

(1976) 11 AHC CK 0017

In the Allahabad High Court

Case No : Income Tax R. No. 571 of 1973

ADDITIONAL COMMISSIONER OF INCOME TAX

APPELLANT

Vs

M/S. LAKSHMI SUGAR MILLS.

RESPONDENT

Date of Decision : 16-11-1976

Acts Referred:

Income Tax Act, 1961 — Section 256, 28, 30, 31, 32

Income Tax Act, 1961 — Section 256, 28, 30, 31, 32

Income Tax Act, 1961 — Section 256, 28, 30, 31, 32

Citation : (1977) 6 CTR 195

Hon'ble Judges : D. M. Chandrashekhar, J

Bench : Division Bench

Judgement

D. M. CHANDRASHEKHAR, J. - The Income Tax Appellate Tribunal, Allahabad Bench (shortly called the Tribunal), has referred to this to this court the following four question of law, under sub-S. (1) of S. 256 of the Income Tax Act, 1961 (shortly called the Act) :

(1) Whether on the facts and in the circumstances of the case the Appellate Assistant Commissioner did not exceed his jurisdiction in enhancing the assessment ?

(2) Whether a correct interpretation of the Notification of the U.P. Government dated 27-1-1961, the resolution dated 10-9-1963, passed by the Board of Directors of the company and the Trust Deed dated 30-9-1963, the liability in respect of gratuity against which the sum of Rs. 2,00,000/- was paid and debited to the gratuity fund in the relevant previous year accrued in the relevant previous year ?

(3) Whether on the facts and in the circumstances of the case the expenditure allowable under S. 28(1) or under S. 37(1) of the Income Tax Act, 1961 is Rs. 50,000, or Rs. 2,03,207 ?

(4) Whether on the facts and in the circumstances of the case the Tribunal was

justified in allowing a deduction of Rs. 50,000/- when the gratuity fund was not approved by the Commissioner of Income Tax required under S. 36(1)(v) of the Income Tax Act, 1961, for 1964-65 assessment year ?"

2. The first three questions have been referred to this court by the Tribunal at the instance of the assessee and the fourth question at the instance of the Revenue.

3. Briefly stated, the relevant facts are these : The assessee is a company carrying on manufacture of sugar since about the year 1935. It has been maintaining its accounts following the mercantile system. The assessment year under reference is 1964-65 for which the accounting year is from 1-10-1962 to 31-9-1963.

4. The Government of India, by its resolution dated December 26, 1957, had appointed a Central Wage Board for the Sugar Industry for working out a wage structure. The Government of India accepted the recommendations of that Board and requested the employers, workmen and the State Government to take immediate steps to implement those recommendations. The question of implementing those recommendations in the States or Uttar Pradesh was considered at a tripartite conference held on 30-3-1961 and attended by the representatives of the U.P. Branch of the Indian Sugar Mills Association and the representatives of organisations of workmen in the Sugar Industry. The representatives of the employers agreed to implement those recommendations. Thereafter, the Government of Uttar Pradesh issued on 27-4-1961 a notification whereunder it was provided, inter alia, that the scheme of gratuity for workmen in the Sugar Industry shall come into force with effect from 1-11-1960.

5. The Board of Directors of the assessee company passed a resolution on 10-9-1963 to the effect that a gratuity scheme for its employees should be started pursuant to the aforesaid notification of the Government of Uttar Pradesh and that a fund should be constituted and transferred to a trust for payment of such gratuity. Accordingly the assessee company executed a deed of trust and got it registered on 30-9-1963, i.e. the last day of the accounting year 1962-63 and its account was debited on 30-9-1963 with a sum of Rs. 2,00,000 for being transferred to that fund. The assessee company made an application to the Commissioner of Income Tax U.P., for according under clause (v) of sub-S. (1) of S. 36 of the Act, his approval to the gratuity fund. However, till today the Commissioner has neither granted nor refused approval to that fund. It would appear that the assessee's application for such approval is still pending with the Commissioner.

