<u>METHODOLOGIES OF PARKING/ FUNDING THE LIABILITY OF LEAVE ENCASHMENT OF EMPLOYEES OF COMPANY</u>

{Objective: To separate liability due to employees so that dues of employees are secured.}

❖ <u>PAYGO - PAY FROM CURRENT REVENUE AS & WHEN FALL DUE</u>:

- Every year, Company creates provision based on actuarial valuation determined by actuary. Such provision is not allowed as business expenses (i.e. added back to profit while computing tax liability) ;
- If the money to be set aside remains with Company, it pays Corporate Tax on Interest Income.

❖ <u>INSURER MANAGED FUND– TAKING POLICY WITH INSURANCE COMPANY</u>:

- Premium paid to Insurance Company under Group Leave Encashment Scheme is deductible u/s 37(1) of Income Tax Act ;
- By setting apart the funds required for the scheme, the interest earned on the funds will not be forming part of other income in Statement of Profit & Loss of Company;
- However, Insurance Company while calculating the actuarial valuation will take into consideration the interest earned on the fund available and the balance amount only will be required by Company to be made good;
- There are interpretation issues on tax treatment of:
    - **i.** Business expenses since disbursal/ settlement happens to the employees at a future point of time; and
    - **ii.** Contribution as Perquisite since premium is paid by employer for the employees' benefit.

❖ <u>FUNDED THROUGH IRREVOCABLE TRUST- FORMING SUPERANNUATION EMPLOYEE WELFARE BENEFITS TRUST</u>

- Contribution paid to the Trust Fund by an employer is treated as business expenses and is tax deductible;
- The interest earnings on the investments of the Trust will be exempted from tax and to this extent the Incremental provision to be made by the company on account of Leave Encashment would be lower;
- However, there is an interpretation issue on exemption to approval of Trust Fund that needs to be addressed since, in place of employees, Company would contribute Trust fund wholly whereas one of the conditions written in Income Tax {Rule 16C (2) read with Sec.10 (23AAA)} is that "Contributions to the fund are to be made by the employees by way of periodical subscription".