

Early Impressions

Navigating India's New Labour Codes



EXECUTIVE SUMMARY

India's New Labour Codes represent one of the most consequential regulatory shifts affecting workforce cost, compensation design, and financial reporting in recent decades. While the reforms are often discussed from an HR or compliance standpoint, their most immediate and enduring impact sits squarely with CFOs, boards, and audit committees.

The Legal Reset

The consolidation of 29 Central labour laws into four comprehensive Codes — the Code on Wages, Industrial Relations Code, Code on Social Security, and the Occupational Safety, Health, and Working Conditions Code — fundamentally rewrites the regulatory architecture governing employment. Although enacted between 2019 and 2020, the Codes will take effect through phased notification of Central and State rules. Once operational, they will replace legacy interpretations that organizations have relied upon for decades, increasing the importance of legal interpretation, rule tracking, and defensible compliance positions.

Wage Definition: The Structural Inflection Point

At the core of the reforms lies the redefinition of the concept of “wages.” The Codes introduce an inclusive–exclusive framework covering all remuneration payable to an employee, with basic pay, dearness allowance, and retaining allowance forming the core components.

Specified allowances and benefits are excluded, subject to an overall cap. Where such exclusions exceed 50% of total remuneration (or such percentage as may be notified), the excess amount is deemed to form part of wages for statutory purposes. In effect, this mechanism results in wages constituting at least 50% of total remuneration for statutory computation, even where salary structures are heavily allowance-driven.

This is not merely a payroll reclassification exercise. The revised definition directly alters the base for provident fund, gratuity, bonus, leave encashment, and other statutory benefits, creating a structural step-up in long-term employee benefit obligations. Government clarifications also reinforce that this wage definition applies consistently across all labour laws subsumed within the Codes, limiting scope for selective interpretation.

For many organizations, existing compensation structures — particularly those optimized through allowances — may no longer be sustainable without triggering increased statutory costs or compliance risk.

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Accounting Impact: Immediate and Non-deferrable

From a financial reporting perspective, labour code alignment has clear and immediate consequences. Where compensation restructuring is driven by compliance with the new wage definition and does not represent a genuine increase in employee pay, the resulting increase in gratuity and leave obligations constitutes a plan amendment or benefit enhancement rather than a change in actuarial assumptions.

Recent clarifications and frequently asked questions issued by the ICAI reinforce that compliance-driven recharacterization of pay components gives rise to past service costs under the applicable employee benefit standards.

Under Ind AS, this impact is recognized immediately in profit or loss as past service cost. Indian GAAP offers limited deferral only for unvested benefits, while US GAAP follows a materially different AOCI-based Amortization model. Importantly, interim financial reporting standards do not permit deferral until year-end — the impact must be recognized in the first interim period following the effective date of the relevant provisions.

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INDIA’S NEW LABOUR CODES: A CFO AND BOARDROOM BRIEFING

From Legislative Reform to Financial Reality

For decades, India’s labour framework was governed by 29 Central statutes enacted between the 1920s and the 1970s. While these laws reflected the industrial realities of their time, over the years, they evolved into a fragmented and compliance-heavy regime, misaligned with modern employment models and increasingly inadequate in extending social security to India’s changing workforce.

Against this backdrop, the Government of India undertook a comprehensive reform exercise, drawing substantially from the recommendations of the Second National Commission on Labour (2002). This reform culminated in the consolidation of all 29 Central labour laws into four comprehensive Labour Codes enacted between 2019 and 2020:

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

Collectively, the Codes aim to simplify compliance, introduce uniform definitions (most notably of “wages”), facilitate digital-first administration, enhance occupational safety and welfare standards, and significantly expand the statutory social security framework to cover previously excluded segments of the workforce.

While the Codes have been enacted, their operational impact depends on rule notification and enforcement at both the Central and State levels. As these reforms move from policy intent to operational reality, organizations must prepare for a structural shift in workforce compliance, cost structures, and financial reporting.

