
(1995) 04 AP CK 0038

In the Andhra Pradesh High Court

Case No : Referred Case No. 70 of 1986

Commissioner of Income Tax

APPELLANT

Vs

Bakelite Hylam Ltd.

RESPONDENT

Date of Decision : 25-04-1995

Acts Referred:

Income Tax Act, 1961 — Section 28, 30, 31, 32, 33

Citation : (1995) 127 CTR 46 : (1996) 217 ITR 469

Hon'ble Judges : S.S. Mohammed Quadri, J;B.S. Raikote, J

Bench : Division Bench

Advocate : Deokinandan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

B.S. Raikote, J.—The Income Tax Appellate Tribunal, Hyderabad Bench "B", has referred the questions mentioned hereunder to this court for opinion u/s 256(1) of the Income Tax Act, 1961, vide its order dated January 23, 1986, passed in R. A. Nos. 317 and 318/ (Hyd) of 1983 in appeals I. T. A. Nos. 605 and 620/ (Hyd) of 1982 for considering the following questions, i.e., question No. 2 in R. A. No. 317/ (Hyd) of 1983 and question Nos. 3, 4 and 5 in R. A. No. 318/ (Hyd) of 1983 :

Question No. 2 in R. A. No. 317/ (Hyd) of 1983 :

"(1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is justified in holding that the sum of Rs. 47,104 representing fee for technical services constitute revenue expenditure allowable u/s 37 of the Income Tax Act, 1961?"

Questions Nos. 3, 4 and 5 in R. A. No. 318/ (Hyd) of 1983 :

"II (3) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that the commission paid to the managing director, Dr. W. R. Carrea, should not be taken into consideration for purposes of computing the disallowance u/s 40(c) of the Income Tax Act, 1961?"

(III) (4) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that the assessee is entitled for deduction u/s 80V in respect of the interest disallowed u/s 40A(8) of the Income Tax Act?

(IV) (5) Whether, on the facts and in the circumstances of the case the Appellate Tribunal was justified in holding that the amount of Rs. 74,124 was deductible?"

2. This matter pertains to the assessment year 1978-79. The assessee is one, Bakelite Hylam Limited, Hyderabad. It is a registered company.

3. Learned counsel appearing on both sides do not dispute that the question No. 2(1) R. A. No. 317/ (Hyd) of 1983, has already been answered by a Full Bench of this court in Praga Tools Ltd. Vs. Commissioner of Income Tax, . Hence, following the same, we answer this question in the affirmative, that is to say, in favour of the assessee and against the Revenue.

4. Likewise, learned counsel appearing on both sides admitted that even question No. 4 in R. A. No. 318/ (Hyd) of 1983 also is covered by the decision in Jaipuria Samla Amalgamated Collieries Ltd. etc. Vs. The Commissioner of Income Tax, West Bengal, . Hence, following the same, we accordingly answer this question also in the affirmative, that is to say, in favour of the assessee and against the Revenue.

5. Learned counsel appearing on both sides placed their respective contentions with regard to questions Nos. 3 and 5 (II and IV) in R. A. No. 318/ (Hyd) of 1983.

6. We now take up question No. 3 (II). This question pertains to the claim of the assessee that the commission paid to Dr. W. R. Carrea, the managing director of the company, was an allowable deduction. In respect of this Dr. W. R. Carrea, the Income Tax Officer worked out disallowance u/s 40(c) of the Income Tax Act (hereinafter referred to as "the Act") as under :

Rs. P. "Salary 57,339.00 Rent, etc., after deducting 1/3rd for office was 7,995.00
Medical expenses 2,505.00 Commission 28,670.00 ----- Total 96,509.00
Less : Allowable 72,000.00 ----- Disallowance 24,509.00"

----- 7. In the appeal preferred by the assessee, the Appellate Commissioner agreed with the order of the Income Tax Officer disallowing the commission paid to Dr. Carrea. On a further appeal by the assessee before the Income Tax Appellate Tribunal, the Tribunal, having regard to the absence to the word "commission" in section 40(c) in contrast to section 40(b) of the Act, held that the commission paid to Dr. Carrea, the managing director, was an allowable deduction. It relied upon its own decision passed on an earlier occasion regarding the present assessee for the assessment years 1973-74 to 1976-77 and, ultimately, held that if the commission was excluded from the purview of operation of section 40(c) of the Act, there could be no disallowance of any part of the amount paid to Dr. Carrea.

