
(1983) 01 MAD CK 0036
In the Madras High Court
Case No : Tax Case No. 142 of 1979

Commissioner of Income Tax

APPELLANT

Vs

Mc. Dowell and Company Ltd.

RESPONDENT

Date of Decision : 17-01-1983

Acts Referred:

Income Tax Act, 1961 — Section 36(1), 37

Citation : (1984) 38 CTR 318 : (1985) 156 ITR 162

Hon'ble Judges : V. Ratnam, J;N.V. Balasubramanian, J

Bench : Division Bench

Advocate : J. Jayaraman and Nalini Chidambaram, for the Appellant; S.V. Subramaniam, Subbaraya Ayyar, Padmanabhan and Ramamani, for the Respondent

Judgement

Balasubrahmanyam, J.—This is a reference under the I.T. Act, 1961. The assessee owns a distillery at Sheratelly in Kerala State engaging a

number of workmen. Under the Kerala Industrial Employees' Payment of Gratuity Ordinance, 1969, which came into force on December 10,

1969, and which was replaced later by the Kerala Industrial Employees' Payment of Gratuity Act, 1970, gratuity had to be paid at the rate of 15

days' wages every year to every worker. The workmen in the assessee's distillery at Sheratelly were covered by the provisions of the Ordinance

and, hence, the assessee was under a statutory obligation to pay gratuity to its workmen at the time of termination of their services.

2. In the assessment year ended December 31, 1969, the assessee claimed to have made a provision towards gratuity amounting to Rs. 61,178

and charged it to profit and loss. In the relevant assessment year 1970-71, the assessee claimed this sum as an allowable deduction in the

computation of its profits from Sherately distillery. The ITO disallowed the claim by reference to a quite inappropriate provision in the Act,

namely, s. 36(1)(v), which related to the deduction of contributions by an assessee to an approved gratuity fund, which is quite a different thing

altogether. The officer mistook the real nature and purpose of a provision made by the assessee in its profit and loss account and balance-sheet on

the basis of its statutory liability for payment of gratuity.

3. On appeal from the assessment, the AAC realised the distinction between a claim for allowance of a yearly contribution made by an assessee to

the trustees of an approved gratuity fund, on the one hand, and a claim for deduction of a provision for gratuity allowable under the general

principles of commercial accounting, on the other. The AAC observed that having regard to the compulsions of the Kerala Statute on gratuity to

workmen, the assessee was justified in making a present provision for its overall gratuity liability to its workmen under the statute. The AAC further

observed that although the gratuity payable to each workman was in the nature of a contingent liability, the assessee was nevertheless entitled to

make a current provision therefore on the basis of the discounted value of its overall commitment to pay gratuity to its workmen and to claim the

provision as a deduction here and now in the computation of its profits. In this view, the AAC remanded the case to the ITO with a direction that

the ITO should "determine the present value of this contingent liability which had arisen during the accounting period under consideration on

actuarial principles and allow the same as deduction.

4. This decision of the AAC was objected to by the ITO in appeal before the Appellate Tribunal. The Tribunal observed that Rs. 61,178 was

calculated at the rate of 15 days' wages for every completed year of services of the employees. The Tribunal regarded this sum of Rs. 61,178 as a

provision". The Tribunal further observed that a provision for gratuity was chargeable against net profits and deductible as such in the computation

of taxable income under the head "Business". However, they did not disturb the order of the AAC remanding the matter to the ITO.

5. In this reference, at the instance of the Department, we are asked to examine the correctness of the orders of the AAC and the Tribunal on the

basis of the following question of law :

Whether, on the facts and the circumstances of the case, the Appellate Tribunal was right in holding that the AAC was justified in allowing the

provision for gratuity relating to the accounting period under consideration on actuarial valuation as an admissible deduction ?

6. We must observe, even to start with that it is not quite clear from the order of the Tribunal whether they had examined the matter in detail in

order to be able to say that Rs. 61,178 represents the present discounted value of the assessee's overall commitment to pay gratuity to its

workmen on the basis of an actuarial valuation. It would, however, appear to us that so-called provision made by the assessee in the books was

only the aggregate sum calculated at the rate of 15 days's wages for all its workmen in regard to the number of years of service they have put in up

to the end of the account year in question. We must say that the mere aggregation of 15 days wages for every year of service of all the workmen

put together cannot be regarded as a provision. A provision for gratuity, in the real sense of the term, must be a matter for actuarial valuation,

taking note of ever so many factors, and of finally arriving at the present discounted value of the ultimate liability for gratuity. It does not appear

either from the order of the Tribunal or from the order of the AAC, the crucial part of which we have earlier referred to, that even in the absence of

an actuarial report on the basis of which alone a provision for gratuity could be made, the ITO is under duty bound to arrive at an appropriate

figure and then deduct the same.

7. This is the purport of the AAC's order of remand to the ITO. We are, however, satisfied that a provision for gratuity, strictly so called, must be

made, not by the officer, but only by the assessee on the basis of an actuarial valuation. The Assessee alone can charge the provision for gratuity,

so arrived at, to his profit and loss account and then carry it to the balance-sheet as a provision under the head "Current liabilities and provisions".

If an assessee in a given case has not done so, but merely claims an ad hoc sum not based on any actuarial valuation and not actually debited by

him to the profit and loss account as a provision, he would not be entitled to the deduction claimed on any principle of commercial accounting. The

AAC was, therefore, in error in remanding the case to the ITO asking him to do the job which the assessee had failed to do himself. We,

therefore, hold that the order made by the AAC was wrong and is based on a wrong approach to the question of deduction of a provision for gratuity. The Tribunal was equally wrong in confirming the AAC's order of remand. We, therefore, answer the question of law in the negative and against the assessee. We would, however, observe that when our opinion in this reference goes to the Tribunal, they must once again examine whether the amount of Rs. 61,178 is a provision for gratuity properly so called, that is to say, a provision made by the assessee in its profit and loss account and carried to the balance-sheet, the provision being based on a scientific actuarial valuation representing the present discounted value of the overall liability for gratuity payable by the assessee under the provisions of the Kerala Statute on gratuity. If the Tribunal were satisfied that what the assessee claims is a real provision, then the Tribunal would be justified in allowing the same. If, on the contrary, the Tribunal finds that it is a mere ad hoc provision or a mere sum total of 15 days' wages for all the previous year's service of all workers, the Tribunal must reject the assessee's claim outright.

8. The reference is disposed of accordingly. There will be no order as to costs.