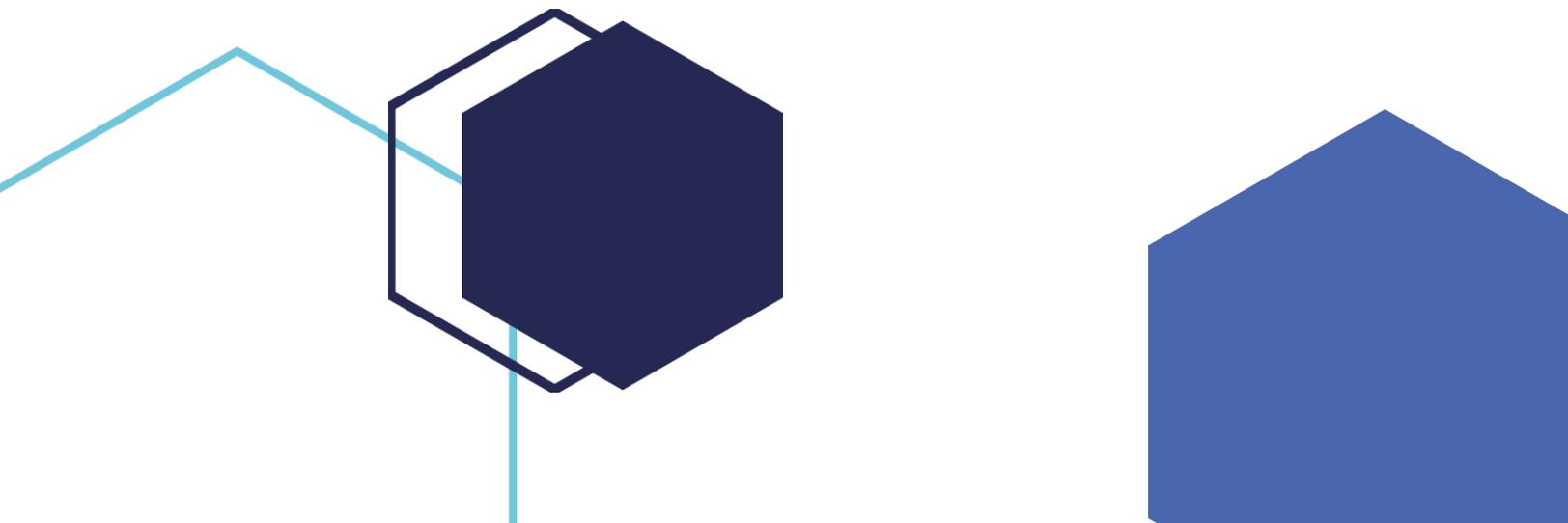




# **The Code On Social Security (2020) - Wages definition implications on Gratuity and other Employee Benefits**

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## Introduction

The **Code on Social Security** has now been passed by both Houses of Parliament and, pending the final formalities, will be a reality. This latest round of Codes come just over a year after the **Code on Wages** was implemented in 2019.

**The Code on Wages, 2019** (effective from 8th August 2019) consolidates the provisions of four labour laws concerning wage and bonus payments and makes universal the provisions for minimum wages and timely payment of wages for all workers in India. The Code repeals and replaces the Payment of Wages Act, 1936, the Minimum Wages Act, 1948, the Payment of Bonus Act, 1965, and the Equal Remuneration Act, 1976.

**The Code on Social Security, 2020** consolidates a number of existing laws, but also outlines a Social Security framework across the country and empowers the Government to introduce social security programs in the future for many additional types of employees and workers.

