

(1991) 01 KAR CK 0004
In the Karnataka High Court
Case No : Tax Referred Case No. 34 of 1984

Commissioner of Gift Tax

APPELLANT

Vs

K.N. Shantha Kumar

RESPONDENT

Date of Decision : 18-01-1991

Acts Referred:

Gift Tax Act, 1958 — Section 16

Income Tax Act, 1961 — Section 28, 36 (1), 37, 40 A (7), 52

Citation : (1991) 190 ITR 667 : (1991) 1 KarLJ 409

Hon'ble Judges : K.B. Navadgi, J;K. Shivashankar Bhat, J

Bench : Division Bench

Advocate : Chander Kumar, for the Appellant; G. Sarangan, for the Respondent

Judgement

K. Shivashankar Bhat, J.—The following question of law has been referred under the provisions of the Gift-tax Act, 1958 :

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in holding that the Gift-tax Officer is not justified in treating the sum of Rs. 45,510 as liability for gratuity which has to be deducted in arriving the break-up value of the shares of the company ?"

2. The relevant facts could be repeated from the statement of the case furnished to us :

The assessee sold two shares of Printers (Mysore) Private Ltd., to Shri K. N. Guruswamy for a sum of Rs. 66,000. For the purpose of Income Tax assessment, a gross capital gain of Rs. 16,000 was disclosed after deducting the cost of shares which amounted to Rs. 50,000, i.e., Rs. 25,000 per share. It was noticed in the course of the said proceedings that the break-up value of the share was Rs. 50,755 and, accordingly, the provision of section 52 of the Income Tax Act, 1961, were invoked whereby, as against the sale of value of Rs. 66,000, the break-up value of Rs. 1,01,510 was adopted for the purpose of computing the correct amount of capital gains. The Gift-tax Officer held in the gift-tax

assessment dated November 28, 1977, that the assessee sold the shares worth Rs. 1,01,510 for a lesser consideration of Rs. 66,000 and thus, to the extent of the difference, the provisions of the Gift-tax Act would be attracted. Accordingly. A notice u/s 16 was issued. In response to the said notice, a nil return was filed to the effect that no liability to gift-tax existed. It was contended before the Gift-tax Officer that the shares had been transferred to Shri K. N. Guruswamy at the correct price of Rs. 66,000 for two shares by taking into account the gratuity which would be ultimately payable by the company to the employees and that, only because of the exclusion of this provision for gratuity, the Department was able to fix or compute the value of the said shares to be Rs. 50,755.

3. The Gift-tax Officer held that there was a deemed gift of the shares of the extent of Rs. 45,510 since the assessee had received only Rs. 66,000 for the two shares which have to be valued Rs. 1,01,510. The assessee's contention that, while computing the value of the shares, the amount of Rs. 8,95,851, reflected as gratuity liability in the balance-sheet of the company should be taken as a liability which could affect the market value of the shares, was not accepted. This liability towards gratuity was valued on actuarial valuation basis. The Appellate Assistant Commissioner affirmed the order of the assessing authority. On further appeal, the Appellate Tribunal held that the liability towards gratuity valued on actuarial valuation basis should be considered as a liability which would effect share valuation and, consequently, the assessee's appeal was allowed. Hence, this reference at the instance of the Revenue.

4. Mr. Chandra Kumar, learned counsel for the Revenue, cited the decision of the Supreme Court in *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, . The Supreme Court held that gratuity was not a debt and, therefore, while valuing the assets of the company under the provisions of the wealth-tax Act, the same cannot be deducted. Having regard to the nature of the gratuity that it cannot be held to be a present liability at all was the reasoning applied by the Supreme Court. It was only a contingent liability and the liability arose only when the employment of the employee was determined by death, incapacity, etc.

5. In *Commissioner of Wealth-tax Vs. Ranganayaki Gopalan and Others*, , the Madras High Court referred to the aforesaid decision of the Supreme Court, but allowed the deduction because there was a scheme for gratuity and the assessee-company agreed to transfer to the proposed trust a particular sum being the liability towards gratuity which arose to its employees, up to a particular date, on the basis of an actuarial valuation.

6. Mr. Chandra Kumar, however, distinguished the decision by pointing out that the liability was incurred by the assessee in the said case by agreeing to transfer the same to a trust.

