

India's Labour Codes & Payroll Impact

A structured guide to understanding how the four new labour codes reshape payroll compliance, wage structuring, and statutory obligations — effective from 21 November 2025.

2025–2026 COMPLIANCE SERIES





WHY THIS MATTERS

Payroll Is at the Centre of Labour Reform

Legal Change

Multiple legacy labour laws consolidated into four labour codes.

Structural Change

Wage definition drives downstream statutory calculations automatically.

Financial Change

Affects take-home pay, employer cost, contributions, and gratuity liabilities.

Once the definition of wages changes, many downstream calculations change automatically — affecting compliance speed and quality.

What, When, Where, Why, How, Who

1

What

Four labour codes replace a large number of older labour laws.

2

When

Operational from **21 November 2025**; 2026 is the first full year of practical payroll impact.

3

Where

Applies across India; state-level rules and wage notifications remain highly relevant.

4

Why

Simplify labour law, standardise wage treatment, and widen worker protection and social security coverage.

5

How

New wage definition, stronger compliance expectations, and tighter payment timelines.

6

Who

Employees, employers, HR, finance, payroll, legal, compliance, and payroll technology teams.

Where Legal Intent Becomes Financial Reality

The Core Principle

The labour codes' success or failure will be judged in payroll outputs — whether the correct wage base is used, settlements happen on time, contributions are accurate, and employers can defend their treatment during inspection or audit.

Payroll Is Most Affected Through:

- Wage definition and salary structuring
- PF, ESI, gratuity, bonus, and overtime implications
- Full and final settlement timelines
- Recordkeeping, auditability, and system readiness

CORE CHANGE

What Is Changing: The Wage Definition

Uniform Wage Definition

A single, central definition of "wages" becomes the compliance anchor across all statutory calculations.

The 50% Rule

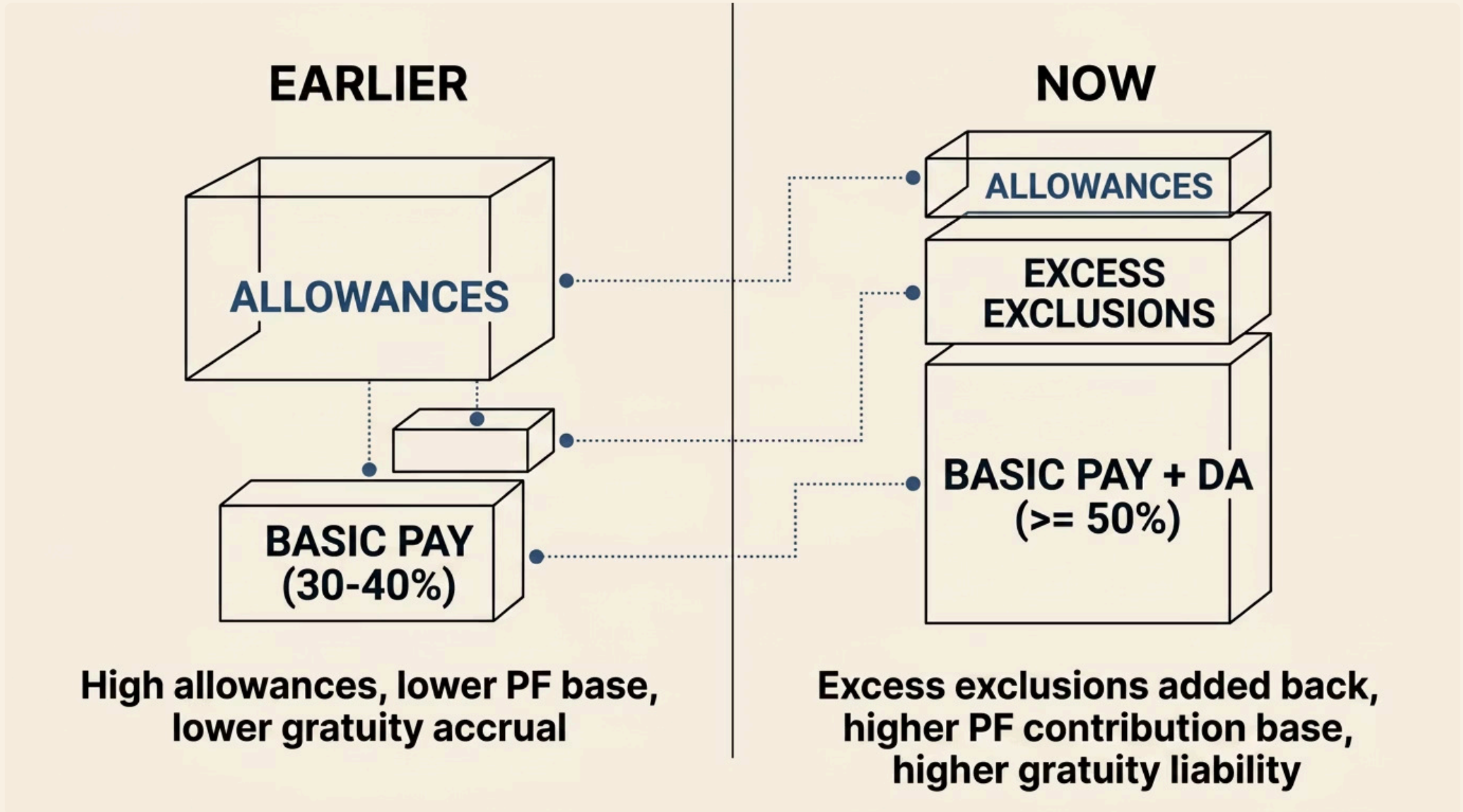
Excluded components cannot be used excessively. If exclusions exceed **50% of remuneration**, the excess is added back into wages.

