

(2004) 12 P&H CK 0009
In the Punjab And Haryana At Chandigarh
Case No : IT Ref. No. 87 of 1988

Commissioner of Income Tax

APPELLANT

Vs

Jamuna Auto Industries

RESPONDENT

Date of Decision : 13-12-2004

Acts Referred:

Income Tax Act, 1961 — Section 256(1), 28, 36(1), 37, 40A
Income Tax Rules, 1962 — Rule 101, 4, 67

Citation : (2005) 195 CTR 185 : (2005) 275 ITR 570

Hon'ble Judges : Tapan Sen, J;G.S. Singhvi, J

Bench : Division Bench

Advocate : Rajesh Bindal, for the Appellant; P.C. Jain, for the Respondent

Judgement

G.S. Singhvi, J.—Whether the assessee could claim deduction in lieu of provision made for gratuity despite the fact that gratuity fund had not been approved by the Commissioner of Income Tax (for short, "the CIT") is the question which arise for determination in this reference made by the Income Tax Appellate Tribunal, Chandigarh Bench, Chandigarh (for short, "the Tribunal") u/s 256(1) of the IT Act, 1961 (for short, "the Act").

2. The assessee is carrying on the business of manufacturing auto spring leaves, etc. For the asst. yr. 1978-79, it filed return on 29th Nov., 1978 declaring total income of Rs. 4,17,784. Inspecting Asstt. Commissioner, Karnal (for short, "the AO") finalised the assessment vide his order dt. 12th March, 1987. He added a sum of Rs. 33,542 to the income of the assessee which the latter set apart as gratuity payable to the employees. CIT(A), Chandigarh, upheld the addition made by the AO on the ground that gratuity fund had not been approved by the CIT. However, the Tribunal accepted the assessee's appeal and allowed deduction to the tune of Rs. 33,542 in lieu of gratuity fund. It referred to order dt. 28th Dec., 1981, passed in ITA No. 869/Chandi/79 in the case of Kay Iron Works (P) Ltd. and held that non-approval of the gratuity fund by the CIT could not be made basis for disallowance u/s 40A(7) of the Act.

3. On an application filed by the CIT u/s 256(1) of the Act, the Tribunal referred the question of law for the opinion of this Court in the following terms :

"Whether, on the facts and in the circumstances of the case, the Tribunal has been right in law in holding that the assessee had complied with the provisions of Section 40A(7) of the IT Act, 1961, and hence its claim cannot be rejected, though the gratuity fund had not been approved by the CIT for the asst. yr. 1978-79."

4. Shri P.C. Jain argued that the Tribunal did not commit any error by granting deduction of Rs. 33,542 in lieu of the provision made for gratuity fund because it fulfilled all the conditions enumerated in Section 40A(7) of the Act. He pointed out that the assessee had made application on 31st Dec., 1975 under Rule 4 of Part "C" of the Fourth Schedule of the Act for approval of the gratuity fund and argued that it could not have been deprived of the benefit of deduction merely because the CIT delayed the grant of approval. Shri Jain emphasised that even though, the approval granted by the CIT vide order dt. 2nd Dec., 1980 was effective from 26th March, 1979, the Tribunal did not commit any error by allowing deduction because the assessee had fulfilled all the conditions enumerated in Section 40A(7) of the Act. In support of his argument, Shri Jain relied on the judgment of Calcutta High Court in Commissioner of Income Tax Vs. Shalimar Wire and Industries Ltd., and of the Supreme Court in Berger Paints India Ltd. Vs. Commissioner of Income Tax, Calcutta, .

