Wage Structuring and Compliance Risk under India's New Labour Codes

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I. Introduction

India's labour law framework has, for decades, been marked by statutory fragmentation, overlapping regulatory mandates, and a heavy dependence on judicial interpretation. Over a period of nearly seventy years, Parliament enacted close to thirty Central labour laws, each addressing discrete aspects of the employment relationship, i.e., wages, bonus, provident fund, gratuity, industrial disputes, occupational safety, contract labour, and migrant workmen. While these enactments were welfare-oriented and responsive to the socio-economic conditions of their time, their cumulative effect was a complex and often inconsistent compliance environment for employers.

One of the most significant consequences of this fragmented regime was the absence of a uniform definition of "wages". Different statutes adopted different formulations, enabling employers to structure remuneration through multiple allowances and variable components, some of which were excluded from statutory benefit computation depending on their nature, frequency, or statutory characterisation. Wage structuring thus evolved as a legitimate, though often litigated, compliance strategy.

Recognising the structural and operational limitations of this regime, Parliament undertook a comprehensive consolidation exercise between 2019 and 2020, resulting in the enactment of four Labour Codes. With their enforcement from 21 November 2025, India has transitioned to a consolidated labour law architecture. This reform has profound implications for corporate wage structuring, payroll governance, statutory contributions, and compliance risk. This article examines these implications from a corporate law perspective, with particular emphasis on the definition of "wages", salary restructuring, performance-linked pay, gratuity, leave entitlements, and principal employer liability.

II. The Pre-Consolidation Regime: Fragmentation and Wage Flexibility

Prior to consolidation, labour regulation in India was governed by twenty-nine Central labour enactments enacted over seventy decades. Each statute operated within its own conceptual and definitional framework. The Payment of Wages Act, the Minimum Wages Act, the Payment of Bonus Act, the Employees' Provident Funds Act, the Employees' State Insurance Act, the Payment of Gratuity Act, the Industrial Disputes Act, the Factories Act, and the Contract Labour (Regulation and Abolition) Act are illustrative of this statutory diversity.

Crucially, the expression "wages" did not carry a uniform meaning across these enactments. This allowed employers to adopt differentiated wage bases for different statutory purposes. Judicial interpretation, particularly under the provident fund regime, sought to curb artificial allowance-based structuring by emphasising substance over nomenclature. Nevertheless, the absence of a single statutory definition preserved a degree of flexibility, albeit at the cost of uncertainty and litigation exposure.

From a corporate standpoint, compliance under the old regime involved managing multiple inspectors, registers, thresholds, and contribution bases. Wage structuring was often driven by risk management rather than statutory clarity.

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III. Consolidation into the Four Labour Codes

To address these deficiencies, Parliament enacted four Labour Codes between August 2019 and September 2020, namely:

a. the Code on Wages, 2019;

b. the Code on Social Security, 2020;

c. the Industrial Relations Code, 2020; and

d. the Occupational Safety, Health and Working Conditions Code, 2020.

These Codes were brought into force with effect from 21 November 2025 pursuant to notifications issued by the Ministry of Labour and Employment. Upon enforcement, the Central enactments subsumed within the Codes stood repealed to the extent provided therein, subject to repeal and savings provisions preserving accrued rights and liabilities.

The stated objectives of the consolidation were simplification of compliance, harmonisation of definitions, expansion of worker coverage, and modernisation of industrial relations and safety standards. Importantly, the Codes do not dilute substantive labour protections. Instead, they centralise and interlink compliance obligations, thereby recalibrating employer risk across the employment lifecycle.

IV. Mapping the Old Regime to the New

The following table illustrates the structural transition from the pre-consolidation regime to the new Labour Codes:

New Labour Code	Regulatory Focus	Central Labour Acts Repealed / Subsumed
Code on Wages, 2019	Regulation of wages, minimum wages, bonus and equal remuneration	(a) Payment of Wages Act, 1936 (b) Minimum Wages Act, 1948 (c) Payment of Bonus Act, 1965 (d) Equal Remuneration Act, 1976
Code on Social Security, 2020	Provident fund, employee insurance, gratuity, maternity benefits, compensation and welfare schemes	(a) Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (b) Employees' State Insurance Act, 1948 (c) Payment of Gratuity Act, 1972 (d) Maternity Benefit Act, 1961 (e) Employees' Compensation Act, 1923 (f) Cine Workers Welfare Fund Act, 1981 (g) Building and Other Construction Workers' Welfare Cess Act, 1996
Industrial Relations Code, 2020	Trade unions, standing orders, industrial disputes, layoffs and retrenchment	(a) Trade Unions Act, 1926 (b) Industrial Employment (Standing Orders) Act, 1946 (c) Industrial Disputes Act, 1947
Occupational Safety, Health and Working Conditions Code, 2020	Workplace safety, health standards, contract labour and working conditions	(a) Factories Act, 1948 (b) Contract Labour (Regulation and Abolition) Act, 1970 (c) Inter-State Migrant Workmen Act, 1979 (d) Mines Act, 1952 (e) Dock Workers (Safety, Health and Welfare) Act, 1986 (f) Plantations Labour Act, 1951 (g) Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 and other sector-specific safety enactments

While the numerical reduction from twenty-nine statutes to four appears dramatic, the more significant change lies in the integration of wage determination with multiple statutory benefits.