The Employees' Compensation Act, 1923

The Employees' State Insurance Act, 1948

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

The Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959

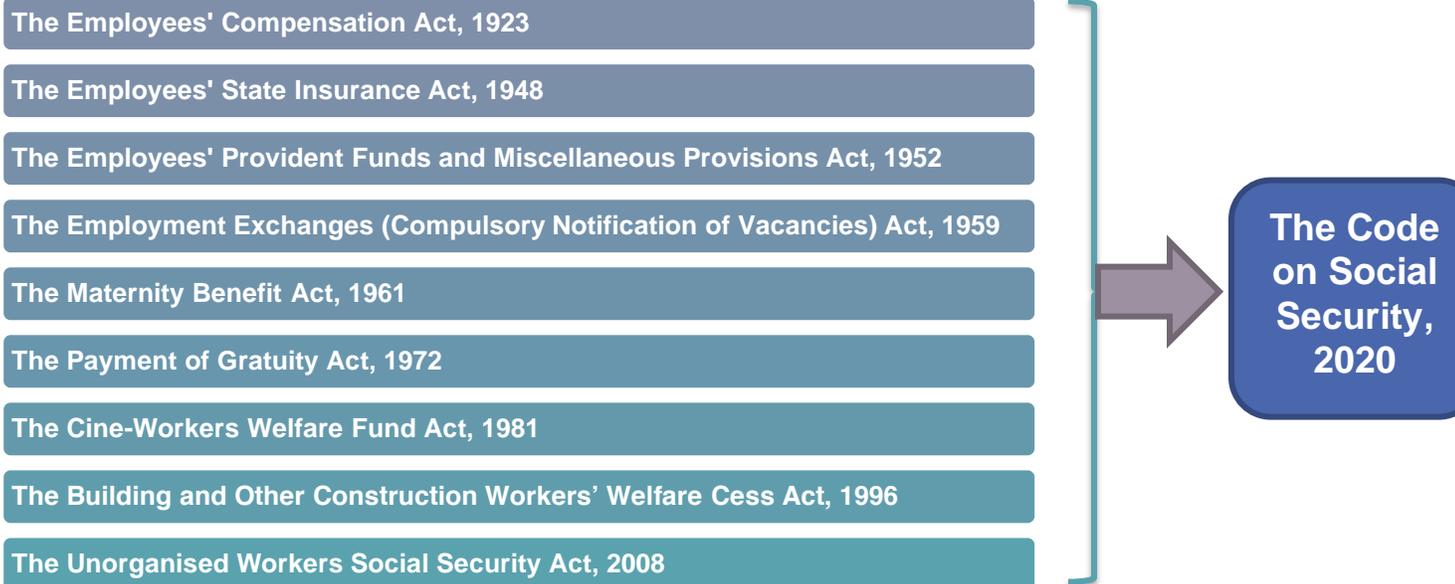
The Maternity Benefit Act, 1961

The Payment of Gratuity Act, 1972

The Cine-Workers Welfare Fund Act, 1981

The Building and Other Construction Workers' Welfare Cess Act, 1996

The Unorganised Workers Social Security Act, 2008



The Code on Social Security, 2020

## Background

After implementation of the above labour codes, the definition of wages would become consistent across various labour acts. Currently most of the benefits are linked to the Basic + D.A. salary which will be now replaced by new definition of wages. As per the new labour code, wages need to be a minimum of 50% of Gross Salary. This led us to study the potential financial impact the definition of “wages” may have for employers and employees for benefits such as Gratuity, Leave Encashment, Pension etc.



## Wage Definition

**Wages definition is a key reform in this legislation which may impact the costs of many organisations and take-home salaries for employees.**

**The definition of wages now has three parts to it - an inclusion part, specified exclusions and conditions which limit the quantum of exclusions. The core definition includes basic pay, dearness allowance and retaining allowance.**

It specifically excludes components such as statutory bonus, value of house accommodation and utilities (light, water, medical etc.), employer contribution to provident fund/ pension, conveyance allowance/ travelling concession, sum paid to defray special work expenses, house rent allowance, remuneration payable under settlement, overtime allowance, commission, gratuity, retrenchment compensation.

**THE SPECIFIED EXCLUSIONS, HOWEVER MAY NOT EXCEED 50 PERCENT OF ALL REMUNERATION, AND IN THE EVENT OF EXCEEDING, SUCH EXCESS AMOUNT WILL BE ADDED IN "WAGES"**

The exclusion limit of 50%, is aimed at ensuring that companies do not adopt compensation structures which result in wages being reduced below 50% of the total remuneration.

## Data Collation & Statistics

We conducted an analysis on employee data of private companies on both the Gross Salary and Basic Salary that was available from actuarial valuation data as at year-end valuations from F.Y. 2015-16 to F.Y. 2019-20 inclusive. Gross salary was referenced from leave valuations for companies that provided encashment on the same else it was considered from when valuations for leave availment were conducted. The data analysed does not include individual components of Gross salary and therefore, we were unable to interpret the precise allowances that may be specifically excluded from the Wages definition. However, based on our experience, the findings still give a reasonable broad representation.

### Total data

Year	No. of Companies	Less than 25%	From 26% to 35%	From 36% to 49%	From 50% to 65%
2020	1,027	3%	16%	49%	32%
2019	1,128	4%	15%	48%	33%
2018	974	3%	19%	48%	30%
2017	830	4%	18%	48%	30%
2016	620	2%	17%	49%	32%

**Table 1 – Percentage of companies with the following Basic to Gross Ratios**

- Table 1 indicates there is no significant change in the salary structure of companies over the years.
- We can see that almost 1/3rd of the companies have a ratio of more than 50%, which is the minimum requirement as per “The Code of Wages 2019”.
- Around 50% of the companies have a ratio in the range of 36% to 49%. It means that these companies may face an increase in the deemed “wages” for benefit calculations by as much as 40% when compared to the current basic salary inclusion alone.