Downstream Impact

This changes the base used for PF, gratuity, bonus, overtime, and other payroll-linked obligations.



Wage Definition & PF Impact



i The PF rate may be familiar, but the base may not be. Payroll teams must ask: *what amount are we applying those percentages to?*

Gratuity & Full and Final Settlement

Gratuity Impact

- **Earlier:** Lower basic pay suppressed gratuity liability growth
- **Now:** Higher wage base means higher gratuity accrual and payout exposure
- **Fixed-term employees** gain gratuity eligibility after **one year** vs. the traditional five-year threshold
- Gratuity provisioning and actuarial assumptions may need revision

Full & Final Settlement

- **Earlier:** Settlements processed over 7–15 days or more
- **Now:** Wages on separation must be paid within **two working days**
- Exit payroll must become workflow-driven, pre-approved, and highly coordinated
- Delay becomes a visible compliance risk

EARLIER VS NOW

Salary Structuring Strategy & Compliance Mindset

Salary Design: Earlier

Optimised for take-home pay and reduced statutory burden. Low-basic models were common and widely accepted.

Salary Design: Now

Must survive legal interpretation and payroll audit. Offer letter templates, salary masters, and payroll rules engines require reconfiguration.

Compliance: Earlier

Focused on monthly filing discipline. Process-heavy execution.

Compliance: Now

Design correctness, system controls, documentation, and auditability. Control failures can begin upstream in HR and compensation design.

Earlier vs Now: At a Glance

Area	Earlier	Now
Wage Base	Heavily allowance-driven	Exclusions capped via 50% framework
PF	Often lower basis	Potentially higher basis
Gratuity	Often lower accrual base	Higher wage-linked liability
Exit Settlement	7–15+ days	Two working days for wage payment
Payroll Governance	Process-heavy	Design-plus-process

📌 The pattern is consistent: payroll must now prove that the **structure itself** is compliant and operationally executable.

