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GOVERNMENT OF INDIA
Income Tax Department
Office of the Commissioner of Income Tax (TDS)
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C.No. 10/CIT(TDS)/2008-09

21 July 2008

To
The Director of Treasuries & Accounts
Panagal Building
No.1, Jeens Road, Saidapet
Chennai 15

Sir,

Subject : Income Tax - Tax on encashment of unearned
leave on private affairs - clarification- reg.

Ref : Your letter In R.C.No.25432/08/E II dated 20.6.2008.

1. Please refer to the above. The definition of 'Salary' as per Section 17 of the Income Tax Act includes "any payment received by an employee in respect of any period of leave not availed of by him" and also "pension". Exemption is available under section 10(10A) of the Income Tax Act when "Cash equivalent of earned leave" is received by him at the time of retirement on superannuation or otherwise. Hence exemption is not available with regard to the cash equivalent of unearned leave received by the employee and is fully taxable under the head salary.

2. Under Section 192(1) of the Income Tax Act, 1961, the 'person responsible for paying' salary to an employee (the FAO or any other designated Officer, as the case may be) is required to estimate the income of the said employee under the head 'salaries' for the whole financial year and deduct income-tax at the rates in force. Further, the deduction must be made equally at the time of each payment, that is, monthly in equal amounts when salary is paid monthly. It must also be noted that 'salary' is taxable on due basis or on receipt basis, whichever is earlier.

3. The two types of cases on which clarification has been sought can be answered in the light of the above general principles.

Case I

Here, the pay drawing officer must estimate the income of the employee (who is retiring in November) under the head 'Salaries' for the whole financial year at the beginning of the financial year. From the facts furnished in your reference the estimate and deduction of tax will be as given below:

- (i) Salary payable from March to November
plus
- (ii) Pension payable from December to February
plus
- (iii) Cash equivalent of unearned leave (if ascertainable
at the beginning of the financial year itself)
Less Chapter VI-A deductions (Section 80C, etc.)
Equals Estimated income under the head 'Salaries'

Tax on the above estimated income must be deducted in the proportion of $1/12^{\text{th}}$ of the tax every month. In case, the retired employee gets his pension from some other treasury, such treasury should deduct the balance tax deductible from December onwards. The above estimate may be furnished to the treasury disbursing pension. The treasury can accept the same and deduct tax deductible taking into account the TDS already made by the earlier office, if any, as per the Form No. 16 issued by such earlier office.

If the cash equivalent of unearned leave is not ascertainable at the beginning of the financial year, it may be included in the computation whenever it is ascertainable and the estimate may be revised and deduction may be made accordingly. If the cash equivalent is paid at the time of retirement in full, the tax on such encashment should also be deducted in full as 'salary' is taxable on due basis or receipt basis whichever is earlier.

salary for March to May and the amount of pension receivable by the retired employees during June to February. Unless the pension receivable is taken into account, estimated total income and tax liability cannot be correctly determined and consequently it will result in incorrect deduction of tax at source. The tax calculated is to be recovered monthly in the proportion of $\frac{1}{12}$ every month as in case 1.

4. Undertakings given by employees to deduct the tax only in February do not have a legal basis and shall not be entertained. It has been prescribed in the law as explained above that the recovery of TDS has to be made every month, based on the estimate of income for the whole financial year. Failing to do so and deducting the tax only at the end of the year will be a gross violation of law.

5. With regard to your last query after the amendment to Section 80D by Finance Act 2007, the deduction under Section 80D is allowable if the medical insurance premium is paid by any mode other than cash. It should have been paid out of income chargeable to tax.

Yours faithfully,

G. N. S.

(J. Albert)
Commissioner of Income Tax (TDS)
Chennai 34

R.C.17565/2008/IS.2 dt 9.08

Copy communicated for information
and necessary action.

To

All ATO's / STB's
in this District

Y. S. S.
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All STBs.

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