FAQs on Labour Codes 2025

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> A useful reference for anyone dealing with gratuity accounting after the new wage definition / eligibility changes. Thank you Suresh Ponnappa for sharing.

The Government of India consolidated 29 older laws into four "New Labour Codes." These include the Code on Wages, Social Security, Industrial Relations, and Occupational Safety. **The Institute of Chartered Accountants of India (ICAI)** released these FAQs to explain the accounting effects of this change. This document clarifies key questions regarding gratuity, leave obligations, interim reporting, and tax impacts.

Question 1

> “Gratuity liability for an entity is likely to increase pursuant to below requirements of the New Labour Codes:
>
> (a) The new Labour Codes have mandated that minimum 50% of total remuneration should include three components, viz., Basic Pay, Dearness Allowance and Retaining allowance, which are collectively referred to as ‘Wages’. If wages are lower than 50% of total remuneration, then it is presumed that wages constitute 50% of total remuneration. The new Labour Codes have

> subsumed the Payment of Gratuity Act, 1972 and they require gratuity payment to all employees to be calculated based on last drawn wages which should be minimum 50% of total remuneration.
>
> (b) Earlier gratuity was payable to an employee if and only if an employee has completed five years of continuous service. Under the new Labour Codes, fixed term employees (which include contracted employees) will be entitled to gratuity on completing one year of service. There is no change in requirement of five years of continuous service requirement for permanent employees.
>
> How should an entity account for increase in gratuity liability arising from the New Labour Codes both under Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules 2015 (as amended) (hereinafter referred to as 'Ind AS') and Accounting Standards notified under the Companies (Accounting Standards) Rules 2021 (as amended) (hereinafter referred to as 'Indian GAAP')?

Response:

The gratuity benefit is an employee benefit and accordingly any increase in an entity's obligation due to application of the New Labour Codes is to be accounted for in accordance with the principles of AS 15, Employee Benefits or Ind AS 19, Employee Benefits, as the case may be.

Under AS 15/ Ind AS 19, the changes to gratuity benefit resulting from the New Labour Codes are plan amendments and they are required to be treated as past service costs.

With regard to past service cost, relevant paragraphs of AS 15 and Ind AS 19 state as under:

AS 15, Employee Benefits

"7.20 Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

94. In measuring its defined benefit liability under paragraph 55, an enterprise should recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an enterprise should recognise past service cost immediately.
95. Past service cost arises when an enterprise introduces a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested. Therefore, past service cost is recognised over that period, regardless of the fact that the cost refers to employee service in previous periods. Past service cost is measured as the change in the liability resulting from the amendment (see paragraph 65).”

Ind AS 19, Employee Benefits

8. …

Service cost comprises:

…

(b) past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan);and

…

.03. An entity shall recognise past service cost as an expense at the earlier of the following dates:

(a) when the plan amendment or curtailment occurs, and

(b) when the entity recognises related restructuring costs (see Ind AS 37) or termination benefits (see paragraph 165).”

The increase in gratuity liability arising due to application of the New Labour Codes is a past service cost as this results in changes to the benefits payable under the plan and treated in

accordance the applicable requirements as below:

(a) Under Ind AS, Ind AS 19 requires past service cost to be immediately recognised as an expense in the Statement of Profit and Loss.

(b) Under Indian GAAP, AS 15 requires vested past service cost (i.e., past service for employees who have already completed applicable service period) to be recognised immediately. For employees who are yet to complete applicable service period, past service cost is amortised over the vesting period and recognised as an expense in the Statement of Profit and Loss.

In view of the above, any increase in gratuity liability arising due to application of the New Labour Codes is required to be recognised as an expense in the Statement of Profit and Loss as per the requirements of the relevant applicable Accounting Standard.

