Mr. X’s reintegration into MB was not to be automatic.
- The ultimate management between MB and DAG remained the same whereby there was a mere transfer of Mr. X’s services to DAG. Neither did Mr. X resign from MB nor was he freshly recruited by DAG.
- Mr. X received a gratuity of INR 559,292 from MB computed using wages last drawn by him in 2004 from the said entity. However, the period of overseas assignment/ services was excluded for the purposes of this computation.
- Mr. X filed a petition before the controlling authority on the grounds that gratuity had to be determined using his ‘annual base salary’ before cessation of services with DAG, besides considering the entire continuous service period from 1996 to 2012. Mr. X also cited a mail correspondence from MB in support of his claim for higher gratuity relying on the provision of section 4(5) of PoGA. If these were to be factored, Mr. X contended that he would be eligible for gratuity amounting to INR 1,651,652. The controlling authority ruled in his favour, and directed MB to make the aforesaid gratuity payment computed by Mr. X.
- Against this, MB filed an appeal before the Appellate Authority for determination of exact amount of gratuity payable based on – (a) the ‘basic salary’ drawn by Mr. X before cessation of services from it considering gap in continuity of services between the two employment spells with MB and DAG, and (b) the prevailing statutory limit of INR 10,00,000 under Section 4(3) of the PoGA.

Issue for consideration:

- Severance of Mr. X’s relationship with MB upon start of his overseas assignment with DAG and determination of continuous service period for the purpose of gratuity as per PoGA.
- Applicability of beneficial gratuity provisions as per Section 4(5) of the PoGA beyond the statutory limit of INR 1,000,000.
- Quantum of gratuity keeping in mind the provisions of section 2(s) and Section 4 of the POGA.

Ruling:

- The Hon’ble Bombay High Court¹ (the Court) upheld the continuity of services for the purpose of determining gratuity as per PoGA.
- Based on the decision in the case of Terna Polytechnic², the Court noted that there was an association in the two spells of services of Mr. X when he was assigned overseas, and his services were transferred within the same group under a common management. This will be tantamount to continuity of service for the purpose

¹ Mercedes Benz India Private Limited - Writ Petition No. 12201 and 12202 of 2023.

² Writ Petition no: 11864 of 2019

of Section 2A of PoGA while determining gratuity.

- As per the decision in case of Transport Manager, Kolhapur Municipal Transport Undertaking, Kolhapur³, the employee has a right to receive better terms for payment of gratuity under any award/ agreement/ contract with the employer. In the present case, the Court held that in absence of any agreement or settlement for higher amount of gratuity between MB and Mr. X, a mere email communication stating that Mr. X was being paid gratuity over and above his legal entitlement cannot be termed as contract admitting better terms as per section 4(5) of PoGA.
- Gratuity is required to be computed based on 'wages' as defined under Section 2(s) of PoGA. 'Wages' includes emoluments earned by the employee, including dearness allowance, and excluding other allowance. The Court directed the controlling authority to determine the exact emoluments that were drawn at the time of cessation of Mr. X's service within the meaning of Section 2(s) of the PoGA, further keeping in mind the statutory upper limit for gratuity.

Our comments:

Continuation of retiral benefits has always been a crucial factor in expatriate assignments. Computation of gratuity in such cases can become complicated on account of the following factors:

- (a) Whether the duration of overseas assignment is to be regarded as a period of continuous service to determine eligibility for payment of gratuity?
- (b) Whether the salary drawn during the overseas assignment would need be considered as last drawn wages to compute the quantum of gratuity?

This ruling clarifies the methodology to compute the gratuity of an employee who is transferred within group entities with "continuity of service", thereby endorsing the beneficial nature of PoGA.

Organizations should assess the impact of this judgment and review the assignment letters with mobility policies to ensure that where the conditions are met, they pay gratuity for the entire service period (with home and host entities) basis the last drawn 'wages' (as defined under Section 2(s) of PoGA) of the employee at the time of final cessation of employment.

Growing talent mobility and increasing mergers & acquisitions lead to transfer of employees between group entities/ companies with the same management. This is a welcome ruling as it safeguards the interest of employees by clarifying that such transfer is not a break in service but is essentially continuous service. Hence, gratuity shall be computed basis last drawn wages prior to the final cessation of employment.

³ Transport Manager, Kolhapur Municipal Transport Undertaking, Kolhapur Vs. Pravin Bhabhutulal Shah and others (2005 I CLR 998)



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