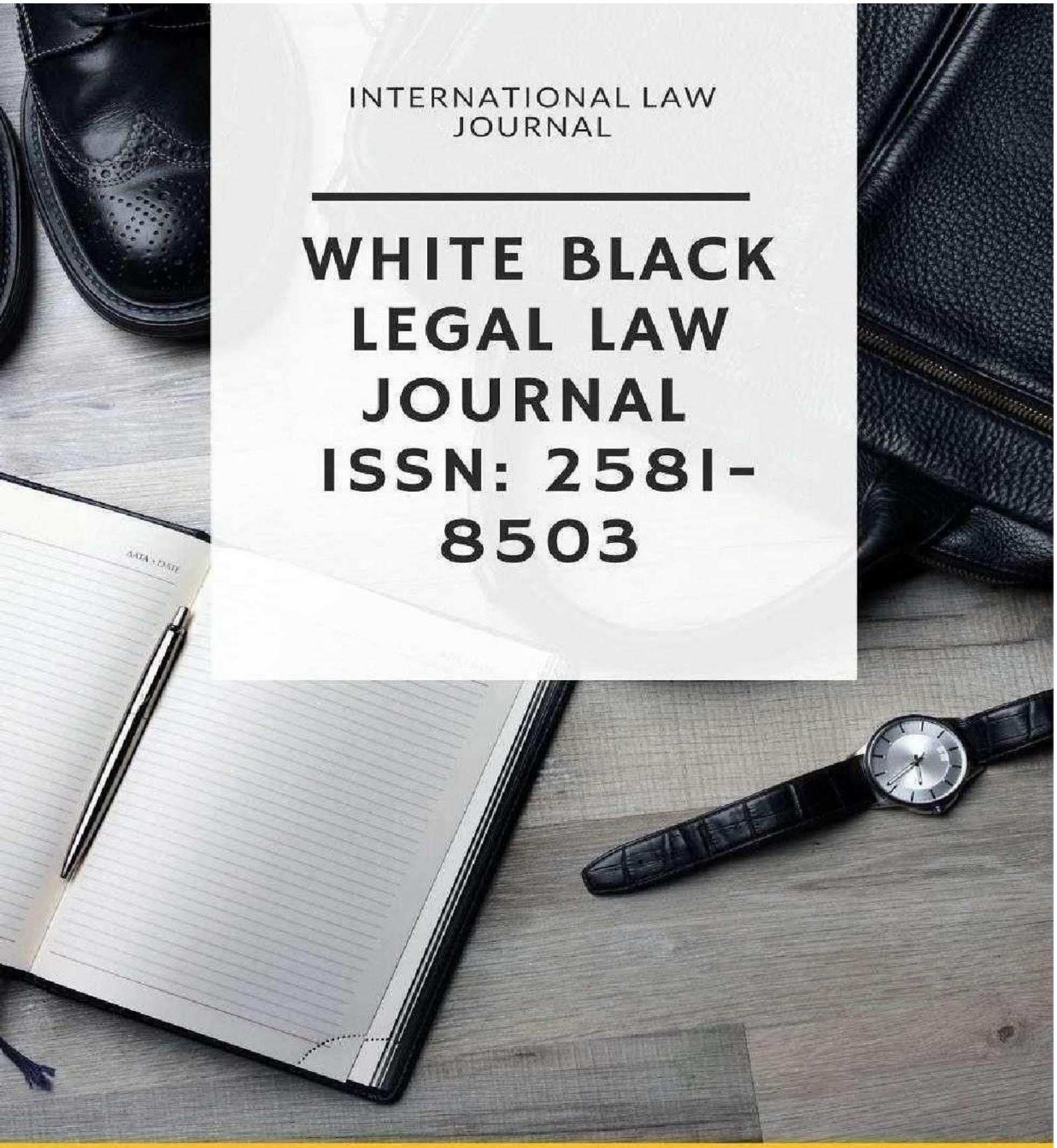


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GRATUITY AS DEFERRED DIGNITY: THE PAYMENT OF GRATUITY ACT, 1972 AND ITS RESHAPING UNDER THE CODE ON SOCIAL SECURITY, 2020