Question 2

> “Assume that under ABC Limited’s salary structure for its employees before the enactment of the New Labour Codes, wage (basic salary +dearness allowance) was only 35% of total remuneration. ABC Ltd. decides to revise its salary structure to comply with the requirements of the New Labour Codes. Along with change in salary restructure, ABC Ltd. decides to grant 15% increase in total remuneration to all its employees vis-à-vis previous estimate of 12% increase. ABC Ltd. has attributed entire increase in remuneration (15%) to basic salary instead of attributing increase to all components. Thus, for example, total remuneration prior to the change was INR 100,000 which included wages of INR 35,000. Post the applicability of the new Labour Codes, total remuneration is INR 115,000 which includes wages of INR 57,500. Can ABC Ltd. treat salary change as change in actuarial assumption resulting in actuarial gain/ loss instead of plan amendment resulting in past service cost?

Response:

In the given case, the change in wages of INR 22,500 has two components: (i) increase in salary of 15% vis-à-vis previous estimate of 12%, and (ii) change in salary structure resulting from attribution of increase in salary entirely to basic salary, instead of attributing increase to all components. The first component is change in actuarial assumption and the second component is a plan amendment. ABC Ltd. should identify impact of these two components separately and treat them accordingly.

In a scenario, where entities choose to restructure salary to align with new labour codes and there is no real increase in the salary then the entire increase in gratuity and leave obligation shall be attributed to past service cost.

Question 3

> “Whilst the New Labour Codes are effective from 21st November, 2025, the supporting Rules are yet to be notified. Based on legal evaluation, the Wage Definition under the New Labour Codes is applicable immediately and an employee, whose last working day is on or after 21st November, 2025, needs to be paid Gratuity as per the requirements of the New Labour Codes. Considering this legal interpretation, whether listed entities having 31st March year end need to recognise additional gratuity obligation arising from the New Labour Codes in financial results for the period ending 31st December, 2025 or they can defer the impact till financial year ending 31st March, 2026?

Response

Both Ind AS 34, Interim Financial Reporting and AS 25, Interim Financial Reporting require that an entity shall apply the same accounting policies in its interim financial statements as are applied in its most recent annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.

However, the frequency of an entity’s reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results. To achieve that objective, measurements for interim

reporting purposes shall be made on a year-to-date basis.

Further, as per paragraph 39 of Ind AS 34 and paragraph 38 of AS 25, costs that are incurred unevenly during an entity's financial year shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.

Considering the above requirements, the increase in gratuity liability arising from new labour codes need to be recognised in interim financial statements/ results for the period ended 31st December, 2025 in accordance with the applicable requirements of Ind AS 19/ AS 15.

Question 4

> "Whether increase in gratuity liability arising from the New Labour Codes should be treated as an adjusting or a non-adjusting event in the financial statements/ results for periods ending prior to 21st November, 2025 (e.g., financial statements/ results for the period ended 30th September, 2025 or 30th June, 2025 and 31st March, 2025) and approved for issuance on or after 21st November, 2025?

Response:

The enactment of New Labour Codes is change in law occurring on 21st November, 2025. The obligation arising from change in the law was not existing on an earlier date. Accordingly, enactment of the New Labour Codes and its consequential impact is a non-adjusting event in the financial statements/ results for periods ending prior to 21st November, 2025 (e.g., financial statements/ results for the period ended 30th September, 2025 or 30th June, 2025 and 31st March, 2025) and approved for issuance on or after 21st November, 2025.

Though treated as non-adjusting event, entities should make appropriate disclosures as required under the applicable accounting standard. Paragraph 21 of Ind AS 10, Events After the Reporting Period requires disclosure regarding the nature of the event and an estimate of the financial effect, unless such an estimate cannot be made. Similar disclosure is required under paragraph 17 of AS

4, Contingencies and Events Occurring After the Balance Sheet Date.

Question 5

> “Like gratuity, the New Labour Codes are also likely to impact leave obligation for the entities. How should an entity account for changes in leave obligation arising from the New Labour Codes both under Ind AS and Indian GAAP?

Response:

Leave obligation is treated as short-term or other long-term employee benefit obligation, as the case may be both under Ind AS 19 and AS 15. Both Ind AS 19 as well as AS 15 require past service cost in respect of other long-term employee benefits to be recognised immediately. Unlike post-employment benefits, AS 15 does not allow amortisation of past service cost on account of changes in other long-term employee benefit obligation even for unvested benefit. Hence, any change in leave obligation arising from the New Labour Codes is recognised as an expense in the Statement of Profit and Loss immediately.

