

New Labour Codes: A Fundamental Shift in Employee Benefit Liabilities

Navigating the Immediate Financial Impact on Gratuity & Leave Liabilities

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Background



4 New Labour Codes

- Code on Wages, 2019
- Code on Social Security, 2020
- Industrial Relations Code, 2020
- Occupational Safety, Health and Working Conditions Code, 2020



Milestones

- Passed by Parliament in 2020
- Notified on 21 November 2025
- Codes subsume legacy legislation
- Rules to be finalized



Key Changes

- “Wages” definition
- Vesting Period
- Mandatory Funding Rules
- Leave Rules for Workers



Financial Impact

- Immediate increase in liabilities
- Past Service Cost
- P&L Impact based on accounting standards
- Opportunity Cost of mandatory funding

Agenda

Key Drivers

- ❖ Definition of “Wages”
- ❖ Vesting Conditions
- ❖ Mandatory Funding for Gratuity
- ❖ Leave Rules for “Workers”



Implications

- ❖ Accounting & Reporting
- ❖ Affected Organizations

Challenges

- ❖ Open Issues
- ❖ Common Myths & Pitfalls



Action Plan

- ❖ Analyze & Review Payroll Data
- ❖ Identify Key Employee Groups
- ❖ Quantify & Assess Impact

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Key Drivers: Definition of “Wages”

- ✓ Uniform definition of "Wages" for multiple employee benefits, ensuring consistency and significant changes
- ✓ "Wages" now includes all remuneration (Basic, Dearness Allowance, Retaining Allowance, etc.) but explicitly excludes specific components
- ✓ Critical proviso that limits the value of exclusions to 50% of employee CTC

Total Remuneration – Sum of Exclusions = Wages

“Wages” must be $\geq 50\%$ of Total Remuneration for retirals

Key Exclusions:

- ✓ Statutory Bonus
- ✓ House Rent Allowance (HRA)
- ✓ Conveyance Allowance
- ✓ Overtime Allowance
- ✓ Commission
- ✓ Gratuity & Termination Benefits
- ✓ Pension/PF Contributions
- ✓ Special Expenses
- ✓ Awards/ Settlements on order of court/tribunal
- ✓ Retrenchment / Ex-gratia paid on termination
- ✓ House-accommodation or supply of amenities (light, water etc.)

Key Drivers: Definition of “Wages”

BEFORE

(Under The Payment of Gratuity Act, 1972)

APPLICABLE SALARY FOR GRATUITY:

Basic Pay + Dearness Allowance (DA)

No minimum threshold

Implication:

Employers could maintain a lower Basic and/or Dearness Allowance component, thereby resulting in a lower liability

AFTER

(Under The Code on Social Security, 2020)

APPLICABLE SALARY FOR GRATUITY:

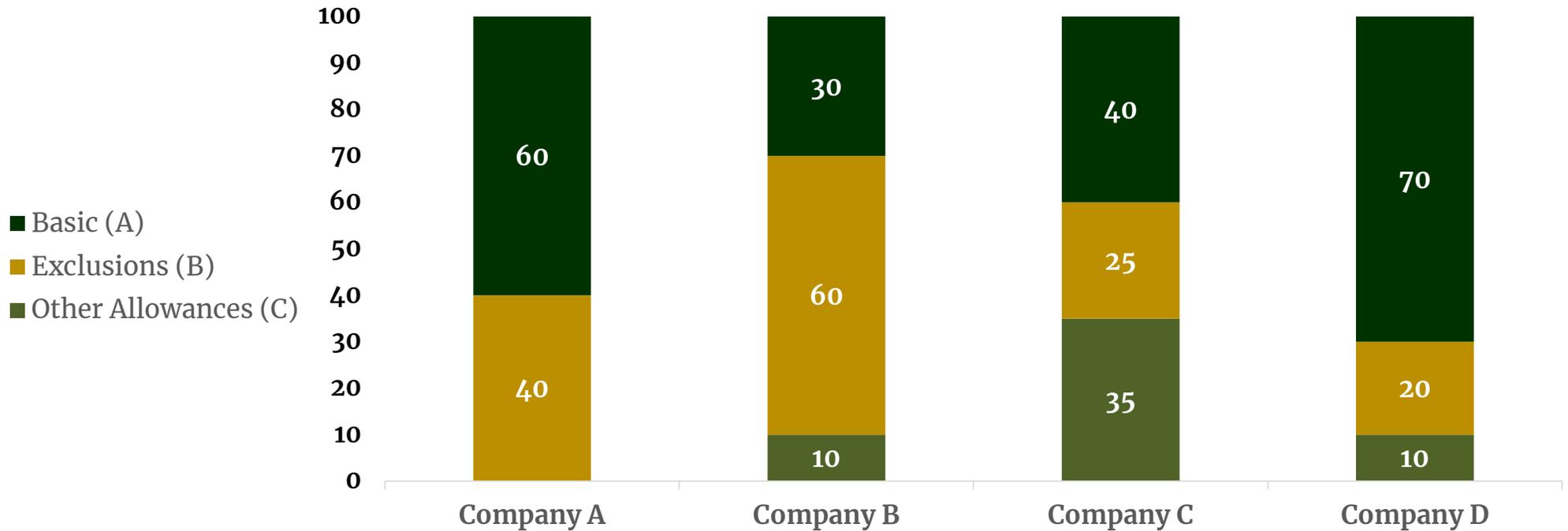
Total Remuneration **minus** Exclusions

Subject to Minimum of **50%** of Total Remuneration

Implication:

