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(1980) 04 DEL CK 0031

In the Delhi High Court

Case No : L.P.A. No. 83 of 1979

C.K. Karunakaran — APPELLANT

Vs

Union of India and others — RESPONDENT

Date of Decision : 30-04-1980

Acts Referred:

Citation : (1980) ILR Delhi 896 : (1981) 127 ITR 136

Hon'ble Judges : S. Ranganathan, J;Leila Seth, J

Bench : Division Bench

Judgement

S. Ranganathan, J.—This appeal raises an interesting and a some-what difficult question regarding the extent of exemption available under the I.T. Act, 1961, to a Government servant in respect of a lump sum received by him (on his deemed retirement from service due to his absorption into a public sector undertaking) in place of the payments which he would have been entitled to receive had he retired from the Government service in the normal course.

2. On general principles, the receipt of a lump sum be an employee on the commutation of the pension payments which he would otherwise be entitled to receive would be in the nature of a capital receipt (except, perhaps, where the pension is in the nature of a deferred remuneration). This general rule stood abrogated by the very comprehensive definition of "profits in lieu of salary" contained in Expln. 2 to s. 7(1) of the Indian I.T. Act, 1922. However, it appears that the Legislature did not then intend to bring commuted pension to tax, for, s. 23 of the Finance (No. 2) Act, 1965, declared :

"Notwithstanding anything contained in the Indian Income Tax Act, 1922(11 of 1922), any sum due to or received by any person in commutation of pension shall not be included and shall be deemed never to have been includible in computing the total income of such person under the provisions of that Act."

3. The language of s. 17(3) of the I.T. Act, 1961, corresponds to that of Expln. 2 to s. 7(1) of the 1922 Act but the Finance (No. 2) Act of 1965, introduced a

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limited exemption regarding commuted pension with retrospective effect from April 1, 1962, the date of commencement of the 1961 Act. The exemption, couched in guarded language is in respect of :

Section 10(10A)(i) :

"Any payment in commutation of pension received under the Civil Pensions (Commutation) Rules of the Central Government or under any similar scheme applicable to the members of the civil services of the Union or holders of posts connected with defense or of civil posts under the Union (such members or holders being persons not governed by the said Rules) or to the members of the all-India services or to the members of the defense services or to the members of the civil services of a State or holders of civil posts under a State or to the employees of a local authority or a corporation established by a Central, State or Provincial Act;

(ii) any payment in commutation of pension received under any scheme of any other employer, to the extent it does not exceed -

(a) in a case, where the employee receives any gratuity, the commuted value of one-third of the pension which he is normally entitled to receive, and

(b) in any other case, the commuted value of one-half of such pension,

such commuted value being determined having regard to the age of the recipient, the state of his health, the rate of interest and officially recognised tables of mortality :

Provided that the maximum limit of payment specified in sub-clause (ii)(a)or sub-clause (ii)(b) shall not apply in respect of any such payment made before the day of August 19, 1965."

4. The question in the present appeal is whether an amount, received by the appellant, wholly qualifies for this exemption or not.

5. No, for the factual background in which the question arises :

The petitioner, C. K. Karunakaran, joined the Central Services (Class I) on July 31, 1959, in what was known as the Industrial Management Pool. The pool, which had been constituted in 1957, was abolished with effect from the afternoon of March 31, 1977. In the meantime, the services of the petitioner had been lent to a public sector corporation, the Oil & Natural Gas Commission (ONGC). The resolution of the Govt. of India dated January 31, 1977, deciding to abolish the pool (which is not before us) seems to have also decided to give an option to the officers belonging to the pool who were on deputation elsewhere to get absorbed in their place of deputation. The petitioner exercised the option offered to him.