8. Learned counsel appearing on both sides brought to our notice, the relevant provisions of the Income Tax Act and also certain judicial pronouncements in that behalf, to drive home the respective points. Section 40(b) and (c) of the Income Tax Act reads as under :

"40. Amounts not deductible. - Notwithstanding anything to the contrary in sections 30 - 39, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",-

(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm;

(c) in the case of any company. -

(i) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to a person who has a substantial interest in the company or to a relative of the director or of such person, as the case may be,

(ii) any expenditure or allowance in respect of any assets of the company used by any person referred to in sub-clause (i) either wholly or partly for his own purposes or benefit,

if in the opinion of the Income Tax Officer any such expenditure or allowance as is mentioned in sub-clauses (i) and (ii) is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, so, however, that the deduction in respect of the aggregate of such expenditure and allowance in respect of any one person referred to in sub-clause (i) shall, in no case, exceed -

(A) where such expenditure or allowance relates to a period exceeding eleven months comprised in the previous year, the amount of seventy-two thousand rupees;

(B) where such expenditure or allowance relates to a period not exceeding eleven months comprised in the previous year, an amount calculated at the rate of six thousand rupees for each month or part thereof comprised in that period."

9. Relying on section 40(b) and (c) of the Act, learned counsel appearing for the assessee contended that the intention of the Legislature has to be inferred from clauses (b) and (c) of section 40. He contended that so far as the firm is concerned, in section 40(b) of the Act, the Legislature has used the words "any payment of interest, salary, bonus, commission or remuneration" made by the firm to any partner of the firm, and so far as the company is concerned, under clause (c) of section 40, it has used the word only "remuneration" paid to the director by the company. The word "commission" was conspicuously absent from section 40(c) of the Act. Therefore, wherever a commission is paid to the director, section 40(c) of the Act does not apply and he, accordingly, supported

the judgment of the Income Tax Appellate Tribunal.

10. On the other hand, learned counsel appearing for the Revenue submitted that the word "remuneration" is wide enough so as to include any salary, commission, wages, wherever the same is paid towards the services rendered by the director. In the instant case, W. R. Carrea was paid this commission as remuneration for the services rendered by him. Therefore, the commission paid to Dr. Carrea was one covered by section 40(c) of the Act and it is accordingly disallowable. He invited our attention to a number of authorities to support his contention.

11. We have carefully considered the import of section 40(b) and (c) of the Act. Section 40(b) contemplates disallowance of the payments like salary, bonus, commission, or remuneration made to a partner of the firm and section 40(c) contemplates disallowances out of the expenses incurred by the company that if the expenditure has resulted directly or indirectly in the provision of any remuneration or benefit or amenity to a director. In order to understand the scope of section 40(b) and (c) of the Act, we have to notice the concept of the firm as a legal entity different from the company.

12. A person becomes a partner in the firm mainly for sharing the profits of the firm. Whenever the interest, salary, bonus, commission, etc., are paid to him, they are necessarily towards his share of the profit. So far as the company is concerned, either a director or an employee gets only a remuneration or a recompense for the services rendered by such employee or director to the company. In certain cases, such director or employee may be entitled to certain other benefit or amenities. From this analysis, it is clear that the Legislature has used the word "remuneration" in section 40(c) of the Act pertaining to the company. Such remuneration or a recompense paid to a director may be in different forms or under different names. The director may be paid remuneration in the form of salary or commission. Section 40(c) of the Act has three important limbs : (i) there must be an expenditure incurred by the company; (ii) such an expenditure must have resulted directly or indirectly in the provision of any remuneration or benefit or amenity to a director; and (iii) such an expenditure or allowance should be for the benefit of such director or relative or a person who has substantial interest in the company. If these conditions are fulfilled, then in whatever the form the recompense is given to the director, it is remuneration. The meaning of the word "remuneration" has been given in the Law Lexicon, compiled and edited by P. Ramanatha Aiyer (1987 edition), as under :

"Remuneration" is a wider term than "salary". "Remuneration", means, a quid pro quo. Whatever consideration a person gets for giving his services seems to me a "remuneration" for them. Consequently, if a person was in receipt of a payment or of a percentage, or any kind of payment which would not be an actual money payment, the amount he would receive annually in respect of this would be "remuneration" (per Blackburn J., R. v. Postmaster-General [1876] 1 QBD 658)."