6. In the assessment for the year 1964-65 the assessee claimed a sum of Rs. 2,03,207 as expenditure towards gratuity to its employees. Of this amount, Rs. 2,00,000 represented the amount transferred to the gratuity fund on 30-9-1963 and Rs. 3,207 was stated to have been actually paid as gratuity to its employees who retired during the accounting year ending on 30-9-1963. An expenditure of

Rs. 3,335 was also claimed as having been incurred towards stamp duty and other expenses for execution and registration of the aforesaid trust deed.

7. The Income Tax Officer allowed the whole of Rs. 2,03,207 as deductible expenditure but disallowed, inter alia, expenditure of Rs. 3,335.

8. Feeling aggrieved by the disallowance of certain items claimed as expenditure, the assessee company preferred an appeal to the Appellate Assistant Commissioner who felt that the Income Tax Officer was not justified in allowing Rs. 2,03,207 as deductible expenditure without discussing the merits of the assessee's claim. He, therefore, issued a notice to the assessee company to show cause why this sum should not be added back and its income enhanced correspondingly. After considering the explanation of the assessee company, he added back the sum of Rs. 2,03,207. He observed that the sum of Rs. 2,00,000 transferred by the assessee company to the gratuity fund represented an ad hoc reserve for a future liability and did not, therefore, represent any revenue expenditure in the relevant previous year. Regarding the sum of Rs. 3,207 he observed that it had not been explained as to when it was paid and how the several amounts of the gratuity were actually calculated.

9. Against the order of the Appellate Assistant Commissioner, the assessee company went up in appeal to the Tribunal. Of the two members of the Bench of the Tribunal who heard the appeal, the Accountant Member took the view that the entire sum of Rs. 2,03,207 should be allowed as permissible deduction in computing the assessee company's income. He also observed that the Appellate Assistant Commissioner had traveled beyond the records of assessment and had no jurisdiction to enhance the income assessed by adding back the sum of Rs. 2,03,207.

10. On the other hand, the Judicial Member of the Tribunal held that the Appellate Assistant Commissioner did not exceed his power in disallowing the sum of Rs. 2,03,207 and enhancing the income of the assessee and that however a sum of Rs. 50,000 only should be allowed as expenditure towards gratuity in that assessment year. He further held that since the assessee company had adopted the mercantile system of accounting, it could not claim deduction of Rs. 3,207 which amount was said to have been actually paid to its employees during the accounting year.

11. The two points of difference of opinion between the two members of the Bench of the Tribunal, were referred to another Member of the Tribunal who agreed with the views of the Judicial Member. Thereafter, the Tribunal, in accordance with the majority view that the Appellate Assistant Commissioner did not exceed his jurisdiction in enhancing the assessment of income, but that out of the total amount of Rs. 2,03,207 claimed as expenditure towards gratuity only a sum of Rs. 50,000 should be allowed.

12. Regarding the first question, Shri Ashok Gupta, learned counsel for the assessee, submitted that in exercising the power to enhance the assessment of

income, the Appellate Assistant Commissioner could not consider a new source of income or disallow an item of expenditure not considered by the Income Tax Officer. Shri Gupta contended that there was no discussion by the Income Tax Officer of the question whether the deduction of Rs. 2,03,207 claimed by the assessee should or should not be allowed and that it was not open to the Appellate Assistant Commissioner to consider the question of allowability of this sum when the same had not been considered by the Income Tax Officer.

13. On the other hand, the learned Standing Counsel for the Income Tax Department contended that the Appellate Assistant Commissioner did not exceed his jurisdiction in adding back the sum of Rs. 2,03,207 as he had neither travelled beyond the records of assessment nor considered a point not considered by the Income Tax Officer. The learned Standing Counsel drew our attention to the statement in the assessment order to the effect that the Income Tax Officer was computing the income after scrutiny of the profit and loss statement of the assessee company. The learned standing Counsel argued that since the sum of Rs. 2,03,207 had been shown as expenditure in the profit and loss statement, this item of expenditure must be regarded as having been considered and allowed by the Income Tax Officer and that this inference was reinforced by the fact that he had disallowed some other items of expenditure shown in the profit and loss statement. The learned Standing Counsel maintained that it was not necessary for the Income Tax Officer to give reasons or to write an elaborate order when he allows as deductible an item of expenditure.

