

Important points for Gratuity and Leave encashment actuarial valuation arising from the New Labour Codes:

1. What is the definition of wages?

Reference – The Definition of wages at point (88) on Page 12 in The Code of Social Security, 2020

Extract from the code –

"wages" means all remuneration, whether by way of salaries, allowances or otherwise, expressed in terms of money or capable of being so expressed which would, if the terms of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment, and includes, —

(a) basic pay;

(b) dearness allowance; and

(c) retaining allowance, if any,

but does not include— (a) any bonus payable under any law for the time being in force, which does not form part of the remuneration payable under the terms of employment;

(b) the value of any house-accommodation, or of the supply of light, water, medical attendance or other amenity or of any service excluded from the computation of wages by a general or special order of the appropriate Government;

(c) any contribution paid by the employer to any pension or provident fund, and the interest which may have accrued thereon;

(d) any conveyance allowance or the value of any travelling concession;

(e) any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment;

(f) house rent allowance;

(g) remuneration payable under any award or settlement between the parties or order of a court or Tribunal;

(h) any overtime allowance;

(i) any commission payable to the employee;

(j) any gratuity payable on the termination of employment;

(k) any retrenchment compensation or other retirement benefit payable to the employee or any ex gratia payment made to him on the termination of employment, under any law for the time being in force:

Provided that for calculating the wages under this clause, if payments made by the employer to the employee under sub-clauses (a) to (i) exceeds one-half, or such other per cent. as may be notified by the Central Government, of the all remuneration calculated under this clause, the amount which exceeds such one-half, or the per cent. so notified, shall be deemed as remuneration and shall be accordingly added in wages under this clause: Provided further that for the purpose of equal wages to all genders and for the purpose of payment of wages, the emoluments specified in sub-clauses (d), (f), (g) and (h) shall be taken for computation of wage.

Interpretation –

The new Labour Codes have subsumed the Payment of Gratuity Act, 1972 and they require gratuity payment to all employees to be calculated based on last drawn wages which should be minimum 50% of total remuneration.

These codes establish a standardized framework where the core components of "wages" must primarily include Basic Pay, Dearness Allowance (DA), Retaining Allowance (If any), and Special Allowance. To arrive at the legally approved wage figure, employers must systematically exclude the specific components listed from point (a) to (k) from an employee's total remuneration to arrive at "wages".

A significant statement in this definition states that if these exclusions (a) to (i) collectively exceed 50% of the total remuneration, the excess amount must be added back to the "wages" for statutory calculations.

For example, an employee with a total remuneration of ₹1,00,000 whose exclusions (HRA, Conveyance, Bonus) total ₹60,000 has exceeded the 50% limit by ₹10,000. In this scenario, that ₹10,000 must be added back to the wage base, and companies are encouraged to consult their legal or authorized departments to assist in restructuring these salary components.

2. How special allowance treated in wage definition? Is it part of wages?

Reference –

The Definition of wages at point (88) in The Code of Social Security, 2020

Extract from the code –

Same as for Question 1

Interpretation –

In most modern corporate salary structures, "Special Allowance" constitutes a substantial portion of an employee's total pay. Since the term "Special Allowance" is not explicitly mentioned in the list of statutory exclusions (a) to (k), it logically follows that this component should be treated as a part of the core "wages" for the purpose of benefit calculations. However, if a company chooses to define this allowance in a way that aligns it with one of the specific exclusions permitted under the Act, they may legally remove it from the wage definition.

3. What are fixed term employees?

Reference –

The industrial Relations code, 2020. Page no.3 point (o).

Extract from the code –

"fixed term employment" means the engagement of a worker on the basis of a written contract of employment for a fixed period: Provided that—

- (a) his hours of work, wages, allowances and other benefits shall not be less than that of a permanent worker doing the same work or work of similar nature**
- (b) he shall be eligible for all statutory benefits available to a permanent worker proportionately according to the period of service rendered by him even if his period of employment does not extend to the qualifying period of employment required in the statute; and**
- (c) he shall be eligible for gratuity if he renders service under the contract for a period of one year;**

Interpretation –

Fixed-term employees (FTEs) are defined as workers engaged via a written contract for a specific period, and the code ensures they receive benefits and compensation at par with permanent workers doing similar work. The primary distinction is that an FTE's tenure is bound by a defined service term, after which they leave the organization as per their contract. Unlike permanent staff who typically have longer vesting periods, an FTE becomes eligible for gratuity if they render at least one year of continuous service. Consequently, any FTE hired for a duration of less than one year will not qualify for gratuity and should not be included in gratuity valuations.

4. When gratuity is applicable for Fixed term employees?

Reference –

The industrial Relations code, 2020. Page no.3 point (o).

Extract from the code –

Same as for question 3.

Interpretation –

The law defines that a fixed-term employee (FTE) must complete a continuous service period of at least one year or provide one full year of dedicated service to successfully reach the statutory "Vesting Period" required for gratuity eligibility. This legal framework effectively ensures that while these employees enjoy benefits at par with permanent staff, the right to receive a gratuity payout is fundamentally depend upon meeting this one-year criteria. Consequently, it follows that any fixed-term employee whose contract duration is less than one year will not qualify for gratuity benefits.

5. On what basis is gratuity is being paid to Fixed term employees?

Reference –

The code on Social security, 2020, Point 53, Page 42

Extract from the code –

Provided also that in the case of an employee employed on fixed term employment or a deceased employee, the employer shall pay gratuity on pro rata basis

Interpretation –

A significant shift in the new code is that gratuity for fixed-term employees must be paid on a pro-rata basis. This means that the calculation is based on the exact period of service rendered; for instance, if an FTE completes 1 year and 6 months of service, the gratuity is calculated specifically for that duration rather than being rounded to the nearest year as is common for other employee categories.