## By Employee Count

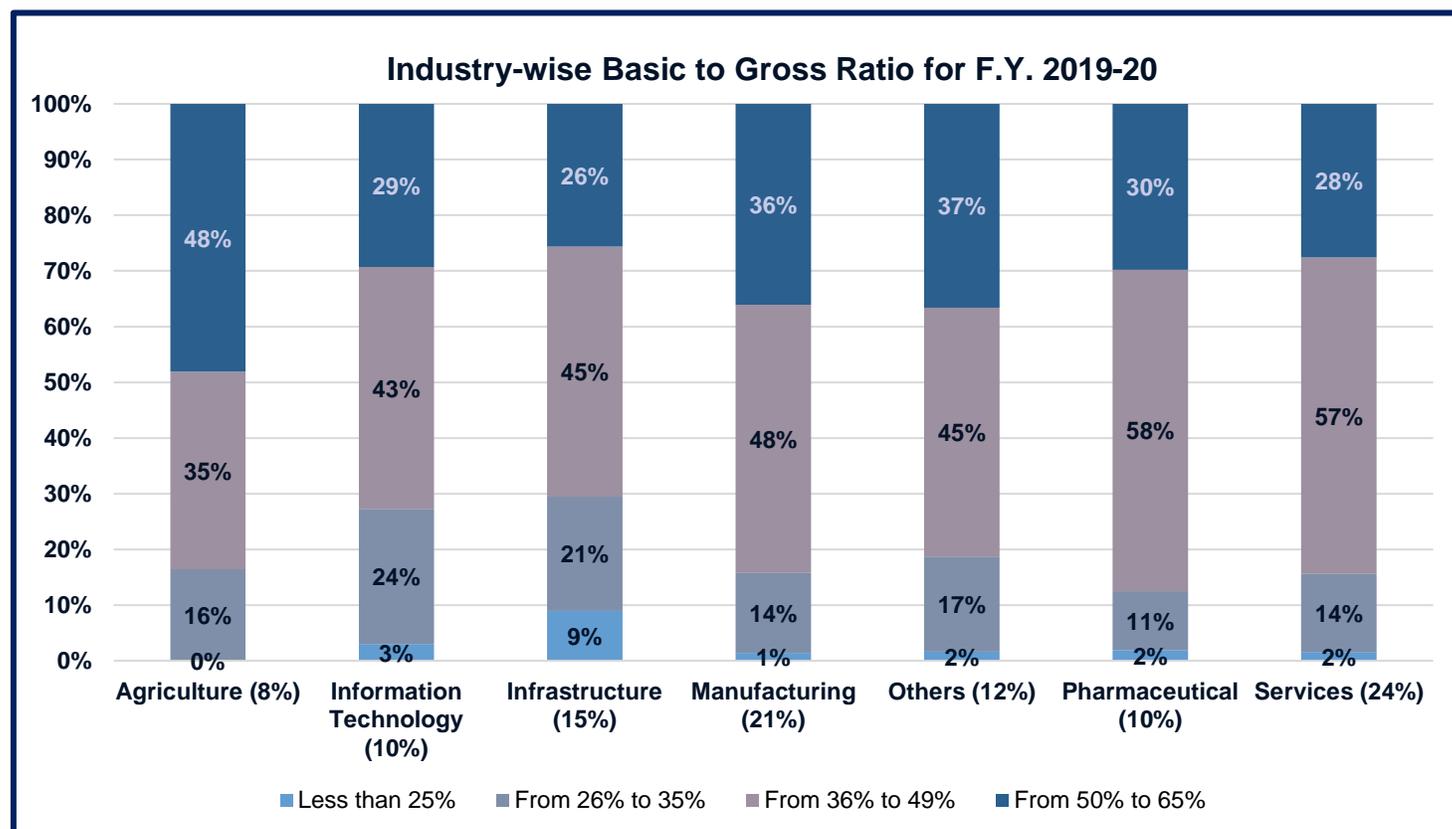
For Employee Benefit Valuations for F.Y. ending 31st March 2020 (considering the cut-off Date of data received by 15th August 2020), we analysed data from 1,027 companies. It can be seen that the findings are similar, no matter the employee strength.