14. In support of his contention Shri Gupta strongly relied on the decision of the Supreme Court in Commissioner of Income Tax vs. R. B. Hardutroy Motilal Chamaria, in which the power of enhancement of income by the Appellate Assistant Commissioner under S. 31(3) to the old Act has been considered. There, in the assessment proceedings for the year 1952-53 the assessee had claimed on the basis of entries in his books of account that he had borrowed three sums of Rs. 2,50,000, Rs. 1,50,000 and Rs. 30,000 from three parties. The Income Tax Officer considered the genuineness of these borrowings and did not believe that those three sums had been borrowed. He, therefore, treated these three sums as assessable income of the assessee. When the assessee took up the matter in appeal, the Appellate Assistant Commissioner considered that altogether a different amount of Rs. 5,85,000/- should also be included in the total income of the assessee after giving a deduction of Rs. 1,80,000/-. After referring to its carrier decisions, the Supreme Court observed thus :-

"The principle that emerges as a result of the authorities of this Court is that the Appellate Assistant Commissioner has no jurisdiction; under S. 31(3) of the Act, to assess a source of income which has not been processed by the Income Tax Officer and which is not disclosed either in the return filed by the assessee or in the assessment order, and therefore the Appellate Assistant Commissioner cannot travel beyond the subject matter of the Assessment. In other words, the power of enhancement under S. 31(3) of the Act is restricted to the subject

matter of assessment or the source of income which have been considered expressly or by clear implication by the Income Tax Officer from the point of view of the taxability of the assessee As we have already stated, it is not open to the Appellate Assistant Commissioner to travel outside the records, i.e. the return made by the assessee or the assessment order of the Income Tax Officer with a view to find out new sources of income and the power of enhancement under S. 31(3) of the Act is restricted to the sources of income which have been the subject matter of consideration by the Income Tax Officer from the pointer of view of taxability. In this context consideration does not mean incidental or collateral examination of any matter by the Income Tax Officer in the process of assessment. There must be something in the assessment order to show that the Income Tax Officer applied his mind to the particular subject matter or the particular source of income with a view to its taxability or to its non-taxability and not to any incidental connection."

Their Lordships held in that case that as the Income Tax Officer had not considered the entry of Rs. 5,85,000 from the point of view of its taxability, the Appellate Assistant Commissioner had no jurisdiction in appeal under S. 31 of the Old Act to enhance the assessment.

15. The learned Standing Counsel pointed out that the above decision of the Supreme Court has no application to the present case in as much as the Income Tax Officer there had not considered the taxability of Rs. 5,85,000, where as in the present case the Income Tax Officer had considered whether the sum of Rs. 2,03,207 shown in the profit and loss statement should be allowed as deductible expenditure. The learned Standing Counsel added that in the aforesaid decision the Supreme Court had not dissented from its earlier decision in Commissioner of Income Tax vs. McMillan and Co. in which their Lordships quoted with approval the following observations of Chagla, C.J. in Naraindas Manordas vs. Commissioner of Income Tax.

"It is clear that the Appellate Assistant Commissioner has been constituted a revising authority against the decisions of the Income Tax Officer; a revising authority not in the narrow sense of revising what is the subject matter of the appeal, not in the sense of revising those matters about which the assessee makes a grievance, but a revising authority in the sense that once the appeal is before him he can revise not only the ultimate computation arrived at by the Income Tax Officer but he can revise every process which led to the ultimate computation or assessment. In other words, what he can revise is not merely the ultimate amount which is liable to tax, but he is entitled to revise the various decisions given by the Income Tax Officer in the course of the assessment and also the various income of deduction which came in for consideration of the Income Tax Officer."

The learned Standing Counsel maintained that in the light of the aforesaid observations of Chagla, C.J., (which were approved by the Supreme Court) it was clear that the Appellate Assistant Commissioner had the power the revise the

decision of the Income Tax Officer in allowing Rs. 2,03,207 as deductible expenditure.