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WHAT THE LABOUR CODES CHANGE — AT A GLANCE

Code on Wages, 2019

The Code on Wages subsumes four earlier legislations: the Payment of Wages Act, the Minimum Wages Act, the Payment of Bonus Act, and the Equal Remuneration Act. Its key reforms include:

- 01 Extension of minimum wage protection to all employees across organized and unorganized sectors.
- 02 Empowerment of the Central Government to notify a national floor wage, aimed at reducing inter-State disparities in minimum wages.
- 03 Introduction of a uniform definition of “wages,” with specified inclusions and exclusions. Certain allowances are capped, with any excess over the prescribed threshold deemed to form part of wages for statutory purposes, effectively resulting in wages constituting at least 50% of total remuneration.
- 04 Overtime payable for work beyond 48 hours a week at a rate not less than twice the normal rate of wages.
- 05 Prescribed timelines for payment of final dues on separation, generally requiring settlement within a short period, subject to applicable rules.

Government clarifications also indicate that components such as performance-based incentives, ESOPs, variable pay, and reimbursement-based payments are not treated as wages, while leave encashment is excluded from allowances for the purpose of applying the 50% cap.

These changes have direct implications for payroll design, statutory contributions, and long-term employee benefit obligations.

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An illustration of the allowance rule, as provided in the FAQ, is set out below:

Total remuneration: INR 76,000 per month

Break-up

- Basic Pay + Dearness Allowance (DA): INR 20,000
- Allowances: INR 40,000
- Other components (gratuity, retrenchment compensation, etc.): INR 16,000

For the purpose of the allowance rule, allowances refer to components **other than Basic + DA**, excluding certain statutory terminal benefits. Hence, allowances considered = INR 40,000.

Application of 50% rule

- **Maximum allowable allowances for calculation of wages**
50% of total remuneration (INR 76,000 × 50%) = **INR 38,000**
- **Actual allowances paid = INR 40,000**
- **Excess allowance over 50% limit**
INR 40,000 – INR 38,000 = **INR 2,000**

Impact on wages

- Excess allowance of **INR 2,000** shall be **added back to wages (Basic Pay + DA)** for statutory compliances.

Revised wages for statutory calculations

INR 20,000 + INR 2,000 = **INR 22,000**

While the Ministry's illustration helps explain the allowance cap, including gratuity within a monthly "total remuneration" construct may invite differing interpretations. As gratuity is a deferred terminal benefit and excluded from wages, this approach could blur the distinction between statutory wage mechanics and CTC-style presentation. Employers should therefore apply caution and closely monitor how enforcement authorities operationalise this aspect once the Codes are implemented.



Industrial Relations Code, 2020

The Industrial Relations Code consolidates the Industrial Disputes Act, 1947, the Trade Unions Act, 1926, and the Industrial Employment (Standing Orders) Act, 1946. Key features include:

01

Prior government approval for lay-offs, retrenchment, and closure applicable to establishments employing 300 or more workers (subject to State-specific thresholds where notified).

02

Formal recognition of fixed-term employment, with parity of wages and statutory benefits with permanent employees, including gratuity eligibility where service thresholds are met.

03

Requirement of a 14-day notice period for strikes and lockouts across all establishments.

04

Establishment of a re-skilling fund for retrenched workers, with employer contributions linked to retrenchment compensation, subject to prescribed rules.

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The Code aims to strike a balance between labour flexibility and enhanced income security for workers, while introducing new compliance considerations for employers.

Occupational Safety, Health and Working Conditions Code, 2020

The OSH Code consolidates 13 existing labour laws, including the Factories Act, the Contract Labour (Regulation and Abolition) Act, the Mines Act, and the Inter-State Migrant Workmen Act. Its key provisions include:

01

A single registration framework for establishments, to be obtained within prescribed timelines following applicability.

02

Harmonized standards for health, safety, and working conditions across sectors.

03

Mandatory welfare facilities such as drinking water, canteens, and crèches, linked to establishment size and nature of operations.

04

Enabling provisions for women to work in all establishments and across all shifts, including night shifts, subject to consent and prescribed safety safeguards.

