WHY COMPANIES SHOULD REFRAIN FROM RESTRUCTURING EMPLOYEES' SALARIES UNDER THE LABOUR CODES

The most notable feature of the Codes is the introduction of a uniform definition of "wages", which forms the basis for calculating social security and related benefits such as Provident Fund (PF), Employees' State Insurance (ESI), gratuity, statutory bonus, and maternity benefits.

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Editor : Labour Law Reporter

On and from 21st November, 2025, the substantive provisions of the Labour codes, viz. The Code on Wages, 2019; The Code on Social Security, 2020; The Industrial Relations Code, 2020; and the Occupational Safety, Health and Working Conditions Code, 2020 came into force. The most striking feature of the Codes, insofar as the general public perception is concerned, is the uniform definition of "wages". It is as per the said definition that social security and other benefits, such as Provident Fund (PF), Employees' State Insurance (ESI), gratuity, statutory bonus, and maternity benefits etc., are calculated.

Industry leaders across the spectrum have been signalling that company and manpower costs may rise owing to the enforcement of the Labour Codes. The definition of wages might contribute to such cost increase in some ways. With respect to ESI, many more persons are set to be covered under its ambit since the new definition of wages excludes certain prominently paid components such as House Rent Allowance (HRA), which under the erstwhile regime were taken into consideration for the purpose of reckoning an employee's eligibility as per the Rs.21,000/- wage threshold. Insofar as gratuity is concerned, the same will now have to be calculated not only on the Basic and Dearness Allowance components of salary, but on all payments which are paid to an employee as per the terms of his employment, barring the components which the definition specifically excludes. Then comes the infamous "50% addback rule" which has caused much clamour in the industry. Simply speaking, if the exclusions specified under the definition of wages were to exceed 50% of all remuneration being paid to an employee, then the excess amount will have to regarded as part of wages.

For many, wage restructuring is the ultimate panacea to all the problems. Wage restructuring might essentially involve transferring some amount from one component of the employee's salary to the other so as to decrease the overall costs. This might also involve the managements introducing a new salary component altogether. The proponents of wage restructuring argue that no prejudice would be caused to the employees merely because some amount is being exchanged between components; after all, there is no reduction in the total amount which an employee is getting paid. While this argument is ostensibly correct, the provisions of the Codes call for a deeper introspection.

The Codes Themselves Have Inbuilt Restrictions Against Wage Restructuring

Section 124 of the Code on Social Security provides that an employer cannot, directly or indirectly, reduce the wages of an employee only for evading his liability of payment of any contributions under the Code or such that the total quantum of benefits that the employee is entitled to under his terms of employment are reduced. In other words, the clear impute of section 124 of the said Code is that the wages of an employee cannot be reduced for the purposes of reducing the PF/ESI or other statutory liabilities, including gratuity. It may be noted that this section corresponds to section 12 of the Employees' Provident Fund & Miscellaneous Provisions Act, 1952, which has now been repealed.

The Courts have interpreted the said provision in such a manner that the total quantum of benefits must not be reduced by reason only of the liability of the employer for payment of any contribution or benefit *[See, Som Prakash Rekhi v. Union of India and Another, 1981 (1) LLJ 79].* The Delhi High Court has clarified the scope of this section by holding that the total amount of money or money's worth which the employer was paying or contributing should not be reduced. It went to hold that if the total quantum of benefits is not reduced, then, notwithstanding the alteration in the rate of contribution alone, there is no violation of the said section *[See, R.K. Mohta v. U.O.I, 1992 (64) FLR 1158].*

Further, the Kerala High Court in *N. Vijayan, Instructor, Milma Training Centre, Kerala Cooperative Milk Marketing Federation Limited and Others v. Secretary to Government, Agriculture (Dairy) Department and Others*, 2004 LLR 240, has gone on to hold that the section does not contemplate all such cases of reduction of the quantum of contribution by the employer. By the said section, an employer is prohibited from reducing the wages of the employee so as to escape from a liability for the payment of any contribution/social security benefit. Even if wages reduced, but not for the purpose of avoiding the contribution and contribution was indeed being paid, there would be no violation of this section. The Bombay High Court in *N.T.C. (S.M.) Ltd. v. Kamla Singh and Ors.,* 2017 (3) CLR 328 has opined that even if certain components of an employee's wages are increased such that his social security benefits are reduced, the same would be prohibited.

Generally speaking as well, industrial law discourages wage alteration to the prejudice of workers. The Supreme Court in the landmark judgment of *Workmen represented by Secretary v. Management of Reptakos Brett & Co. Ltd. & Anr.*, 1992 AIR 504, has held that it is only under very extraordinary circumstances that wages can be altered to the prejudice of workers. In such cases, sufficient proof of precarious financial position will have to be offered by the employers.

A synthesis of the above referred case law would make it conspicuous that alteration of an employee's wage structure solely for the purpose of decreasing costs is not permitted.

Undertakings and Agreements Hold No Value

The Codes seek to ensure that the companies do not get a free ride by convincing employees in signing cleverly worded agreements and undertakings. It has been specified under section 161 of the Code on Social Security that any agreement contrary to the provisions of the said Code will hold no value and will be illegal from the very beginning. Thus, making employees consent to the purported wage restructuring arrangements will not have any legal sanctity.

The Mandatory 21 Day Notice

Even if one were to ignore section 124 of the Code on Social Security, there are other provisions of the Codes which also make the process of restructuring difficult. As per the mandates of section 40 of the IR Code, in case an employer wants to change any service condition his workers, a mandatory 21-day notice will have to be served before affecting such change. The Code explicitly recognizes “wages” and “customary concessions and privileges” as service conditions. Thus, for any component that falls within the definition of wages, no unilateral decision can be taken by the management. Any changes made without serving the statutory notice will make the change illegal from the inception.

If a component is not a part of wages and is being paid since some time, it would take the character of a customary payment, like HRA. By virtue of it being of such character, the 21-day notice will have to be served in such cases as well. For payments to be regarded as customary, the payment has to have been made over an unbroken series of years i.e. for a sufficiently long period; it should have been paid even in years of loss and should not depend on the earning of profits; and should have been made at a uniform rate throughout.

The 50% Addback Rule Getting Triggered Does Not Point Towards any Illegality

A salary structure being positioned in such a manner that the exclusions overshoot 50% of the total remuneration would not make it illegal. The 50% addback rule is merely a deeming provision which creates a legal fiction. No provision of the Codes calls upon the employers to ensure that the 50% addback rule does not come into play. The said rule merely lays down the consequences which would flow once the wages of an employee take a certain shape. Even otherwise, restructuring of wages only for preventing the operation of the 50% addback rule would essentially require the employer to transfer the excess amount from the excluded components to the included components. This would be a circular exercise which would not beneficial for anyone.

Since the Codes are relatively new, one can only estimate how things are going to unfold in the future. It will remain to be seen how Courts interpret the question of wage restructuring – a practice which companies today are so fervently carrying out.

https://www.businesstoday.in/impact-feature/story/why-companies-should-refrain-from-restructuring-employees-salaries-under-the-labour-codes-516584-2026-02-17?utm_source=btweb_story_share

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