**Journal of International Commercial Law and Technology**
**Print ISSN:** 1901-8401

Website: https://www.jiclt.com/

*Article*

# The Dark Side of Third-Party Payroll: Exploitation, Job Insecurity, and the Inadequacy of Labour Law Protections in India

**Article History:**

**Name of Author:**
Poorva Nagar[1], Prof Dr Geetanjali[2]

**Affiliation:**
[1]Research Scholar, Oriental University (Department of Law), Indore, India
[2]Principal, Acropolis Institute of Law, Indore, Madhya Pradesh, India.

**Corresponding Author:**
Poorva Nagar
Poorvanagar94@gmail.com

**How to cite this article:**
Nagar P, *et, al,* The Dark Side of Third-Party Payroll: Exploitation, Job Insecurity, and the Inadequacy of Labour Law Protections in India. *J Int Commer Law Technol*. 2026;7(1):475–479.

**Received**: *25-12-2025*
**Revised**: *15-01-2026*
**Accepted**: *27-01-2026*
**Published**: *12-02-2026*

*©2026 the Author(s). This is an open access article distributed under the terms of the Creative Commons Attribution License (http://creativecommons.org/licenses/by/4.0*

**Abstract**: The swift development of technologies of artificial The pervasive use of third-party payroll arrangements in India's private sector has created a paradigm of precarious work, fundamentally undermining the traditional employer-employee relationship. This article provides a critical doctrinal and policy analysis of this employment model. It argues that the existing legal framework, primarily the Contract Labour (Regulation and Abolition) Act, 1970, is ill-equipped to address the systematic exploitation enabled by third-party intermediation. The study examines how these arrangements facilitate job insecurity, wage suppression, and denial of social security, while allowing principal employers to evade statutory liabilities. Through an analysis of judicial pronouncements and sector-specific case studies, the article highlights the gap between the constitutional mandate of ensuring decent work and the ground reality for millions of contract workers. It concludes that incremental legal reforms are insufficient and calls for a foundational re-evaluation of accountability in triangular employment relationships, alongside stringent enforcement and robust social protection floors.

**Keywords**: Third-Party Payroll, Contract Labour, Job Security, Worker Exploitation, Triangular Employment Relationship, Contract Labour (Regulation & Abolition) Act 1970, Equal Remuneration, Social Security, Labour Law Enforcement, Gig Economy.

## INTRODUCTION

The Indian labour market has undergone a profound transformation in recent decades, characterized by a strategic shift from direct, permanent employment towards flexible, non-standard work arrangements.[1] Among these, hiring through third-party payroll—a triangular relationship where a worker is employed by a staffing agency but works under the control and supervision of a user enterprise—has become ubiquitous, particularly in sectors like information technology, banking, manufacturing, and logistics.[2]

Proponents champion this model for granting organizations operational flexibility, cost efficiency, and a buffer against market volatility.[3] However, this

[1] Second National Commission on Labour, *Report* (2002), Vol. I, Ch. 7 (noting the growth of "flexible" employment patterns).

[2] *Id.*; K.R. Shyam Sundar, *The Contract Labour (Regulation and Abolition) Act, 1970: A Critical Review*, 52 Indian J. Indus. Rel. 23, 25-27 (2016).

[3] Nena Petrovic, *How Do Third-Party Payroll Providers Simplify Payroll for Indians*, TOPSOURCE

flexibility for employers often translates into profound insecurity for workers. The legal fiction of a separate employer—the staffing agency—severs the direct link between the worker and the entity for whom the labour is performed. This severance has become a potent tool for circumventing the protective umbrella of core labour legislation, including laws on job security, wages, and working conditions.[4] The result is a burgeoning class of "precarious workers" who perform essential functions but remain trapped in cycles of temporary engagement, unequal pay, and denied benefits.[5]

This article posits that the current exploitation is not merely a failure of enforcement but a systemic outcome facilitated by an outdated legal architecture. It employs a doctrinal methodology to analyse the statutory gaps and judicial interpretations that have enabled this regime. Subsequently, it adopts a policy-oriented approach to evaluate proposed reforms and recommend a coherent framework for ensuring dignity and security for all workers, irrespective of their employment contract's nomenclature.

