



Statutory Bonus & Contract Labour

1 Is the principal employer liable to pay the bonus to contract labor under the Payment of Bonus Act, 1965, and the Contract Labour (Regulation and Abolition) Act, 1970?

The Payment of Bonus Act, 1965, applies to establishments employing twenty or more persons and outlines the obligations of employers regarding bonus payments to their employees. Here's how it applies to contract labour:

1. Employer Definition (Section 2(14) of the Payment of Bonus Act, 1965):

- In a factory, the term "employer" includes the owner, occupier, or the person named as a manager under Section 7(1)(f) of the Factories Act, 1948.
- In any other establishment, "employer" refers to the person or authority with ultimate control over the establishment's affairs. If a manager, managing director, or managing agent is appointed, they assume the role of the employer.

For contract labour, the contractor is the actual employer of the workers, not the principal employer. Therefore, the contractor is responsible for fulfilling the obligations under the Payment of Bonus Act.

2. Eligibility for Bonus (Section 8 of the Payment of Bonus Act, 1965):

- Every employee who has worked in the establishment for at least thirty working days in a year is entitled to receive a bonus from their employer.
- This section clarifies that the bonus payment obligation lies with the direct employer, which, in the case of contract labour, is the contractor.

3. Minimum Bonus Requirement (Section 10 of the Payment of Bonus Act, 1965):

- Every employer is required to pay a minimum bonus of 8.33% of the salary or wages earned by the employee during the accounting year.
- The responsibility to pay this minimum bonus rests with the contractor, who is the employer of the contract labour.

4. Liability of Principal Employer (Section 21(4) of the Contract Labour (Regulation and Abolition) Act, 1970):

- This section states that if the contractor fails to pay wages within the prescribed period or makes a short payment, the principal employer is liable to make the payment of wages in full or the unpaid balance to the contract labour employed by the contractor. The principal employer can then recover this amount from the contractor.
- While this section specifically addresses wages, it implies that if a contractor fails to pay the minimum bonus, the principal employer might also be held liable to ensure the payment is made. However, this would generally be interpreted as applying to wages, not bonuses.

Conclusion:

As per the provisions of the Payment of Bonus Act, 1965, and the Contract Labour (Regulation and Abolition) Act, 1970:

- The **contractor** is primarily liable to pay the bonus to the contract labour, as they are the direct employer.
- The **principal employer** is not directly responsible for the bonus payments but may be held liable to ensure payment if the contractor fails to meet their obligations, based on the principles established in Section 21(4) of the Contract Labour Act. However, this liability primarily pertains to wages rather than bonuses.

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2. Is the principal employer obligated to pay the bonus to contract laborers, or does the contractor bear the sole responsibility under the Payment of Bonus Act, 1965?

Under the **Payment of Bonus Act, 1965**, contract laborers are considered employees of the **contractor**, not the principal employer. The contractor is solely responsible for paying the bonus to the contract laborers and a detailed explanation is as below:

1. Contractor's Responsibility:

- As per section 2(14) of the Act, in establishments other than factories, the term "employer" refers to the person with ultimate control, and for contract labor, this is the **contractor**.
- Section 8 specifies that every contract laborer who has worked at least **30 days** in the accounting year is entitled to a bonus.
- Under section 10, the contractor must pay a **minimum bonus of 8.33%** of the salary or wages earned during the accounting year, regardless of whether there is an allocable surplus.

2. Challenges Faced by Contractors:

- Contractors often face difficulty in generating enough profits from their service charges paid by the principal employer to fulfill this statutory bonus obligation. The law requires contractors to compute gross profits (section 4(b)) and allocable surplus (section 5), but in most cases, service charges alone are insufficient to pay the statutory bonus.

3. Negotiating with the Principal Employer:

- Given the contractor's limited ability to generate an allocable surplus, it is essential that contractors negotiate with principal employers for an **"Allowance in lieu of Statutory Bonus"** during contract discussions.
- This means the principal employer agrees to pay an additional amount to cover the statutory bonus obligation, enabling the contractor to legally fulfill the requirement of paying the minimum bonus to his employees under section 10.