AUTHORED BY - A MARIO MISHAL

Abstract

Gratuity sits at an unusual crossroads in Indian labour law. It is part reward, part deferred wage and part social security, and for decades it has been governed by a compact statute, the Payment of Gratuity Act, 1972. Since 21 November 2025 the entitlement has a new statutory home in the Code on Social Security, 2020. This article explains the nature and purpose of gratuity, then works through eligibility, continuous service, calculation, forfeiture and enforcement under the 1972 Act. It then examines what the Code changed, chiefly the one-year rule for fixed-term employees and the broader definition of wages, and what it deliberately left untouched. The article argues that the older case law remains a living resource, while the new provisions leave several drafting questions that tribunals and courts will have to settle.

Keywords: Gratuity; Payment of Gratuity Act, 1972; Code on Social Security, 2020; fixed-term employment; continuous service; forfeiture.

1. Introduction

Ask anyone who has spent thirty years in a factory, a school or a bank what they are quietly looking forward to on their last working day, and the answer usually has a figure attached: the gratuity. It is rarely the largest sum an employee will ever receive, yet it carries a weight its size does not explain. It is the employer's acknowledgement, in rupees, that someone gave the best part of their working life to the enterprise.

For students of Labour Law II, gratuity is usually met as the Payment of Gratuity Act, 1972, a short statute that nonetheless produces a surprising amount of litigation. That familiar picture has now shifted. The Code on Social Security, 2020 merged nine earlier laws into a single framework, and it came into force on 21 November 2025 alongside the other three labour codes (Press Information Bureau [PIB], 2025). Any updated study of gratuity therefore has to hold two texts in view at once: the old Act that shaped decades of judicial reasoning, and the Code

that now carries the entitlement forward.

This article does that in a deliberately practical way. It explains what gratuity is, walks through eligibility, calculation, forfeiture and enforcement, and then asks what the Code really changed. The central argument is modest but, I think, important. The Code's most visible reform, the one-year rule for fixed-term employees, is genuine and welcome. But much of the gratuity architecture is still the 1972 design, which means the older judgments continue to matter, and the new provisions have introduced a few uncertainties of their own.

2. Origins and Legal Nature of Gratuity

Before Parliament stepped in, gratuity in India was largely a matter of employer goodwill. Some companies paid it as an ex gratia gesture, others agreed to it in settlements, and industrial tribunals gradually began to award it as part of the conditions of service. The Supreme Court's early thinking can be seen in *Jeewanlal (1929) Ltd v Its Workmen* (AIR 1961 SC 1567), where gratuity was understood as recognition of long and meritorious service rather than a mere present from the management. The idea that it was something earned, and not something granted, slowly took hold.

The 1972 Act turned that idea into a statutory right. Three features of the Act explain its character. First, the right does not depend on the employer's mood: once the conditions are satisfied, payment is mandatory. Second, the Act sets a floor and not a ceiling, because an employer may pay more under a contract or award, and the Act expressly says that better terms are not disturbed (Government of India, 1972, s. 4(5)). Third, the entitlement is protected. Gratuity cannot be attached in satisfaction of a decree or order of a court, and the Act overrides inconsistent provisions in other laws or instruments.

Seen this way, gratuity occupies a middle position. It is not a gift, because the law compels it. It is not quite ordinary wages either, because it becomes payable only at the end of a qualifying period of service. Many writers therefore describe it as a form of deferred compensation for loyalty, and a safety net at the moment the pay cheque stops. That dual identity explains why courts have generally interpreted the Act in favour of employees while still insisting that the statutory conditions be met.

3. Scope and Key Definitions

The 1972 Act applies to factories, mines, oilfields, plantations, ports and railway companies, and to shops and establishments in which ten or more persons are employed, or were employed

on any day in the preceding twelve months. It can also be extended to other establishments by notification. One feature that students sometimes miss is the principle of continuity of coverage: once an establishment has come within the Act, it stays within it even if its headcount later falls below ten (Government of India, 1972, s. 1(3)).