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The OSH Code significantly raises the baseline for workplace safety and welfare, with associated cost and governance implications for employers.

Code on Social Security, 2020

The Code on Social Security consolidates nine social security legislations into a unified framework and significantly expands coverage. Notable provisions include:

01

Formal recognition of gig and platform workers within the statutory social security architecture.

02

Introduction of the concept of “aggregators,” defined as digital intermediaries or marketplaces connecting buyers and service providers.

03

Establishment of a Social Security Fund, with aggregators required to contribute up to a prescribed percentage of turnover, subject to statutory caps linked to payments made to gig and platform workers.

04

Presumptive treatment of employment-related accidents, including commuting accidents, as work-related for the purpose of compensation, subject to prescribed conditions.

These provisions mark a fundamental shift in how non-traditional work arrangements are regulated and financed.

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WHY THE LABOUR CODES DEMAND CFO ATTENTION

While the Labour Codes were conceived as regulatory simplification measures, their implications extend well beyond HR policy. From a finance and reporting perspective, they represent a structural reset of employee benefit economics, with direct consequences for profit and loss, balance sheets, and disclosures.

Recent professional guidance has reinforced a clear message: labour code alignment is as much a financial reporting issue as it is a compliance exercise.

Gratuity and Leave: When Compliance Becomes a Balance Sheet Reset

(Ind AS 19 / AS 15 — Employee Benefits)

The revised definition of wages, which effectively mandates that wages constitute at least 50% of total remuneration, fundamentally alters gratuity computations. When combined with gratuity eligibility for fixed-term employees upon meeting prescribed service thresholds, this results in a structural increase in defined benefit obligations.

From an accounting perspective:

- 01 The increase in obligation represents a plan amendment or benefit enhancement, rather than a change in actuarial assumptions.
- 02 The resulting impact is treated as past service cost.
- 03 Under Ind AS, such past service cost is recognized immediately in profit or loss in the period of amendment.
- 04 Under Indian GAAP (AS 15), vested past service cost is recognized immediately, while unvested cost is amortized over the remaining vesting period.

Leave benefits, unlike gratuity under Indian GAAP, offer no scope for deferral. Under both Ind AS and Indian GAAP, the impact is reflected immediately in earnings.

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Salary Restructuring: Substance Over Form

(Ind AS 19 / AS 15 — Employee Benefits)

As organizations realign compensation structures to comply with the revised wage definition, a critical distinction emerges between substance and form:

01

Genuine increases in employee compensation affect actuarial assumptions.

02

Re-characterisation of pay components purely to meet statutory thresholds constitutes a benefit enhancement.

Where restructuring is compliance-driven and does not result in a real increase in employee compensation, the entire incremental gratuity and leave liability is treated as past service cost, with immediate P&L impact under Ind AS.

For CFOs, this distinction determines whether the impact is absorbed through actuarial remeasurement or recognized visibly within operating results.

Interim Reporting: No Scope for Deferral

(Ind AS 34 / AS 25 — Interim Financial Reporting)

A common misconception is that labour code impacts can be deferred until year-end. Financial reporting standards do not permit such deferral:

01

Interim financial statements must apply the same accounting policies as annual financial statements.

02

Measurements are made on a year-to-date basis.

Consequently, organizations must recognise the increased obligation in the first interim period following the effective date of the relevant provisions.

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Taxes and Deferred Tax Assets

(Ind AS 12 / AS 22 — Income Taxes)

While tax laws governing deductibility remain unchanged, the accounting impact is immediate:

01

The amount of increase in obligation to the extent deductible as business expense in the current year impacts current tax measurement for the year.

02

The amount of increase in obligation to the extent will be deductible in future years results in deferred tax assets, subject to recoverability assessments.

These second-order effects require careful modelling and judgement.

Exceptional Item Presentation: Disclosure Matters

(Ind AS 1 / AS 5 — Presentation of Financial Statements)

Given that labour code impacts arise from new legislation and are non-recurring in nature, companies may consider a separate presentation based on materiality, subject to auditor concurrence and consistency with past practice.