16. We think the learned Standing Counsel is right in his submission that the question of allowability of Rs. 2,03,207 as expenditure towards gratuity, was considered by the Income Tax Officer though he has not expressly adverted to this item separately in his order. When the Income Tax Officer stated that he was computing the income after scrutiny of the profit and loss account, it is reasonable to infer that he applied his mind to each of items shown in the profits and loss statement including the item of Rs. 2,03,207 shown by the assessee as expenditure towards gratuity. The fact that the Income Tax Officer had disallowed some of the items shown the profit and loss statement of the assessee company would re-enforce the inference, that he had applied his mind to this item. The decision of the Supreme Court in *Motilal Chamarias* case is clearly distinguishable as the Income Tax Officer there had not considered at all certain entries which the Appellate Assistant Commissioner held for the first time as representing undisclosed income.

17. Even so. Shri Ashok Gupta maintained that consideration by the Income Tax Officer of this item of Rs. 2,03,207, was only incidental or collateral and that according to the ruling of the Supreme court in *Motilal Chamarias* incidental or collateral examination of any matter by the Income Tax Officer in the process of assessment.

18. We are unable to accede to the contention of Shri Gupta that consideration by the Income Tax Officer of this item of expenditure (Rs. 2,03,207) was only incidental or collateral. The Income Tax Officer considered directly the question of allowability of various items of expenditure shown in the profit and loss statement of the assessee company, disallowed some items and allowed those items which he considered ought to be allowed though he might not have recorded his reasons for allowing most of those items

19. However, Shri Gupta contended that the Appellate Assistant Commissioner could not deal with that part of the assessment order which was not the subject matter of the appeal by the assessee. Shri Gupta sought to derive support for his contention from the decision of this Court in *Madan Studio vs. Assistant Commissioner*. There, the Sales Tax Officer had accepted the assessee's claim that the turnover of photographs was exempt from Tax, but rejected the account books of the assessee and estimated then turnover of photographic goods (as distinct from photographs). At the hearing of the appeal preferred by the assessee, the department's representative argued the appellate authority that the turnover of photographs was also liable to tax and had been wrongly exempted by the Sales Tax Officer. There upon, the appellate authority issued a notice to the assessee to show cause why the turnover of photographs should not be brought to tax. It was at that stage that the assessee approached this court by a writ petition. This Court held that the notice issued by the Appellate authority requiring the petitioner to show cause why the turnover of photographs be not

brought to tax, was without jurisdiction. Satish Chandra, J., who spoke for the Bench, observed thus at page 286 :

"S. 9 does not confer any right of appeal on the department or the Commissioner of Sales Tax The facts that the Commissioner of sales tax has not been given any of appeal but has been given a right of revision must be borne in mind while construing the ambit of the appellate jurisdiction given by S. 9. In the context the appellate jurisdiction cannot usurp the revisional jurisdiction under S. 10 Else the position would be that an assessment order or a portion of it against which the commissioner is aggrieved would be liable to challenge not only before the revising authority under S. 10 but also before the appellate authority under S. 9 and different results may be reached by these authorities. That would cause confusion Further, if the appellate authority is construed to possess jurisdiction to go outside the purview of the subject matter of the appeal filed by the dealer, it will virtually amount to reading into s. 9 the conferment of the suo motu jurisdiction which the Act confers upon the revising authority alone. The existence of suo motu jurisdiction in more than one authority against the same assessing authority is neither desirable nor in accordance with the scheme of the Act under which this jurisdiction is reserved only in the revising authority. For these various considerations we are unable to read the phrase "confirm, reduce, enhance, or annul" occurring in sub-S. (3) of S. 9 to include that part of the assessment order which is not the subject matter of the appeal, that is that part of the assessment order against which no relief is prayed for in the memorandum of appeal of the dealer. The appellate authority, in our opinion, is confined to the subject matter of the appeal preferred by the dealer. It cannot to outside it."