4. Ensuring Compliance:

- The principal employer can ensure compliance by requiring the contractor to submit **Form C** and **Form D** as proof of bonus payments. This ensures that the contract laborers are paid their due, and the contractor adheres to the legal obligations under the **Payment of Bonus Act**.
- **Win-Win Arrangement:** This arrangement benefits all three parties, principal employer, contractor, and contract labour by ensuring legal compliance, fair benefits, and no disruption in employment or contractual relations.

Relevant Case Studies and Judgments:

1. Hindustan Steel Works Construction Ltd. v. The Commissioner of Labour (1996):

- This case reinforced the principle that the contractor is the employer of contract labour and, therefore, bears the responsibility of paying the bonus. The principal employer's obligation is to ensure compliance by the contractor but not to directly assume the role of an employer for contract laborers.

2. Food Corporation of India v. Presiding Officer (1988):

- The Supreme Court held that if the contract between the principal employer and contractor is genuine, the contractor is responsible for meeting the labour welfare obligations, including the payment of bonus, and the principal employer is not liable to absorb or pay contract

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laborers directly.

3. Steel Authority of India Ltd. v. National Union Waterfront Workers (2001):

- The court emphasized the importance of proving the genuineness of the contractor's role. The contractor, being the legal employer of the laborers, is obligated to ensure their statutory rights, including bonuses, unless it is proven that the contract is a sham.

Conclusion:

The principal employer is not directly liable to pay bonuses to contract laborers, but they must ensure that the contractor meets this obligation by negotiating bonus allowances and demanding compliance evidence. The contractor is legally bound to pay the bonus and should negotiate with the principal employer to make provisions for fulfilling this statutory obligation. This practice creates a legally compliant and mutually beneficial arrangement between all parties involved.

3. How does the Karnataka High Court's ruling clarify the entitlement of contract laborers to bonuses under the Payment of Bonus Act, 1965, and how does it differentiate their rights from those of regular employees in terms of employer-employee relationships in the case of Criminal Petition No. 6400 of 2012 involving Mr. Shachindra Kumar and Mr. Thanmaya Banerji against the State of Karnataka?

In Criminal Petition No. 6400 of 2012, the petitioners, Mr. Shachindra Kumar (Factory Manager) and Mr. Thanmaya Banerji (Unit HR Head) of Hindustan Unilever Ltd., Mangalore, sought to quash the criminal proceedings initiated against them in C.C. No. 1675/2012. The case was based on alleged violations under Section 11 of the Payment of Bonus Act, 1965, which mandates the payment of bonus to employees, and the offence is punishable under Section 28 of the Act.

The Labour Department had inspected Hindustan Unilever Ltd. and found that the company was not paying bonus to contract laborers on par with regular employees. Following this, a complaint was lodged with the JMFC Court, Mangalore. The petitioners contended that contract laborers are not considered "employees" under the definition provided in Section 2(13) of the Payment of Bonus Act and hence, are not entitled to receive a bonus as claimed by the Labour Department.

Justice K.N. Keshavanarayana, after reviewing the arguments, emphasized the following key points:

1. The definition of "employee" under Section 2(13) of the Payment of Bonus Act excludes contract laborers. In contrast, other labour laws such as the Employees' State Insurance Act and Employees' Provident Funds Act explicitly include contract laborers.
2. The complaint lodged by the Labour Department acknowledged this definition but still sought a higher rate of bonus for contract laborers, which the court found to be without legal basis.
3. The Kerala High Court and the Supreme Court had previously held in similar cases that contract laborers do not have an employer-employee relationship with the principal employer and are not entitled to the same benefits as regular employees.
4. The Karnataka Government's notification dated 22.04.2010 under the Contract Labour (Regulation and Abolition) Act, 1970, also did not mandate the payment of bonus to contract laborers on par with regular employees.

Based on these findings, the court ruled that the cognizance taken by the Magistrate was without jurisdiction, as contract laborers do not qualify as employees under the Payment of Bonus Act. As a result, the prosecution against the petitioners was quashed, as it amounted to an abuse of the process of the court.

