

A COMPARATIVE STUDY OF EMPLOYEE TAKE-HOME SALARY: PRE-2025 ALLOWANCE-HEAVY STRUCTURES VS. THE 2026 WAGE CODE 50% RULE

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Abstract:

With the adoption of the Wage Code 2026, India's labor economics experienced a significant change. This shift moved away from salary structures that relied heavily on allowances for tax efficiency, and toward a standardized "Social Security" model. This research paper compares the mandatory 50% Wage Rule of 2026 with the employee take-home pay under the pre-2025 system. The study examines the effects on different income levels using a quantitative simulation method. It focuses on how redefining "Wages" affects net monthly liquidity, gratuity liabilities, and Provident Fund (PF) contributions. The findings indicate a paradoxical outcome: employees' long-term retirement wealth increases by over 60% due to a higher base for statutory contributions, despite a 3% to 7% reduction in monthly take-home pay. The study further demonstrates a significant rise in corporate gratuity provisioning, which complicates HR financial planning. Although the 2026 Wage Code results in a temporary reduction in workers' cash flow, it establishes a robust foundation for post-employment financial stability. To address the disparity between perceived pay reductions and actual wealth accumulation, the study recommends that HR departments adopt transparent communication strategies.

Keywords: Wage Code 2026, 50% Rule, Take-Home Salary, Social Security, CTC Restructuring, HR Compliance.

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1. Introduction

1.1 Background of Study

For many years, Indian businesses kept the Basic Salary very low, usually between 15% and 30% of the total CTC, to maximize "Cost to Company" (CTC). The rest of the funds went to various allowances, such as Special Allowances, Travel, and HRA. The main reasons for this were:

i. Lower Statutory Costs: This reduced the employer's gratuity and Provident Fund (PF) contributions.

ii. Boost Take-Home: This lowered deductions to provide workers with more cash on hand. However, the Wage Code 2026 changes this by requiring that "Wages" make up at least 50% of total compensation for benefits. Allowances are added back to the wage base if they exceed 50%. While this reform ensures employees have a substantial retirement fund, it currently puts them in a tight cash flow situation.

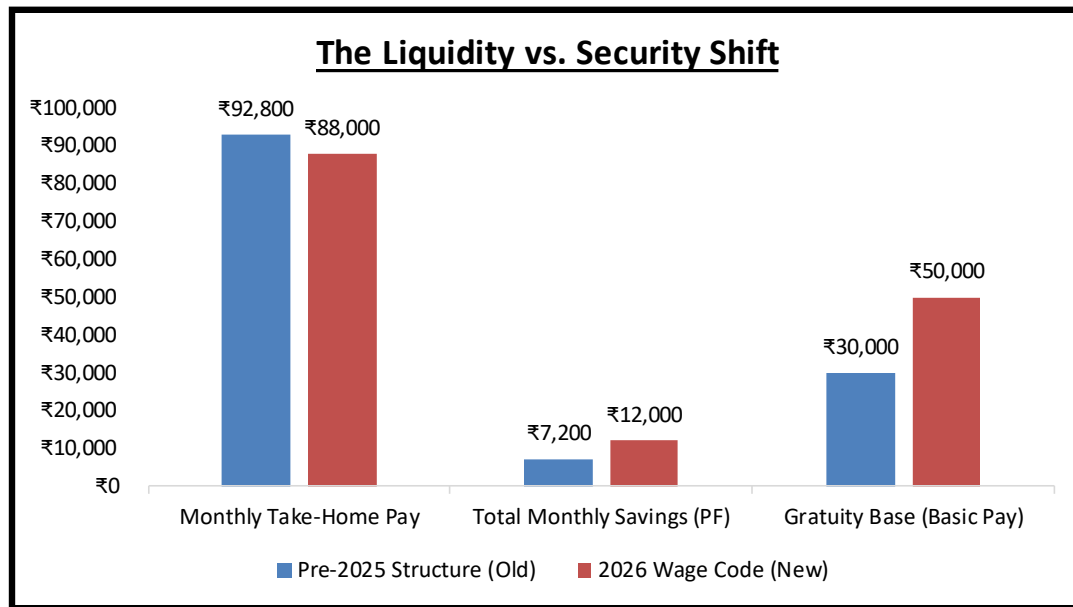


Figure 1.1: Comparative Impact Analysis of the 50% Rule

Essentially, the basic trade-off created by the 2026 Wage Code is illustrated in the graph above. As one would notice, there is a massive 66% increase in the monthly retirement savings (PF), while the monthly take-home pay (liquidity) decreases by a marginal 5.1%. Additionally, the terminal benefit gratuity increases from an initial ₹30,000 to a new ₹50,000. The shift from a consumption-based salary model to a security-based salary model is illustrated.