20. No doubt, the above observations of this Court seem to support the contention of Shri Ashok Gupta. But the ruling of the supreme Court in McMillans case does not appears to have been brought to the notice of the Bench of this Court which decided Madan Studios case and the decision of this Court therein inconsistent with the aforesaid ruling of the Supreme Court. Since the ruling of this court in Madan Studios case is in regard to S. 9 of this U.P. Sales Tax Act and the present reference is under the Income Tax Act, we do not consider it necessary to refer to a Full Bench the question whether the law laid down by this court in Madan Studios case requires reconsideration.

21. For the reasons stated above we are unable to acceded to the contention of Shri Ashok Gupta that the Appellate Assistant Commissioner had no power to go into the question correctness of the decision of the Income Tax Officer in allowing the expenditure of Rs. 2,03,207 as deductible.

22. We shall now take up the second question referred to us. In Appendix V to the notification of the Government of Uttar Pradesh dated 27-4-1961, the relevant portions of clause 1 read :

"1. Short title, extent and commercement

(a) This scheme may be called the Sugar Industry Workmens Gratuity Scheme.

(b).....

(c) It shall come into force with effect from November 1, 1960."

23. From the aforesaid portions of the Government notification it is clear that the gratuity scheme for workman in sugar industry came into force with effect from 1-11-1960. But it was argued by Shri Ashok Gupta that the recital in the preamble of the aforesaid Government notifications that the representatives of the employers had agreed to implement the recommendations of the Wage Board, would show that the Government had left it to the employers to implement the scheme as soon as they could do so because each to them had to prepare a scheme for his establishment and that consequently his liability to pay gratuity would not arise until such scheme was prepared by him.

24. It may be, that each employer required considered time to prepare a gratuity scheme for his establishment and that he had to postpone payment of gratuity to his employees who might have retired in the meanwhile. But all that would not have the effect of postponing the date with effect from which his liability to pay gratuity would arise, till such fund was constituted. Such liability arose with effect from 1-11-1960 and thereafter there was accrual of further liability, year by year, as the total length of service of each employee who continued in service, increased year by year.

25. The view that we take receives support from the observations of this court in *Madho Mahesh Sugar Mills (P) Ltd. vs. Commissioner of Income Tax and Swadeshi Cotton Mills Co. vs. Income Tax Officer*. In both those cases the Revenue had contended that the liability to pay gratuity did not arise on 1-11-1960 but arose subsequently.

26. In *Madho Mahesh Sugar Mills* case also in pursuance of the aforesaid Government notification dated 27-4-1961 the assessee therein had provided for gratuity in its accounts for the year ending on 30-9-1967 (relevant for the assessment year 1962-63) by crediting Rs. 1,37,811 to the gratuity account and debiting that amount to the profit and loss account. The assessee's claim that this amount was a deductible item of expenditure in that assessment year, was disallowed by the Income Tax Appellate Tribunal on the ground that the assessee's liability to pay gratuity in the relevant accounting period, was not ascertained and hence was only a contingent liability which the assessee had to meet at a further date as and when a particular event took place. This court upheld the claim of the assessee relying upon the following observations of the Supreme Court in *Metal Box Company of India Ltd. vs. Their Workman*.

"In the case of an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually

expended or paid."

In *Swadeshi Cotton Mills* case the assessee who followed the mercantile system of accounts, had provided in its accounts for the liability to pay gratuity that accrued in that year as per the actuarial valuation report and claimed deduction of such estimated liability. The Income Tax Officer had disallowed the claim. Following the earlier decision in *Madho Mahesh Sugar Mills*, case this court held that the assessee's claim for the estimated future liability on account of gratuity based on the actuarial valuation, should have been allowed by the Income Tax Officer.

27. Thus we have no hesitation in rejecting the contention of Shri Gupta that liability to pay gratuity accrued for the first time only in the previous year for the assessment year 1964-65.

28. The third question referred to this Court is whether the expenditure towards gratuity whether allowable in the assessment year 1964-65, was the entire sum of Rs. 2,03,207 or only Rs. 50,000.

29. As stated earlier, the Tribunal held that the liability of the assessee towards payment of gratuity pertaining to the relevant accounting year, could be estimated only at Rs. 50,000 as per the assessee's own admission and that this sum should be allowed as deductible expenditure.