Gratuity salary will be at least 50% of total remuneration through Deemed Wages, ensuring larger gratuity payouts to employees

Key Drivers: Definition of “Wages”



Gratuity Salary as per Payment of Gratuity Act

Basic = 60

Basic = 30

Basic = 40

Basic = 70

“Wages” as per Code on Social Security

Basic = 60

Basic + Other Allowances subject to Minimum of 50 = 50

Basic + Other Allowances = 75

Basic + Other Allowances = 80

Key Drivers: Vesting Conditions

BEFORE

(Under The Payment of Gratuity Act, 1972)

APPLICABLE VESTING PERIOD FOR GRATUITY:

5 years' continuous service for all employees

IMPLICATION:

No Gratuity payouts in case an employee leaves before 5 years or if contract ends before completion of 5 years

AFTER

(Under The Code on Social Security, 2020)

APPLICABLE VESTING PERIOD FOR GRATUITY:

Continuous service of 5 years for full-time employees

Continuous service of 3 years for journalists

Continuous service of 1 year for FTC employees

IMPLICATION:

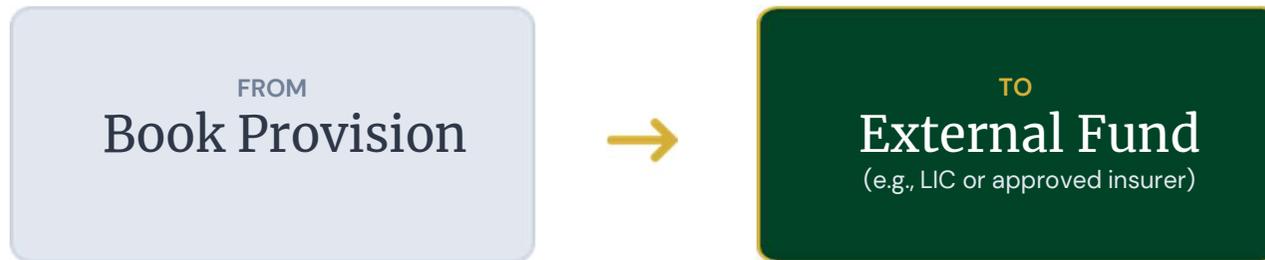
Gratuity payouts will be made for contract employees even if contract duration is less than 5 years

Indirect Financial Impact

Even if FTCs are employed via a third-party contractor on a "cost-plus" model, this cost may be passed on to the company.

Key Drivers: Mandatory Funding for Gratuity

External funding of gratuity liability will be mandatory for all entities from a date to be specified in the future



⚠ For companies with unfunded gratuity plans, this represents a future cash outflow. There is also an opportunity cost, as funds will get tied up instead of being available for working capital

Who is Exempt?

- ✓ Entities controlled by the Government
- ✓ Entities that already have an approved self-managed gratuity fund
- ✓ Entities with >500 employees that establish an approved self-managed fund

⚠ No P&L Impact

There will be no P&L impact on account of this change. There will however be a reduction in the balance sheet liability driven by a corresponding reduction in assets

Key Drivers: Leave Rules for “Workers”

Who is considered a “Worker”

As per Occupational Safety, Health & Working Conditions Code:

A "worker" means any person employed in any establishment to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, except:

1. Employed in a managerial or administrative capacity
2. Employed in a supervisory capacity with wages exceeding INR 18,000 per month
3. Subject to Air Force Act, 1950, or the Army Act, 1950, or the Navy Act, 1957
4. Employed in the police service or as an officer or other employee of a prison

Leave Encashment for Workers

- Leave Encashment must now be paid on "Wages"
- “Workers” allowed to carry forward a maximum of 30 days from one calendar year to the next
- Any leaves applied for but not approved can be carried forward without any limit
- Leave balances above 30 days to be encashed at the end of the year on “Wages”
- “Workers” entitled to one day of leave for every 20 days of work during calendar year

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Implications: Accounting & Reporting

These changes are classified as a "Plan Amendment" under the accounting standards and are recognized as a Past Service Cost (PSC)

Gratuity

- Increase driven by "Wages" definition & inclusion of FTC employees
- PSC treatment for each accounting standard as below

Leave Encashment

- Increase primarily due to updated leave rules for "Workers"
- Movement in liabilities will flow through the P&L immediately