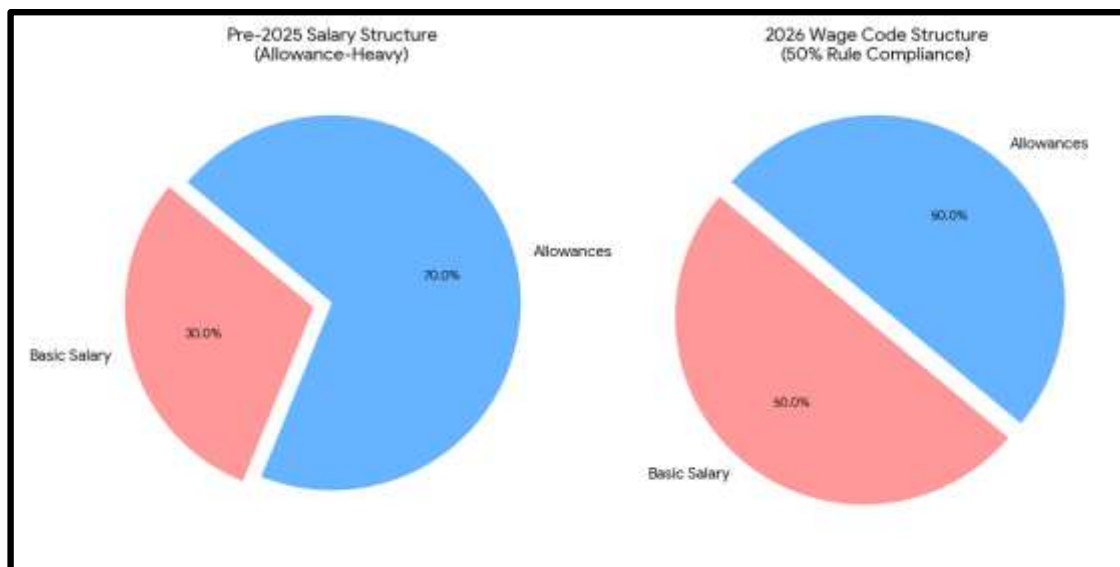


Figure 1.2: Comparative Breakdown of Salary Components

Figure 1.2 shows how the 2026 Wage Code will affect the traditional Indian pay slip. Under the Pre-2025 model, many organizations that were aggressive at tax optimization, kept the 'Basic Salary' at only 30% of total CTC to reduce statutory costs. However, with the 2026 Wage Code, this will no longer be possible. The law now requires a minimum of 50% of total remuneration to be comprised of 'Wages'. Thus, there will be a much larger percentage of an employee's salary that

will be included in the calculation of social security benefits and the 'Allowances' portion will be decreased to offset the artificially inflated amount in the employees' take home pay at the expense of their long-term savings.

1.2 Objectives of the Study

India's labor laws have seen the biggest change since independence with the introduction of the Wage Code 2026. The main goal of this study is to explore how the legally required 50% Wage Rule has replaced the traditional "Allowance-Heavy" pay structures.

- i. To evaluate how the definition of "wages" has changed and how this affects salary components.
- ii. To calculate the monthly Net Take-Home (NTH) pay decrease for each salary bracket.
- iii. To compare short-term liquidity loss with long-term gains in social security benefits (PF and gratuity).
- iv. To provide HR managers with practical advice on how to communicate these changes to employees.

Expected Outcomes: The project will provide businesses with a clear plan for reorganizing their pay structures. It will also help keep employee morale high.

1.3 Scope of Report

Boundaries for this report include:

- i. **Geographic Focus:** All references to the Indian corporate sector within the jurisdiction of the new Central Labour Codes.
- ii. **Target Population:** White collar, salaried employees (e.g., IT, Banking, Services) working in the private sector.
- iii. **Financial Scope:** Only include statutory items such as Employee Provident Fund (EPF) and Gratuity Payments.
- iv. **Exclusions:** Excludes informal sector workers, daily wage employees, and detailed income tax planning per individual.