30. However, Shri Gupta contended that since the assessee company had paid Rs. 2 lakhs by transferring that amount to the gratuity fund in the accounting year relevant to the assessment year 1964-65 the entire amount should be treated as expenditure deductible in that year either under S. 28(i) or S. 37(1) of the Act. He maintained that it would not make any difference whether the assessee company was following the mercantile system or the cash system of accounts.

31. On the other hand, the learned Standing Counsel contended that since the assessee company was following the mercantile system of account, what it could claim as deductible in the assessment year 1964-65 was only the liability that accrued in the relevant previous year and not what it paid in that year and that the year in which a payment was actually made towards such liability, was wholly immaterial under the mercantile system of accounts.

32. The mercantile system of accounting was explained thus by the Supreme Court in *Kashav Mills Ltd. vs. Commissioner of Income Tax*.

"the system brings into credit what is due immediately it becomes really due and before it is actually received and it brings into debit expenditure the amount for which legal liability has been incurred before it is actually disbursed."

In *Kedarnath Jute Manufacturing Co.s* case the Supreme Court reiterated the legal position thus :

"If the method of accounting is mercantile system then the deduction will be

permissible in the year in which the liability relates irrespective of the point of time when the liability was actually discharged."

33. In support of his contention that even under the mercantile system of accounting the assessee company could claim deduction of 50,000 in the year in which this sum was transferred to the gratuity fund, Shri Gupta relied on the decision of a Bench of this Court (of which one of us was a member) in the matter of M/s. Banwari Lal Madan Mohan, Bareilly. Thereafter a partial partition of a Hindu undivided family on 31.3.1960 its business was taken over by some of its members who formed themselves into a partnership firm. In the balance sheet of the undivided family as drawn on 31.3.1960 a provision was made for Rs. 28,230 towards sales tax upto that date. The Sales Tax Officer assessed on 23.3.1961 the family business to sales tax for the year 1959-60 and determined it as Rs. 1,23,518. Ultimately in appeal, sales tax was reduced to Rs. 36,714 and this amount was paid by the partnership-firm in the year 1961-62. In the assessment of the partnership firm to income tax for the year 1962-63 it claimed a deduction of Rs. 11,484 being the amount paid in excess of the amount provided by the joint family in the balance sheet as on 31-3-1960. The I.T.O. had disallowed that claim but in appeal the Income Tax Appellate Tribunal allowed that claim holding that the assessee firm had taken over all the assets and liabilities of the joint family firm including the liability to sales tax and that such liability was quantified in the order passed in appeal whereafter the assessee paid sales tax in the previous year relevant to the assessment year 1962-63. On a reference made by the Tribunal, this Court upheld the view taken by the Tribunal and observed that in as much the Hindu undivided family had been following the mercantile system of accounting and had made provision for the tax only on an estimate basis, it was in the year in which it was quantified finally that the actual liability to sales tax was finally determined and that the excess amount over that for which provision was made by the joint family accrued undoubtedly in the year in which it was finally determined. That decision proceeded on the peculiar facts of that case. There, the additional liability of Rs. 11,484 towards sales tax was determined and paid only in 1961-62 relevant for assessment year 1962-63. Hence this decision does not in our opinion, help Sri Gupta.

34. Reliance was also placed by Shri Gupta on the decision in Commissioner of Income Tax vs. Nathumal Totaram. There, the assessee firm was assessed to sales tax for the year 1949-50. It disputed its liability to sales tax and contested the case right upto the Supreme Court, but without success. In the assessment to Income Tax for the year 1958-59 it claimed to have made provisions for sales tax in its mercantile system of accounts in the previous year and showed this amount as deductible expenditure for the assessment year 1958-59. The Income tax Officer disallowed that claim on the ground that when the assessee had made provisions in its account for sales tax it had been disputing its liability to sales tax. In the reference before the High Court it was contended for the Revenue that liability to sales tax had accrued in the year 1949-50 itself when the sales

were made and that the assessee who was following the mercantile system of accounting, could not claim deduction for this tax in the assessment year 1957-58. Their Lordships of the High Court at Gauhati held that since the final demand for the full amount of tax was made during the previous year for the assessment year 1957-58 and the assessee debits its account with this particular liability in that provisions year, the assessee could claim deduction of sales tax in the assessment for the year 1957-58. Their Lordship observed that the decision of the Supreme Court in *Kedarnath Jute Mills* case could not be understood as laying down that an enforceable claim to sales tax which was demanded in the year in which the accounts of the assessee had been debited with amount of that tax, should be disallowed on the ground that the assessee should have claimed deduction of that amount in earlier years.

