

HOUSE RENT ALLOWANCE: EVOLVING RELEVANCE UNDER THE NEW TAX AND WAGE FRAMEWORK

House Rent Allowance (**HRA**) continues to be an integral component of most employer Cost to Company (**CTC**) structures in India. Historically, HRA has served a dual purpose, as a standard compensation element and as one of the most widely used tax exemptions for salaried employees.

With the introduction of Section 115BAC under the Income Tax Act, 1961, employees were given the option to migrate to a concessional tax regime with limited exemptions. Under this regime, employees could opt for a standard deduction, and it appeared that the relevance of the HRA exemption would diminish.

However, with the transition to the Income Tax Act, 2025 and the Income Tax Rules, 2026 (**IT Act**), the position has evolved rather than weakened. Additionally, with HRA continuing to be excluded from the definition of “wages” under the Code on Wages, 2019 (**Wage Code**), it has become a standard component of most CTC structures.

The dual tax regime under the IT Act continues and provides individuals with the option to choose between the existing tax regime and the concessional tax regime. Further, the IT Act has now extended the benefit of the higher HRA exemption of 50% of salary, which was previously limited to the four cities of Mumbai, Delhi, Kolkata, and Chennai, to additional metropolitan cities such as Bengaluru, Hyderabad, Ahmedabad, and Pune.

Further, as the HRA coverage expands, tax authorities are increasingly focused on ensuring that the benefit of this exclusion under the Wage Code and the corresponding tax exemption is not misused. The regulatory approach is clearly moving towards greater scrutiny. The IT Act introduces Form 124, replacing the earlier Form 12BB, and strengthens disclosure and documentation requirements through revised declaration mechanisms. Form 124 now requires employees to provide additional details such as landlord information, rent paid/receipts, relation with landlord etc. This reflects a clear intent by tax authorities to curb misuse of HRA exemptions by making bogus HRA claims within families, where no genuine rental transaction exists. At the same time, labour regulators remain focused on ensuring that compensation structures do not reduce social security contributions by increasing HRA component.

With these changes, employers and employees will need to revisit HRA structuring to determine the optimal level that balances both wage exclusions under the Wage Code and tax exemptions under the IT Act. Additional information will have to be collected and maintained by employers as this exercise will now take place under heightened scrutiny from both labour and tax authorities, with one ensuring that social security contributions are not reduced and the other ensuring that exemption benefits are not misused through inadequate documentation.

ELP Comments

It appears that HRA will continue to be a standard component of CTC structures. However, its structuring now requires greater care and a more balanced approach.

From a labour law perspective, HRA must be aligned with the definition of wages under the Wage Code. Employers need to ensure that HRA is not structured in a way that results in an artificial reduction of social security contributions, as this is likely to attract regulatory scrutiny.

At the same time, from a tax perspective, the claim of HRA exemption must be backed by proper and adequate documentation in accordance with the requirements under the IT Act.

We hope you have found this information useful. For any queries/clarifications, please write to us at insights@elp-in.com or write to our authors:

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