

**(1992) 09 GUJ CK 0028**  
**In the Gujarat High Court**

**Case No :** Income-tax Reference No. 80 of 1979

Commissioner of Income Tax

APPELLANT

Vs

Gaekwar Mills Ltd.

RESPONDENT

**Date of Decision :** 15-09-1992

**Acts Referred:**

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

**Citation :** (1993) 202 ITR 272

**Hon'ble Judges :** S.D. Dave, J;G.T. Nanavati, J

**Bench :** Division Bench

**Advocate :** M.J. Thakore, for the Appellant;

**Judgement**

G.T. Nanavati, J.—The Income Tax Appellate Tribunal has referred the following question to this court u/s 256(1) of the Income Tax Act, 1961 :

"1. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the assessee, which was following the mercantile system of accounting was entitled to a deduction either under the provisions of section 28 or section 37 of the Income Tax Act, 1961, of its actuarially valued gratuity liability of Rs. 20,22,000 under the Payment of Gratuity Act, 1972, for which no provision had been made ?"

2. Briefly stated, the facts are that the assessee is a textile mill and it claimed before the Income Tax Officer, deduction in respect of gratuity as per actuarial valuation, amounting to Rs. 20,22,000 during the assessment year 1973-74. The Income Tax Officer disallowed the claim. The appeal filed by the assessee before the Appellate Assistant Commissioner was rejected. The assessee, therefore, preferred an appeal to the Tribunal. The Tribunal found that the assessee had followed the mercantile system of accounting and that it had quantified its liability towards gratuity on the basis of actuarial valuation. Admittedly, no provision was made in the accounts in respect of payment of gratuity. For this reason and also because the liability to pay gratuity arose as a result of the

Payment of Gratuity Act, 1972, the Tribunal held that section 40A(7) did not apply and that the assessee was entitled to claim deduction on ordinary commercial principles. Taking this view, the Tribunal allowed the appeal. The Revenue feeling aggrieved by the said decision, applied to the Tribunal to refer the abovesaid question to this court. As the question of law did arise out of its order, the Tribunal has referred the same to this court for its opinion. The question whether the assessee would be entitled to deduction of the gratuity liability under other provisions of the Act is now finally settled by the decision of the Supreme Court in *Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another*, wherein it is held that, for gratuity to be deductible, the conditions laid down in section 40A(7) had to be fulfilled. The deduction could not be allowed on general principles under any other section of the Act, because sub-section (1) of section 40A made it clear that the provisions of the section had effect notwithstanding anything to the contrary contained in any other provision of the Act relating to the computation of income under the head "Profits and gains of business or profession". In other words, section 40A had effect notwithstanding anything contained in sections 30 to 39 of the Act. The Supreme Court has further held that the right to receive gratuity is a contingent right and the liability to pay gratuity continues to be a contingent liability qua the employer. It is further held that contingent liabilities do not constitute expenditure and cannot be the subject-matter of deduction even under the mercantile system of accounting. In view of this clear decision of the Supreme Court, the question which has been referred to us will have to be answered in the negative, i.e., in favour of the Revenue and against the assessee. No order as to costs.