35. Shri Gupta next referred to a summary of the decision of the Gujarat High Court in *Ms. Patidur vs. C.I.T.* A full text of the decision is not available. According to that summary, facts of that case were these. The assessee firm had made certain sales on consignment basis between Samvat year 2016 and 2018. Under the impression that no sales tax was payable on those sales, it had not made any provision for payment of sales tax. In the Samvat year 2021 the Sales tax Officer held that the assessee was liable to pay sales tax on those sales and determined its liability as Rs. 67,085 for those years. The assessee paid that amount and claimed deduction of this amount in the assessment deduction of this amount in the assessment to Income Tax for the year 1966-67. This claim was disallowed by the Income Tax Officer on the ground that sales tax was paid, did not pertain to the year of account in which the assessee had not accepted its liability and had contested the levy of sales tax in appeal. Ultimately the Tribunal affirmed the view of the Income Tax Officer. Disagreeing with the view of the Tribunal, the High Court of Gujarat held that since the assessee was under an impression that the sales on consignment basis were not liable to sales tax he would not have made entries in his books of accounts on the respective dates when the sales were effected, but that once the Sales-tax Officer determined that liability it became crystallised and the assessee was justified in making an entry and providing for the liability arising out of the Sales-tax Officer's decision. The decision of the Supreme court in *Kedarnath Jute Manufacturing Co.s* case does not appear to have been noticed by their Lordships of the High Court of Gujarat.

36. All the above three cases relied on by Shri Gupta are distinguishable from the present case in as much as the liability to sales tax in those cases was in dispute in the respective years in which such liability would have formally accrued. But in the present case there was no dispute regarding the liability of the assessee company to pay gratuity in the year in which such liability accrued. As the assessee company was following the mercantile system of accounting, only in the year in which the liability for gratuity accrued irrespective of the year in which the assessee paid any amount towards gratuity.

37. Thus out of the amount of Rs. 2,03,207 paid by the assessee company towards gratuity during the accounting year ending on 30-3-1963, only the sum of Rs. 50,000 representing the liability for gratuity that accrued during that accounting year, was allowable as expenditure in the assessment year 1964-65.

38. We shall now take up the fourth question, namely deductibility of Rs. 50,000 as expenditure.

39. As stated earlier, the gratuity fund constituted by the assessee company has not yet been approved by the Commissioner of Income Tax in accordance with the rules contained in part C or the Forth Schedule to the Act. Hence the sum of Rs. 2 lakhs provided by the assessee in its accounts fund, could not be claimed as a deduction under clause (v) of sub-S. (1) of S. 36 of the Act.

40. Even so, the question is whether the assessee could claim deduction of this amount under clause (i) of S. 28 or S. 37(1) of the Act.

41. In *Badridas Daga vs. Commissioner of Income Tax* the Supreme Court while considering sub-S. (1) of S. 10 of the Old Act which correspond to clause (i) S. 28 of the present Act observed thus at page 14 :

"It is to be noted that while S. 10(1) impose a charge on the profits or gains of a trade, it does not provide how those profits are to be computed. S. 10(2) enumerates various items which are admissible as deductions, but it well settled that they are not exhaustive of all allowances which could be made in ascertaining profits taxable under S. 10(1) profits and gains which are liable to be taxed under S. 10(1) are what are understood to be such according to ordinary commercial principles."

