Decoding: The Code on Social Security, 2020 (India)

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Background

After being first presented almost a year ago, The Code on Social Security, 2020 was finally passed by the Parliament and subsequently received the President's assent on the 28th of September 2020. This was one of the three labour codes which received the assent and kick-starts a process where decades-old labour laws in India get merged into the four labour codes. The Government expects this codification would significantly ease labour law compliance for employers, cut-down red-tape and labour related litigation, enhances social security for employees and overall improve India's ranking in doing business and attracting foreign investments.

As the name suggests, the Code on Social Security aims to consolidate existing social security laws and extend the same to all employees in organized or unorganized sectors. While the detailed rules would be framed and be available in the coming months, let us look at some of the bigger amendments that have been made and how it impacts organizations, employers and employees.

Consolidates existing Labour Laws

The Code on Social Security consolidates the following 9 existing labour laws.

1. The Employee's Compensation Act, 1923;
2. The Employees' State Insurance Act, 1948;
3. The Employees' Provident Funds and Miscellaneous Provisions Act, 1952;
4. The Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959;
5. The Maternity Benefit Act, 1961;
6. The Payment of Gratuity Act, 1972;
7. The Cine-Workers Welfare Fund Act, 1981;
8. The Building and Other Construction Workers' Welfare Cess Act, 1996;
9. The Unorganized Workers' Social Security Act, 2008.

While consolidating labour laws is an action in the right direction, organizations would really benefit if ongoing compliance requirements is limited to one Annual Return covering all the above laws. Similarly, new organizations setting up their businesses would want to have one form covering all their licensing and registrations under the Code.

Definition of Wages

This is one of bigger changes expected to impact the contributions and benefits under the Code. The new Wages definition includes Basic Pay, Dearness Allowance and Retaining Allowances and excludes all the other allowances. However, excluded allowances should not exceed 50 percent of the Gross salaries in which case the excess above 50 percent would be included in the definition of Wages. In other words, Wages should not be less than 50% of the Gross salary. For majority of organizations in India, Basic wages constitutes 30% to 50% of gross pay and therefore higher costs would be incurred by the employer if the new definition is applied retrospectively to schemes such as Gratuity and Leave encashment which are provisioned on Basic wages. Schemes such as Provident Fund and Employees State Insurance could be less impacted as these have wage caps for eligibility and contributions.

It should also be noted that wages-in-kind paid to employees too falls within the same clause and any excess wages-in-kind above 50% of gross salary would be clawed back within the definition of wages. This would have an implication of Flexible Compensation structures being adopted by many organizations in India where flexible benefits such as Company provided Car, Housing, Professional Development etc. are offered as part of Cost to Company (CTC model). More clarity is awaited on these issues

Separately it remains to be seen that whether supplementary retirement benefit plans like National Pension Scheme (NPS) and Superannuation which have historically being linked to Basic wages would also now get linked to the new definition of Wages.

Social Security for Gig and Platform workers

The Code establishes formal definitions of these new categories of employees which are “outside of traditional employer-employee relationship”. In view of a significant increase in hiring of platform workers by aggregators like Ride sharing services, food delivery services, logistics etc. the Code provides for a road-map by which several social security plans like life insurance, health, maternity, old age protection would be set up for these workers to be financed by the Centre, State and the Employer. Specifically, the Code requires aggregators to contribute 1-2 percent of their annual turnover towards social security schemes for these workers. This is a great step to ensure adequate protection of the Gig workforce who are currently not under any formal social security plans

Provident Fund applicability and rate

The Code specifies the rate to be 10% or 12% of pay as decided by the Government. Moving to a lower rate of 10% would boost the cash-in-hand salary by 4% under a CTC model but have a significant adverse impact on the retirement saving accumulations under the Provident Fund scheme. Separately one of the clauses highlights potential to exclude an organization from Provident Fund based on an agreement between employers and majority of employees. This needs more clarity on the eligibility and applicability. Considering Provident Fund is the only formal scheme which mandates regular savings towards retirement, it would be preferable to keep the scheme mandatory with the contribution rate being unchanged at 12 percent

Gratuity

As explained above, the change in definition of wages would lead a sharp increase in accounting and actuarial liabilities for organisations. For example, an organization which historically capped Basic wage at 30% of Gross Salary would see their Balance Sheet liabilities rise by approximately 60% if they must move to the new definition of Wages retrospectively. A similar impact could be seen in Leave encashment liabilities if organisations encashes the accumulated leaves on Basic wages only. Organisations should assess the financial impact of this in advance and provision adequately so that there are no surprises towards the end of the financial year.

Fixed-Term Employments

The Code acknowledges Fixed-Term employment based on a written contract and provides that wages, allowances and benefits of fixed term employers should be no less than those of permanent employees. This could have large implications on organizations which regularly hire large number of fixed-term employees for project work at lower salaries as compared to permanent employees. Compliance to these provisions should lead to a rise in wage bills for these organizations. As organizations must maintain records of different type of workers employed by them, those not offering wage parity between permanent and fixed term employees could be pulled up for non-compliance. Additionally, Gratuity for Fixed term employees shall be paid on pro-rated basis indicating it would be paid without any vesting criterion of 5 years’ service again leading to a higher cost for employers.

Other Rules

Besides the above, the Code reiterates some of the key benefits currently being offered under the Maternity Benefits Act which mandates 26 weeks of paid maternity leave and the provision of Creches which has not seen complete compliance across India. The Employees Compensation Act too retains most of its provisions and shall be applicable for organizations not covered under the Employees State Insurance Chapter although it needs to be clarified if there is a cap on wages for the calculation of compensation in case of death or disability.

Overall the Code on Social Security is a step in the right direction to improve India’s position in the Ease of Doing Business ranking and encourage foreign investment in the country. Organizations would look forward to the detailed rules to be published under the Code to confirm if the actual compliance obligations would be reduced once the Code is implemented.

Contact Information

We're here to empower results, if you would like further information or to discuss these or other retirement matters, please reach out to:

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