Impact on Employees, Employers & Payroll Teams



Employee

- Possible reduction in take-home pay where PF basis rises
- Stronger long-term PF and gratuity accumulation
- Greater transparency and faster exit settlement



Employer

- Potential increase in PF and gratuity cost
- Higher compliance pressure on salary design and exits
- Greater audit and reputational risk if implementation is weak



Payroll Team

- Rebuild salary templates and payroll configurations
- Strengthen exit-processing capability for two-day timeline
- Prepare for higher scrutiny on documentation and controls



FINANCIAL IMPACT

Taxes, Cost & Budgeting Implications

Tax Clarity

Labour code changes primarily affect payroll structure and statutory benefits — **not the income-tax slab framework itself**. However, a changed salary mix can alter employee cash flow, PF contribution, and perceived tax position. Payroll reporting must clearly distinguish statutory changes from tax-policy changes.

Cost & Budget Impact

- Higher PF outflow increases recurring employment cost
- Higher gratuity base increases long-term liability and provisioning
- Exit compliance may require process automation investment
- Payroll, HRIS, and ERP reconfiguration creates one-time implementation cost

STATE-LEVEL CAUTION

One National Code Does Not Mean One Rulebook

Central Framework

The four codes are central laws, but implementation depends significantly on state-specific rules and notifications.

Minimum Wage Sensitivity

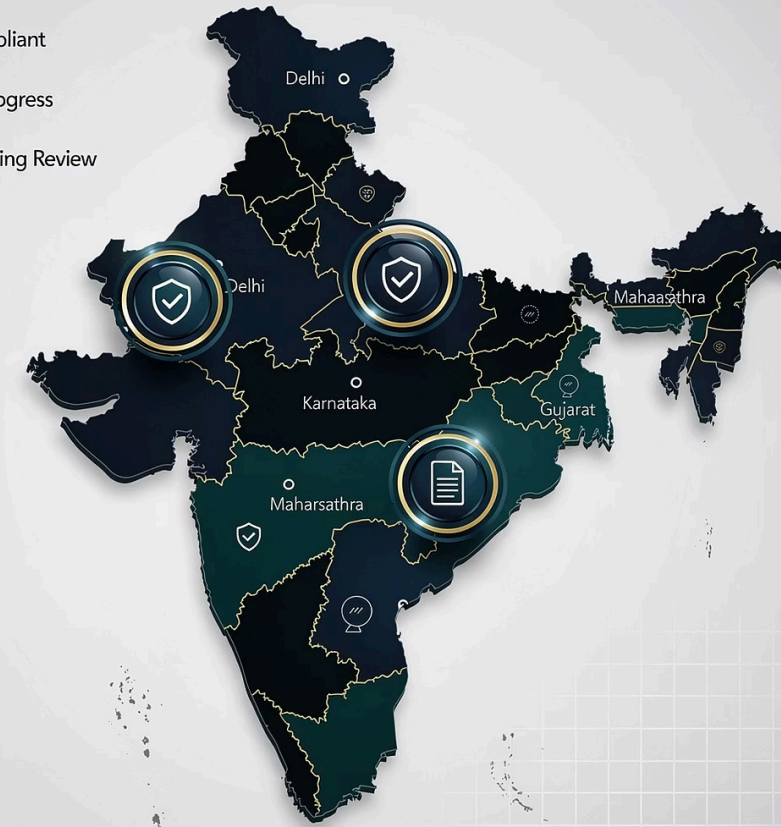
Minimum wage mapping remains location-sensitive and role-sensitive across states.

Avoid Uniform Assumptions

Payroll teams must maintain a **state-sensitive compliance layer** — especially where wages, registers, notices, and operational requirements differ.

