Labour Codes – Impact on Compensation Structure and Benefits

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After almost a five year wait, the labour codes have finally been implemented effective November 21, 2025. This is one of the most significant reforms in recent years which aim to simplify and harmonize labour laws in India. While we may have to wait for some of the operational procedures / rules to be framed, companies will have to start the transition process with immediate effect.

We at WTW have prepared a note that provides a refresher on some of the key changes and sets out a summary of the likely implications on compensation structure, retirement benefits, group health and other benefits. The insights are drawn from our experience working with several leading companies, as well as from survey responses collected over the past few years.

Definition of "wages"

Wage can be higher than 50% of remuneration

The first proviso of the definition of wages suggests that specific allowances exceeding 50% of the remuneration will be added back to wages. In light of this, a common interpretation is that wages will now have to be 50% of the remuneration.

We would like to clarify that the wage could be higher than 50% of the total remuneration (and is often seen to be the case based on our analysis of current salary structures across the market). This is because various prevalent components of the current salary structure (e.g. special / supplementary allowance) that have not been explicitly mentioned in the specified exclusions within the definition of wages are likely to be added to wages, pushing the wage above 50%.

In other words, 50% of the remuneration is the floor and not the cap for the purpose of determining wages. It's also possible that even if the current basic salary is greater than 50% of the total remuneration, wage can still exceed basic salary.

New definition of "wages" is applicable to all employees

The new definition of "wages" (which is uniform across all codes) is applicable to all employees and is not restricted to only those earning below a certain threshold.

The definition of "employee" is broad and includes those employed in managerial as well as supervisory roles. While there is a reference to a "wage ceiling", this seems to apply only for the purpose of Provident Fund (PF), Employees' Pension Scheme (EPS), Employees Deposit Linked Insurance (EDLI) and Employees' State Insurance (ESI).

Basic salary need not increase to 50% of remuneration

There seems to be a common notion that in order to comply with this definition, employers will have to increase the basic salary to at least 50% of the remuneration. It is important to note that the Code on Wages does not compel an employer to change its current salary structure. It is only the definition of wage that is changing, and it does not specify that basic salary itself needs to be pegged at a certain threshold.

In practice, however, due to the new definition of wages, certain components of the salary structure may be rebalanced to minimise financial exposure. Employers may also use this as an opportunity to simplify and harmonise salary structures that have become complex to administer. This may lead to either an increase in basic salary or removal of some other components.

Implications on compensation structure

The introduction of the new labour codes—particularly the uniform and expanded definition of "wages"—will require companies to fundamentally reassess the design of their compensation structures. Since "wages" now include most salary components except for a narrow set of specified exclusions, many existing structures with large special or supplementary allowances will need to be reviewed and redesigned.

The broadened coverage and uniformity embedded within the new wage construct mean that organisations can no longer rely on fragmented pay architecture or legacy salary designs that dilute statutory linkages. Instead, compensation structures will need to be re-evaluated through the lens of sustainability of retirement benefit costs, internal equity, and the total rewards philosophy of the company.

For employers, the implementation of the new labour codes signals a structural shift in how compensation frameworks must be engineered, moving from a historically allowance-heavy design to a more simplified, compliant, and financially prudent compensation structure. Employers must review and determine any potential impact on take home pay for employees and decide on risk mitigation steps.

Impact on Retirement Benefits (Gratuity)

Impact is significant

It is now clear that the new definition of wages would mean that the applicable wage to be used for the calculation of gratuity could be significantly higher than the current basic salary (+DA), which, in most cases, will lead to a material increase in the gratuity benefits. This is the case for almost every employer that we analysed because of the way salaries are generally structured in India. Even those companies where the current basic salary is greater than 50% of the remuneration are likely to be impacted.

Impact likely to apply for prior service as well

As per the Social Security Code, the basic structure of the gratuity payment formula remains unaltered at 15 days of the last drawn wages, for the number of years of service. Given that "wages" now assumes a broader definition, the last "wage" would be used to reckon for all the years of service. Hence, prima facie, it seems that the impact will extend to prior service as well.

Impact may not be proportionate to increase in wages

It may not be appropriate to assume that the impact will be proportionate to the increase in wages, especially when determining the impact on gratuity liabilities. For example, if the current basic salary is 35% of the remuneration, the impact on gratuity liability is not necessarily as simple as taking a proportionate increase, i.e. ~ 50%/35%.

This is because the new wage may be higher than 50% of the remuneration, as discussed above, and this could vary across different classes of employees depending on existing salary structures. Secondly, the extent of the impact could be contingent on the gratuity formula, especially if the INR 2M limit applies. For instance, if the company applies the INR 2M limit, the resulting impact could be lower than the proportionate increase in the wage.

