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COMMISSIONER OF INCOME-TAX, BOMBAY
v.
VANAZ ENGINEERING (P) LTD., BOMBAY

MAY 2, 1986

B

[R.S. PATHAK, R.B. MISRA AND G.L. OZA, JJ.]

Income Tax Act, 1961, Sections 22, 29 and 40A(7)(b)(ii) - Gratuity - Scheme introduced for first time in assessee firm in 1970 - On basis of Actuarial Report total liability as on December 31, 1970 debited to Profit and Loss Account - Assessment proceedings - Income Tax Officer disallowing burden of liability - Appellate Assistant Commissioner and Tribunal allowing that liability - Appeal by Revenue to Supreme Court - Whether assessee entitled to deduction of entire amount - Held question arises - Matter remanded to High Court for fresh consideration.

C

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The respondent-firm (assessee) had no gratuity scheme for the years preceding the calendar year 1970, but such a scheme was formulated for the first time in the middle of 1970 and put into operation with effect from July 1, 1970.

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The respondent debited to the Profit and Loss Account, a sum of Rs. 2,11,305 as a charge against the profits being the total liability as on December 31, 1970 on account of the gratuity scheme. This amount was provided on the basis of an actuarial report prepared by a Consulting Actuary.

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In assessment proceedings for the assessment year 1971-72, the Income-Tax Officer was not prepared to allow the entire amount claimed by the respondent as the provision on account of gratuity. The burden of the liability was ascertained as Rs. 1,84,056 on the basis of a certificate obtained by the assessee from the consulting actuary. The Income Tax Officer therefore allowed the liability only to the extent of Rs.27,249 the difference between Rs. 2,11,305 and Rs. 1,84,056.

G

On appeal, the Appellate Assistant Commissioner held that the entire amount was allowable and gave a relief of Rs.1,84,056.

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The appeal of the Department to the Income Tax Appellate Tribunal having been dismissed, the Department sought for a reference of the question whether the assessee was entitled to deduction of the entire amount.

On the basis that the Appellant Tribunal and the High B Court had rejected the Departments application, the Department came in appeal to this Court under Article 136.

In the Appeal, it was contended on behalf of the Department that as the provisions of s.40A(7)(b)(ii) of the Income Tax Act 1961 have not been satisfied, the respondent C was not entitled to the deduction of the gratuity amount.

Allowing the appeal,

HELD: It is necessary that the High Court should examine whether the provisions of s.40A(7)(b)(ii) of the Act have been D complied with in the instant case, having regard to what has been laid down in **Sh. Sajan Mills Ltd. v. Commissioner of Income Tax M.P. and another**, [1985] 156 I.T.R. 585. [955 F]

There is no dispute between the parties that the first condition in the said provision has been satisfied by the E respondent. What remain is to determine whether the second and third conditions are also satisfied. [955 F-G]

Judgment under appeal set aside. Case remanded to High Court for fresh consideration. [955 G-H]

F **D.V. Baput I.T.O. Companies Circle Bombay v. Tata Iron & Steel Co. Ltd.**, C.A. No. 1247 of 1980 decided on January 8, 1986 followed.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 4253 of 1983.

G

From the Judgment and order dated 9th March, 1979 of the Bombay High Court in I.T. Ref. No. 485 of 1976.

S.C. Manchanda and Ms. A. Subhashini for the appellant.

H Mrs. A.K. Verma and Joel Peres for the Respondent.

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The Judgment of the Court was delivered by

PATHAK, J. This appeal by special leave is concerned with a question of some importance.

The respondent, which maintains its accounts on the mercantile system, follows the calendar year as its accounting period. It had no gratuity scheme for the years preceeding the calendar year 1970, but such a scheme was formulated for the first time in the middle of 1970 and was put into operation with effect from July 1, 1970. The scheme provided that in the case of the retirement or resignation of any employee he would be eligible to gratuity provided he had put in 15 years of continuous service. In the case of death or permanent physical or mental disablement, an employee was eligible for gratuity at different rates depending upon whether he had put in ten years of continuous service or more. In the case of termination of service or retrenchment, no gratuity was payable upto five years of continuous service, and was payable at rates thereafter depending upon whether the continuous service was from five years to ten years, ten to fifteen years or more than fifteen years. No gratuity was payable if an employee was dismissed for misconduct, for causing laws to the company, for violant action and similar reasons. The respondent had debited to the Profit and Loss account a sum of Rs. 2,11,305 as a charge against the profits, being total liability as on December 31, 1970 on account of the gratuity scheme. There is no dispute that this amount was provided for on the basis of an actuarial report prepared by a consulting actuary.