5. Shri Rajesh Bindal, learned counsel for the Revenue, argued that the assessee was not entitled to deduction in lieu of the amount allegedly set apart for gratuity because its application for approval of employees' gratuity fund had not been sanctioned by the CIT. He referred to order dt. 2nd Dec., 1980 passed by the CIT to show that the original application submitted by the assessee on 31st Dec., 1975 under Rule 4 of Part "C" of the Fourth Schedule to the Act was defective in many respects. He then pointed out that after removing the shortcomings, the amended trust deed was filed on 15th March, 1979 and argued that approval granted by the CIT w.e.f. 26th March, 1979, cannot relate back to the date of application so as to entitle the assessee to claim deduction for the asst. yr. 1978-79. Shri Bindal referred to the judgment of the Supreme Court in Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, and various High Courts including this Court in Bitoni Lamps Ltd. Vs. Commissioner of Income Tax, ; Kumson Motor Owners Union Ltd. Vs. Commissioner of Income Tax, ; Balasubramania Foundry Vs. Commissioner of Income Tax, ; Commissioner of Income Tax Vs. Official Liquidator of Ahmedabad Mfg. and Calico Ptg. Co. Ltd., ; Commissioner of Income Tax Vs. Coimbatore Premier Corporation (P.) Ltd., and Commissioner of Income Tax Vs. Coimbatore Premier Corporation Pvt. Ltd., and argued that deduction in lieu of the amount of gratuity could not have been claimed by the assessee for the asst. yr. 1978-79 because till then, the gratuity fund had not been approved by the CIT.

6. We have thoughtfully considered the respective arguments. In order to

appreciate the rival contentions in a correct perspective, it will be useful to notice Sections 40A(1) and 40A(7)(a) and (b) of the Act, which read as under :

"Section 40A(1) of the Act

40A(1). The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "Profits and gains of business or profession".

40A(7)(a) and (b) of the Act

(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;

(ii) any provision made by the assessee for the previous year relevant to any assessment year commencing on or after the 1st day of April, 1973 but before the 1st day of April, 1976 to the extent the amount of such provision does not exceed the admissible amount, if the following conditions are fulfilled, namely :

(1) the provision is made in accordance with an actuarial valuation of the ascertainable liability of the assessee for payment of gratuity to his employees on their retirement or on termination of their employment for any reason :

(2) the assessee creates an approved gratuity fund for the exclusive benefit of his employees under an irrevocable trust, the application for the approval of the fund having been made before the 1st day of January, 1976 : and

(3) a sum equal to at least fifty per cent of the admissible amount or where any amount has been utilised out of such provision for the purpose of payment of any gratuity before the creation of the approved gratuity fund, a sum equal to at least fifty per cent of the admissible amounts as reduced by the amount so utilised, is paid by the assessee by way of contribution to the approved gratuity fund before the 1st day of April, 1976, and the balance of the admissible amount or, as the case may be, the balance of the admissible amount as reduced by the amount so utilised is paid by the assessee by way of such contribution before the 1st day of April, 1977."

7. A reading of the provisions reproduced above shows that notwithstanding any other provision in the Act, the provision for future use by the assessee out of its gross profits of the year of account for payment of gratuity to its employees is not allowable as a deduction in the computation of profits and gains of the year

of account, unless the case is covered by one or other of the two sub-clauses of Clause (b) of Section 40A(7) of the Act. Sub-clause (i) of Clause (b) is attracted only if the assessee makes provision for payment of gratuity in an approved gratuity fund. To put it differently, provision for gratuity made only in an approved gratuity fund entitles the assessee to claim deduction in the computation of profits and gains of the year of account.

8. In *Shree Sajjan Mills Ltd. v. CIT* (supra), their Lordships of the Supreme Court interpreted Section 40A(7)(a) and (b) of the Act and held that unless the conditions specified in Clause (b) are fulfilled, the provision made by the assessee for future use for payment of gratuity to the employees cannot be allowed as a deduction in view of the embargo placed under Clause (a) on deduction of amounts provided for future use in the year of account for making the ultimate liability for payment of gratuity. After making reference to the non obstante clause in Section 40A, the Supreme Court observed that the legislative intent was obvious that even if certain payments or provision made by the assessee were otherwise deductible u/s 28 or 37, the same would not be deductible in view of Section 40A of the Act except in the circumstances indicated therein.