Even if the company offers a gratuity scheme that is already more generous than the statutory provisions, there is likely to be an impact. However, the impact could be lower than the proportionate increase in the wage, depending on the how the company frames its gratuity policy in the future. It is important to note that under no circumstances can the gratuity benefit be lower than what is required to be payable under the existing legislative framework.

Impact likely to flow through Profit and Loss Account (P/L)

The situation here seems to be a case of a change in the salary "definition" applicable for gratuity calculation (from basic salary to the new definition of wages). Under Accounting Standard IND AS 19, our initial view is that this change is likely to be treated as a plan amendment and the one-time impact (on prior service) will, therefore, flow through P/L.

The Other Comprehensive Income (OCI) is meant for actuarial gains and losses that result from increases or decreases in the present value of the defined benefit obligation because of changes in actuarial assumptions and experience adjustments. Experience adjustments may arise from unexpectedly high increases in salaries in a year as compared with the assumptions. Under the current situation, the increase in liabilities is not due to higher salary increases but due to a change in the applicable definition of salary. Whenever the gratuity limit has changed in the past (e.g. from INR 1M to INR 2M), the impact has been shown as a Past Service Cost, taken through P/L and not OCI.

Fixed-term employees eligible for gratuity

One of the significant changes introduced in the Social Security Code is that Fixed-term employees will be eligible for the same statutory benefits that are available to permanent employees, proportionately according to the period of service rendered. This includes payment of gratuity on a pro-rata basis at the time of expiration of the fixed-term employment, wherein the condition of 5 years of service is not required. This will lead to additional costs for employers, especially for those who hire significant number of employees on fixed-term contracts.

Impact on Retirement Benefits (Provident Fund)

PF Section of the Social Security Code not yet implemented

The Ministry of Labour notification no. S.O. 5319(E) dated November 21, 2025, indicates that the Social Security Code does not immediately repeal the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 ('PF Act').

The repeal and savings section mentions that any rule, notification, enactment, appointment or benefit provided by the provisions of the PF Act or the Employees' Provident Funds Scheme, 1952 ('PF Scheme') shall remain in force as long as they are not contrary to the provisions of the Social Security Code. Furthermore, the provisions of the PF Scheme shall remain in force for a period of one year from the date of Commencement of this code (i.e., November 21, 2025), to the extent they are not inconsistent with the provisions of this code.

In view of the above, the provisions of the PF Act and its schemes are still in force in so far as they do not contradict any of the provisions of Chapter III (Employees' Provident Fund) of the Social Security Code. Whenever a new set of Social Security Code provisions would apply, they would probably affect only those employees whose monthly wage is up to the statutory threshold (currently at INR 15,000 per month).

Impact on leave encashment

Possible increase in long-term leave liabilities

Leave continues to be governed by the provisions of the Shops and Establishment Acts (S&E) of the respective states, which have themselves not undergone a change. It remains to be seen whether S&E Acts of various states will adopt the same definition of wage as the Central Labour Code(s).

However, the Occupational Safety, Health and Working Conditions (OSH) Code provides for annual leave and encashment of leave, which is linked to the new definition of wages. While the OSH section relates to "workers", the new definition of "worker" is broad enough, i.e. it includes all employees except those employed in a managerial, supervisory and administrative capacity.

We understand that this new definition of "worker" may mean that this provision is applicable to a large section of the workforce for most companies, who will need to comply with the leave encashment provision stipulated under the OSH Code. Given that companies would generally want to adopt the same policy for all employees (irrespective of cadre), it is likely that there will be an increase in long term liabilities of leave benefits due to the new definition of wage being applied.

Leave encashment in service

The OSH code also has a provision of leave encashment while in service. This is applicable under two situations:

- If the worker demands for encashment of leave at the end of the calendar year.
- Any leave balance in excess of the maximum carry forward of 30 days, can be encashed in service

Companies may need to update their leave policies to introduce a provision of leave encashment in service in line with the requirement of the OSH code.

