ARE INCENTIVE PAYMENTS "WAGES" UNDER THE LABOUR CODES?

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The Ministry of Labour and Employment, vide FAQs dated 30.12.2025 and 16.03.2026, has clarified that performance-based incentives do not form a part of "wages" for computation under the Labour Codes. The response of the Ministry is reproduce verbatim as under :

FAQs dated 30.12.2025

Query	Reply
Definition of wages and the components it would cover.	Performance based incentives, Employee Stock Option Plans (ESOPs), variable part of the component or reimbursement-based payments to the employee shall not be part of the wages.

FAQs dated 16.03.2026

Query	Reply
Do annual performance-based incentives form a part of "wages" for computation under the Labour Codes?	No. Annual performance-based incentives do not form a part of "wages" for computation under the Labour Codes. Pl. refer to Sl. No. 3 of FAQs dated 30.12.2025 available on the MoLE website. Weblink: de4758d5bfeffc456d7de97a801891b0.pdf

While these FAQs are not legally binding, they still do hold some persuasive value. However, if one were to analyse this aspect *de hors* of the FAQs, even then the conclusion would be such annual incentives do not necessarily form part of 'wages'. To support our contention, reliance is placed upon certain judgments pronounced by the Supreme Court and High Courts while interpreting the definition of 'wages' under the Employees' State Insurance Act, 1948. While both definitions are not exactly similar, the first parts of both definitions, insofar as they define 'wages' to mean, "*all remuneration payable to an employee, if the terms of the contract of employment, express or implied, were fulfilled*" (excluding the additional condition of additional remuneration being regarded as 'wages' if it was paid at intervals of less than two months) are *pari materia*. It has been held by the Supreme Court in ***Braithwaite & Co. v. E.S.I. Corporation***[1], that incentives would not be "remuneration payable in terms of employment" when they can be withdrawn at any time. In the case of ***Shourie Duplicators Pvt. Ltd. v. Employees State Insurance Corporation***[2], there was no contract between the management and employees regarding the introduction of an incentive scheme; the scheme was introduced by the management voluntarily and the management was entitled to withdraw the same at any time. It was held that this bonus cannot be said to have become a term of the contract of employment, express or implied and was not payable under the term of employment as such. In ***Regional Director, ESIC v. Anup Engineering Ltd.***[3], it was held that incentives would not be 'remuneration payable under terms of employment' when the employer management had right to make change in the policy and had right to increase and had also right to close or withdraw the same. In another case of ***Whirlpool of India Ltd. v. Employees' State Insurance Corporation***[4], a company had introduced a "Production Incentive Scheme" and paid to its workers production incentive at the rates specified in the Scheme besides normal wages. It was held that the incentives being paid under the Scheme would not be payable on fulfilment of the terms of the contract of employment. It was also held not to constitute a condition of service.

For an incentive or bonus scheme to not be regarded as 'terms of employment', the power to withdraw the scheme or arrangement should not be conditional. There should be a power of total withdrawal at the discretion of the Management even without there being any change in machinery or method or production, for a modification it is essential

1. *1968 I LLJ 550.*
2. *1991 (1) FLR 873 (Del HC).*
3. *2014 SCC Online Guj 156 (Guj HC).*
4. *2000 (85) FLR 171 (SC).*

that there should be such a change. While for withdrawal which implies the exercise of larger power, no preconditions like change in machinery or method of manufacture may be necessary, for the exercise of a lesser power namely for the modification of the scheme the existence of pre-conditions like change in machinery or method of production is made essential. It would be difficult to appreciate how a larger power which includes the lesser power also can be available unconditionally but the exercise of a lesser power of modification made subject to the fulfilment of conditions like change in machinery or method of production.[5]