9. In *Bitoni Lamps Ltd. v. CIT* (supra), a Division Bench of this Court referred to the judgment of the Supreme Court in *Shree Sajjan Mills Ltd. v. CIT* (supra) and held as under :

"Section 40A(7)(a) of the Act provides that no deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to its employees on their retirement or on termination of their employment but this is subject to the provisions of Clause (b). Clause (b) falls for our determination and the relevant portion of the same deserves to be reproduced :

"(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."

The exceptions contained in the aforesaid provision are two : (1) when provision is made for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, and (2) when provision is made for the purpose of any gratuity that has become payable during the previous year. For meeting the liability in future, no deduction is permissible. In this case, during the relevant period, there was no approved gratuity fund and the question of contributing towards that fund did not arise nor was any liability created during the previous year so as to make a provision for payment of gratuity. Both the ingredients being absent in this case, deduction could not be allowed. The view we have taken finds support from a decision of the apex Court in *Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, .*"

10. In *Kumson Motor Owners Union Ltd. v. CIT (supra)*, a Division Bench of Allahabad High Court reiterated that in order to avail the benefit of deduction u/s 40A(7)(b) of the Act, it must be shown that the provision was made strictly in the manner laid down in that clause.

11. In *Balasubramania Foundry v. CIT (supra)*, a Division Bench of Madras High Court held that the assessee is not entitled to the deduction of the provision made towards the gratuity liability without complying with the provisions of Section 40A(7) of the Act. The Division Bench further held that deduction cannot be allowed on general principles under any other section.

12. In *CIT v. Official Liquidator, Ahmedabad Manufacturing & Calico Printing Co. Ltd. (supra)*, a Division Bench of Gujarat High Court held as under :

"The claim was rejected in view of the provisions of Section 40A(7) of the Act of 1961, which was enacted with retrospective effect from 1st April, 1975, requiring creation of an approved gratuity fund as a necessary condition before any provision for gratuity could be allowed u/s 36(1)(v) of the Act. The assessee's claim was founded either on Section 28 or 37 of the Act. An amount of Rs. 1,54,00,000 being accrued liability of gratuity payable to the employees was debited in the books of account of the assessee in the P&L a/c. Another sum of Rs. 66,85,759 was not at all debited to the P&L a/c or claimed as provision for accrued liability on account of gratuity. The issue is now no more *res integra* in view of the decision in the case of *Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another*, which lays down that any allowance on account of any provision made for gratuity which has accrued during the course of the year can only be considered on satisfying the conditions of Section 40A(7) and not otherwise."

13. In *CIT v. Coimbatore Premier Corporation (P) Ltd. (supra)*, a Division Bench of Madras High Court laid stress on the existence of "approved gratuity fund" and observed :

"In order to claim deduction for payment of gratuity, the conditions laid down in Section 40A(7) of the IT Act, 1961, have to be fulfilled. The deduction cannot be allowed on general principles under any other section of the Act, because Sub-section (1) of Section 40A of the Act makes it clear that the provisions of the section have effect notwithstanding anything to the contrary contained in any other provisions of the Act, relating to the computation of income under the head "Profits and gains of business or profession". The statutory provisions refer to an "approved gratuity fund". The approval referred to is the approval of the CIT which is required to be obtained in terms of the rules contained in Part C of Schedule IV of the Act, which deals with "approved gratuity fund". It is not sufficient to have made a provision or to have made a payment by way of premium to a scheme of gratuity, even if it is under an irrevocable deed of trust. What is required further is the approval of the Chief CIT or the CIT. In the absence of any such approval, the fund cannot be treated as an approved

gratuity fund."

14. The facts of the case in hand show that even though, the assessee had applied for approval of gratuity fund on 31st Dec., 1975, its application was not entertained by the CIT because of the discrepancies and shortcomings in the trust deed. The amended trust deed was filed in the office of the CIT on 15th March, 1979. Thereafter, the CIT granted approval to the gratuity fund w.e.f. 26th March, 1979. All this is clearly borne out from paras 2 to 6 of order dt. 2nd Dec., 1980 passed by the CIT which read as under :

"2. The trust deed, rules and the accounts of the Fund were examined and certain discrepancies were pointed out to the applicant. Consequently, the trustees removed the shortcomings in the various clauses and definitions given in the trust deed and the Fund rules from time to time. The applicant-Fund thereafter drew up an amended trust deed (applied as deed of variation) on 10th Oct., 1978 and filed it in this office on 15th March, 1979.