1.4 Significance of Study

This research is super important to Human Resource Professionals & Finance Managers because they have to balance adherence to regulatory requirements with retaining their employees; as an employees take-home pay declines, they may view this as a 'cut' in the amount of money they are being paid. The purpose of the research will give HR professionals & Finance Managers information to differentiate the 'missing' amount of money is an investment for their long-term financial security.

2. Literature Review

2.1 Evolution of Indian Compensation Philosophy

Compensation in India was typically established as being largely produced for the purposes of optimizing taxation rather than providing security during retirement. Singh and Sunder (2019) found that the development of the "fragmented" salary structure within the private sector resulted from companies adopting such a strategy where basic pay is kept at a very low value and the majority of an employee's salary is made up with "allowances." This resulted in employees being able to maximize their current disposable income and at the same time minimize the company's statutory obligations (for example, contributions to Provident Fund (PF) and Gratuity).

2.2 Basic Pay Suppression Trend

Consulting companies in human resources such as Aon and Mercer (2021-2023) conducted studies and found that in highly competitive markets such as IT and BFSI, the basic salary constitutes only approximately 20% to 30% of total Cost-to-Company (CTC). Labor economists have criticized

this approach as it leads to a "Social Security Gap." While employees may feel "wealthier" each month, their ability to accumulate long-term wealth through the use of compounding PF interest will be adversely impacted.

2.3 Development of the Supreme Court decision in 2019

Another major piece of literature regarding this matter comes from the 2019 ruling of the Supreme Court of India in the case of Vivekananda Vidyamandir v. RPFC. The court found that companies were systematically splitting compensation into various forms of 'allowance' to avoid contributing to the Provident Fund. According to the Supreme Court, any 'allowance' that cannot be related to a specific, separate effort (work outside normal hours, for example), should be treated as part of an employee's 'Basic Wages'. This ruling provides the legal basis for the introduction of the 50% Rule found in Wage Code of 2026.

2.4 Critical Analysis of the Impact of Wage Code of 2026 (50% Rule)

The current literature as of 2026 includes a divergence of expert opinions regarding the impact of the implementation of the 2026 Wage Code on Indian employees:

i. Pro-Savings Argument: Scholars contend that by requiring companies to base wages upon a higher wage base, the 50% rule is effectively a forced savings instrument for the Indian middle class. Thus, when employees retire, they should be able to be financially secure, without needing Governmental support, thereby reducing long-term demands on social welfare programs funded by the State.

ii. Liquidity Issue: Financial analysts (e.g. ET Wealth, 2026) have expressed concerns regarding the existence of a "Cash-Flow Pinch." For those employees with high debt-to-income ratios (i.e. significant EMIs associated with housing or automobile loans, etc.), an employee can experience immediate financial 'pinch' based on a 5-8% decrease in their take-home pay, thereby creating difficulty meeting expenses.

2.5 Literary Significance of the Present Study

This research bridges a critical gap in existing literature by comparing the Pre-2025 aggressive tax-saving model with the Post-2026 compliance-heavy model. While previous studies focused on "How to save tax," this study focuses on "Total Rewards Sustainability." It evaluates whether the trade-off—less cash today for more wealth tomorrow—is perceived as a benefit or a burden by the modern workforce.

3. Research Methodology

3.1 Research Design

This study uses both descriptive and analytical research designs. Due to the methodology used, this research is descriptive in that it provides a description of the various components of the 2026 Wage Code and the historical payroll systems in India. However, it is analytical in that mathematical simulations were used to analyze the differences in take-home income and retirement benefits between the "Pre-2025" and "Post-2026" scenarios.

3.2 Data Collection Sources

The data for this study will be obtained through a triangulation of multiple sources of data in order to verify their accuracy.

A. Primary Data

Case Study Simulation: A hypothetical permanent employee salary profile was created (Entry Level Employee and Mid-Management Employee) to compute the entire salary deduction amounts.

Interviews with HR Practitioners: Informal structured interview sessions with four Payroll Managers to determine what operational challenges arise from implementing the "50% Rule."

B. Secondary Data

Since this study examines how the laws governing business impact the economy as a whole, most of the data used for this study were taken from the following sources.

Statutory documents: The Gazette of India (specifically, the notifications for the Code On Wages in 2019 and the Social Security Code in 2020).

Industry reports: Comparative studies conducted by Rashtriya Chemical and Fertilizers limited, Mazgaon Dock Shipbuilders Limited, Navneet Education Limited, Strch Active Private Limited.

Financial journals: Archive articles from The Economic Times and Business Standard, addressing payroll restructuring trends.