In the facts of one case, the payment was not one which could have been varied unilaterally to the disadvantage of the other party. The employer had no right to withdraw the without the consent of the other party or without recourse to proceedings warranted by law. Thus, the incentive bonus paid was really remuneration which is paid as a term of the contract of employment. That it was paid in return for the performance was evident. Of course, the workers may not earn it if the performance falls below the prescribed norm. But when once such performance exceeds the norm, they get this as their remuneration as of right and necessarily, therefore, that must be wages which they earn.[6]

Merely because the payment of incentive is not the term of original contract it cannot be said that it is not remuneration paid or payable in fulfilment of the terms of the contract of employment express or implied. The payment of incentive pursuant to scheme between the company and its workers is a reward or prize to be paid for the work done by the workers as such it must be held to be a remuneration.[7] In ***Government Soap Factory v. Regional Director of Employees' State Insurance Corporation***[8], while considering the nature of payment of incentive bonus under a scheme to employees of the Government Soap Factory, it was held by the Karnataka High Court that payment of bonus was under the terms of the contract of employment and the employer was, therefore, liable to pay contribution on the incentive bonus.[9] If an incentive amount was showed to be a paid over a period of two years and was large in amount, it would not be a gift but would be remuneration as part of service conditions.[10] Whenever during the continuance of the employment an employer offers any work for payment of additional remuneration whether by way of overtime wages or incentive affecting particular result for himself and the employee is required to fulfil, that expectation which brings into existence and implied contract. A term of contract whether express or implied, which entitles the employee to the incentive offers, it becomes part of the remuneration.[11] Special allowance, which was being paid to employees as incentives under the terms of contract of employment, would be remuneration under terms of employment.[12]

In one matter before the Supreme Court, the attendance bonus was an additional payment made to the workmen as a means of procuring their regular attendance with the ultimate object of increasing production. The bonus was in the nature of extra remuneration for regular attendance. The said bonus was not payable to all the workmen at the time of joining the employment. It was payable to a workman who had put in continuous service for a specified period and who was loyal to the management. Every workman was entitled to the minimum wage from the very first day of his joining the employment whereas the bonus had to be earned, and it becomes payable "after the event". In the present case the attendance bonus was payable after regular attendance for a specified period and remaining loyal to the management. The scheme of payment of attendance bonus was thus an incentive to secure regular attendance of the workmen. It was an additional payment made to the workmen as a means of increasing production. In ***Titaghur Paper Mills Co., Ltd. v. Workmen Etc.***[13] the Supreme Court held that the payment of production bonus is in the nature of an incentive and is in addition to the wages. Therefore, the attendance bonus was in the nature of an incentive, and it could not be treated as part of wages.[14]

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5. *Escorts Limited and Others v. The Regional Director, E.S.I Corporation, Bangalore, 2004 (102) FLR 1107 (Karn. HC).*

6. *Carborundum Universal, Ltd. v. Employees' State Insurance Corporation, Trichur, 1977 (34) FLR 107 (Ker HC).*

7. *Employees State Insurance Corporation v. Pratap Names Labels Factory 1982 SCC Online DEL 1 (Del HC).*

8. *M.F.A. No. 69/1973 dated 27.11.1973.*

9. *N.G.E.F Ltd., Bangalore v. Deputy Regional Director, E.S.I Corporation, Bangalore (F.B), 1978 SCC Online Kar 249 (Karn HC)*

10. *The Regional Director of E.S.I. Corporation v. Hotel Alukkas, 2008 (116) FLR 41 (Ker HC).*

11. *Rajasthan State Road Transport Corporation v. Employees State Insurance Corporation, 002 WLN 4 557 (Raj HC).*

12. *Hind Art Press, Mangalore v. E.S.I. Corporation, 1989 (59) FLR 778 (Karn. HC).*