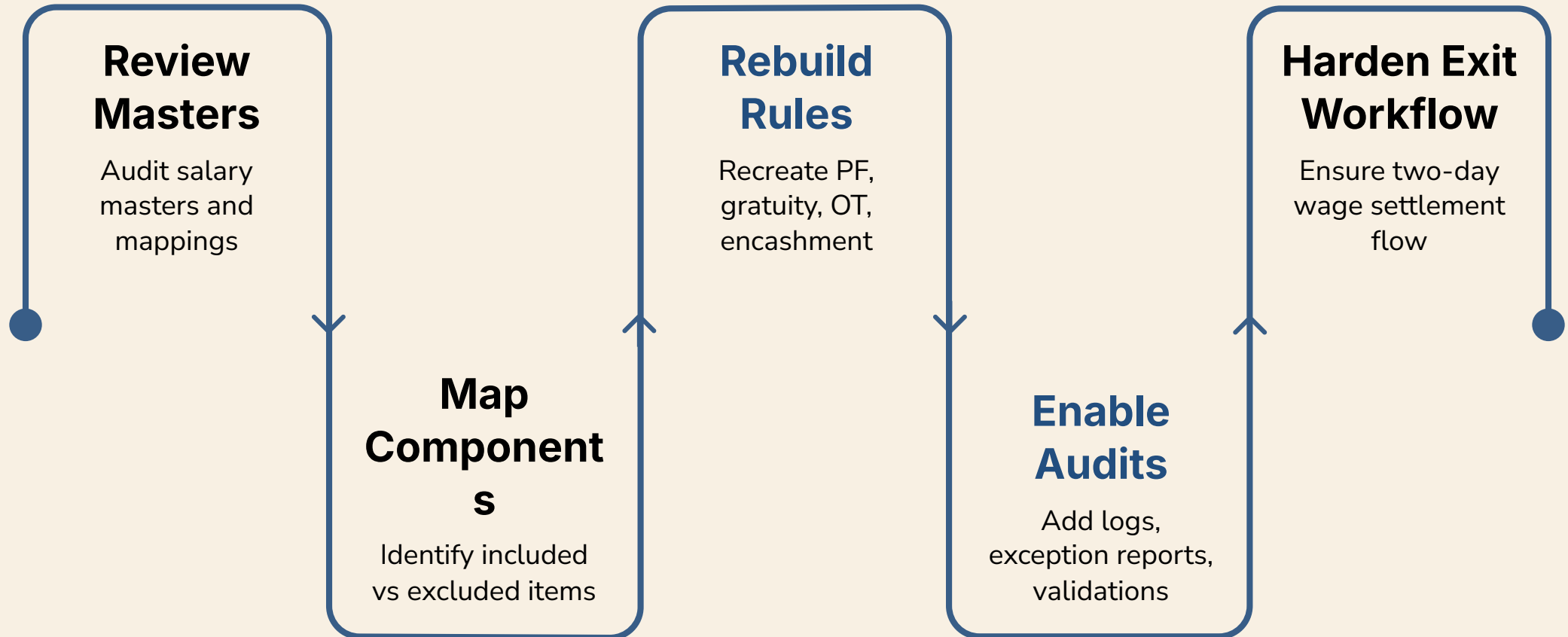
India Compliance Overview

-  Compliant
-  In Progress
-  Pending Review



Regulatory Coverage Map

Data and System Readiness



Treat the labour codes as a **systems project**, not a policy memo. If pay components, rules engine, approvals, and exit workflows are not aligned, compliance will fail in production.

Best Practices: Employees & Employers

For Employees

- Understand salary breakup, not just CTC
- Ask how PF and gratuity are calculated under the revised structure
- Review take-home versus long-term benefits before reacting to changes
- Check final settlement timelines and documentation at exit

For Employers

- Redesign salary structures proactively — do not wait for disputes
- Validate cost impact before rollout
- Align HR, payroll, finance, legal, and IT before go-live
- Maintain defensible documentation on wage treatment and statutory logic
- Rehearse exit processing for two-day compliance

Best Practices: Payroll Team

01

Wage-Definition Validation

Create a validation model for every pay structure against the revised wage definition.

02

Statutory Mapping Library

Maintain a component-wise statutory mapping library for PF, ESI, gratuity, and bonus.

03

Exception Dashboards

Build dashboards to flag low-basic or high-exclusion cases for review.

04

Updated SOPs & Communication

Update full and final settlement SOPs; prepare employee FAQs and manager talking points.

05


Periodic Compliance Audits

Run mock reviews and compliance audits to institutionalise the changes.

READINESS CHECK

Are You Ready? The Compliance Checklist

- Tested all salary structures against the revised wage definition
- Measured PF and gratuity cost impact
- Updated payroll software, pay codes, and validation rules
- Aligned HR letters and CTC templates
- Trained payroll and HR business partners
- Can complete wage settlement within two working days of separation
- State-wise compliance monitoring in place
- Employee communication materials ready

 Readiness is not about awareness. Readiness means **policy, system, process, governance, and communication** are all aligned.