Past Service Cost Treatment – Gratuity

IND AS 19 / IAS 19

Recognized **immediately** in the P&L

AS 15R

Vested employees: Immediate P&L recognition
Unvested employees: Amortised until vesting

US GAAP

Initially Recognised in OCI
Recycled to P&L over time

 We believe auditors will insist on taking this impact within Q3 of FY 25–26, especially in case of limited reviews or full audits

Implications: Affected Organizations



Low Basic Salary as % of total remuneration



Companies operating in service industries



Companies providing gratuity without a ceiling



Large workforce categorized as "Workers"



Sizeable FTC working population



Companies with unfunded gratuity plans

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Challenges: Open Issues

- ✔ How does “Wages” definition consider perquisites (e.g. Sodexo vouchers, reimbursements)?
- ✔ Interpretation of Variable Pay? Included in overall CTC? Included in Wages?
- ✔ Impact of bonuses such as Retention Bonus and LTIPs on “last drawn” salary ?
- ✔ Treatment of ESOPs? Included in overall CTC? Included in Wages?
- ✔ Transition arrangements or one-time impact for Wages definition? Will ICAI provide guidance on accounting?
- ✔ Who gets covered under the definition of “Workers”? Junior or Non-managerial roles for skilled jobs
- ✔ Notification date for mandatory funding? Minimum funding rules? Transitional arrangements?
- ✔ Which salary should be used to calculate gratuity if employee leaves today?

Challenges: Common Myths & Pitfalls

A few common myths surrounding the Labour Codes:

Compensation Re-Structure Mandatory

- ❖ Re-structuring of components is not a necessity
- ❖ Basic salary does not need to be 50% of CTC
- ❖ Deemed “Wages” for retirements will be considered as minimum 50% of CTC

High % of Basic = Less Impact

- ❖ Impact still possible if Basic more than or equal to 50% of CTC
- ❖ “Implied Inclusions” will still lead to impact
- ❖ No impact only if Basic is at least equal to 50% of CTC and all other components are part of “Exclusions”

Company Schemes to pay gratuity on “Wages”

- ❖ Company schemes can still pay gratuity on scheme salary definition
- ❖ Scheme salary definition can continue to be “Basic” only
- ❖ Gratuity payout has to be at least equal to stipulations of the Codes

Not impacted due to third-party FTCs

- ❖ Liabilities associated with third-party FTC employees
- ❖ Cost++ model will lead to costs of gratuity being passed on by contractor
- ❖ Challenges in accurately estimating liability due to lack of information

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Action Plan: Analyze & Review Payroll Data

Objective: To establish the applicable salary under the new definition of "Wages" under the codes

- ✓ **Map Components:** Review every payroll component for every employee
- ✓ **Categorize:** Classify each component as either part of "Wages" or as one of the specified "Exclusions"
- ✓ **Consult Experts:** Liaise with labour lawyers and experts to get clarity on each component of remuneration
- ✓ **Test the Threshold:** For each employee, calculate the sum of "Exclusions" as a percentage of their total remuneration to test against the 50% threshold
- ✓ **Determine Final "Wages":** Based on the test, arrive at the final "Wages" figure to be used for calculating Gratuity (for all) and Leave Encashment (for "Workers")

Action Plan: Identify Key Employee Groups

Fixed-Term Contract Employees

- ✓ Segregate all employees on fixed-term contracts
- ✓ Identify FTC employees on third-party payrolls
- ✓ Study contracts to check who liability falls upon
- ✓ Decide gratuity policy applicable to FTC employees
- ✓ Formulate assumptions for FTC valuations

"Workers"

- ✓ Review job roles (managerial, administrative, supervisory)
- ✓ Review salary levels (Less or more than 18k per month)
- ✓ Identify employees covered under definition of "Workers"
- ✓ Formulate leave policy applicable to Non-workers
- ✓ Calculate assumptions applicable to each category

FTC employees working for the company via third party payrolls should ideally have separate valuations

Action Plan: Quantify & Assess Impact

What is an impact assessment?

- ✓ A quantification of the increase in your Gratuity (and Leave) liabilities
- ✓ An explanation of the Past Service Cost and how it will be treated as per the accounting standard
- ✓ A breakdown into the various aspects of the impact (Wages definition vs FTC employees)

How can it help?

- ✓ Allows you to incorporate the impact into Q3 forecasts and budget for Q4
- ✓ Braces senior management for the upcoming impact, thereby avoiding surprises
- ✓ Follows principles of the accounting standards and satisfies audit requirements

Being cognizant of the impact helps you stay ahead of the curve while navigating these changes. We recommend conducting an impact assessment to quantify the expected change in liability

Contact Us

For further details or to schedule an impact assessment.

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Disclaimer: The views expressed in this note are based on our understanding of the Labour Codes, notified with effect from 21st November 2025. While we have taken care to ensure accuracy, this document is for informational purposes and should not be construed as legal advice.