## Doctrinal Analysis: The Legal Architecture of Third-Party Payroll and Its Gaps

### A. Statutory Framework and the Principle Employer Liability

The primary legislation governing contract labour is the Contract Labour (Regulation and Abolition) Act, 1970 (CLA). The Act defines a "contractor" as a person who undertakes to produce a given result through contract labour or supplies such labour, and a "principal employer" as the owner or head of the establishment where the work is executed.[6] The CLA's regulatory mechanism requires registration of principal employers and licensing of contractors, mandating provisions for canteens, restrooms, and first aid.[7]

Most critically, Section 21 of the CLA holds the principal employer ultimately responsible for ensuring payment of wages to the contract labour.[8] This provision was interpreted expansively by the Supreme Court in *Steel Authority of India Ltd. & Ors. v. National Union Waterfront Workers & Ors.*, which held that if a contractor fails to pay wages or violates other conditions of employment, the liability falls squarely on the principal employer.[9] The Court emphasized that the CLA was social welfare legislation meant to protect a vulnerable section of society and must be interpreted purposively.

However, in practice, the efficacy of Section 21 is diluted in third-party payroll scenarios. Staffing agencies often position themselves not as "contractors" supplying labour for a specific "work" but as the formal employers handling payroll and compliance, while the user enterprise disclaims employer status. This semantic distinction creates a grey area where the direct accountability envisaged in *Steel Authority* is difficult to establish, especially for clerical, IT, or service roles not tied to a specific, identifiable "work contract."[10]

### B. The Erosion of "Master-Servant" Relationship and Statutory Protections

The foundational common law test for an employment relationship is the extent of control exercised by the employer over the employee.[11] Third-party payroll deliberately obfuscates this "master-servant" relationship. While the principal employer controls the work (the *what*, *when*, and *how*), the staffing agency controls the administrative facets of employment (the salary, statutory deductions, and formal contract). This bifurcation allows principal employers to argue they are not the "real" employers, thereby evading statutes that hinge on the existence of an employment relationship.

For instance, the Industrial Disputes Act, 1947 (IDA), which provides protections against retrenchment and unfair termination, applies only to "workmen" employed in an "industry."[12] When a worker is terminated by a staffing agency at the behest of a principal employer, the legal dispute often gets mired in jurisdictional questions about the true employer, delaying or denying justice.[13] Similarly, eligibility for benefits under the Employees' Provident Funds and

WORLDWIDE (Jun. 8, 2022, https://topsourceworldwide.com/blog/how-do-third-party-payroll-service-providers-in-india-make-payroll-easy/.

[4] Shruti Kapil & Anam Khan, *The Illusion of Flexibility: Contract Labour in India*, 44 Econ. & Pol. Wkly. 41, 42-43 (2009).

[5] "Precarious work" is characterized by insecurity, lack of benefits, and low wages. See International Labour Organization, "From Precarious Work to Decent Work" (2012).

[6] Contract Labour (Regulation and Abolition) Act, 1970, sub section 2(1)(b) & (c).

[7] *Id.*, Ch. III (Registration) & Ch. IV (Licensing).

[8] *Id.*, Sec. 21(1) ("The principal employer shall be responsible for payment of wages… if the contractor fails to do so.")

[9] Steel Authority of India Ltd. & Ors. v. National Union Waterfront Workers & Ors., (2001) 7 SCC 1, ¶ 125.

[10] This is often termed the "supply of labour" vs. "contract for service" distinction. *See R.K. Panda v. Steel Authority of India*, (1994) 2 LLJ 282 (SC).

[11] Control Test: See, Dharangadhra Chemical Works Ltd. v. State of Saurashtra, (1957) SCR 152.

[12] Industrial Disputes Act, 1947, Sec. 2(s) (definition of "workman").

[13] *See Balbir Singh v. Punjab Roadways*, (1994) 1 LLJ 260 (P&H HC) on complexities in determining employer in contract labour disputes.