The definition of "employee" is broad. It reaches people doing manual, skilled, unskilled, technical, clerical or supervisory work for wages, but it excludes apprentices and persons holding civil posts under the Central or State Government who are already governed by their own gratuity or pension rules. The question of whether teachers counted as employees became a real controversy. In *Ahmedabad Private Primary Teachers' Association v Administrative Officer* ((2004) 1 SCC 755) the Supreme Court held that teachers were covered, and Parliament later settled the matter through the Payment of Gratuity (Amendment) Act, 2009, which made the position explicit with effect from 3 April 1997.

"Wages" matters more than it first appears, because it is the base on which every rupee of gratuity is calculated. Under the 1972 Act, wages means emoluments earned in cash, including dearness allowance, but excluding bonus, commission, house rent allowance, overtime and other allowances (Government of India, 1972, s. 2(s)). In practice, this meant that an employee whose salary was split into a small basic pay and a large bundle of allowances ended up with a smaller gratuity than the headline salary suggested. This is exactly the gap the new Code attempts to narrow, as discussed later.

4. Eligibility and the Idea of Continuous Service

Under section 4(1), gratuity becomes payable when employment ends after the employee has completed at least five years of continuous service, and the ending takes one of three forms: superannuation, retirement or resignation, or death or disablement caused by accident or disease. The five-year requirement is waived where service ends through death or disablement, which is a humane exception that reflects the social security purpose behind the law. In the case of death, the amount goes to the nominee, or to the legal heirs if no valid nomination exists.

The phrase "continuous service" is the real battlefield. Section 2A treats service as continuous if it is uninterrupted, and it does not allow certain breaks to count against the employee. Absence due to sickness, accident, leave, lay-off, strike or lockout that is not illegal, or cessation of work not caused by the employee's fault, does not break continuity. For an employee who has not literally worked every day of a year, the Act uses a minimum attendance

test: broadly, 190 days in a year for underground mine work or establishments working fewer than six days a week, and 240 days in other cases. Seasonal establishments follow a different pattern.

The Act also deals with part-years in a sensible way. A fraction of a year exceeding six months is rounded up to a full year for the purpose of calculation. So an employee who retires after twelve years and seven months is treated as having twelve completed years plus one more, and receives gratuity for thirteen. Little rules like this are easy to overlook in an exam answer, but they change the final figure in real cases.

5. Calculating Gratuity

The formula is one of the few parts of labour law that can be stated in a single line. For employees covered by monthly rates, gratuity equals the last drawn wages multiplied by fifteen, divided by twenty-six, and then multiplied by the number of completed years of service (Government of India, 1972, s. 4(2)). The divisor of twenty-six reflects the assumption that a month contains twenty-six working days, so fifteen days' wages is fifteen twenty-sixths of a month's wages. For seasonal employees, the rate is seven days' wages for each season.

A simple illustration helps. Suppose an employee's last drawn monthly wages, which means basic pay plus dearness allowance, were ₹40,000, and she retires after eight years of continuous service. Her gratuity is 40,000 × 15 ÷ 26 × 8, which comes to roughly ₹1,84,615. If she had instead served eight years and seven months, the part-year would be rounded up and the multiplier would be nine, giving about ₹2,07,692.

There is also a statutory ceiling. Following the 2018 amendment, the maximum gratuity that can be claimed under the Act stands at ₹20 lakh, and the Central Government can raise it by notification. The ceiling applies to the statutory entitlement only. Because section 4(5) leaves room for contractual improvement, an employer who has promised more in a service agreement or policy is bound by that promise. Students should also remember that the tax treatment of gratuity is a different subject altogether, governed by income tax law rather than labour law, and this article does not go into it.