6. On December 28, 1977, the Bureau of Public Enterprises of the Govt. of India which the petitioner was serving addressed a letter to the Pay & Accounts Officer,

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Ministry of Finance, North Block, New Delhi, conveying the sanction of the president to the permanent absorption of the petitioner in the ONGC w.e.f. April 1, 1977, "in the public interest." This letter, inter alia, stated, in paras. (ii), (iii) and (iv) that the petitioner would be entitled to pro rata pension and death-cum-retirement gratuity based on the length of his qualifying service in the Government till the date of permanent absorption in the ONGC under the normal rules applicable to Govt. servants. However, clause (v) proceeded to say :

"(v) The officer will exercise an option within six months of the date of issue of this letter, for either of the alternatives indicated below -

(a) Receiving the pro rata monthly pension and death-cum-retirement gratuity as admissible under clauses (ii), (iii) and (iv) above under the Government of India Rules;

(b) Receiving the pro rata gratuity and a lump sum amount in lieu of pension worked out with reference to commutation tables obtaining on the date from which pension will be admissible and payable under option orders."

7. Clause (vi) stated that the petitioner would be eligible for family pension to the extent permissible under the Central Civil Services (Pension) Rules, 1972 (hereinafter referred to as the "Pension Rules") and other Govt. orders bearing on the subject. Clause (viii) stated :

"In case Sri Karunakaran opts to receive pension as in para. (v)(a) but wishes to commute a portion of his pension such commutation will be regulated in accordance with the Government of India Rules in force at the time."

8. It appears that the petitioner, like several other officers placed in a similar position, opted for the course suggested in para. (v)(b) of the above letter and applied, on February 18, 1978, for "commutation of his full pension." In April-May, 1978, it was decided that "payment of the commuted value of pension" of Rs. 90,909 be made to the petitioner. The Accountant-General, Bombay, however, sought instructions from the Pay & Accounts Officer, Ministry of Finance, New Delhi, regarding "the portion of the commutation amount that is taxable" before releasing the amount. A letter addressed by the petitioner to the ITO, Bombay, referring to a decision of the Bombay Benches of the Income Tax Appellate Tribunal of November, 1974, in the case of one P. Murlidharan (I.T.A. No. 2421 of 73-74 and 1516 of 74-75) and requesting him to advice the Accounts Officer at Bombay not to deduct any tax on commuted pension apparently evoked no response, and on July 3, 1978, the Pay & Accounts Officer, Ministry of Finance, New Delhi, replied to the Accountant-General at Bombay to say that "the paying branch will be responsible for deduction of Income Tax at source from pension payments including commutation." The petitioner, thereupon, filed a writ petition in this court, contending that the "commuted pension" payable to him is not taxable and praying, (a) that the letter dated July 3, 1978, be quashed, and (b) that the Accounts Officer at Bombay be directed to pay the "commuted pension of the petitioner without deducting tax at source or

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otherwise." The writ petition has been dismissed and hence this appeal.

9. Before proceeding to deal with the issues raised, it is necessary to refer to certain other relevant aspects which have a bearing on the present case.

(1) We have referred earlier to clause (v)(b) of the letter of the Government to the petition which referred to a lump sum payment. The rules governing this payment are rr. 37 and 37A of the Central Civil Services (Pension) Rules, 1972, which may be extracted here :

"37. Pension on absorption in or under a corporation, company or body. - A Government servant who has been permitted to be absorbed in a service or post in or under a corporation or company wholly or substantially owned or controlled by the Government or in or under a body controlled or financed by the Government shall, if such absorption is declared by the Government to be in the public interest, be deemed to have retired from service from the date of such absorption and shall be eligible to receive retirement benefits which he may have elected or deemed to have elected, and from such date as may be determined, in accordance with the orders of the Government applicable to him :

Provided that the Government shall have no liability for the payment of family pension in such a case :

Provided further that no declaration regarding absorption in the public interest in a service or post in or under such corporation, company or body shall be required in respect of a government servant whom the government may by order, declare to be a scientific employee.

37A. Payment of lump sum amount to persons on absorption in or under a corporation, company or body. - (1) Where a Government servant referred to in rule 37 elects the alternative of receiving the death-cum-retirement gratuity and lump sum amount in lieu of pension, he shall, in addition to the death-cum-retirement gratuity, be granted :

(a) on an application made in this behalf, a lump sum amount not exceeding the commuted value of one-third of his pension as may be admissible to him in accordance with the provisions of the Civil Pensions (Commutation) Rules; and

(b) a terminal benefit equal to twice the amount of the lump sum referred to in clause (a), subject to the condition that the Government servant surrenders his right of drawing two-thirds of his pension."