This enunciation was reiterated by the Supreme Court in *Calcutta Company Ltd. vs. Commissioner of Income Tax*. The above legal position is made clear in sub-S. (1) of S. 37 of the present Act which provides that any item of expenditure not coming within S. 30 to 36 but laid out of expended wholly and exclusively for the purpose of the business or profession, shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession. S. 37(1) is a residuary provision extending deduction to all items of business expenditure not specifically provided by S. 30 to 36 of the Act unless any of such items are not expressly declared as not deductible under S. 40.

42. If any expenditure is incurred by the assessee towards payment of gratuity to, its employees, then such expenditure being expended wholly and exclusively for the purposes of business of the assessee, should be allowed under S. 37(1) of the Act, to be deducted in computing income even though such payment of gratuity does not come within the scope of clause (v) of S. 36 of the Act. This is, of course subject to the prohibition contained in sub-clause (iv) of S. 40 that payment to a provident fund or other fund established for the benefit of employees of the assessee, shall not be permitted to be deducted in computing income unless the assessee has made effective arrangements to secure that tax

shall be deducted at source from any payments made from the fund which are chargeable to tax under the head Salaries. There is no dispute in the present case that the gratuity scheme framed by the assessee has provided for deduction at source from any payment to gratuity made to its (the assessee's) employees.

43. The view we take receives support from the following observations of the Bombay High Court in *Aata Iron & Steel Co. Ltd. vs. D. V. Bapat*, Income Tax Officer :

"S. 30 to 37 would seem to consist of a list of permissible allowances and deductions as enumerated therein. S. 40 contains provisions for certain amounts which are expressly declared as ones not to be deducted in computing income chargeable in computing income chargeable under the head profits and gains of business or profession Now the question which would seem to arise on a consideration of the scheme of the Act pertaining to sections would be whether the list of allowances and deductions enumerated is exhaustive. It seems to be now well settled by several decisions of the Supreme Court that this list is not in the exhaustive sense that an item of loss or expenditure incidental to business may be deducted in computing profits and gains even if it does not specifically find place within any of these sections provided it is an item which is allowable as a deduction on ordinary commercial principles."

However, the learned Standing Counsel contended that clause (v) of S. 36(1) of the Act must be regarded as an exhaustive provision in regard to deductibility of expenditure incurred for payment towards gratuity to employees and that if any such payment does not come within the ambit of that clause, then by necessary implication such payment cannot be treated as a deductible expenditure even if it is incurred wholly or exclusively for the purpose of the business.

44. A similar contention was considered and replied by the Bombay High Court in *Tata Iron and Steel Company's case*. There also the assessee had claimed deduction of a sum of money on the footing that that sum represented its gratuity liability on actuarial valuation. It was contended for the Revenue that that sum could not be allowed as deduction in view of the provisions of S. 36(1) of the Act. Repelling that contention the Bombay High Court said at page 330 :

"There appears to us to be no implied prohibition contained in the Income Tax Act against allowing such provision as a deduction before the figure of profits is calculated or arrived at".

We are in respectful agreement with the above observations of the Bombay High Court.

45. Thus we are unable to accept the contention of the learned Standing counsel that the Tribunal could not treat even Rs. 50,000 as deductible expenditure under S. 28(i) or S. 37(1) of the Act. As result of the foregoing discussion our answers to the questions referred to us are as follows :

(1) On the fact and in the circumstances of the case the Appellate Tribunal was legally correct in holding that the Appellate Assistant Commissioner did not exceed his jurisdiction in enhancing the assessment.

(2) On a correct interpretation of the Notification of the U.P. Government dated 27-4-1961, the resolution of the Board of Directors of the assessee Company and the Trust Deed dated 30-9-1963, the liability of the assessee company in respect of gratuity commenced on 1-11-1960.

(3) On the facts and in circumstances of the case the expenditure allowable under S. 28(i) or under S.(1) of the Income Tax Act, 1961 was only Rs. 50,000.

(4) On the facts and in the circumstances of the case the Tribunal was justified in allowing a deduction of the Rs. 50,000 for the assessment year 1964-65 even though the gratuity fund constituted by the assessee company was not approved by the Commissioner of Income Tax as contemplated by S. 36(1)(v) of the Income Tax Act, 1961.

46. In the circumstances of the case we make no order as to costs in this reference.