Regardless of the presentation, the transparent disclosure of the nature of the change, its quantum of impact, and implications for future periods is critical, particularly in IPOs, M&A transactions, and lender discussions.

Divergence Under US GAAP

Under US GAAP, prior service costs arising from plan amendments are recognized in Accumulated Other Comprehensive Income and amortized to profit or loss over the remaining service period of employees as part of the net periodic pension cost. This treatment contrasts with the immediate P&L recognition required under Ind AS.

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A PRACTICAL COMPLIANCE PLAYBOOK FOR COMPANIES

The Labour Codes require organizations to move beyond checklist compliance towards a structured, judgement-led approach that integrates legal interpretation, financial modelling, and operational readiness. CFOs and CHROs should consider the following actions as part of a disciplined compliance programme:

Conduct a comprehensive wage and remuneration diagnostic

Undertake a detailed mapping of every component of total cost-to-company — fixed pay, allowances, incentives, reimbursements, and benefits — against the statutory definition of “wages”. Identify components that may be excluded, capped, or reclassified under the 50% wage rule. This exercise should be supported by legal interpretation to ensure positions are defensible.

Model financial impact before restructuring compensation

Before implementing any changes to salary structures, quantify the downstream impact on provident fund, ESIC, gratuity, bonus, and leave encashment obligations. Scenario modelling should clearly distinguish between genuine pay increases and compliance-driven recharacterization, given their materially different accounting outcomes.

Reassess gratuity and long-service liabilities

Recompute gratuity obligations using revised wage bases and reassess actuarial assumptions. Evaluate whether additional provisioning or immediate recognition of past service cost is required under applicable accounting standards, including interim reporting considerations.

Review fixed-term, gig, and platform worker exposures

Assess workforce composition to identify exposure under fixed-term employment provisions, gig and platform worker definitions, and aggregator obligations. Clarify registration, contribution, and disclosure requirements under the Code on Social Security, and ensure that contractual arrangements align with the statutory intent.

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Revalidate working hours, overtime, and shift practices

Review existing policies on working hours, overtime eligibility, and shift arrangements, including night shifts and flexible schedules. Ensure alignment with statutory thresholds, consent requirements, and sector-specific rules.

Align payroll, HRMS, and compliance systems

System readiness is critical. Payroll and HRMS platforms must be capable of applying revised wage definitions, testing the 50% threshold, accurately calculating statutory contributions, and meeting compressed timelines for full and final settlements. Reliance on manual workarounds materially increases compliance risk.

Establish a regulatory monitoring and governance mechanism

Create a structured process to track Central and State-level rules, notifications, and clarifications. Assign clear ownership for interpretation, implementation, and escalation of labour code developments to senior finance and HR leadership.

Strengthen capability through targeted training

Many labour law failures arise from execution gaps rather than intent. Invest in focused training for HR, payroll, and finance teams on revised wage definitions, documentation standards, inspection preparedness, and audit response protocols.

Align board and senior management communication

Ensure that the Board, Audit Committee, and senior management are regularly briefed on labour code exposures, financial impacts, and compliance posture. Alignment on risk appetite and employee-impact trade-offs is essential before implementing structural compensation changes.

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The revised statutory definition of wages has increased gratuity and other long-term employee liabilities for many companies, creating a material P&L impact this period. While salary restructuring may mitigate the impact, such measures take time due to legal review, approvals, and labour union concurrence. This introduces judgement-intensive complexity in financial reporting, placing pressure on reported outcomes where the impact may be temporary and expected to unwind in subsequent periods.

More broadly, India's Labour Codes represent a fundamental reset of employment regulation and employee benefit economics. For organizations, the challenge is not limited to statutory compliance, but also extends to compensation design, financial reporting integrity, stakeholder communication, and changes to systems and processes.

Companies need to approach labour code alignment not as a payroll revision, but in a more integrated manner with a long-term strategic approach.

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