Rule 37 (which had originally governed such cases) contemplated that the extent of retirement benefits were to be decided by orders of the Government from time to time. However, r. 37A was introduced, pursuant to a decision of the Government, on April 9, 1973, with effect from April 21, 1973, but sub-r. (2) of the rule makes it clear that it was deemed to have been applicable to all cases of payments received by such employees on or after July 24, 1971. The payment made to the present petitioner was in terms of r. 37A.

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(2) The date July 24, 1971, appears to have been provided for in r. 37A(2) because though the scheme of lump sum payments in lieu of pension for such employees appears to have been in force since 1969 or so, the bifurcation of the lump sum payment into two components provided for in r. 37A(1) had been introduced informally by a memo of the Finance Ministry of that date which had been issued to clarify a number of queries and doubts that had been raised, particularly in regard to the taxability of the amounts received by the employee. This memorandum, inter alia, stated :

"(i) The pro rata gratuity paid to the employee would be exempt from Income Tax.

(ii) Where the employee opted for a lump sum in lieu of pension. Such lump sum would consist of two distinct components -

(a) the commuted value up to the normal limit of 1/3rd the pension; and

(b) a terminal benefit equivalent to the capital value of 2/3rd of the pension payable in consideration of the optee''s surrendering the right of drawing 2/3rds pension, as also the family pension.

(iii) Consequently, the payment referred to in (a) above will be exempt from Income Tax but not that referred to in (b). However, in respect of the latter, the recipient could claim appropriate relief of spread over (which, it may be noted, is available u/s 89 of the Income Tax Act, 1961)."

This memo also refers to steps being on foot to amend the rules accordingly which, as noted earlier, was done on April 9, 1973, with the benefit covering all cases of retirement after July 24, 1971. The above position regarding taxability was also reiterated in a memorandum issued by the same Ministry on April 13, 1973, explaining the newly introduced r. 37A and, again, in a memo issued on April 8, 1976.

(3) After the above memo of 1971 became operative, the question of taxability of lump sum received by such an employee came up for consideration before the Bombay Bench of the Tribunal in Murlidharan''s case, earlier referred to, and was decided in November, 1974, holding in favor of complete exemption. Since this decision would affect a large number of cases, the Central Board of Revenue had to take a decision whether it should be accepted or taken up on reference to the High Court. On May 20, 1976, it seems, the Board decided to accept the decision "as laying down the correct position in law." This appears from a letter of the Commissioner of Income Tax dated September 10, 1976 (placed before us by the counsel for the appellant) which proceeds further to direct the ITO not only to apply the decision in future but also to rectify orders already made, assessing such receipts, in the light of the decision of the Board. The Board, however, reconsidered the matter in consultation with the Ministry of law and decided that the terminal benefit under r. 37A(1)(b) would be taxable though eligible for relief under s. 89. This was clarified in a circular issued on July 1, 1978, which also

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directs remedial action under s. 263 in all cases where relief had been granted earlier. This circular does not refer to its earlier decision in the matter but refers to the Govt. memorandum dated April 13, 1973.

10. It may be mentioned that in the case of a civil servant in government service the maximum commutation permitted is to the extent of one-third of the pension payable to him where he is governed by one of certain specified schemes and to the extent of one-half of the pension in other cases. The uncommitted residue of the pension in either case should not be less than Rs. 240 per annum; vide rr. 3 & 4 of the Civil Pensions (commutation) Rules (hereinafter referred to as the "Commutation Rules"). It was also stated before us that defense personnel are entitled to commute up to 43% of the pension payable to them. The commutation is permitted subject to certain rules which prescribe for a medical examination when commutation is sought more than a year after retirement and in accordance with the multiples prescribed in the tables prescribed for the purpose and revised from time to time.