Question 6

> “Can an entity present additional expense resulting from increase in gratuity/ leave obligation due to the new Labour Codes as an exceptional item in the Statement of Profit and Loss?

Response:

Ind AS Schedule III to the Companies Act 2013 (as amended) requires separate presentation of exceptional items in the Statement of Profit and Loss. However, the term ‘Exceptional items’ is neither defined in Ind AS Schedule III nor in Ind AS. However, Ind AS 1, Presentation of Financial Statements has reference to material items in paragraphs 85, 86, 97 and 98.

Paragraph 85 of Ind AS 1 requires that additional line items, headings, and subtotals in the statement of profit and loss shall be presented, when such presentation is relevant to an understanding of the entity's financial performance. Further, paragraph 86 provides that disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense.

Paragraph 97 of Ind AS 1 requires that when items of income or expense are material, an entity shall disclose their nature and amount separately. Paragraph 98 states that circumstances that would give rise to the separate disclosure of items of income and expense include:
(a) write-downs of inventories to net realisable value or of property, plant, and equipment to recoverable amount, as well as reversals of such write-downs;
(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
(c) disposals of items of property, plant, and equipment;
(d) disposals of investments';
(e) discontinued operations;
(f) litigation settlements; and
(g) other reversals of provisions.

As per Ind AS 1, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

From the above, it appears that all material items are not exceptional items. In other words, exceptional items are those items which meet the test of 'materiality' (size and nature) and the test of 'incidence'.

Broadly, similar requirements exist under Indian GAAP.

One may argue that change in gratuity and leave obligation is arising from enactment of new legislation which is an event of non-recurring nature. Considering this and depending on materiality of impact, an entity may evaluate whether it is acceptable to present additional expense resulting

from increase in gratuity/ leave obligation due to the new Labour Codes as an exceptional item in the Statement of Profit and Loss. Irrespective of whether the expense is presented as exceptional item, the entity should make relevant disclosures to explain impact arising from enactment of the New Labour Codes.

Question 7

> "What will be current and deferred tax implications of increase in gratuity and/ or leave encashment obligation arising from the New Labour Codes?

Response:

There are no special provisions under the Income Tax Act, 1961/ Income Tax Act, 2025 (as amended) dealing with tax deduction for increase in gratuity/ leave benefit obligation arising from enactment of the New Labour Codes. Thus, income tax deduction in respect of such increase in obligation is governed by the same provisions of the Income Tax Act, 1961/ Income Tax Act, 2025 (as amended) as are applicable to gratuity/ leave encashment obligation arising in normal course of business. In particular:

(a) Contributions due and paid to an approved gratuity fund/ trust are allowed as a deductible business expense in the year in which the contribution is made, i.e., on an actual payment basis.

(b) In respect of unfunded gratuity plan and/ or contribution to unapproved gratuity fund/ trust, deduction as business expense will be allowed only in the year of gratuity becoming payable to the employee.

(c) In respect of provision for accrued leave salary benefit, deduction as business expense is allowed on actual payment basis.

Considering the above requirements and requirements of Ind AS 12, Income Taxes, the amount of increase in obligation to the extent deductible as business expense in the current year impacts current tax measurement for the year.

However, the amount of increase in obligation to the extent will be deductible in future years results in a deductible temporary difference under Ind AS 12. Subject to consideration of prudence as required under Ind AS 12, these deductible temporary differences result in recognition of deferred tax asset.

Similarly, under AS 22, Accounting for Taxes of Income, the amount of increase in obligation to the extent deductible as business expense in the current year impacts current tax measurement for the year.

However, the amount of increase in obligation recognised as expense and to the extent will be deductible in future years results in a timing difference under AS 22. Subject to consideration of prudence as required under AS 22, these timing differences result in recognition of deferred tax asset.

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