6. Forfeiture: When the Right Can Be Taken Away

Because gratuity is treated as earned, forfeiture is the exception, and the Act confines it to limited situations (Government of India, 1972, s. 4(6)). First, where an employee's service has been terminated for any wilful omission or negligence causing damage, loss or destruction of

the employer's property, gratuity can be forfeited to the extent of the damage or loss. Second, gratuity may be forfeited where service is terminated for riotous or disorderly conduct or any violent act, or for an offence involving moral turpitude committed in the course of employment. Two practical points follow. The first is that forfeiture is not a general penalty for misconduct. An employer who dismisses someone for, say, insubordination or absenteeism cannot, on that basis alone, withhold gratuity, because the statute does not list those grounds. The second is that the employer carries the burden of bringing the case within the statutory words. Courts have repeatedly cautioned that a provision which takes away a vested statutory benefit must be read strictly. The Supreme Court's decision in *Union Bank of India v C.G. Ajay Babu* ((2018) 9 SCC 529) is frequently cited in this area, and it is worth reading in full for how the Court approaches the relationship between disciplinary action and statutory forfeiture.

For an examination, the safest approach is to present forfeiture as a two-limb structure, separating the damage-based forfeiture, which is proportionate to loss, from the conduct-based forfeiture, which is tied to violence, disorder or moral turpitude. Then add a sentence on strict construction, and you have covered what most examiners look for.

7. Enforcement: How the Right Is Actually Claimed

A right that cannot be enforced is only a hope, and the Act builds a fairly complete machinery to avoid that. The appropriate Government appoints Controlling Authorities with powers to enforce the Act and decide disputes. Gratuity is expected to be paid within thirty days of becoming payable. If the employer delays beyond that, the Act provides for simple interest at a rate notified by the Government, unless the delay was due to the employee's own fault (Government of India, 1972, s. 7).

The claim process is meant to be light on formality. The employee, or the nominee in the case of death, applies in writing, and the employer is expected to determine the amount and issue a notice with the amount of gratuity. If the employer disputes the claim, whether on eligibility, the amount or forfeiture, the matter goes to the Controlling Authority, which conducts a summary inquiry. An appeal lies to the appellate authority within the statutory period, and an employer appealing against an order for payment must deposit the amount first. This deposit rule is a quiet but effective protection against delay tactics.

If the employer still does not pay, the amount can be recovered as arrears of land revenue, and the Act also creates offences and penalties, including imprisonment, for non-compliance. The Act additionally contemplates compulsory insurance for employers, so that an employer's

insolvency or cash shortage does not leave retired workers empty-handed. In reality, enforcement depends heavily on workers knowing their rights and having the confidence to claim them, which is why legal literacy among employees remains the most underrated part of this subject.

8. What the Code on Social Security, 2020 Changed

The Code on Social Security, 2020 absorbed the Payment of Gratuity Act into its framework, with the gratuity provisions centred on section 53 (Government of India, 2020). The government's own explanatory material describes the Code as merging nine existing social security laws and extending protection across a wider range of workers (PIB, 2025). For gratuity specifically, three developments deserve attention.

The first and most discussed is fixed-term employment. Under the old Act, a worker engaged for a fixed term of, say, two years never reached the five-year threshold and so received nothing. Under section 53 of the Code, fixed-term employees directly engaged by an employer become eligible for gratuity after one year of continuous service, instead of five (PIB, 2025). Several commentators describe the entitlement as proportionate or pro rata to the period actually served (Outlook Money, n.d.). State governments have also moved in the same direction in their own rules. Gujarat's amendment rules, for instance, provide fixed-term employees with gratuity after a minimum of one year of continuous service, and Delhi has adopted a similar pro-rated model (DLA Piper, 2025).

The second development concerns wages. The Code adopts a uniform and wider definition of wages that covers basic pay, dearness allowance and retaining allowance, with certain components excluded, and the exclusions are not allowed to exceed half of total remuneration (Basunivesh, n.d.; Outlook Money, n.d.). The effect is that, for employees whose employers previously kept basic pay artificially low, the base for gratuity may rise. The formula itself, fifteen days' wages for each completed year, is unchanged, and the five-year requirement for regular employees stays in place. The following table summarises the comparison.