Common Mistakes to Avoid

→ Oversimplifying the Wage Rule

Assuming only basic salary labels matter, instead of testing the underlying wage definition against the 50% framework.

→ Ignoring Exits and Gratuity

Focusing only on monthly payroll while ignoring long-term gratuity impact and the two-day exit settlement requirement.

→ Treating Compliance as Payroll-Only

Control failures begin upstream in HR and compensation design — compliance is cross-functional.

→ Ignoring State-Specific Dependencies

Assuming uniform implementation across all states when wage and rule variations remain significant.



Questions Leaders Should Ask Payroll



Which pay structures are most exposed?



What is the employer cost impact?



Can we meet the two-day separation timeline?



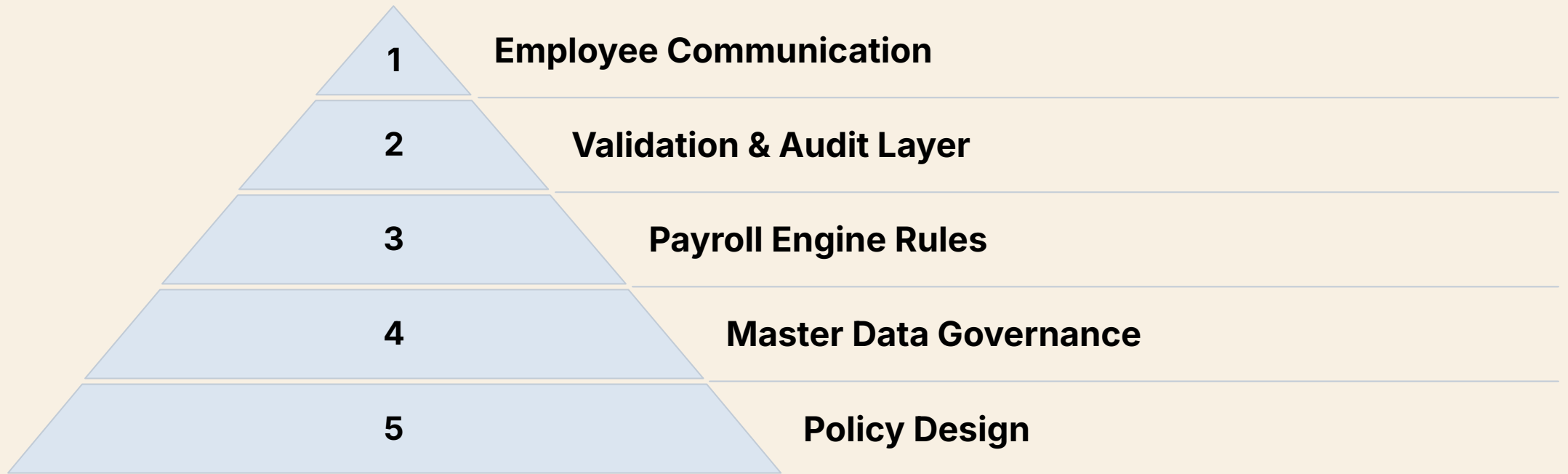
Where are the state-specific risks?



How are we communicating the change to employees?

These questions define what good governance looks like for CFOs, CHROs, and business heads overseeing the transition.

The Five Layers of Successful Implementation



Every failure point in payroll generally sits in one of these five layers. Successful implementation requires an **operating model**, not just a policy circular.



Closing Message: From Calculation to Compliance Architecture

The Shift

From flexible salary engineering to **defensible wage structuring**.

The Imperative

Act now on design, systems, controls, and employee communication.

The Opportunity

Organisations that redesign early and strengthen governance will lead — not just comply.

The labour codes are a payroll transformation issue, not just a payroll processing issue. Redesign structures early, strengthen governance, and equip payroll teams to explain, execute, and defend their outputs.