13. In Commissioner of Income Tax, West Bengal Vs. Calcutta Stock Exchange Association Ltd., , the Supreme Court while interpreting the word "remuneration" has held as under (at page 228) :

"The word "remuneration", though it includes "wages", may mean payment, which, strictly speaking, may not be called "wages". It is a term of much wider import including "recompense", "reward", "payment", etc. It, therefore, appears to us that the learned Chief Justice was not entirely correct in equating "remuneration" with "wages". The sub-section further requires that the remuneration should be "definitely related" to the specific services. In other words, it would be shown that those services would not be available to the members or such of them as wish to avail themselves of those services, but for specific payments charged by the association as a fee for performing those services."

14. From the above decision, it is clear that the word "remuneration" is a wider concept and that includes all kinds of recompense to a person for the services rendered by him. In another case, i.e. Gestetner Duplicators P. Ltd. v. CIT [1979] 177 ITR 1, the Supreme Court was considering a case, in which under a contract of employment, the assessee has been paying to its salesmen in addition to the fixed monthly salary "a commission" at a fixed percentage of the turnover achieved by the salesmen, the rate of percentage varying according to the "class of article" sold and category to which each salesman belonged. In that context, the Supreme Court held as under (at page 12) :

"The definition of "salary" in rule 2(h) includes dearness allowance if the terms of employment so provide and excludes all other allowances and perquisites. It does not in terms exclude "commission" as such and, in our view rightly, for, though ordinarily according to the Shorter Oxford English Dictionary "commission" means "a pro rata remuneration for work done as agent", in business practice commission covers various kinds of payments made under different circumstances. In Raja Ram Kumar Bhargava Vs. Commissioner of Income Tax, U.P. and V.P. Lucknow, , the Allahabad High Court has pointed out how in certain circumstances commission payable to an employee may, in fact, represent the salary receivable by him for the services rendered to the employer. At page 694 of the report, the relevant observation run thus :

"The word "commission", in business practice, covers various kinds of payments made under different circumstances. There are cases where a servant is employed by a businessman and, as a condition of his employment, it is agreed prior to the services having been rendered that he would be paid for his services at a fixed rate of percentage of the turnover or profits. In such a case, it is clear that the commission payable to the employee will, in fact, represent the salary to be drawn by him for his services. The payment on the percentage basis will only determine the measure of the salary."

It is thus clear that if under the terms of the contract of employment

remuneration or recompense for the services rendered by the employee is determined at a fixed percentage of turnover achieved by him then such remuneration or recompense will partake of the character of salary, the percentage basis being the measure of the salary and, therefore, such remuneration or recompense must fall within the expression "salary" as defined in rule 2(h) of Part A of the Fourth Schedule to the Act."

15. From this ruling of the Supreme Court, it is clear that if a "commission" is paid to a director or to an employee, by the company towards the services rendered by such employee or a director, it would be a remuneration. In fact, in Commissioner of Income Tax Vs. Avon Cycles (P.) Ltd., , the High Court of Punjab and Haryana was considering the distinction between clauses (b) and (c) of section 40 as under :

"It may be observed that in section 40(b), the Legislature used the words "any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm". If the word "remuneration" also connotes the concept of commission, it was not necessary for the Legislature to have used the word "commission" in clause (b) of section 40. The Legislature advisedly did not use the word "commission" in clause (c) of section 40 of the Act. . . . It is a well-settled proposition of law that if there is any ambiguity in a particular provision of the Income Tax Act, the statement of the Finance Minister, which formed the basis for the introduction of the Bill can also be taken into account. Reference in this connection may be made to the decisions of their Lordships of the Supreme Court in The Sole Trustee, Lok Shikshana Trust Vs. The Commissioner of Income Tax, Mysore, and Indian Chamber of Commerce Vs. Commissioner of Income Tax , West Bengal II, Calcutta, . The Finance Minister in his speech gave reasons for the proposed amendment in clause (ix) of the Finance (No. 2) Bill, 1971, by which the provisions of section 40(c) of the Act were sought to be amended in the following words (see [1971] 80 ITR 93) :