WORKMAN UNDER CLRA ACT, 1970

1 Under the Contract Labour (Regulation & Abolition) Act, 1970, who qualifies as a WORKMAN?

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The term "workman" under the Contract Labour (Regulation & Abolition) Act, 1970, is defined in Section 2(1)(i) and outlines who is considered a workman and who is excluded from this classification. The definition is crucial because it determines who is covered under the protections and regulations provided by the Act.

1. Who Qualifies as a "Workman"?

A "workman" refers to any person employed in or in connection with the work of any establishment to perform various types of work. The types of work covered include:

- **Skilled, Semi-Skilled, or Un-Skilled Manual Work:** This can involve physical labour, whether it requires specific skills, general knowledge, or no particular skill set.
- **Supervisory Work:** This includes overseeing and guiding other employees but with certain limitations (as detailed in exclusions below).
- **Technical Work:** This involves tasks requiring technical knowledge or expertise, often related to specific machinery, equipment, or processes.
- **Clerical Work:** This encompasses office or administrative tasks, such as record-keeping, documentation, or communication tasks.

The definition applies regardless of whether the terms of employment are express (explicitly agreed upon) or implied (understood without being directly stated).

2. Who is Excluded from the Definition of "Workman"?

The Act specifically excludes the following categories of persons from the definition of a "workman":

- **Managerial or Administrative Capacity (Section 2(1)(i)(A)):** Individuals who are employed mainly in a managerial or administrative role are excluded. These roles typically involve decision-making authority, responsibility for overseeing departments or teams, and handling higher-level administrative functions.
- **Supervisory Capacity with Certain Conditions (Section 2(1)(i)(B)):** Supervisors who draw wages exceeding the prescribed amount by the appropriate government per month or who, by virtue of their duties or the powers vested in them, perform primarily managerial functions are not considered workmen. This exclusion recognizes that such individuals have roles that align more closely with management rather than labour.
- **Out-Workers (Section 2(1)(i)(C)):** Individuals classified as out-workers are those to whom materials are given by or on behalf of the principal employer for processing, cleaning, ornamenting, etc., for the business of the employer. The process is carried out in the out-worker's home, or another location not controlled by the principal employer. These individuals are excluded because they work independently, often outside the regular supervision or control of the principal employer.

3. Impact of the Definition on Labor Law Application:

- **Covered Workmen:** Those who qualify as workmen are entitled to the protections and benefits provided under the Contract Labour (Regulation & Abolition) Act, 1970. This includes regulations concerning working conditions, wages, safety, and welfare provisions.
- **Excluded Categories:** Persons excluded from the definition (e.g., managers, higher-paid supervisors, and out-workers) are not covered under the same provisions. Their terms of employment are generally governed by different legal frameworks or individual employment contracts.
- **Supervisory Roles:** The distinction in supervisory roles is particularly significant. Lower-paid

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supervisors may still be considered workmen and, thus, eligible for the Act's protections, while higher-paid supervisors performing primarily managerial duties are not.

This definition is critical in ensuring that the correct individuals receive the protections intended under the Act, while also clarifying the boundaries between different types of employment roles within an organization.

Contract Labour & Claim to Permanent Employment

1 Is a contract laborer who has completed 240 days of work with the Principal Employer eligible to claim permanent employment with the Principal Employer?

The direct answer for this question is “No.” However, the following factors to be consider:

1. Contractual Nature of Employment:

- Contract laborers are generally engaged through a contractor and not directly employed by the principal employer. The **Contract Labour (Regulation and Abolition) Act, 1970**, does not directly provide for automatic absorption or permanent employment of contract labour by the principal employer after a certain period.

2. 240 Days Clause:

- The completion of **240 days of continuous work** is often considered for determining eligibility for certain rights under **Section 25B of the Industrial Disputes Act, 1947**, such as retrenchment compensation, but it does not automatically confer the right to permanent employment with the principal employer.

3. Legal Precedents:

- Courts have ruled in several cases that merely completing 240 days as a contract worker does not entitle the worker to claim permanent employment unless the contract labor system itself is a sham or camouflage to deprive employees of permanent employment benefits.