11. The writ petition does not give any inkling regarding the stand of the Pay & Accounts Officer and other respondents and the extent to which they considered the amount payable to him as liable to tax. But the reply filed by the respondent takes the same line as the memorandum dated April 13, 1973, and April 8, 1976, and the circular dated July 1, 1978. The stand is that the lump sum payable to the petitioner consists of two components. The first is an amount arrived at by commuting, in accordance with the Commutation Rules, one-third of the pension payable to the petitioner. This is exempt from tax. The other is a "terminal benefit" equal to twice the above amount, also payable to the assessed. Though this is paid only on his surrendering his rights to receive the balance of 2/3rds of the pension, this payment is not covered by s. 10(10A)(i) of the Act.

12. Anand J. [vide C.K. Karunakaran Vs. Union of India (UOI) and Others,] accepted the contention of the respondents. It appears that before the learned judge it was the common case of the parties that the payment made under clause (a) of r. 37A(1) of the Pension Rules is exempt from tax and that the dispute was as to whether the terminal benefit, in addition to the above payment, to which the petitioner was entitled under clause (b) of the said rule would also qualify for exemption. Further, it was also not disputed that "rule 37A was added primarily to introduce uniformity in the matter of exemption under s. 10(10A) of the Income Tax Act, because, but for this rule, the entire amount in lieu of pension receivable by a civil servant on absorption would be exempt from tax while the exemption in the case of an ordinary retiring civil servant would be confined to the commuted value of one-third of the pension." The argument for the writ petitioner appears to have been that while the payment under clause (a) was exempt under the opening words of s."10(10A)(i)" as a payment in commutation of pension received under the Commutation Rules of the Central Government "the payment under clause (b) would be exempt under one of the other categories mentioned therein, viz., as a "payment in commutation of

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pension received under any similar scheme applicable to members of the civil service of the Union, referred to hereinafter as "the second limb" of the section. The learned judge agreed that clause (b), which also provides for payment of a terminal benefit in lieu of pension, is in the nature of "a similar scheme" envisaged by the above words but pointed out that to qualify for exemption under this limb of the section, another condition had to be also satisfied-a condition required by the words in parenthesis "(such members.... being persons not governed by the said Rules)." Observing that it was not disputed that, until absorption in the new service, the petitioner was governed by the Commutation Rules the learned judge held that the petitioner would not be entitled to the exemption as it could not be said that the petitioner was not governed by the Commutation Rules. It was immaterial that the Commutation Rules applied only to the commutation under clause (a) but not to the terminal benefit under clause (b).He observed [1980] 121 ITR 760 :

"The provision does not contemplate the benefit of exemption being given to payments of the same nature by two different sets of rules and that is why the provision that the persons, who are entitled to the benefit under a similar scheme, must not be persons to whom the Commutation Rules would apply. A contrary interpretation would apparently frustrate the very object of r. 37A, i.e., to bring uniformity of treatment in the matter of exemption from tax between a retiring civil servant and a civil servant who is deemed to have retired because of absorption in another service. Any other interpretation would lead to an anomaly that a civil servant, who was absorbed in another service and had merely deemed to have retired from service, would be put in a more advantageous position than the civil servant who may finally retire."

13. In the result, though the learned judge agreed with the criticisms of the petitioner''s counsel that it was unfair and inequitable to tax pensionary benefits granted to members of fixed income groups at the time of retirement after long service with an employer, he concluded that the petitioner''s claim for exemption under s. 10(10A)(i) was based on infirm reasoning and so not maintainable in law and that the writ petition had, Therefore, to be dismissed.

14. Realizing, perhaps, the inherent weakness of the arguments addressed on behalf of the writ petitioner before Anand J., Shri O. P. Vaish, counsel for the appellants, took a different line of argument before us. He contended that it was not correct to break up and consider the two components of the payment under r. 37A, treating one as a payment under the Commutation Rules and the other as some other payment in the nature of a terminal benefit. His argument was the the Commutation Rules applied to a person only when he retired in the normal course and was permitted to commute 33 1/2 or 50% of the pension, as the case may be. Persons in the position of the present appellant, who exercise the option for lump sum payment, were not governed by these rules but were governed by a different but similar scheme envisaged by rr. 37 and 37A of the Pension Rules. Such a person was permitted to commute the entirely of his pension. This was

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partly by way of concession given to him in view of the fact that he is forced to retire from service much earlier than he would have normally retired and partly intended to enable the Government to square up once and for all the accounts of an employee who had left its service to join some other organisation. The whole payment was, Therefore, exempt under the second limb of section 10(10A)(i).