V. The Central Pivot: The Definition of "Wages"

The cornerstone of the consolidated labour law framework is the uniform definition of "wages". Section 2(y) of the Code on Wages defines wages as comprising only three components basic wages, dearness allowance, and retaining allowance, while expressly excluding specified components enumerated under sub-clauses (a) to (k). The proviso to the definition introduces a deeming fiction whereby excluded components under clauses (a) to (i), to the extent they exceed fifty per cent of total remuneration, are required to be added back to wages. The add-back operates arithmetically and mechanically, i.e., it does not convert the nature of the excluded allowance but statutorily deems the excess portion to be wages.

This definition is substantially and materially identical across all four Labour Codes. The legislative intent is unmistakable: wage determination must be uniform across wage regulation, social security, industrial relations, and occupational safety. Consequently, any misclassification of remuneration now has cascading implications across provident fund, gratuity, bonus, leave wages, and other statutory benefits.

VI. Statutory Text versus Administrative Guidance

Following enforcement, the Ministry of Labour and Employment issued draft Central Rules in order to operationalise the provisions of the Labour Codes and and create a supervisory template for State Governments to adopt. Subsequently, multiple FAQ documents were published by the ministry providing illustrative guidance on implementation. Certain illustrations, particularly those treating gratuity as part of total remuneration, have created ambiguity.

From a legal standpoint, the position is settled. The definition of wages is a statutory construct. Administrative guidance and illustrative FAQs, while relevant for clarification, cannot override or dilute clear statutory language. Where inconsistencies arise, the statute must prevail. Employers who rely solely on administrative illustrations contrary to the statutory framework expose themselves to compliance and litigation risk.

VII. Performance-Linked Pay and Gratuity Computation

The treatment of performance-linked incentives is one of the most sensitive issues under the new regime. The Labour Codes do not define performance pay as a separate statutory category. Its treatment must therefore be determined by applying the definition of wages in light of the nature, frequency, and contractual character of the payment.

Performance-linked incentives are typically variable, contingent upon achievement of defined benchmarks, and not ordinarily payable as part of assured remuneration. The Explanation to Rule 34 of the draft Social Security Rules clarifies that payments linked to performance or productivity and paid annually are excluded from wages for the purpose of gratuity computation. FAQs issued by the Ministry reiterate this position.

Significantly, the statutory fifty-per-cent add-back rule applies only to the exclusions expressly enumerated under Section 2(y)(a) to (i). Performance-linked incentives do not fall within these exclusions and are therefore not

aggregated for threshold computation. However, courts will continue to apply a substance-over-form test. Any payment that is assured, uniform, and ordinarily payable cannot be shielded from scrutiny merely by labelling it as performance pay.

VIII. Salary Restructuring and Section 124 of the Social Security Code

Section 124 of the Social Security Code prohibits employers from reducing wages or benefits "by reason only" of their liability to make social security contributions. The provision is intended to prevent employers from passing on the burden of statutory contributions to employees.

Significantly, the provision does not prohibit bona fide restructuring of salary components. Restructuring remains permissible where there is no reduction in overall remuneration or benefits and where the restructured components genuinely conform to the statutory definition and exclusions. The provision codifies principles that had earlier evolved judicially and embeds them into the statutory framework.

The Code also expressly preserves employees' entitlement to better terms of benefits under any award, agreement, or contract. Employers may therefore compute gratuity under both statutory and internal policy frameworks and pay the higher amount without violating Section 124.

IX. Grandfathering of Statutory Benefits and Leave Entitlements

The Labour Codes operate prospectively. Leave accrues periodically and is governed by the law in force at the time of accrual. Gratuity, on the other hand, crystallises only upon termination of employment. Where termination occurs after enforcement of the Social Security Code, gratuity must be computed entirely under the new framework. The Codes do not recognise a generalised doctrine of grandfathering beyond this accrual-based distinction.

Under the OSH Code, leave policies cannot derogate from the statutory minimum accumulation and encashment framework under Section 32. Internal policies providing for lapse of statutorily accrued leave are not sustainable. Employers may offer more generous leave benefits, but not less.