Miscellaneous Provisions Act, 1952, and the Employees' State Insurance Act, 1948, can become contentious when the nominal employer (the agency) is a shell entity with minimal capital.[14]

**C. Judicial Responses: From Deference to Growing Scrutiny**

The judiciary has grappled with the challenges posed by indirect employment. The initial trend leaned towards a formalistic interpretation, respecting the contractual separation between the agency and the worker.[15] However, a more substantive and rights-based approach is gradually emerging.

The Supreme Court's landmark judgment in *Secretary, State of Karnataka v. Uma Devi* emphasized regularization only through proper recruitment processes.[16] Ironically, this ruling, intended to curb backdoor appointments, has been misused to justify the perpetual temporary engagement of workers through contractors, denying them permanency despite years of service.[17]

A significant corrective came in *Jaggo v. Union of India*, where the Supreme Court critiqued the pervasive misuse of temporary contracts.[18] The Court distinguished between "illegal" appointments (made in violation of rules) and "irregular" appointments (made in sanctioned posts but not through the regular process) and held that individuals in the latter category, serving continuously for long periods, deserve regularization. The Court explicitly linked the exploitation in government contracts to similar practices in the private gig economy, signalling a broader concern.[19]

Conversely, cases like *Latha & Anr. v. T.V. Sahadevan & Ors.* illustrate the limits of protection. The Kerala High Court denied compensation under the Employees' Compensation Act, 1923, to a deceased electrician, holding him to be an independent contractor.[20] This ruling underscores the vulnerability of workers who, despite being in a dependent working relationship, are classified as independent contractors to deny them statutory benefits—a practice rampant in the platform/gig economy.[21]

The principle of "equal pay for equal work," a constitutional goal under Articles 14, 16, and 39(d), has been vigorously affirmed by the Supreme Court.[22] In *State of Punjab v. Jagjit Singh*, the Court held that temporary employees performing the same duties as permanent employees are entitled to equal pay.[23] Yet, enforcing this against a private entity using a third-party payroll remains a herculean task for individual workers, revealing a chasm between judicial doctrine and practical enforceability.

**Critical Evaluation of Law and Policy: Systemic Exploitation and Enforcement Failures**

**A. Manifestations of Exploitation in Key Sectors**

The doctrinal gaps analyzed above manifest in concrete patterns of exploitation across industries:

1. **IT & Services:** The case of "invisible employees" at major tech firms, where contract engineers perform identical work to permanent staff for 40-50% lower pay and no benefits, exemplifies "wage arbitrage" enabled by third-party contracts.[24] Termination is swift during downturns, with no obligation for retrenchment compensation under the IDA.[25]
2. **Manufacturing:** As seen in Tamil Nadu's automobile plants, contract workers are deployed in core production lines—legally questionable under the CLA, which envisages contract labour for peripheral work[26]—under hazardous conditions without safety gear or insurance. Mass terminations during disputes highlight the absence of job security.[27]
3. **Banking & Finance:** Banks extensively use third-party payroll for sales and customer service roles. Workers face perpetual temporariness, unrealistic targets, and denial of bonuses and PF, with unionization attempts met with replacement by a new batch of contract workers.[28]

---

[14] Employees' Provident Funds and Miscellaneous Provisions Act, 1952, Sec. 2(f); Employees' State Insurance Act, 1948, Sec. 2(9).

[15] E.g., earlier High Court judgments that strictly viewed the staffing agency as the sole employer.

[16] Secretary, State of Karnataka v. Uma Devi, (2006) 4 SCC 1.

[17] Ashish Tripathi, *Supreme Court Expresses Concern Over Pervasive Misuse of Temporary Employment*, DECCAN HERALD (Dec. 26, 2024), https://www.deccanherald.com/india/supreme-court-expresses-concern-over-pervasive-misuse-of-temporary-employment-3332770.

[18] Jaggo v. Union of India, (2024) INSC 1034.