15. It appears to us that this contention of the learned counsel is well founded. Rule 37 contemplates the grant of such retirement benefit to this category of employees as may be envisaged by Government orders from time to time. The scheme of benefits to such employees was originally being announced by orders of the Government issued from time to time. These were replaced by r. 37A which contemplates the alternative of a "lump sum amount in lieu of pension" in addition to the death-cum-retirement gratuity. In other words, such an employee is allowed to commute the whole of this pension and receive a lump sum instead. If r. 37A had simply said that he would be permitted to commute his whole pension on the same lines as the Government servant retiring in normal course can commute a part of his, there would have been no difficulty and the lump sum received in commutation would have been exempt as a commuted payment received under a scheme similar to that envisaged by the Commutation Rules. The difficulty is created because r. 37A proceeds further to dissect the lump sum into two components, one equal to the commuted value of one-third of his pension and another equal to twice the above amount. The contention for the respondents is that, since clause (a), r. 37A(1), contains a reference to the Commutation Rules, the lump sum computed and paid under that clause would be a payment received under the Commutation Rules. But, it is said, when we come to clause (b), no relief would be available because, though it also envisages a lump sum in commutation of the remaining two-thirds of the pension under a similar scheme, that would be a receipt by a person who is governed by the Commutation Rules and who in fact has received the lump sum under clause (a) only by virtue of those rules. But we think that Mr. Vaish is correct in saying that the two clauses of r. 37A(1) should not be separated and considered as standing on different footing. We say so for the following reasons. In the first place, the scheme of rr. 37 and 37A is to give the employee the alternative to opt either for the normal monthly pension applicable to all Government servants with the corresponding right to commute such portion thereof as is permissible under the Commutation Rules or the death-cum-retirement gratuity plus a lump sum in lieu of pension. In other words, the employees are either governed by the Commutation Rules or by the alternative, but similar, scheme of r. 37A. In the latter case, they cannot be said to be governed by the Commutation Rules which permit the commutation only a part of the pension. To say that they are governed by the Commutation Rules in part for purposed of clause (a) and not governed by them so far as clause (b) is concerned is to introduce an artificial dichotomy into a straight alternative provided between two different schemes. Secondly, full effect should be given to the use of the words "lump sum in lieu of pension" in the main part of the rule. Clauses (a) and (b) only provide that this

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lump sum is to be computed in two stages. The first stage is to calculate the lump sum which the employee would have been commuting one-third of the pension on the basis of the Commutation Rules. In other words, the reference to the commutation rules is only to provide the measure of the lump sum payable under clause (a). The effect of it is not that the employee would be governed by the Commutation Rules so far as the payment is concerned. On the other hand, it only stipulates calculation of an amount which would have been received had he retired in the normal course and opted to be governed by the usual rules of commutation in regard to one-third of the pension. A third important aspect to be borne in mind is that under clause (a) the lump sum is not to exceed the commuted value of one-third of the pension. There are two possible cases which this may cover. One is that the employee may choose to commute less than one-third of his pension in which case he cannot be said to be governed by the Commutation Rules. This eventuality, however, is highly unlikely. In such a case, since the employee will get only the lump sum under clause (a) plus twice the said amount under clause (b) the whole of the pension will not get commuted and it is not possible to conceive of any employee commuting less than one - third under clause (a). The other possibility is that the employee may be entitled to commute, under the Commutation Rules (if they applied), more than a third of his pension. Though as in the case of the present petitioner, normally, these rules envisages commutation of only a third, the rules do permit some employees to commute half the pension due to them. But even such employees, if they opt for the scheme under r. 37A, can get a lump sum under clause (a) of the commuted value of only one-third. Of course, the reason for this provision is clear, viz., that under cls. (a) & (b) put together, the employee should not be entitled to get more than the commuted value of his pension. But we are only concerned to point out from this that in such cases it would not be correct to say that he is receiving the payment calculated as per clause (a) under the Commutation Rules. For these reasons, we think that the more harmonious and reasonable construction of rr. 37 and 37A is to say that they outline a scheme of commutation similar to but different from that provided for in the Commutation Rules and that the availability of exemption for the lump sum received under r. 37A(1) should be considered as one integral whole and under the second limb of s. 10(10A)(i). We think that the separate consideration of the two components of the lump sum paid would not be a correct way of construing the scheme of rr. 37 and 37A in the context of the provision for exemption.