X. Contractor Engagements and Principal Employer Liability

The OSH Code continues the principal employer framework previously contained in the Contract Labour Act. Where labour is deployed through contractors at the establishment of the principal employer, residual statutory liability may arise, particularly in cases of default in wage payment or safety compliance. Contractual allocation of responsibility cannot override statutory obligations, and cost implications must be assessed on a contract-specific basis. While commercial contracts may allocate financial burden inter se, they do not displace statutory liability under the OSH Code.

XI. Sector Specific Implication under the New Labour Codes

The practical impact of the consolidated labour regime is not uniform across industries. The recalibrated definition of wages, the fifty-per-cent threshold, and the expanded compliance architecture under the Codes will produce sector-specific adjustments in compensation strategy, risk allocation, and cost modelling.

A. EPC and Infrastructure

Engineering, Procurement and Construction (EPC) and infrastructure

enterprises operate through multi-tier contracting structures involving principal employers, contractors, and sub-contractors across geographically dispersed project sites. The Occupational Safety, Health and Working Conditions Code strengthens traceability of wage payment and safety compliance across these tiers. Principal employers may face residual exposure in cases of wage default, safety breaches, or misclassification of workforce engagement.

Further, project pricing models traditionally assume a certain cost-to-company structure premised on allowance-heavy compensation formats. The fifty-per-cent wage threshold may increase statutory contribution outflows, thereby affecting bid pricing, escalation clauses, and long-term concession models. Contractor indemnity clauses will likely be revisited to address OSH-linked liability risks.

B. IT and ITES

The IT/ITES sector historically adopted a low-basic, high-allowance salary structure to optimise provident fund and gratuity outflows. The uniform wage definition significantly disrupts this model. While allowances remain permissible, any excess beyond fifty per cent of total remuneration is mandatorily recharacterised as wages.

For organisations with large white-collar workforces and high employee mobility, the impact will be felt in increased gratuity provisioning, social security contributions, and payroll restructuring. Start-ups and growth-stage technology companies, in particular, may need to reassess compensation design without eroding talent competitiveness.

C. Manufacturing

Manufacturing establishments face dual exposure under wage and OSH frameworks. The integration of safety, working conditions, and wage compliance under a unified code strengthens inspection capacity. Any misalignment between payroll classification and statutory registers may attract scrutiny.

Additionally, the expansion of definitions relating to contract labour and inter-state migrant workers may affect workforce mapping and compliance documentation in industrial clusters.

D. Banking, Financial Services and Insurance (BFSI)

The BFSI sector is characterised by performance-linked incentive cultures, including variable pay, bonuses, and productivity-linked rewards. While genuine performance-linked incentives remain outside the statutory fifty-per-cent computation threshold, disputes may arise where variable pay becomes structurally assured or uniformly distributed.

Institutions with high bonus-to-basic ratios may need to reassess documentation clarity to ensure performance incentives withstand substance-over-form scrutiny.

XII. Risk and Litigation Forecast: The Emerging Dispute Landscape

The consolidation of labour laws is unlikely to reduce litigation in the short term. Instead, the locus of dispute is expected to shift.

A. Performance Pay: The Next Provident Fund Litigation Wave?

The provident fund jurisprudence of the past decade centred on whether allowances were universally, ordinarily, and necessarily payable. A similar wave of litigation may now emerge around performance-linked pay. Courts may be called upon to determine whether variable incentives are genuinely contingent or disguised fixed remuneration structured to avoid statutory contributions.

Where incentive structures lack objective metrics or are paid uniformly across the workforce, they may invite recharacterisation.

B. Principal Employer Liability under the OSH Code

Contractors may increasingly contest indemnity enforcement or seek contribution from principal employers in cases of safety violations or wage defaults. Conversely, principal employers may strengthen contractual oversight and documentation to mitigate exposure. Litigation may arise around the degree of supervision sufficient to attract liability.

C. Retrospective Claims and Allowance Misclassification

Although the Codes operate prospectively, disputes may arise regarding misclassification of allowances post-enforcement. Employees or trade unions may assert that certain payments were incorrectly excluded from wages, thereby affecting gratuity or social security entitlements. The quantum of such claims, particularly in long-tenured employment relationships, may be significant.

The initial years of enforcement are likely to witness interpretative litigation clarifying the scope of exclusions and the operation of the fifty-per-cent threshold.

XIII. Conclusion

Enforcement under the Labour Codes is expected to evolve progressively. Initial implementation may focus on procedural compliance; however, over time, data integration through digital registers and centralised portals may enable cross-verification of wage declarations, social security contributions, and safety filings. Technology-driven compliance architecture may reduce opacity in wage structuring.

State Governments, empowered to frame rules under the Codes, may introduce interpretative variations in implementation. Harmonisation efforts, particularly through model rules and digital platforms, will determine the degree of uniformity achieved in practice.

The long-term trajectory suggests a shift from inspector-centric enforcement to data-centric regulation. Employers who proactively digitise payroll governance and align compensation design with statutory architecture will face lower regulatory friction in the years ahead.