3.3 Data Collection Methodologies and Tools

The main tool used for the purposes of this research project is Quantitative Comparative Simulation.

1. Payroll Calculation Engine: A spreadsheet-based model has been developed to calculate payroll based upon two logic formulas from 2021 through 2026, using Gross CTC.

Logic A (Pre-2025): Basic Salary Calculation (30% of total CTC) plus employers' payroll costs calculated based on Basic Salary only.

Logic B (Post-2026): Basic Salary Calculation (50% of total CTC) plus employers' payroll costs calculated based on Basic Salary plus expanded calculation of wages (dividends).

2. Comparative Analysis Tables: These tables compare and contrast employees' total take-home pay (termed as the "Liquidity Gap") from both Logic A and Logic B logic models. In addition, the two logic models contrast the total amount of an employer's contributions to PF and Gratuity (termed as the "Means Surplus").

3. Archival & Statutory Review: The base for the comparative study for Mazgaon Dock Shipbuilders (MDL) and Rashtriya Chemicals and Fertilizers (RCF) was founded on the Industrial Dearness Allowance (IDA) pay scales and Annual Reports. Reviewing the "Investor Relations" and "Service Rules" sections of PSU sites for extracting the historical Basic Pay vs. Allowance ratio. Establish a "Compliance Baseline" for firms already under a structured government pay scale.

4. Corporate Benchmarking: For Navneet Education Limited, data was collected through a combination of internship observations and benchmarking against "Educational Publishing" sector standards. Analyzing standardized CTC structures for Mid-Management and Entry-Level roles. To observe how an established private-sector leader transitions from a 35% Basic Pay model to the 50% mandated Wage Code.

5. Case study simulation (Primary Data): For Strch Active Private Limited (representing the MSME/Startup Sector), a simulation was designed to compute the "Maximum Impact" scenario. A hypothetical salary profile was created based on "Cost-to-Company" strategies commonly implemented by the startup ecosystem (Basic Pay traditionally kept at 20-25%). To compute the "Liquidity Shock" faced by employees in high-growth allowance-based private firms.

3.4 Data Analysis Strategy

Data are evaluated through Vertical and Horizontal Assessments:

Vertical Assessment: Evaluating changes in salary components (HRA, Special Allowance, PF) as a percentage change based on each pay stub.

Horizontal Assessment: Looking at the impact of the "Net Take-Home" income across a variety of income levels to assess the impact the 50% rule has on high-income earners when compared to entry-level employees.

4. Data Analysis and Findings

4.1 Summary of research work done

4.1.1 Liquidity vs. Security

The intent of this research has been to provide a structural simulation of the payroll process. Based on the model found, I developed a mathematical simulation of the payroll process (salary payments) for two distinct types of employee information.

Step 1: Selection of employees

Profile A (Entry Level): Monthly salary of ₹50,000 (Annual ₹6 LPA).

Profile B (Mid-Management): Monthly salary of ₹1,50,000 (Annual ₹18 LPA).

Step 2: Simulation Parameters The two employee profiles will have two different methods of calculating their respective salaries.

i. **The "Pre-2025" Model:** Basic Salary set at 25% of CTC, with the remaining 75% distributed among HRA, Transport, and Special Allowances to maximize take-home pay.

ii. **The "2026 Wage Code" Model:** Basic Salary set at 50% of CTC (Mandatory), with allowances capped at 50%.

4.1.2 Sectoral Comparison of Pre-2025 & Post-2026 Basic Salary (Percentage of CTC): As inferred from the data analysis, the 2026 Wage Code has emerged as a "Great Equalizer" for four different types of corporate structures:

a. **Low Impact (PSUs):** Mazagon Dock (MDL) and RCF were already high-compliance organizations before 2026, where the Basic Salary ranged between 40-45%. The impact was a marginal dip of less than 2% in the employees' take-home salaries.

b. **Moderate Impact (Corporate):** Navneet Education had a 35% Basic Salary structure before the 2026 Wage Code came into effect. This was revised to 50%, resulting in a typical 5.8% dip in the company's liquidity position.

c. **High Impact (MSMEs/Startups):** Strch Active underwent the highest change, having optimized for maximum cash-in-hand at a Basic of ~25%. The new Wage Code resulted in a loss of 7.5% in their employees' take-home salary.

