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INDIA'S NEW LABOR CODES EXPAND GRATUITY PAYMENT RULES: KEY UPDATES FOR EMPLOYERS

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Multinational employers are grappling with big changes under India's new labor codes that took effect in November 2025 – and we're breaking down the key impacts in a series of insights. India's Social Security Code not only defines new categories of workers, it also modernizes the framework governing "gratuity payments" – a statutory benefit payable to employees upon termination in recognition of long-term service. These provisions replace the Payment of Gratuity Act while expanding eligibility and changing how gratuity is calculated. Are you prepared to comply with expanded rules? Here are the top four things you need to know about the new gratuity payment framework and five steps you can take now.

1. Expanded Eligibility for Fixed-Term Employees

The Social Security Code extends eligibility for gratuity to fixed-term employees. Some things will remain the same as under the former Payment of Gratuity Act. For example, gratuity still must be paid to employees who have continuously been in the service of an employer for more than five years upon termination, superannuation (retirement due to age), resignation, or death or disablement due to accident or disease.

The Social Security Code, however, extends gratuity eligibility to fixed-term employees. These employees are

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entitled to gratuity upon termination of their contract. Specifically, gratuity becomes payable to fixed-term employees on a pro-rata basis after one year of continuous service. This change increases gratuity exposure for employers that rely on short-term contracts or project-based staffing.

2. Impact of "Wages" Definition

The Code on Wages, 2019, introduced a uniform definition of "wages" that directly affects gratuity calculations under the Social Security Code. Wages are broadly defined to include all remuneration payable in cash, including basic pay and dearness allowance (cost of living adjustments paid to certain individuals), subject to limited exclusions.

Critically, excluded allowances may not exceed 50% of total remuneration. Where allowances exceed that threshold, the excess amount is deemed to be wages for statutory purposes. Because gratuity is calculated on the basis of wages, this change effectively raises the gratuity calculation base for many employees.

Under the Social Security Code, eligible employees are entitled to gratuity at the rate of 15 days' wages for every completed year of service or part thereof in excess of six months. When read together, the revised wage definition and the gratuity formula are expected to result in higher gratuity payouts.

3. Additional Gratuity Calculation Rules

The Social Security Code further clarifies that:

- The Central Government may specify changes to the number of days' wages that are used as the gratuity calculation baseline.
- Piece-rated workers are entitled to gratuity based on the average wages earned during the three months immediately preceding termination.
- Seasonal employees are entitled to gratuity at the rate of seven days' wages for each season.
- Fixed-term employees and deceased employees' beneficiaries receive gratuity on a *pro rata* basis.

4. Ceiling, Payment, and Compliance

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Whereas the Payment of Gratuity Act set a statutory ceiling on gratuity payments, the Social Security Code authorizes the Central Government to specify the applicable ceiling, which is currently ₹2,000,000 (approximately $22,000 USD). Employers and employees, however, may contract for more favorable gratuity terms.

Once gratuity becomes payable, employers must determine the amount and provide notice to the applicable employee, as well as to the relevant authority. Payment must be made within 30 days. An employer who fails to submit the gratuity payment in time will incur interest.

Effective Date

The new gratuity requirements are in force as of November 21, 2025, and apply prospectively from that date. Although certain provisions of the Social Security Code will be implemented only after the Central Government issues further rules (including, for example, a new unified registration system for employees that is still under development), those pending rules do not delay employers' obligation to account for and pay gratuity to the expanded class of covered workers.

Your 5-Step Action Plan

Businesses with employees in India should consider taking the following five steps now to comply with the expanded rules:

1. Assess and Classify Workforce Appropriately: Review workforce classifications to identify fixed-term employees.

2. Review Payment Policies and Adjust Accordingly: Assess renumeration structures to ensure compliance with the 50% wage threshold.

3. Update Gratuity Provisioning and Cash-Flow Planning: Reassess gratuity accruals and financial reserves to account for expanded eligibility and potentially higher wage bases, particularly for fixed-term and allowance-heavy compensation structures.

4. Prepare Internal Processes to Meet Notice and Payment Timelines: Ensure payroll and HR teams are prepared to calculate gratuity accurately, issue statutory notices promptly, and complete payment within the prescribed timelines to mitigate interest and enforcement exposure.

5. Keep up with Additional Changes to India's Labor Code: Read our prior insights here and here, and monitor our International Practice Group Insights Page for more publications.

Conclusion

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