"I am firmly of the view that the fiscal instrument must be deployed to discourage payment of high salaries and remunerations which go ill with the norms of egalitarian society. I, accordingly, propose to impose a ceiling on the remuneration of company employees which would be deductible in the computation of taxable profits. The ceiling is being set at Rs. 5,000 per month. Together with the existing ceiling of Rs. 1,000 per month in the case of perquisites, the allowable overall ceiling on remuneration and perquisites, for the purposes of taxation, will be at Rs. 6,000 per month. In addition, I am proposing to reduce the tax deductible limits of daily allowance to employees while on tour."

The note on this clause of the Finance (No. 2) Bill, 1971, is as follows [1971] 80 ITR 143 :

"Sub-clause (b) seeks to amend section 40(c) under which expenditure incurred by a company on the provision of any remuneration or benefit or amenity to directors, persons who have a substantial interest in the company and their

relatives and the expenditure or allowance in respect of any assets of the company which are used by such persons for their own purposes or benefit is not allowed as a deduction to the extent such expenditure or allowance is, in the opinion of the Income Tax Officer, excessive or unreasonable. Under the amendment, the deduction on account of such expenditure or allowance will be further subject to an overall ceiling limit of Rs. 72,000 in respect of any one director or person who has a substantial interest in the company or relative of a director or of such person."

The speech of the Finance Minister and the note would suggest that the provisions were amended to discourage the payment of high salaries and remunerations to the persons mentioned in the section."

16. In the above decision, the High Court of Punjab and Haryana was considering a "commission" paid by the company to another firm in discharge of contractual obligations, for the services rendered by the firm in its business activity to the company. Their Lordships held that if any commission is paid to a third party-firm under some contractual obligation, that would not be a commission paid to a director, incidentally, the partners in that firm might be the directors. From this decision, it is clear that as per the statement made by the then Finance Minister on the floor of the House, section 40(c) was specifically inserted, so as to discourage payments of high salaries and remuneration or benefit or amenity to directors or to persons, who have substantial interest in the company or relatives and also the expenditure or allowance in respect of any assets of the company, which are used by such persons for their own purposes or benefit, by making such remuneration or allowance not deductible to the extent such expenditure or allowance was in the opinion of the Income Tax Officer excessive or unreasonable. Under the said amendment, the deduction on account of such expenditure or allowance was made subject to an overall ceiling limit of Rs. 72,000 in respect of a director or a person, who has substantial interest in the company or a relative of a director or of such person. Therefore, the object of section 40(c) was that under the guise of some other name, a director or a person having substantial interest in the company or his relative should not derive benefit more than the ceiling imposed by the section at Rs. 72,000. Finally, having regard to the facts and circumstances of that case, the High Court of Punjab and Haryana held that a "commission" paid to a third party under contractual obligation of the company would not be a remuneration. This decision would be relevant for this case, since it was held in that case "remuneration" includes "commission" also. In fact, the principle laid down in that case has been approved by the Supreme Court in CIT v. Avon Cycles P. Ltd. - S. L. P. (Civil) No. 7477 of 1981 as noticed in [1983] 144 ITR 14 under the heading "From our reporter at the Supreme Court" under "Amounts not deductible": Amount paid by company to sole selling agent whose partners are its directors, which reads as under :

"26-9-1983 : Their Lordships, P. N. Bhagwati and V. Balakrishna Eradi JJ.,

dismissed a SLP by the department against the judgment dated May 12, 1980, of the Punjab and Haryana High Court in Income Tax Reference No. 56 of 1979, reported in Commissioner of Income Tax Vs. Avon Cycles (P.) Ltd., , whereby the High Court, on a reference, held that the commission paid by the assessee-company to its sole selling agent, a firm whose partners were also the directors of the assessee, was not paid to the directors of the assessee, but as commission to its sole selling agent and the partners who got a share in the profits of the firm got it as partners of the firm and not as directors of the assessee and that, therefore, section 40(c) of the Income Tax Act, 1961, would not apply to such payment : CIT v. Avon Cycles P. Ltd. (S. L. P. (Civil) No. 7477 of 1981)."

