
(1990) 07 MAD CK 0070

In the Madras High Court

Case No : Tax Case No. 24 of 1980 (Reference No. 24 of 1980)

Commissioner of Income Tax

APPELLANT

Vs

Central Art Press

RESPONDENT

Date of Decision : 06-07-1990

Acts Referred:

Income Tax Act, 1961 — Section 37(1)

Citation : (1991) 189 ITR 618

Hon'ble Judges : Somasundaram, J; Ratnam, J

Bench : Division Bench

Advocate : N.V. Balasubramaniam, for the Appellant; T.V. Balakrishnan and R. Meenakshisundaram for C.V. Mahalingam and K.J. Rebello, for the Respondent

Judgement

Ratnam, J.—In this tax case reference u/s 256(2) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), at the instance of the Revenue, the following questions of law have been referred to this court for its opinion :

"1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee is entitled to the deduction of a sum of Rs. 70,000 representing retrenchment compensation and gratuity paid in the assessment year 1969-70 ?

2. Whether the Appellate Tribunal's finding that the payment was made in the course of carrying on of the business and not on the closure of the business based on valid materials and is sustainable in law ?"

2. The assessee is a registered firm engaged in the business of running a printing press. In the course of the assessment proceedings for the accounting period ending on March 31, 1969, relevant for the assessment year 1969-70, the claim of the assessee for deduction of a sum of Rs. 70,000 paid as retrenchment compensation and gratuity was allowed by the Income Tax Officer, but he, however, later, reopened the assessment and disallowed the claim of the assessee on the ground that the retrenchment compensation and gratuity

amounts were paid only in view of the closure of the business and, therefore, not entitled to deduction u/s 37(1) of the Act. On appeal by the assessee before the Appellate Assistant Commissioner, he took the view that the payments were made by the assessee owing to the closure of its business and hence cannot be subjected to tax treatment as expenses incurred by the assessee wholly and exclusively for the purposes of the business and upheld the disallowance. On further appeal by the assessee before the Tribunal, on the view that the liability had arisen before the actual closure of the business and also for the purposes of the business, it upheld the claim of the assessee and that has given rise to the questions of law referred to earlier.

3. u/s 37(1) of the Act, any expenditure (not being expenditure of the nature described in Sections 30 to 36 and Section 80VV and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". The question now is, whether the assessee laid out or expended a sum of Rs. 70,000 wholly and exclusively for the purpose of the business. Annexure "D" to the stated case sets out the terms of the deed of dissolution executed on March 15, 1969, between the partners of the assessee-firm. Paragraph 5 therein sets out the reasons for the closure of the business and also the date of such closure in the following terms :

"Whereas, owing to a stay-in strike resorted to by the workers in the business which was not given up in spite of the advice of the officials of the Labour Department and whereas the workmen also resorted to demonstration and shouting of filthy slogans, the business had to be closed down on March 3, 1969, due to circumstances beyond the control of the parties hereto."

4. From the aforesaid provision in the deed of dissolution, even according to the assessee, the business had to be closed down on March 3, 1969, owing to reasons beyond its control. Annexure "E" to the stated case is the specimen notice sent to the individual workers of the assessee-firm on March 3, 1969, and that states that pursuant to the decision of the partners of the assessee-firm to close down the business, the services of the workmen are terminated with immediate effect and that amounts as shown thereunder will be paid. Though the business of the assessee, as per the terms of the deed of dissolution, was closed on March 3, 1969, it appears that the books were closed only on March 15, 1969, and during the period between March 4, 1969 and March 15, 1969, the assessee had incurred some expenditure. Relying on this, the Tribunal concluded that the closing down of the business of the assessee had not taken place on March 3, 1969, when the payments deduction of which is claimed by the assessee were made by the assessee, but that the actual and final closure had taken place only on March 15, 1969, and the liability of the assessee to pay retrenchment compensation and gratuity had arisen during the previous year prior to the closure of the accounting year and should be regarded as payments clearly

revenue in nature and admissible u/s 37(1) of the Act. The view so taken by the Tribunal runs counter to the terms of the deed of dissolution referred to earlier. While, even according to the assessee, according to the terms of the deed of dissolution, the business was closed on March 3, 1969, it is really difficult to understand the view taken by the Tribunal that the closure had not taken place on March 3, 1969, when the payments in question were made, but that the business was carried on till March 15, 1969, when the accounts were closed and the closure of the business was effected. In the course of its order, the Tribunal, while accepting the provision in the deed of dissolution to the effect that the business had been closed down on March 3, 1969, proceeded to state that it had to be viewed in the background of the factors prevalent at the relevant point of time and that showed that the assessee had no other option except to discharge the workers. We fail to see how, in the face of the clear and unambiguous terms in the deed of dissolution, it was open to the Tribunal to hold that the clause in the deed of dissolution did not operate in the background of the prevalent factors at that point of time. What those prevalent factors were which would have a material effect on the term regarding the closure of the business in the deed of dissolution has not been referred to by the Tribunal. The Tribunal also failed to notice that it was the decision taken by the assessee to close down its business with effect from March 3, 1969, that gave rise to the liability for payment of retrenchment compensation and gratuity to the workmen sought to be retrenched and not the carrying on the business activity of the, assessee. The payment of retrenchment compensation and gratuity is referable and attributable to the closure of the business of the assessee with effect from March 3, 1969. The nexus between the closure of the business of the assessee on March 3, 1969, and the payment of retrenchment compensation and gratuity on that date as per the books of account cannot be lost sight of. It may be that, for the purpose of putting into effect the earlier decision to close down the business on March 3, 1969, and to carry on the winding up operations and settling the accounts, some time had been taken till March 15, 1969, but that cannot enable the assessee to claim that the business had been carried on between March 4, 1969, and March 15, 1969, so as to claim the expenditure on the payment of retrenchment compensation and gratuity as a revenue expenditure. Even in the course of its order, the Tribunal, in paragraph 5, had accepted that the assessee had a claim against it for payment of retrenchment compensation and gratuity and those amounts were paid to the workers and as the closure of the business had taken place only on March 15, 1969, and as it was open to the assessee to have continued the business even thereafter, the expenditure incurred by the assessee would be in the nature of a revenue expenditure admissible u/s 37(1) of the Act. We are unable to agree with this line of reasoning of the Tribunal, for, even according to the Tribunal, between March 4, 1969 and March 15, 1969, collections were made and pending orders were executed, though the printing business was not carried on by the assessee by itself, but through others. After the decision taken by the assessee to close down its business with effect from March 3, 1969, the circumstance that some expenditure was incurred in the