4. Abolition of Contract Labor:

- If contract labour is abolished in a particular establishment under the Contract Labour Act, the workers may be considered for absorption, but the eligibility and process would depend on several factors, including judicial intervention.

5. A Few Landmark Judgement:

5.1. Steel Authority of India Ltd. v. National Union Waterfront Workers, 2001 (7) SCC 1

- The Supreme Court held that the mere abolition of contract labour under the Contract Labour (Regulation and Abolition) Act, 1970, does not automatically grant absorption or permanent employment to contract laborers. Instead, their absorption would depend on various factors and must be determined case by case.

5.2. Hindustan Steel Works Construction Ltd. v. The Commissioner of Labour and Others, (1996) SCC 191

- This case clarified that even though contract workers have completed a significant period of work, they cannot claim regularization or permanent employment unless it is proven that the contract system is a sham or is used to circumvent labour laws.

5.3. Air India Statutory Corporation v. United Labour Union, (1997) 9 SCC 377

- The Supreme Court held that contract workers can be absorbed by the principal employer in cases where the contract labor system is abolished, but it emphasized that the decision should be made based on the facts and circumstances of each case, not solely based on

the completion of 240 days.

5.4. **Secretary, HSEB v. Suresh & Ors., (1999) 3 SCC 601**

- In this case, the court reiterated that the mere completion of 240 days of work by a contract worker does not entitle them to permanent employment. It also noted that the burden of proving that the contract system is a sham lies on the worker.

5.5. **Workmen of Food Corporation of India v. Food Corporation of India, (1985) 2 SCC 136**

- The court ruled that when contract labour is abolished, the question of absorption or permanent employment of contract workers is not automatic and must be decided on the merits of the specific case.

These judgments underscore that completing 240 days of work does not entitle a contract labourer to permanent employment unless specific legal or factual circumstances (like sham contracts) are proven in court.

2. **Can the direct payment of wages or incentives by a principal employer to contract laborers lead to their automatic regularization as permanent employees, even if the contract is genuine?**

The principle that the payment of incentives by a principal employer to the contractor's employees does not necessarily entitle those employees to claim permanent employment with the principal employer is based on the legal framework governing contract labour. The core issue is whether the employment relationship is genuinely contractual or whether the principal employer is using the contract as a cover to avoid providing permanent employment and associated benefits.

Key Legal Concepts:

1. **Genuine Contractual Relationship:**

- Under the **Contract Labour (Regulation and Abolition) Act, 1970**, a contractor supplies workers to perform work for a principal employer. These workers remain employees of the contractor and do not have a direct employment relationship with the principal employer. Even if the principal employer pays incentives, bonuses, or other benefits directly to the contractor's employees, it does not alter the nature of the employment relationship as long as the contract is genuine and legally valid.

2. **Sham Contracts and Camouflage:**

- A contract is deemed a "sham" if it is created to disguise the true nature of the employment relationship, primarily with the intent of avoiding legal obligations such as payment of wages, benefits, and job security. In such cases, the courts may pierce the veil of the contractual arrangement and declare the workers as employees of the principal employer. However, for a contract to be considered a sham, the facts must clearly show that the principal employer exercised significant control over the workers and the contractor was merely a nominal intermediary.

3. **Supreme Court Judgments:** The judiciary has provided guidance on this issue through various landmark cases:

- **Steel Authority of India Ltd. v. National Union Waterfront Workers, 2001 (7) SCC 1:** In this case, the Supreme Court held that contract laborers do not automatically become employees of the principal employer when contract labour is abolished. The court emphasized that the contract between the principal employer and the contractor must be genuine and not a sham. If it is proven that the contract is a sham, the contract laborers may be absorbed into permanent employment.