7. Learned counsel for the assessee, Sri Sarangan, referred to rule 1D of the Wealth-tax Rules and contended that the principle applicable to wealth-tax

valuation could be usefully applied to the cases arising under the Gift-tax Act also.

8. In *Controller of Estate Duty, Mysore Vs. J. Krishna Murthy*, a Bench of this court also held that, in the absence of specific rules for valuation under the Estate Duty Act, the Wealth-tax Rules can be looked into for the said purpose, the latter being an allied legislation. Rule 1D of the Wealth-tax Rules governing the valuation of unquoted equity shares of any company was applied in the said decision while valuing the shares for the purpose of the Estate Duty Act.

9. The decision of the Supreme Court in *Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another*, was cited. The Supreme Court had to consider whether the provision made in the profit and loss account for the estimated present value of the contingent liability properly ascertained and discounted on an actuarial basis has to be excluded from the income of the assessee u/s 28 or 37 of the Act. The various kinds of provisions and payments in respect of gratuity were considered and the Supreme Court rejected the claim of the assessee. The Supreme Court, after referring to *Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad*, pointed out that the gratuity is a "provision" made by the assessee. The Supreme Court held that the amount set apart by way of provision or by way of reserve or fund to meet the liability of gratuity as and when it becomes payable will not be a deductible allowance or expenditure. Thereafter, after referring to *Metal Box Company of India Ltd. Vs. Their Workmen*, it was pointed out that (156 ITR 599) :

"Contingent liabilities discounted and valued as necessary could be taken into account as trading expenses if these were sufficiently certain to be capable of being valued. An estimated liability under a gratuity scheme even if it amounted to a contingent liability, if properly ascertainable and its present value was fairly discounted was deductible from the gross profits while preparing the profit and loss account. In view of this decision and other decisions that followed it, it became permissible for an assessee if he so chose to provide in his profit and loss account for the estimated liability under a gratuity scheme by ascertaining its present value on accrued basis and claiming it as an ascertained liability to be deducted in the computation of the profits and gains of the previous year.

10. It would thus be apparent from the analysis aforesaid that the position till the provisions of section 40A(7) were inserted in the Act in 1974 was as follows :

"(1) Payments of gratuity actually made to the employee on his retirement or termination of his services were expenditure incurred for the purpose of business in the year in which the payments were made and allowed u/s 37 of the Act.

(2) Provision made for payment of gratuity which would become due and payable in the previous year was allowed as an expenditure of the previous year on accrued basis when mercantile system was followed by the assessee.

Provision made by setting aside an advance sum every year to meet the

contingent liability and gratuity as and when it accrued by way of provision for gratuity or by way of reserve or fund for gratuity was not allowed as an expenditure of the year in which such sum was set apart.

Contribution made to an approved gratuity fund in the previous year was allowed as deduction u/s 36(1)(v).

(5) Provision made in the profit and loss account for the estimated present value of the contingent liability properly ascertained and discounted on an accrued basis as falling on the assessee in the year of account could be deductible either u/s 28 or section 37 of the Act".

11. It is necessary to note that in the said case, the Appellate Tribunal had allowed deduction of the gratuity liability actuarially ascertained and this was accepted by the Revenue and the question before the Supreme Court was wider in scope, wherein the assessee claimed deduction in respect of the liability which was not actuarially determined and provided for. Therefore, it is clear that the gratuity liability actuarially valued is equated to the present liability. If so, the said liability will have to be necessarily considered as affecting the present market value of the shares.

12. In a decision of the Madras High Court in Commissioner of Wealth-tax and Others Vs. S. Ram and Others, , the Bench elaborately considered this question and held that the liability on actuarial basis cannot be ignored as a mere contingent liability. The value of the unquoted share will have to be ascertained under the break-up value method after deducting the provision for gratuity based on actuarial valuation from the value of the assets of the company.

13. We are in respectful agreement with the above decision which again is based on the decision of the Supreme Court in Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, referred to earlier. Any practical buyer of a share would not ignore the company's liability on an actuarial basis. This principle is now fairly well established.

14. For the reasons stated above, the answer to the question referred to us has to be in the affirmative and against the Revenue.

15. Reference answered accordingly.