Employee Count Range	Percentage of Companies*	Less than 25%	From 26% to 35%	From 36% to 49%	From 50% to 65%
Less than 100	46.2%	4%	16%	49%	31%
From 101 to 500	32.9%	2%	16%	50%	32%
From 501 to 2,500	15.7%	1%	14%	48%	37%
From 2,501 to 10,000	4.00%	2%	29%	41%	27%
From 10,001 to 25,000	0.8%	0%	13%	50%	38%
Above 25,001	0.5%	0%	20%	40%	40%

Table 2 - Percentage of companies with the following Basic to Gross Ratios (by Employee Strength - F.Y. 2019-20)  
\*may not add to 100% due to rounding

## By Industry

Looking at the same 1,027 companies, we can see that there are some variations across industry sectors. The reasons behind this could be attributable to the industry specific wage structures i.e. industries with a lower ratio could be providing performance-based bonuses or commissions or have consciously kept a lower basic salary to keep take home pay higher.



Others includes industries such as Banking, Export Import, Mining, Insurance, Hospitality, retails consumer products, transportation. We have a reasonable spread of industries in our data, with the percentage of companies under a particular industry mentioned next to the industry name in the above graph.



## Implications on Employee Benefits and Way Forward

Gratuity benefits are currently linked to Basic + D.A. salary which would now be based on wages in the social security code. Employees may be entitled to an increased benefit, subject to the ceiling of INR 2,000,000. The extent of the impact will also depend on whether a company has no monetary ceiling, or has a separate scheme in place.

(Amount in INR crores)

Sector	Gratuity Defined Benefit Obligation at 31.03.2020	Approx. increase	Approx. Percentage increase
<b>Agriculture</b>	148	52	35%
<b>Information Technology</b>	435	215	49%
<b>Infrastructure</b>	333	136	41%
<b>Manufacturing</b>	894	342	38%
<b>Others</b>	363	132	36%
<b>Pharmaceutical</b>	558	159	28%
<b>Services</b>	624	178	29%
<b>Grand Total</b>	<b>3,355</b>	<b>1,214</b>	<b>36%</b>

While calculating the above increase in Gratuity liability, we have considered change only in applicable wages and have kept other variable such as data, actuarial assumptions, and scheme constant as per each company's previous valuation as on 31-03-2020.

With the 1,027 companies' data, we conducted an impact analysis on the increase in Gratuity actuarial valuation obligation. The "applicable wages" considered in the calculation were increased to 50% of Gross salary, where required. The average approximate increase in obligation was 36%

Companies where leave encashment is provided on Basic salary may observe increase in costs. However, this would depend on the reference to the "wage definition" under The Shops and Establishment Act in their respective states.

The impact of the 50% Wages criteria may be limited for PF contribution and ESIC contribution as much since there is wage ceiling of INR 15,000 and INR 21,000 respectively in place currently.

For organizations contributing to NPS, it will be pertinent to see if the NPS contribution tax allowances and salary definition may change in future, considering the current definition is linked to Basic salary. Should this happen, the annual aggregate 7.5 lakh rupees contribution tax allowance may come into play for more individuals, unless updated itself.

## Conclusion

We see the potential for many companies to be affected now the Wages Code and Social Security Code are in place.

Companies should review their HR Policy to revalidate benefits and ascertain the impact on the provisioning of their long term employee benefits. It is possible that costs of these benefits may get dearer for the employer. Contributions to the Employee Provident Fund may also increase for the employee, which may affect their take home salary.



## Appendix – Definition of Wages under the Social Security Code

### Definition of Wages - Section 2(80):

“Wages” means all remuneration whether by way of salary, 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,—

- basic pay;
- dearness allowance; and
- retaining allowance, if any,

but does not include –

- 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;
- 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;
- any contribution paid by the employer to any pension or provident fund, and the interest which may have accrued thereon;
- any conveyance allowance or the value of any travelling concession;
- any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment;
- house rent allowance
- remuneration payable under any award or settlement between the parties or order of a court or Tribunal;
- any overtime allowance;
- any commission payable to the employee;
- any gratuity payable on the termination of employment;
- any retrenchment compensation or other retirement benefit payable to the employee or any ex gratia payment made to him on the termination of employment:

#### Dearness Allowance (D.A.) -

Dearness allowance is component of salary which is a fixed percentage of an employee’s basic salary, which aims to mitigate the impact of inflation.

#### Retaining Allowance -

Allowance payable for the time being to an employee of any factory or other establishment is not working, for retaining his services.

Provided that, for calculating the wages under this clause, if payments made by the employer to the employee under 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 clauses (d), (f), (g) and (h) shall be taken for computation of wage.

**Explanation:** Where an employee is given in lieu of the whole or part of the wages payable to him, any remuneration in kind by his employer, the value of such remuneration in kind which does not exceed fifteen per cent of the total wages payable to him, shall be deemed to form part of the wages of such employee.\*Definition of Wages is the same as set out in Section 2(y) of the Code on Wages, 2019 notified 8 August 2019



If you have any queries about this article or would like to talk to us about the Code. Wages or the detailed impact on employee benefits, please get in touch with us at:

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