Table 1: Gratuity under the 1972 Act and the 2020 Code (summary)

Aspect	Payment of Gratuity Act, 1972	Code on Social Security, 2020
Regular employees	Five years of continuous service	Five years of continuous service (unchanged)

Aspect	Payment of Gratuity Act, 1972	Code on Social Security, 2020
Fixed-term employees	No special provision; five-year rule applied	Eligible after one year, on a pro rata basis (s. 53)
Formula	15 days' wages per completed year (15/26 for monthly rated)	Same formula
Wages base	Basic + DA; most allowances excluded	Uniform wage definition; exclusions capped at 50% of remuneration
Statutory ceiling	₹20 lakh (2018 amendment)	Ceiling continues in the framework, subject to notification

A short illustration shows why the fixed-term change matters. Imagine a fixed-term employee with last drawn wages of ₹30,000 who completes one year under the contract. On the usual arithmetic, 30,000 × 15 ÷ 26 gives about ₹17,308. Under the old law, this person would have received nothing. The figure above is only illustrative, since the precise method of working out the pro rata amount depends on the final rules and on how the contract ends.

One more point deserves care. Because the Code came into force on 21 November 2025, employees whose service straddles that date raise a transition question. Practitioner commentary cautions against treating the matter as a simple split, with the period before that date calculated under the old law and the period after it under the new one (Bajaj Finserv, n.d.). Until clearer judicial or administrative guidance emerges, anyone advising on a real claim should read the Code, the applicable Rules and any transitional provisions together, and not rely on shortcuts.

9. Critical Reflections and Open Questions

It would be easy to describe the Code's gratuity reforms as an unqualified step forward, but a careful reader will notice some loose threads. Scholars writing on the subject have pointed out that the Code still leaves ambiguity around fixed-term gratuity. Jain and Sharma (n.d.) note that the Code introduces the idea of "pro rata" in this context without a corresponding change in the formula, and they treat that as a drafting oversight that invites uncertainty. They also point to draft central rules proposing a one-year qualification, which shows that part of the detail is being supplied by subordinate legislation rather than by the Code itself. Fatima (2026)

examines the one-year rule critically and reaches a similarly cautious view that the reform is significant but needs sharper statutory expression.

A second concern is behavioural rather than textual. Critics of expanded fixed-term hiring often argue that employers may prefer short contracts to permanent posts, so that workers move from contract to contract without ever accumulating long service. Whether that will actually happen is an empirical question that no one can answer yet, and it would be unfair to treat it as established. What can be said is that a one-year gratuity right narrows the cost advantage of cycling through short contracts, which is arguably part of the policy design.

Third, the wider wage definition cuts in more than one direction. A higher gratuity base is good for employees' terminal benefits, but employers who restructure pay to absorb the cost may adjust other components, and the effect on monthly take-home pay will vary from workplace to workplace. This is a reminder that wage definitions are never neutral accounting choices; they decide who bears the cost of a social benefit.

Finally, the older case law has not become obsolete simply because the statute moved. Issues such as the meaning of continuous service, the strict construction of forfeiture, and the powers of the Controlling Authority arose under the 1972 Act, and courts are likely to continue relying on that reasoning where the Code's language is substantially similar. For a student, this is useful news. The syllabus has been updated, but the underlying logic you learned from the decided cases still does most of the work.

10. Conclusion

Gratuity began as an act of employer goodwill and has grown into a statutory right with its own rules on eligibility, calculation, forfeiture and enforcement. The Payment of Gratuity Act, 1972 gave that right shape, and the Code on Social Security, 2020 has now given it a new home without disturbing its central logic. The most meaningful change is the one-year entitlement for fixed-term employees, which finally acknowledges that a worker on a short contract has also given something of value. The broader wage definition adds to this, though its practical effect will depend on how employers respond.

What remains is the slower work of implementation. Rules must be finalised and read consistently, transitional questions must be clarified, and workers must be able to claim what the law gives them. For anyone studying Labour Law II, the lesson is to read the Code alongside the Act, remember the case law that explains both, and treat every change as a question about whose labour is recognised, and when. Gratuity, in the end, is the law's way of saying that

service matters, and that it should be remembered in writing, in numbers and on time.

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