fulfilment and completion of the prior commitments entered into by the assessee, prior to the taking of the decision, cannot be construed as continuation of the business till March 15, 1969. Even according to the letter of the assessee found in annexure "A" to the stated case, the business of the assessee after March 3, 1969, was the issue of bills and the incurring of expenses other than wages and that clearly indicates that the assessee did not pursue its normal business activities, as before, prior to March 3, 1969, but had merely executed the pending orders through others, as could be gathered from paragraph 5 of the order of the Tribunal. Such activities as were carried on by the assessee between March 4, 1969 and March 15, 1969, could at best be characterised as those intended to facilitate the closing down of the business and not the carrying on of it. Thus, on a due consideration of the decision taken by the assessee to close down its business on March 3, 1969, the issue of notices to the workmen and the execution of the pending orders through others and the issue of bills for collection, it is clearly established that the assessee decided to close down its business on March 3, 1969, when the liability to pay retrenchment compensation and gratuity arose, and the closing of the accounts on March 15, 1969, with some billing transactions between March 4, 1969 and March 15, 1969, would not make any difference and also would not enable the assessee to claim that the payment of retrenchment compensation and gratuity was during the course of the carrying on of the business and would thus be an item of revenue expenditure.

5. Learned counsel on both sides invited our attention to some decisions. But we are of the view that there is no need to make a detailed reference to all of them, except the one in Venkatesa Colour Works Vs. Commissioner of Income Tax, which, in our view, clinches the issue. In that case, the assessee decided to close its factory with effect from April 10, 1967 and an agreement was also entered into between the management and the workmen on April 7, 1967, under which compensation was payable to the workmen. However, the closure of the factory took place only on July 15, 1967, and not on April 10, 1967 and, in accordance with the agreement, the assessee made payments to the workers and claimed to deduct the payments u/s 37(1) of the Act. In considering the propriety of the claim of the assessee, which was rejected by all the departmental authorities and the Tribunal (at page 311), this court pointed out that the closure of the business and the accrual or arising of the liability to pay the compensation are concurrent and one cannot be separated from the other and the compensation payable u/s 25FFF of the Industrial Disputes Act would be an expenditure incurred by the assessee not for the purpose of carrying on of the business, but for closing it down and, therefore, such expenditure cannot be held to be one falling u/s 37(1) of the Act. While holding so, reference was made to the decision of the Supreme Court in Commissioner of Income Tax, Kerala Vs. Gemini Cashew Sales Corporation, Quilon, though that case related to compensation payable on transfer of an undertaking and it was pointed out that if the word "closure" is substituted for the word "transfer", then the decision in Commissioner of Income

Tax, Kerala Vs. Gemini Cashew Sales Corporation, Quilon, , would govern cases falling u/s 25FFF of the Industrial Disputes Act also and a fortiori Section 37(1) of the Act would not be applicable to the case of closure of the business. We hold that the decision in Venkatesa Colour Works Vs. Commissioner of Income Tax, would govern this case also. We, therefore, answer the first question referred to us in the negative and against the assessee.

6. Regarding the second question, we find that the conclusion of the Tribunal cannot be sustained. Merely on the basis that the accounts were closed only on March 15, 1969, despite an earlier decision to close down the business on and from March 3, 1969, it cannot be assumed that the assessee was carrying on its usual business activities during that interval. We had earlier pointed out that, even as per the letter of the assessee appended as annexure "A" to the stated case, the transactions after March 3, 1969, consisted of issue of a large number of bills and the incurring of expenditure other than wages. It is also further seen that, even according to the assessee, in respect of the printing work done in respect of confidential matters, they could not be billed also and from this it is clear that the assessee cannot be said to have carried on the business after March 3, 1969. We had also earlier drawn attention to the nature of the transactions carried on by the assessee after March 3, 1969, and found that those transactions were not the normal transactions of the assessee in the course of running its business, but were intended only to facilitate the closing down. The Tribunal has also accepted that the assessee had held out that it had decided to close down the business from March 3, 1969, though the actual date of closure was March 15, 1969, and till then collections were made and pending orders were executed through others, though the assessee did not carry on its usual business. Under those circumstances, the conclusion of the Tribunal that the payments were made by the assessee in the course of the carrying on of the business by the assessee and not on its closure cannot be said to be based on any material. We, therefore, answer the second question also in the negative and against the assessee. The Revenue will be entitled to the costs of this reference. Counsel's fee Rs. 500.