3. In addition to the discrepancies referred to above, it was also noticed from the receipts and payment accounts and balance sheets of the Fund as on 31st March, 1976, 31st March, 1977 and 31st March, 1978 that a part of the investible one has remained deposited in the saving bank account in the Punjab & Sind Bank Ltd., in contravention of the provisions of Rule 101 r/w Rule 67 of the IT Rules, 1962. The Fund was, accordingly, given an opportunity of being heard on 26th Dec., 1979 when Sh. Mohinder Allag, accounts officer of the firm attended and stated that saving bank account was closed on 26th March, 1979 and the current account had been opened in the Punjab & Sind Bank Ltd., on that date. According to him, the provisions of Rule 101 r/w Rule 67 were hence complied with by the trust. After going through the amended trust deed, etc., it was pointed out to Shri Allag that the requisite conditions for grant of approval had been fulfilled only w.e.f. 26th March, 1979, since the amended deed had been executed on 10th Oct., 1978 and the end money had been invested in accordance with rules only w.e.f. 26th March, 1979. It was, hence made clear to Sh. Allag that approval cannot be granted to the Fund from a date prior to 26th March, 1979.

4. As requested by Sh. Allag, sufficient time was granted to him for submitting written arguments in support of his contention that the Fund should be approved w.e.f. 31st Dec., 1975, and not w.e.f. 26th March, 1979, as proposed. No written arguments in this regard were, however, received.

5. Another opportunity of being heard was granted to the Fund on 17th Nov., 1980 when Sh. Allag was present along with Sh. I.C. Goel, chartered accountant. Both of them agreed that for the time being, approval may be allowed to the Fund w.e.f. 26th March, 1979 only and the question of grant of recognition for the earlier period should be decided separately as expeditiously as possible.

6. In view of the foregoing, I hold that the necessary conditions for grant of approval of gratuity fund in this case were fulfilled only on 26th March, 1979, when the fund moneys were invested in accordance with the provisions of IT

Rules. I, therefore, accord approval to the Jamna Auto Inds., Employees Gratuity Trust Fund, Yamuna Nagar w.e.f. 26th March, 1979."

15. It is, thus, clear that the assessee fulfilled the conditions enumerated in Section 40A(7) of the Act only on 26th March, 1979. Therefore, it was not entitled to claim deduction of Rs. 33,542 on account of provision for gratuity in the year 1978-79. Learned counsel for the assessee could neither show that his client had challenged order dt. 2nd Dec., 1980 passed by the CIT nor that the same suffers from any jurisdictional defect or error of law apparent on the face of the record and is liable to be ignored.

16. In view of the above discussion, we have no hesitation to hold that the Tribunal committed a serious error by ordering deduction of Rs. 33,542 on account of provision for gratuity made by the assessee.

17. The two judgments, on which reliance has been placed by Shri Jain, are clearly distinguishable. The facts of the judgment of Calcutta High Court in CIT v. Shalimar Wire & Industries Ltd. (supra) show that approval to the gratuity fund, for which application was made on 30th Dec., 1975, was granted by the competent authority w.e.f. 27th March, 1976. The Division Bench of the High Court took the view that approval would relate back to the assessment year in question and accordingly declared that the assessee was entitled to deduction of Rs. 4,27,781, representing provision for payment of gratuity made in the previous year ending on 30th June, 1974. In Berger Paints India Ltd. v. CIT (supra), their Lordships of the Supreme Court held that deduction only on actual payment of duty is admissible u/s 43B of the Act, irrespective of the amount included in the valuing closing stock. None of these judgments have any bearing on the question referred by the Tribunal in the present case.

18. In the result, the question referred to this Court is answered in favour of the Revenue and against the assessee.