17. In the light of the above decisions, we hold that if a commission is paid to the managing director for the services rendered by him to the company, such commission is remuneration u/s 40(c) of the Act. The same has also been the view expressed by the High Court of Calcutta in Commissioner of Income Tax Vs. Vikram Shridhar Shriram, . Applying this principle, we hold in this case that the commission paid to Dr. W. R. Carrea, the managing director of the company, would constitute "remuneration" for the purpose of computing disallowance u/s 40(c) of the Act. Therefore, both the Income Tax Officer and the Appellate commissioner have rightly held that such commission was remuneration and the said managing director was entitled to such remuneration up to the ceiling limit of Rs. 72,000 prescribed under that section and as such, the Tribunal was wrong. Accordingly, we answer this question in the negative, that is to say, in favour of the Revenue and against the assessee.

18. The other question that is required to be considered by us is question No. 5 (IV). This question relates to the disallowance of Rs. 74,124 out of the provision for gratuity of Rs. 3,07,792, which was also paid during the year. The provision was worked out as under :

Managerial	Non-Managerial	Total	Rs	Rs.	Rs.	Provision for 1977	: 1,29,838
1,03,831	2,33,669	Provision for 1976	: 20,798	53,326	74,124	-----	-----
-----	1,50,636	1,57,156	3,07,792	-----	-----	-----	-----

19. The Income Tax Officer took the view that only the amount of Rs. 2,33,069 pertaining to the year alone could be allowed on the basis of the mercantile system of accounting and he disallowed an amount of Rs. 74,124 out of the total provision for gratuity of Rs. 3,07,792, on the ground that it related to the previous year. It was the assessee's case that the said shortfall in respect of 1976 was not anticipated and it was ascertained on the basis of the actuary's certificate only during the year. But this case of the assessee was not accepted by the Income Tax Officer and, therefore, he preferred an appeal before the Income Tax Appellate Commissioner, who confirmed an appeal before the Income Tax Officer. It is in these circumstances, the assessee preferred an appeal before the Income Tax Appellate Tribunal, which allowed the appeal, by holding that the gratuity fund was recognised by the Commissioner and the assessee was eligible on the basis of the provision made by it and also on the fact that the amount was

actually paid during the year. The Appellate Tribunal took the view that when the assessee has actually paid towards recognised gratuity fund, the same is allowable u/s 36(1)(v) of the Act and if such gratuity is towards liability of the previous year and a provision was made in the accounting year, the same also was allowable u/s 40A(7)(b)f(i) of the Act, on the basis of the mercantile system, which the assessee was following.

20. Learned counsel for the Revenue contended that the gratuity amount of Rs. 74,124 pertaining to the year 1976 was not allowable, since the same did not accrue in that year. The assessee could have provided for the same in the year 1976 itself. But, on the other hand, learned counsel appearing for the assessee contended that in the previous year, i.e., 1976, the shortfall in respect of such gratuity could not be anticipated and the same could be ascertained on the basis of the actuary's certificate only during the current year and the provision was made for gratuity of the year 1976 during the year and, therefore, it was allowable u/s 40A(7)(b)(i) of the Act. Moreover, he submitted that it is also available because the gratuity was actually paid during the year as per section 36(1)(v) of the Act.

21. In order to appreciate the rival contentions of learned counsel, it is necessary to note section 36(1)(v) of the Act, which reads as under :

"36. Other deductions. - (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28. ...

(v) any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust."

22. Section 40A(7) (a), (b) (i) reads as under :

"40A. Expenses or payments not deductible in certain circumstances. -....

(7) (a) Subject to the provisions of clause (b), no deduction shall be allowed in respect of any provision (whether called as such or by any other name) made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason.

(b) Nothing in clause (a) shall apply in relation to, -

(i) any provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year."