6. On which salary leave Encashment valuation is done?

Reference –

The occupation, safety, health and working conditions code, 2019. Page no 27, point 32.

Extract from the code –

Every worker employed in an establishment shall be entitled for leave with wages subject to the following conditions, namely:—

- (i) that he has worked one hundred and eighty days or more in such calendar year;**
- (ii) that he shall be entitled for one day leave for every twenty days of his work, and in the case of adolescent worker for fifteenday leave for every twenty days of his work, and in the case of adolescent worker for fifteen days of his work, in case of worker employed below ground mine, at the rate of one day for every fifteen days of his work, in such calendar year;**
- (iii) any period of layoff, maternity leave or annual leave availed by such person in such calendar year shall be counted for calculating the period of ninety days or more under clause (i), but he shall not earn leave for the period so counted;**
- (iv) any holidays falling between the leave availed by such person in a calendar year or prefixed or suffixed holiday shall be excluded from the period of leave so availed;**
- (v) in case of such worker whose service commences otherwise than on the first day of January shall be entitled to leave with wages at the rate specified in clause (ii), if he has worked for one-fourth of the total number of days in the remainder of the calendar year; in case such worker is discharged or dismissed from service or quits employment or is superannuated or dies while in service, during the course of the calendar year, such worker or his heir or nominee, shall be entitled to wages in lieu of the quantum of leave to which such worker was entitled immediately before his discharge, dismissal, quitting of employment, superannuation or death, calculated as specified in preceding clause, even if such worker has not worked for the required period under this sub-section making such worker eligible to avail such leave, and such payment shall be made—**

- (a) where such worker is discharged or dismissed or quits employment before the expiry of the second working day from the date of such discharge, dismissal or quitting; and**
(b) where such worker is superannuated or dies while in service, before the expiry of two months from the date of such superannuation or death;

Interpretation –

The statutory extract mentions that employees be granted leave benefits based on the defined "wages." Given that the term "wages" is strictly defined under the new regulatory framework, it is clear that organizations must calculate leave encashment and maintain their financial provisions using this specific wage base.

Disclaimer: Since several state governments have yet to issue specific notifications regarding the new labour codes, the interpretations provided herein are subject to revision. These guidelines will be updated accordingly once the respective state-specific rules and legislative frameworks are formally introduced.

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7. On which salary Leave Availment valuation is done?

Reference –

The occupation, safety, health and working conditions code, 2019. Page no 27, point 32

Extract from the code –

Same as for Question 5

Interpretation –

Prior to the introduction of the New Labour Code, organizations typically prepared leave availment provisions based on internal benchmarks such as "Gross Salary" or "CTC" (Cost to Company). Since the new labour codes does not explicitly mandate a specific salary component for leave availment, organizations may continue using these established benchmarks for their valuations. This approach is acceptable because both Gross and CTC figures inherently exceed the legally defined "wage" base, thereby ensuring the company remains compliant with the 50% threshold requirement for total remuneration as prescribed by the new laws.

8. Does gratuity ceiling remain 20 lakhs?

Reference –

The code on social security, 2020 Point 53, (3) & Ministry of Labour and Employment through a notification in March 2018 (S.O. 1420(E))

Extract from the code –

(3) The amount of gratuity payable to an employee shall not exceed such amount as may be notified by the Central Government.

Interpretation –

The new Code on Social Security specifies that the maximum amount of gratuity payable shall be determined and notified by the Central Government. Since the implementation of the new labor laws, the government has not released any new notification or statement to amend the current ceiling. Therefore, the ₹20 Lakh limit established by the March 2018 notification remains the active legal ceiling for gratuity payments in the private sector.

9. Is Gratuity calculated on Basic + D.A or wages?

Reference –

The code on Social security, 2020, Pages no 41, Point 2

Extract From the code –

(2) For every completed year of service or part thereof in excess of six months, the employer shall pay gratuity to an employee at the rate of fifteen days' wages or such number of days as may be notified by the Central Government, based on the rate of wages last drawn by the employee concerned:

Interpretation –

The code clearly mentions that for calculating wages, a company should use defined wages as a base component for Gratuity computation and its provisioning.

10. Does the current year's calculation factor in the impact of the revised wage definition?

Response – The Government of India has announced that the four Labour codes – The code on wage, 2019, The Industrial Relations code 2020, The Code on Social Security 2020, and the Occupational safety, Health and Working Conditions Code 2020 are made effective from 21st November 2025. Therefore, the impact must be shown in the FY 2025-26.

11. Which salary components are included in the "wages" for valuation purposes (e.g., special allowance, variable bonus, FBP elements, car lease)?

Response - Performance-based incentives, Employee Stock Option Plans (ESOPs), variable part of the component etc shall not be part of the wages.

In most modern corporate salary structures, "Special Allowance" constitutes a substantial portion of an employee's total pay. Since the term "Special Allowance" is not explicitly mentioned in the list of statutory exclusions, it logically follows that this component should be treated as a part of the core "wages" for benefit calculations. The other option a company can explore is to restructure the salary components.

12. What specific employee data is needed for the current year's actuarial valuation?

Response – We require employee salary data both pre-implementation and post-implementation so that we could bring the impact of change in Labour code in the past service cost. The template will be shared separately.

13. How is the increase in Gratuity Valuation (GV) and Leave Valuation (LV) from the new wage definition applied to past years treated in valuation—e.g., as actuarial loss or past service cost?

Response – Past service cost arises when an enterprise introduces a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Hence, increase in liability will be treated as the past service cost.