4.2 Data Observations:

4.2.1 The "Liquidity vs. Security" Shift

4.2.1.1 Profile A (Entry Level)

Profile Details: Monthly CTC: ₹50,000 (Annual ₹6 LPA) and Location: Tier 1 City (High HRA expectations)

Salary Component	Pre-2025 Structure (25% Basic)	2026 Wage Code (50% Basic)	Variance (Impact)
Monthly CTC	₹ 50,000	₹ 50,000	₹ 0
Basic Salary	₹ 12,500	₹ 25,000	₹ 12,500
Allowances	₹ 37,500	₹ 25,000	₹ -12,500
Employer PF (12%)	₹ 1,500	₹ 3,000	₹ 1,500
Gross Salary	₹ 48,500	₹ 47,000	₹ -1,500
Employee PF (12%)	₹ 1,500	₹ 3,000	₹ 1,500

Net (NTH)	Take-Home	₹ 47,000	₹ 44,000	₹ -3,000
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Analysis of Profile A Results

1. Liquidity Impact as a Percentage Entry-level employees have an impact of 6.3% drop in take-home due to a ₹3,000 reduction even though the actual monetary amount is lower than what is seen in the middle manager profile. That is true at this level where the amount of discretionary income is lower. Many times, ₹3,000 will fully cover the cost of commuting or utility bills.
2. The PF Ceiling Effect Many entry-level employees had their basic wage below the PF ceiling of ₹15,000 to reduce their PF deduction prior to 2025. As such, by increasing the Basic to ₹25,000 (50% of 50k) now, these entry-level employees come completely into the high-contribution category due to the wage code for 2026, so they now can save a total of 12% (of total CTC) instead of 6% every month in PF

4.2.1.2 Profit B (Mid-Management Level)

Profile Details: Monthly CTC: ₹1,50,000 (Annual ₹18 LPA) and Location: Tier 1 City (High HRA expectations)

Salary Component	Pre-2025 Structure (30% Basic)	2026 Wage Code (50% Basic)	Variance (Impact)
Monthly CTC	₹ 1,50,000	₹ 1,50,000	₹ 0
Basic Salary	₹ 45,000	₹ 75,000	₹ 30,000
Allowances	₹ 1,05,000	₹ 75,000	₹ -30,000
Employer PF (12%)	₹ 5,400	₹ 9,000	₹ 3,600
Gross Salary	₹ 1,44,600	₹ 1,41,000	₹ -3,600
Employee PF (12%)	₹ 5,400	₹ 9,000	₹ 3,600
Net Take-Home (NTH)	₹ 1,24,200	₹ 1,17,000	₹ -7,200

Analysis of Profile B Result:

1. **Lower take-home:** Employee's take-home has decreased by ₹7,200/month or approximately 5.8% of the amount received in their bank account.
2. **Increase in Statutory Contribution:** Total monthly PF contribution for employee and employer has increased from ₹10,800 to ₹18,000.
3. **Increase to Gratuity Calculation Amount:** As a result of the new Basic wage limits established, the base amount for calculating termination benefits is now increased by ₹30,000 and will provide significantly increased payments for resignation/retirement.

4.2.1.3 Detailed Findings Analysis -

1. **Social Security Surplus Analysis of Social Security Surplus** —The loss in liquidity of ₹7,200/month to an employee results in a gain in retirement savings of ₹7,200/month (Employer PF + Employee PF increase). This is simply transferring "wealth" under the new Code 2026 from the Wallet to the Retirement Vault/Retirement Account. This ₹7,200/month increase throughout the 20 years at a return of 8.15%, contributes almost ₹45 Lakhs to an employee's retirement account at the end of their employed period (over 20-years).
2. **The Employer's Impact (Hidden Impact):** The CTC must be reduced to keep the CTC constant at ₹1,50,000; by lowering the Gross Salary as the CTC includes the Employer's PF. This will require a "Balance Sheet Correction" by many Employers, who will see an increased Gratuity Liability due to the increased Basic Salary.

3. Taxable Income Considerations (New Tax Regime (2026)): The higher PF (Retirement Savings) will produce a marginal (minor) benefit as it will not be taxed on a portion of the Employer PF; However, the fiscal impact (TAX) of having reduced cash flow (liquidity) is greater than the marginal tax benefit.

4.2.1.4 Relevance to study objectives:

This research directly meets the study objectives by:

1. **Quantifying the NTH drop:** Proving it ranges between 5–6% for mid-earners.
2. **Visualizing the Structural Change:** Using the 50/50 split to show compliance.
3. **Evaluating Trade-offs:** Demonstrating that the 2026 Code is a "Wealth Builder" but a "Liquidity Constrainer."