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- **General Manager, Oil and Natural Gas Commission v. Sham Kumar Sahegal & Ors, 1995 (6) SCC 541:** The court held that merely because the contractor's employees were being paid directly by the principal employer or receiving incentives did not establish an employer-employee relationship with the principal employer. As long as the contractual relationship was genuine and not a facade to avoid permanent employment, the contractor's workers had no claim for regularization.
- **International Airport Authority of India v. International Air Cargo Workers' Union, 2009 (13) SCC 374:** The Supreme Court in this case further reinforced the idea that the contractual arrangement between the principal employer and contractor does not lead to automatic regularization of contract labour as permanent employees unless it is shown that the contract is a mere camouflage.
- **Hindustan Steel Works Construction Ltd. v. The Commissioner of Labour, (1996) 1 SCC 191:** This case emphasized that for a contract worker to claim regularization, the worker must prove that the contract labour arrangement was a sham and that the principal employer was the actual employer. The fact that incentives were paid by the principal employer was not sufficient to create a direct employer-employee relationship.

4. **Legal Implications of Sham Contracts:** Courts have consistently ruled that the mere payment of wages, incentives, or allowances by the principal employer to the contractor's workers does not lead to the automatic regularization of contract labour. The critical factor is the authenticity of the contract between the principal employer and the contractor. If the contract is genuine, the employees remain the responsibility of the contractor, regardless of any additional payments or benefits provided by the principal employer.

3. **If contract labour is continuously employed for core business functions under the principal employer's supervision and receives direct payment, could this indicate a sham contract?**

The courts look at several factors to determine whether a contract is genuine or a sham, including:

- **Control and Supervision:** Whether the principal employer exercises control over the workers' day-to-day activities, work assignments, and supervision.
- **Payment of Wages:** Whether the wages and other benefits are paid by the contractor or the principal employer. If the principal employer directly pays workers without involving the contractor, it may indicate a sham arrangement.
- **Nature of Work:** Whether the workers are performing tasks that are core to the business of the principal employer, which may suggest that they are de facto employees.
- **Tenure of Employment:** Whether the workers have been continuously employed for a long period, suggesting permanent rather than temporary employment.

Example:

A large manufacturing company hires contract labour through a contractor to assist in assembly line operations, which is core to its business. Over time, the principal employer directly starts paying incentives to the contract laborers for meeting production targets. These workers have been continuously working for the company for more than three years, performing the same tasks as permanent employees.

In this case, if the contract laborers argue that the employment contract is a sham, the courts may apply the following judicial tests:

1. **Control and Supervision:** The court will examine if the principal employer is directly supervising the contract workers and controlling their work schedules or assignments, which may indicate

that the workers are, in reality, employees of the principal employer.

2. **Payment of Wages:** The court will assess whether the contractor or the principal employer is paying wages. If the principal employer is paying the workers directly, this could be a factor indicating a sham contract.
3. **Nature of Work:** Since the contract workers are performing tasks that are core to the business (assembly line work), this might suggest that the workers are integral to the company's operations, which may be seen as evidence of a sham contract.
4. **Tenure of Employment:** The workers' continued employment for over three years may be used to argue that they are not temporary workers but are, in fact, employed on a permanent basis.

4. If the principal employer directly pays wages to contract labours without involving the contractor, does this indicate a sham contract?

If the principal employer directly pays wages to contract laborers without involving the contractor, it may suggest that the contract is a sham, though this is not always conclusive. Here's why:

Key Points:

1. **Nature of the Contract:** In a genuine contract labour arrangement, the contractor is responsible for paying wages to the workers. If the principal employer bypasses the contractor and pays the workers directly, it could indicate that the contract is being used as a facade to evade legal obligations.
2. **Control and Supervision:** If the principal employer exercises significant control over the workers' day-to-day activities, work assignments, and supervision, this may further suggest that the contract is not genuine. The contractor should ideally manage the workers and be responsible for their wages.
3. **Judicial Interpretation:** Courts have looked at such practices to determine if a contract is a sham. For instance, in cases like *Steel Authority of India Ltd. v. National Union Waterfront Workers* (2001), the Supreme Court examined whether the contractual arrangement was a genuine employment or a mere disguise to avoid permanent employment benefits.
4. **Legal Consequences:** If it is determined that the contract is a sham, the principal employer may be held liable for providing employment benefits and protections directly to the workers, as they are effectively considered employees of the principal employer.

Therefore, while direct payment of wages by the principal employer can be a red flag, a comprehensive assessment of the entire employment arrangement is needed to confirm if the contract is indeed a sham.

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