23. In the instant case, two things are admitted : (i) a provision was made in the present year towards the gratuity payable for the previous year and also for the current year; and (ii) the gratuity of the previous year was also paid along with the gratuity payable in the current year. In *Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another*, , the Supreme Court

noticed the intention of the Legislature while enacting section 40A(7) and section 36(1)(v) of the Act as under (at page 600) :

"The intention of the Legislature in enacting the provision of section 40A(7) would be apparent from the Notes on Clauses of the amendment wherein paragraph 46, after referring to the provisions of section 37(1) and section 36(1) (v) of the Act, it was observed Bhagwandas Narayandas Vs. Commissioner of Income Tax, Ahmedabad and Others, , inter alia, as follows :

"A reading of these two provisions clearly shows that the intention has always been that the deduction in respect of gratuities should be allowed either in the year in which the gratuity is actually paid or in the year in which contributions are made to an approved gratuity fund. A doubt has been expressed that the relevant provisions, as presently worded, do not secure the underlying objective and that a provision made by a taxpayer in his accounts in respect of estimated service gratuity payable to employees will be deductible in computing the taxable income in a case where the provision has been made on a scientific basis in the form of an actuarial valuation. In order to remove uncertainty in the matter, it is proposed to specifically provide in the law that no deduction will be allowed, in the computation of profits and gains of a business or profession, in respect of any reserve created or provision made for the payment of gratuity to the employees on retirement or on termination of employment for any reason. This restriction will, however, not apply in relation to a provision made for the purpose of payment of a sum by way of contribution towards an approved gratuity fund that has become payable during the relevant account year, or for the purpose of meeting actual liability in respect of payment of gratuity to the employees that has arisen during such year."

24. This intention and the purpose of the Legislature was carried into effect by inserting sub-section (7) in section 40A by ensuring the overriding effect over the other provisions of the Act. Therefore, in interpreting or in trying to find out the meaning of that provision, one should, if possible, and in this case it is not at all straining, give effect to that intention and not to make a nonsense of that intention. Clause (a) of the said sub-section provides that no deduction will be allowed in respect of any provision (whether called as such or by any other name) made by the assessee for the payment of gratuity to his employees on their retirement or termination of their services for any reason. The expression "provision" has not been defined in the Act and is not used in any artificial sense but in its ordinary meaning. This is clear from the words (whether called as such or by any other name) occurring in the sub-section. According to Webster, "provision", in its ordinary sense, means "something provided for future use".

25. On a plain construction of clause (a) of sub-section (7) of section 40A of the Act, what it means is that whatever is provided for future use by the assessee out of the gross profits of the year of account for payment of gratuity to employees on their retirement or on the termination of their services would not be allowed as deduction in the computation of profits and gains of the year of

account. The provision of clause (a) was made subject to clause (b). The embargo is on deductions of amounts provided for future use in the year of account for meeting the ultimate liability to payment of gratuity. Clause (b) (i) excludes from the operation of clause (a) contributions to an approved gratuity fund and amounts provided for or set apart for payment of gratuity which would be payable during the year of account. Clause (b) (ii) deals with a situation where the assessee might provide by the spreadover method and provides that such provision would be excluded from the operation of clause (a) provided the three conditions laid down by the sub-clauses are satisfied.

26. The submission of the assessee that if no provision is made by the assessee for gratuity, still the same will be deductible and section 40A(7) will have no application, would defeat the very purpose and object of section 40A(7) and render it nugatory."

27. From this law declared by the Supreme Court, it is clear that wherever a "provision" is made in the accounting year, towards the gratuity payable, the same is allowable u/s 40A(7) of the Act. The same principle was followed by this court in Commissioner of Income Tax Vs. D.B.R. Mills Ltd., , wherein it was held that when a provision is made in the accounting year for such liability, the same is allowable. This court further made a distinction between any sum paid u/s 36(1)(v) and any provision made u/s 40A(7)(b)(i) of the Act and ultimately held that the assessee cannot claim such payment as allowable, without making any provision in the accounting year. In a similar case in Commissioner of Income Tax Vs. G.T.N. Textiles Limited, , the High Court of Kerala held as under (as page 9) :

"Clause (a) of sub-section (7) contains, subject to clause (b), a general prohibition against any deduction being allowed on the basis of a mere provision in respect of gratuity. The exceptions to the prohibition are mentioned in clause (b). Sub-clause (i) of clause (b) contains two limbs. The effect of the first limb of that sub-clause is that the prohibition under clause (a) shall not apply to a provision made in terms of section 36(1)(v). The second limb of that sub-clause in effect provides that the provision made during the "previous year" shall be governed by the law as it stood prior to the amendment introduced by the Finance Act, 1975, with effect from April 1, 1973. This means that deduction on the basis of a provision made in the relevant previous year will be allowed, notwithstanding the amendment."