In assessment proceedings for the assessment year 1971-72 (the relevant accounting period being the calendar year 1970), the Income Tax Officer was not prepared to allow the entire amount claimed by the respondent as a provision on of gratuity. At his instance a certificate was obtained from the consulting actuary regarding the liability as on December 31, 1969 and as on December 31, 1970. The burden of the liability as on December 31, 1969 was Rs. 1,84,056. The Income Tax Officer, therefore, allowed the libility only to the extent of the difference between Rs. 2,11,305 and Rs. 1,84,056 that is to say he allowed Rs. 27,249.

B C D E F G H

On appeal by the respondent, the Appellate Assistant Commissioner of Income Tax, following the decision of this Court in the case of **Metal Box Company of India Ltd. v. Their Workmen,** [1969] 73 I.T.R. 53 held that the entire amount was allowable. Accordingly, he gave a relief of Rs. 1,84,056.

The Revenue proceeded in second appeal to the Income Tax Appellate Tribunal, and the Appellate Tribunal, following an earlier decision rendered by it in a case where the decision of this Court in **Metal Box Company of India Ltd.** (supra), of the Allahabad High Court in **Madho Mahesh Sugar Mills (P) Ltd. v. Commissioner of Income-tax,** [1973] 92 I.T.R. 503 and of the Delhi High Court in **Delhi Flour Mills Co. Ltd. v. Commissioner of Income Tax,** [1974] 95 I.T.R. 151 had been considered, came to the conclusion that the Appellate Assistant Commissioner was right and the entire amount had to be allowed as a charge against the profits. The appeal filed by the Revenue was dismissed.

A similar question was considered at length by the Bombay High Court subsequently in **Tata Iron & Steel Co. Ltd. v. D.V. Bapat, Income-Tax Officer, Companies Circle I(2) Bombay, and Anr.,** [1975] 101 I.T.R. 292 in which a corresponding view was taken by the High Court.

At the instance of the Revenue, a reference was sought from the Appellate Tribunal for the opinion of the High Court on the following question of law :

> "Whether on the facts and in the circumstances of the case, the assessee is entitled in law to the deduction of the entire provision for gratuity amounting to Rs. 2,11,305 either under section 28 read with section 29 or under section 37(1) of the Income Tax Act, 1961?"

It is not clear whether the Appellate Tribunal made a reference or declined it. What purports to be a copy of the order dated 23.4.1980 of the Appellate Tribunal before us appears to indicate that the Appellate Tribunal had indeed referred the question to the High Court. But the special leave petition filed in this Court under Article 136 of the Constitution "against the order dated 9.3.79 of the Bombay

High Court in I.T. Ref. No. 485 of 1976 in the matter of C.I.T. versus Vanaz Engineering Pvt. Ltd. for the assessment year 1971-72", states that the Appellate Tribunal rejected the reference application, and thereafter an application made to the High Court was rejected on April 23, 1980. It is unfortunate that this discrepancy exists in the record before us. It demonstrates a want of sufficient care in preparing the petition. It makes no difference, however, for even if we take it that the High Court rejected the reference application made by the Revenue, we are of opinion that a question of law does arise in the terms sought by the Revenue. We are further of opinion that instead of sending the case back to the High Court and directing it to call for a statement of the case and thereafter to answer the question of law, it would be appropriate to dispose of the case on the merits itself inasmuch as the question is one which has engaged the attention of this Court in a number of cases already. Learned counsel for the parties are also agreed that the case should be disposed of in the same terms as **D.V. Bapat, I.T.O. Companies Circle, Bombay v. Tata Iron & Steel Co. Ltd.**, (C.A. No. 1247 of 1980) decided on January 8, 1986.

It is urged by learned counsel for the appellant that the provisions of s.40A(7)(b)(ii) of the Income Tax Act, 1961 have not been satisfied and, therefore, the respondent was not entitled to the deduction of the gratuity amount. The provisions of s.40A(7)(b)(ii) have been recently construed by this Court in **Shree Sajjan Mills Ltd. v. Commissioner of Income Tax, M.P. & Anr.**, [1985] 156 I.T.R. 585, and it seems to us necessary that the High Court should examine whether those provisions have been complied with in the present case having regard to what has been laid down in that case. There is no dispute between the parties that the first condition in that provision has been satisfied by the respondent. What remains is to determine whether the second and third conditions are also satisfied.

In the circumstances, we think it appropriate to set aside the judgment under appeal and remand the case to the High Court for a fresh consideration of the case in the light of the observations made by us in this judgment.

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The appeal is allowed, the judgment of the High Court is set aside and the case is remanded to the High Court for disposal in accordance with the observations made by us. There is no order as to costs.

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N.V.K. Appeal allowed.