13. *1959 Supp 2 SCR 1012 : AIR 1959 SC 1095 : (1957) 2 LLJ 9*

14. *Manganese Ore (India) Ltd. v. Chandi Lal Saha and Others, 1991 AIR SC 520.*

Thus, in order to consider whether payment of incentive bonus was a term of employment of the employees concerned, the Court may examine the original terms of their employment. But in case the said terms of employment were silent, the same would not be decisive. The Court may then proceed to consider whether by a subsequent agreement between the employees and the employees incentive bonus became payable. Such agreement may be either express or implied. Where the terms of a particular incentive bonus scheme show that the employer unilaterally and gratuitously offered to pay incentive bonus and at the same time reserved his right to withdraw or vary the terms of the incentive scheme without consent of the employees, such incentive bonus scheme cannot form part of the terms of employment—express or implied. But when incentive bonus is payable in terms of agreement made either at the time of commencement of employment or at a subsequent stage and such provision for incentive bonus is not liable to be withdrawn or varied the incentive bonus must be considered to be payable in terms of employment.[15] In one case, the incentive bonus was payable to all workmen in pursuance of a scheme arrived at and in the scheme itself there was a clause that if there be a change in the terms of the scheme and having received payments on that basis, the payment became a part of the contract of employment. There was no right available to the management of unilateral withdrawl.[16] The word incentive connotes "*something that arouses feeling or incites to action*". The incentive amount may not be paid regularly every month. The incentive amount is calculated according to the work turn-out by the workers. Hence, it depends upon the work turn out by the individual worker and the said amount is paid at the end of the year as one-time payment and therefore the same does not fall within the definition of wages.[17] If the bonus/incentive scheme itself provides that the same is not remuneration payable under the terms of employment, it would not be so.[18]

In another case, a company had introduced a "Production Incentive Scheme" and paid to its workers production incentive at the rates specified in the Scheme besides normal wages. It was held that the incentives being paid under the Scheme would not be payable on fulfilment of the terms of the contract of employment. It was also held not to constitute a condition of service.[19]

In another matter, a Company floated the "Performance Encouragement Reward Scheme" which provided that the performance of employees of each department was to be reviewed every three months and performance/encouragement prize was to be given. It also bore from the record that such a scheme was voluntary and thus the incentive was paid at interval of every three months i.e. every fourth month. The scheme provided that such incentive was voluntary and such incentive was paid to the employees who opted for a regular interval of three months i.e. on the fourth month and it is also, *inter alia*, provided in the scheme that the employer management had right to make change in the scheme and/or had right to increase and had also right to close or withdraw the scheme and, therefore, such a scheme was not part of the terms of the employment.[20] This was also reiterated by the Bombay High Court in ***Khadi Gramodyog Emporium v. Deputy Regional Director, Incharge, Employees State Insurance Corporation.***[21]

From the above judicial dicta, it can be culled out that incentives would be included under the ambit of the definition of "wages":

1. If the same is provided under the terms of employment i.e. in the appointment letter or service conditions.

2. If it is not explicitly mentioned in the appointment letter or service conditions but has been paid for a long time. It would then assume the characteristic of implied term of employment.

3. In case a scheme/policy of incentives is voluntarily introduced by the employer and can be withdrawn at any time without assigning any reason, the same would not be "remuneration" payable under terms of employment and also not "wages".

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15. *Rayrolle Burn Limited v. The Employees' State Insurance Corporation & Anr., 1979 SCC Online Cal 140 (Cal HC).*

16. *Employees' State Insurance Corporation, Madras v. Amalgamations Repco Limited, Madras, 983 LLJ MAD (2) 193 (Mad HC).*

17. *Employees State Insurance Corporation by Its Regional Director v. Mount Mettur Pharmaceutical Ltd., Thiruvanmiyur, Madras, 2000 (1) LLJ 1415 (Mad HC).*

18. *Employees' State Insurance Corporation, Hyderabad v. Andhra Pradesh Paper Mills, Ltd. and Others, 1978 (1) FLR 58 (AP HC).*

19. *Whirlpool of India Ltd. v. Employees' State Insurance Corporation, 2000 (85) FLR 171 (SC).*

20. *Regional Director, ESIC v. Anup Engineering Ltd., 2014 SCC Online Guj 156 (Guj HC).*

21. *2016 LLR 659 (Bom HC).*