Implications on Employee Health and Wellbeing Programmes

- **Mandatory annual health check-ups:** Employers are now legally required to provide free annual health check-ups for all workers above the age of 40 years. This provision is designed to foster a preventive healthcare culture and support early detection of health issues.
- **Broadened ESIC coverage:** The Employees' State Insurance Corporation (ESIC) coverage is expanded nationwide, now including establishments with fewer than 10 employees (on a voluntary basis) and mandatorily for units with even a single employee in hazardous processes. This move ensures medical benefits and social security protections for a wider segment of the workforce.
- **Enhanced health safety standards:** The Codes introduce national standards for occupational safety and health across industries. This includes mandatory safety committees at worksites with 500+ employees and regular safety training, especially in hazardous industries and plantations.
- **Canteen, drinking water, and rest facilities:** MSMEs and other sectors must now provide basic amenities, including canteens, drinking water, and rest areas, supporting better workplace health and hygiene.
- **Special provisions for high-risk sectors:** Sectors such as mining, hazardous industries, plantations, and dock work must provide full ESI medical facilities, annual health check-ups, and mandatory protective equipment. These steps are designed to minimize workplace accidents and ensure prompt healthcare.

Implications for Group Term Life and Group Personal Accident Programmes

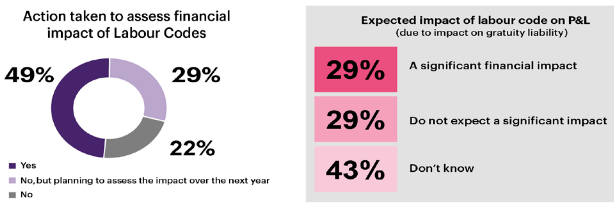
- **Universal Social Security:** Under the Code on Social Security (2020), all workers including gig, platform, and unorganized sector workers are now eligible for social security benefits, which encompass, ESIC, insurance, and related protections. This broadens the scope and necessity for robust group term life and group personal accident insurance programmes.
- **Mandatory Social Protection:** The Codes require principal employers to extend health and social security benefits including insurance coverage for death and personal accidents to contract and fixed-term employees, aligning their benefits with those of permanent staff.
- **Coverage for commuting accidents:** The Social Security Code explicitly recognizes certain commuting accidents as employment-related, qualifying affected employees or their beneficiaries for accident insurance benefits, subject to conditions of time and place of employment.
- **Expanded definitions and eligibility:** Definitions of "worker" now include gig, platform, and digital media workers, making them eligible for group insurance and accident protections. Aggregators (such as app-based companies) are mandated to contribute to social security, further supporting insurance programme funding.
- **Gender-neutral and inclusive benefits:** The Codes mandate equal treatment and benefits for all workers, including women and transgender persons, ensuring equitable access to group insurance programmes.

Industry preparedness

WTW's State of Retirement Survey 2024, which included responses from 138 leading employers in India, revealed that about 50% of companies had assessed the financial impact of labour codes. In most cases, there is a significant impact, especially with respect to gratuity liabilities.

Half have assessed the financial impact of labour codes

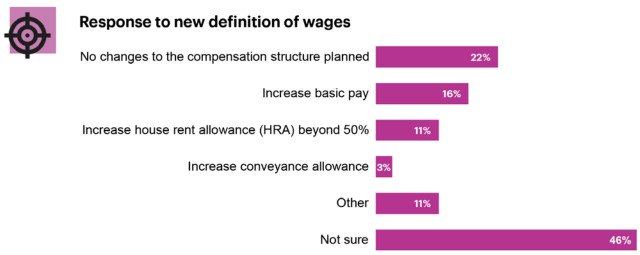
Over 2 in 5 are unsure of the impact on the gratuity liability



LHS Q: Has your organisation taken any action to assess the financial impact of the Labour Codes ?
RHS Q: The changes in the labour code will have an impact on the gratuity liability, and in turn the profit and loss (P&L) for the organisation. What will be the expected financial Impact of the labour code on your organisation's P&L? And is your organisation planning to change its gratuity policy as a result?
Note Percentages may not sum100%due to rounding
Source: The State of Retirement Benefits in India –2024

When asked about whether they had changed the compensation structure in response to the new definition of wages, most companies said that they were unsure or had planned no changes to the compensation structure yet. We understand that several companies had decided to change their compensation structure; however, they had not implemented the same, as they were waiting for the Government to announce the implementation date.

Almost half are unsure about their response to the new definition of wages



Q: How is your organisation planning to change its compensation structure in response to the new definition of wages? *Please select all that apply.*
Source: The State of Retirement Benefits in India – 2024

Concluding remarks

The new labour codes expand social security to more employee groups and introduce a uniform wage definition, ensuring all workers receive a minimum level of benefits. While this may increase costs for employers, especially around retirement benefits, the workforce will gain in the long run. Employers must update health, group term life, and personal accident insurance to meet the new rules. Coverage should now include gig, platform, and contract workers, with stronger health and safety benefits across industries. Insurers, in turn, should prepare for higher demand for group insurance products that meet these broader requirements.

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