16. We quite appreciate that some difficulty may be felt in placing the above construction by reason of the memoranda dated July 24, 1971, April 13, 1973, and April 8, 1976, which indicate that the intention of the Government was that only the amount calculated under clause (a) should be eligible for exemption. It has also been argued for the respondent that the bifurcation by r. 37A itself of the lump sum contemplated to be paid under it has no meaning except in the context of such an intention. We have, however, come to the conclusion, after some thought, that this should not stand in the way of the acceptance of the

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contention urged on behalf of the appellant. In the first place, the rule-making authority may well have thought that, since the normal practice was to commute only one-third of the pension, it would be easier to describe the lump sum payable by reference to this amount instead of using more involved language which may give rise to difficulties. Secondly, the memoranda only express the Government''s interpretation of the impact of r. 37A on the issue of Income Tax exemption and cannot be considered conclusive. Thirdly, the Government itself was speaking in two voices about the scope of the exemption, for, initially at least, the CBDT thought that the decision of the Income Tax Appellate Tribunal in Murlidharan''s case was correct and deserved to be accepted. The letter dated December 13, 1977, issued to the appellant did not refer to rr. 37 and 37A but only talked of a lump sum in commutation of pension. Fourthly, if one peruses cls. (10), (10A) and (11) of s. 10 of the I.T. Act, 1961, one finds that these unequivocally bespeak the intention of the Legislature to exempt all terminal benefits received by a Government servant-whether called death-cum-retirement gratuity or pension or any other name-and, in this context, it would not be correct to interpret the relevant clause as breaking away from this pattern in the absence of compulsive language. Lastly, there can be no doubt that rr. 37 and 37A were intended to grant a benefit to this category of employees. Even without this alternative, some of the employees could have got even one-half or 43% of the pension due to them, commuted free of Income Tax. It could not have been intended to narrow down even this benefit in the case of such employees who retire in these circumstances. In the case of those who could have commuted only one-third, the permission to commute the balance subject to payment of Income Tax would confer very little benefit if a substantial part of the amount has to be paid away as tax. Mr. Verma suggested that the very fact that they can get a lump sum which they could not have got otherwise is itself a benefit and, anyhow, they had an option which they must be considered to have exercised to their best advantage. There is some truth in this, but, we think, the whole scheme has to be taken in its broad setting and in the context of the fact that these employees are "deemed" to have retired after a few years of service when some of them might not have become entitled to their full pension. If the Government, having all considerations in mind, decided to permit them to commute their entire pension, there is no reason in principle why this commutation should be treated on a different footing from other cases of commutation of Government pension.

17. Mr. Vaish also drew our attention to two decisions of the Karnataka High Court in the cases of C.P. Ohrie Vs. Accountant-General and Others, and B.V.S. Rao Vs. Commissioner of Income Tax, Karnataka-II and Another, , where a learned single judge of that court has taken the view that the entire amount paid under r. 37A would be exempt. One of these cases related to a defense employee to whom the payment was made in one lump sum and not bifurcated as under r. 37A and who, in the normal course, would have commuted 43% of his pension. Even in such a case, the Commissioner appears to have considered only one-

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third to be exempt. We agree with the view taken by the Karnataka High Court.

18. Mr. Vaish also raised contentions based on the doctrine of equitable estoppel and the binding nature of the circulars issued by the CBDT. These contentions cannot be permitted to be raised for the first time in the appeal. We also think that the factual background for basing these contentions has not been clearly made out. However, in view of the conclusion we have arrived at above, it is unnecessary to discuss these contentions further.

19. In the result, we allow the appeal and the writ petition. We direct the third respondent to pay the entire amount due to the appellant under r. 37A(1) without deduction of any Income Tax at source.

20. In the circumstances, however, we direct the parties to bear their own costs in this appeal.

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