[19] Id. at ¶ 22

[20] Latha & Anr. v. T.V. Sahadevan & Ors., MANU/KE/3277/2023 (Ker. HC Nov. 23, 2023).

[21] Uber B.V. v. Heller, 2020 SCC 16 (Can.) for a comparative perspective on misclassification in the gig economy.

[22] *See* Const. of India, arts. 14, 16, 39(d).

[23] State of Punjab v. Jagjit Singh, (2017) 1 SCC 148.

[24] Based on documented protests and media reports from Bengaluru's IT sector, 2021-2023.

[25] Industrial Disputes Act, 1947, § 25F (conditions for valid retrenchment).

[26] Contract Labour (Regulation and Abolition) Act, 1970, § 10 (power to prohibit employment of contract labour in core, perennial work).

[27] Documented incidents in automobile plants in Tamil Nadu (Chennai, Sriperumbudur belts), 2020-2022.

[28] reports by the All India Bank Employees' Association (AIBEA) on contract labour in banks.

4. **Gig/Platform Economy:** Delivery and ride-hailing platforms represent the extreme of this model, classifying workers as "partners" or "independent contractors."[29] This denies them all traditional employment rights, despite algorithmic control that dictates their work, payments, and penalties.[30]
5. **Healthcare:** The pandemic exposed the grim reality of contract nurses and paramedics working grueling hours on the frontlines for a fraction of the permanent staff's salary, without hazard pay or adequate protective equipment, and facing instant termination for protest.[31]

**Policy Incoherence and the New Labour Codes**

The government's response has been marked by policy incoherence. The four new Labour Codes, intended to simplify and modernize law, offer a mixed bag. The Occupational Safety, Health and Working Conditions Code, 2020, expands the definition of "contract worker" and "principal employer," potentially broadening accountability.[32] The Code on Social Security, 2020, for the first time, recognizes "gig workers" and "platform workers" and proposes social security funds.[33]

However, these Codes retain the fundamental tripartite structure without imposing *joint and several liability* on the principal employer for all labour law violations.[34] The requirement for registration and licensing remains, but enforcement machinery is chronically understaffed and under-resourced.[35] The Second National Commission on Labour (2002) had already highlighted the ineffectiveness of the inspection system and recommended stronger penalties and worker-led monitoring, suggestions largely unimplemented.[36] The Codes, in their current form, do not adequately address the root cause: the economic incentive for businesses to externalize employment responsibilities to evade law.

## IV. Conclusion and Recommendations: Towards a Dignified Work Paradigm

**The Imperative for Systemic Reform and a Roadmap Forward**

The third-party payroll system, in its current form, constitutes a legally sanctioned mechanism for the transfer of risk from capital to labour. It has created a two-tiered workforce where a privileged minority enjoys security and benefits, and a vast majority languishes in precarity, performing identical work. This is antithetical to the constitutional vision of social and economic justice.

Mere tinkering with existing laws is insufficient. What is required is a paradigm shift in legal and policy thinking. The recommendations below propose a multi-pronged strategy:

1. **Legislative Reform:** Amend the CLA and relevant Codes to establish *irrebuttable joint and several liabilities* of the principal employer and the contractor for all statutory dues, benefits, and safe working conditions. The principal employer must be the guarantor of last resort.[37]
2. **Presumption of Employment:** Introduce a legal presumption that any person performing work for another, under its control and direction, is an employee. The burden to disprove this relationship for the purposes of labour laws should lie with the engaging entity.[38]
3. **Automatic Regularization:** Mandate that any worker engaged through a contractor or agency for a continuous period exceeding two years (or 240 days in a year for three consecutive years) shall be deemed a direct employee of the principal employer, entitled to equal pay and conditions.[39]
4. **Strengthened Enforcement & Transparency:** (a) Drastically increase penalties for violations to be deterrent, linked to company turnover. (b) Mandate real-time digital attendance and wage payment tracking for all contract workers, accessible to labour departments. (c) Require public disclosure of the number and conditions of contract workers in annual reports of listed companies.[40]
5. **Universal Social Security:** Decouple core social security benefits (pension, health insurance, accident