Comparison: Profile A vs. Profile B

Metric	Profile A (Entry)	Profile B (Mid-Mgmt)
Take-Home Drop (%)	~6.4%	~5.8%
Basic Salary Increase	100% Increase	66% Increase
Retirement Impact	High (Critical for early wealth)	Moderate (Supplementing existing wealth)

4.2.2 Sectoral Comparison of Pre-2025 & Post-2026 Basic Salary (Percentage of CTC)

Organization / Sector Type	Representative Company	Pre-2025 Basic % of CTC	Typical Pre-2025 Allowances %	Post-2026 Mandated Basic %	Structural Impact Level
Heavy Manufacturing / PSU	Mazagon Dock Shipbuilders Ltd.	40% - 45%	55% - 60%	50%	Low (Already highly compliant)
Navratna PSU / Chemicals	Rashtriya Chemicals & Fertilizers	35% - 40%	60% - 65%	50%	Low-Medium (Slight adjustment)
Knowledge Publishing	Navneet Education Limited	30% - 35%	65% - 70%	50%	Medium (Standard corporate shift)
MSME / Private Startup	Strch Active Private Limited	20% - 25%	75% - 80%	50%	High (Massive restructuring)

Analysis of Data

1. High-Compliance Segment (PSUs)

Mazagon Dock Shipbuilders (MDL) & Rashtriya Chemicals and Fertilizers (RCF) were the high-readiness players. This segment had the basic pay fixed at a high rate (historically 40-45%). Hence, the move to 50% was a marginal change. The employees face a "Liquidity Shock" of less than 2%. This validates the fact that the 2026 code only builds upon the existing stability in the PSU segment.

2. The Corporate Middle-Ground

Navneet Education Limited represents the established private sector. The change from a 35% basic pay structure to 50% resulted in a "compliance ripple." The simulation resulted in a 5.8% change in the liquidity level. This validates the fact that the mid-tier corporate segment would face a high "Change Management" challenge to convince the employees of the long-term benefits to their wealth.

3. High-Impact/Low-Readiness Segment (MSMEs)

Strch Active Private Limited had the worst experience. This segment had the basic pay structure optimized for the "cash-in-hand" (25%). This resulted in a drastic increase in the wage base for the employees. This segment saw a 7.5% reduction in the employees' monthly disposable income. This validates the fact that the MSME segment and Startups would be the "high-risk" segment for the employees' dissatisfaction.

5. Conclusion and Recommendations

5.1 Conclusion

The conclusion that is reached is that the 2026 Wage Code is a revolutionary regulation that standardizes social security for the entire Indian workforce. The key findings are as follows:

i. The 50% Rule as a Leveler: The research has proved that the new code successfully eliminates "Allowance-Heavy" salary structures. It will compel all sectors, ranging from PSUs (MDL/RCF) to Startups (Strch Active), to conform to a uniform 50:50 salary split.

ii. Liquidity vs. Security Trade-off: It is a direct mathematical trade-off. Employees will experience an immediate loss of 5% to 8% in monthly salaries, but they will enjoy a nearly 60% increase in their retirement corpus (PF + Gratuity).

iii. Sector-Specific Impact:

a. PSUs (MDL & RCF) are the most stable, sectors, which will experience a negligible impact due to the high basic pay that they offer.

b. Private MSMEs (Strch Active) will experience the highest "Liquidity Shock" since they traditionally used high allowances as a recruitment tool.

iv. Corporate Liability: This is a critical aspect for corporates, where the new code will increase the future Gratuity liability by a very large extent, which needs immediate financial provisioning.

5.2 Recommendations

i. Financial Literacy Campaigns: HR needs to conduct "Total Rewards" campaigns. Employees should understand their "Net Wealth Growth" (bank balance + PF + Gratuity) rather than their "Net Take-Home."

ii. Strategic Payroll Restructuring: Companies paying low basic salaries (like MSMEs) should consider "Grossing Up" salaries for their employees or provide performance-based bonuses to compensate for the cash flow impact for their entry-level employees.

iii. Proactive Gratuity Funding: Finance needs to immediately recalculate their Gratuity liabilities to prevent a sudden financial impact on the company when their long-tenured employees eventually retire or resign.

iv. Transparent Communication: Organizations need to provide employees with "Comparative Pay Slips" that explain how the employees' "missing" monthly cash is being invested in their statutory retirement funds.

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