A Note regarding claim of deduction in respect of a sum payable to an employee in lieu of leave to his credit – Section 43B(f)

As per the provisions of section 43B(f) of the Income-tax Act, 1961 (the Act), any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee shall be allowed only in the previous year or financial year in which such sum is actually paid by him. In other words, the claim for deduction in respect of the provision made by an assessee-employer in relation to the liability under the leave encashment scheme is not allowable as per the provisions of section 43B(f) of the Act.

The aforesaid clause (f) of section 43B was challenged before the Calcutta High Court as *ultra-vires.* The Calcutta High Court considered the aforesaid issue in the case of *Exide Industries Ltd. Vs Union of India [2007] 292 ITR 470 (Cal)* and held the aforesaid clause (f) of section 43B as arbitrary, unconscionable and *de-hors* the Supreme Court decision in the case of *Bharat Earth Movers Vs CIT [2000] 245 ITR 428 (SC),* and accordingly, struck down the same.

In this context, it would be relevant to refer to the judgement of the Apex Court in the case of *Bharat Earth Movers Vs. C.I.T. [2000] 245 ITR 428 (S.C.).* In this case the issue before the Hon. Supreme Court was whether provision for leave encashment was an allowable deduction or not. It was held that the provision made by the assessee-company for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by the employees of the company, inclusive of the officers and the staff, subject to ceiling on accumulation as applicable on the relevant date, was entitled to deduction out of the gross receipts of the accounting year, during which a provision is made for the liability. The liability was not a contingent liability.

After the pronouncement of the aforesaid judgement, clause (f) was inserted in section 43B of the Income-Tax Act, 1961, vide Finance Act, 2001, with effect from 1.4.2002. As per the newly inserted clause (f) of section 43B, any sum payable by the employer to its employees as leave encashment shall be deductible only in the previous year, in which the sum is actually paid by the employer to its employees. The aforesaid clause (f) was inserted in section 43B, only to nullify the impact of the aforesaid judgement of the Apex Court in the case of Bharat Earth Movers.

The Calcutta High Court has now struck down the aforesaid clause (f) of section 43B, being arbitrary, unconscionable and de hors the Supreme Court decision. The Head-Note of the aforesaid judgement of Calcutta High Court on page 471 of the Report is reproduced as follows :

The original enactment of section 43B in the Income-tax Act, 1961, was to curb unreasonable deduction on the basis of the mercantile system of accounting without discharging statutory liabilities. It was observed by the Legislature that such enactment was necessary as there had been a trend to evade statutory liabilities on the one hand and claim appropriate benefit under the Act on the other. Under clause (f) of section 43B, any sum payable by the employer to its employees as leave encashment shall be deductible only in computing the income referred to in section 28 of that previous

year in which the sum is actually paid by the employer to its employees. While inserting clause (f) no special reasons were disclosed. Although such disclosure was not mandatory yet the subject amendment widens the scope of the original section. Leave encashment is neither a statutory liability nor a contingent liability. It is a provision to be made for the entitlement of an employee achieved in a particular financial year. An employee earns certain amount by not taking leave which he or she is otherwise entitled to in that particular year. Hence, the employer is obliged to make appropriate provision for the said amount. Once the employee retires he or she has to be paid such sum on cumulative basis which the employee earns throughout his or her service career unless he or she avails of the leave earned by him or her. That does not have any nexus with the original enactment. An employer is entitled to deduction for the expenditure he incurs for running his business which includes payment of salary and other perquisites to his employees. Hence, it is a trading liability. As such he is otherwise entitled to deduction of such amount by showing it as a provisional expenditure in his accounts. The Legislature by way of amendment restricts such deduction in the case of leave encashment unless it is actually paid in that particular financial year. The Legislature is free to do so after it discloses reasons therefor and such reasons are not inconsistent with the main object of the enactment. Without such reasons the enactment is inconsistent with the original provision. The Legislature must disclose reasons which would be consistent with the provisions of the Constitution and the laws of the land and not for the sol e object of nullifying the Supreme Court decision. Thus, section 43B(f) has to be struck down being arbitrary, unconscionable and de hors the Supreme Court decision.

In view of the aforesaid judgement of the Calcutta High Court, section 43B(f) is no longer a good law and hence not applicable in the computation of income of the tax-payer, the same having been held as *ultra vires* the Constitution. In view of the aforesaid reason, the judgement of the Apex Court in the case of Bharat Earth Movers (*supra*) will continue to be a good law. Therefore, the provision made by a tax-payer for meeting the liability in respect of the leave encashment, will be allowable as a deduction in computing the total income of the tax-payer.

It is, therefore, advisable that the provision made by the assessee-employer for meeting the liability, in respect of leave encashment, should be claimed as a deduction in the computation of the total income for the purpose of return of income of the assessee.

Place : Pune (S.K. Tyagi)

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