[29] Code on Social Security, 2020, § 2(35) & (55).
[30] Algorithmic Management: ILO, World Employment and Social Outlook 2021, Ch. 5.
[31] reports on strikes by contract nurses in Hyderabad and Delhi hospitals during 2020-2021.
[32] Occupational Safety, Health and Working Conditions Code, 2020, Sub Sec. 2(1)(z)(iv) & 2(1)(s).
[33] Code on Social Security, 2020, Ch. IX.
[34] Joint and Several Liability is a legal doctrine where each responsible party is individually liable for the entire obligation.
[35] Government of India, Ministry of Labour & Employment, Annual Report 2022-23 (noting vacancy rates in inspectorates).
[36] Second National Commission on Labour, *supra* note 1, Recommendations 7.68-7.72.
[37] The "client liability" provisions in some European directives on temporary agency work.
[38] Section 83 of the U.K. Employment Rights Act 1996 (presumption of employee status in certain cases).
[39] **Inspired by** provisions in the Industrial Employment (Standing Orders) Act, 1946, and judicial thought in *Jaggo*.
[40] **Transparency** as a regulatory tool. *See* Simon Deakin, *The Contract of Employment*, 154.

cover) from the specific employer-employee link. Fund it through a combination of a central government corpus, a nominal platform transaction levy (for gig work), and mandated employer contributions regardless of contract type. The Code on Social Security must be operationalise in this spirit.[41]

6. **Facilitation of Collective Bargaining:** Actively protect the right of contract workers to form and join unions. Recognize sector-wise or platform-wise unions to bargain with user enterprises and staffing agencies collectively. Establish fast-track labour courts for adjudicating disputes of contract workers.[42]

The dignity of work is a non-negotiable constitutional principle. The current exploitation via third-party payroll is a systemic failure that demands urgent, structural correction. The law must evolve to recognize economic realities over legal formalities, ensuring that the pursuit of business flexibility does not come at the cost of fundamental worker rights.

**Conclusion**

The investigation into India's third-party payroll system reveals a landscape where legal formality has triumphed over substantive justice, creating a regime of sanctioned precarity. This model, while lauded for its business efficiency, has systematically eroded the foundational pillars of labour protection: job security, equitable remuneration, and social security. The doctrinal analysis confirms that the existing legal framework, with its porous definitions and fragmented accountability, is not merely inadequate but is often weaponized to circumvent the spirit of protective legislation. Judicial pronouncements, though increasingly cognizant of this exploitation, offer sporadic redress rather than systemic reform.

The sectoral case studies—from IT professionals and factory workers to delivery riders and nurses—are not isolated tragedies but symptoms of a deep-seated structural flaw. They illustrate how triangular employment relationships facilitate a deliberate transfer of economic risk from capital to labour, creating a disposable workforce denied basic dignity. The much-heralded new Labour Codes, while acknowledging modern work arrangements, fall short of bridging the accountability chasm between the principal employer and the contract worker.

Therefore, incremental adjustments will not suffice. The path forward demands a paradigmatic shift in labour policy that prioritizes the human right to decent work over the unbridled pursuit of flexible hiring. This necessitates robust legislative action to establish *irrebuttable joint liability* of user enterprises, legal presumptions of employment to combat misclassification, and mandates for the automatic regularization of long-term engagements. Concurrently, enforcement must be revitalized through deterrent penalties, technological transparency, and the empowerment of a truly inclusive collective bargaining mechanism.

Ultimately, the question is one of national priority: will India's economic growth continue to be underpinned by a vast underclass of insecure workers, or will it be built on the foundation of equitable and dignified employment for all? The constitutional promise of social and economic justice remains unfulfilled for millions trapped in the third-party payroll web. Correcting this is not merely a legal or economic imperative but a moral one, essential for building a just and sustainable society.

[41] ILO Recommendation No. 202 concerning National Floors of Social Protection (2012).

[42] The Trade Unions Act, 1926, needs amendment to explicitly facilitate unionization of contract and platform workers.