28. In TRIPLICANE PERMANENT FUND LTD. Vs. COMMISSIONER OF Income Tax AND ANOTHER., , the High Court of Madras summarised the legal position with reference to section 36(1)(v) and section 40A(7) of the Act as under (at page 504) :

"While considering the incremental liability arising in the matter of contribution made to the gratuity fund, this court, in the case of Commissioner of Income Tax, Tamil Nadu-II Vs. Madras Rubber Factory Limited: (No. 2), , restated the legal position on this point as under :

"As pointed out by this court in Commissioner of Income Tax, Tamil Nadu-V Vs. Sitalakshmi Mills Ltd., , it has now become well-established that where an employer has a gratuity scheme rendering him liable to pay gratuity to workmen and where having regard to the liability which might arise under the scheme, the employer obtains a scientific actuarial calculation under which the present discounted value of the gratuity liability is ascertained and where the employer charges his profit and loss account with the incremental value of the year and also makes a provision for that amount, the employer will be entitled to compute his net profits after deducting the figure of incremental liability. That the assessee will be entitled to deduct the incremental liability for payment of gratuity during the accounting year, if he had made a claim on the basis of actuarial valuation, is clear from the decision of the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, ."

29. A similar question also arose before this court in the case of Commissioner of Income Tax Vs. Andhra Prabha P. Ltd., , wherein it was held as under (headnote) :

"That section 36(1)(v) of the Act provided for deduction of any amount actually paid by way of contribution to an approved gratuity fund created by the employer while section 40A(7) introduced by the Finance Act, 1975, with effect from April 1, 1973, prohibited deduction of a provision for gratuity, the prohibition, however, not extending to, (a) provision for contribution to an approved gratuity fund, or (b) provision for payment of gratuity for which a liability has arisen during the year. These two provisions did not cover the case where a provision was made for a future payment on a "scientific" method of calculation. The present claim being of a provision made for a future payment calculated on scientific basis, the amount was not covered by any of the specific provisions of the statute and hence, was allowable in the computation of the profits u/s 28 itself."

30. This decision was confirmed by the Supreme Court in Commissioner of Income Tax, Madras Vs. Andhra Prabha P. Ltd., . The Supreme Court in Commissioner of Income Tax, Madras Vs. Andhra Prabha P. Ltd., , pointed out that the legal position on this point has been analysed by this court in its recent decision in Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, . Thus, the Supreme Court in Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, , after considering all the prior decisions, on this point, summarised the legal position as under (headnote page 587) :

"The position till the provisions of section 40A(7) were inserted in the Act in 1973 was as follows :

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

Even after the introduction of the provisions of section 40A(7) in the Act in 1973, there is no change in the legal position so far as the actual payment of gratuity is concerned. Hence, the actual payment made towards gratuity liability is allowable in the year in which it is paid."

31. In the light of the judicial pronouncements referred to above, we are of the opinion that whenever an assessee, by making a provision for the gratuity payable for the previous year, has paid the same by making a provision in the accounting year, the same is allowable u/s 36(1)(v) read with section 40A(7)(b) (i) of the Income Tax Act. By applying this principle to this case, we hold that the gratuity amount of Rs. 74,124 for which a provision was made and actually the same was paid in the accounting year, is accordingly allowable, and the Income Tax Appellate Tribunal is correct in allowing the same by setting aside the orders of the Income Tax Officer and the Appellate Commissioner. Accordingly, we answer this question in the affirmative, that is to say, in favour of the assessee and against the Revenue.

32. In the result, this reference case is accordingly answered; we make no order as to costs.