
(1983) 08 MAD CK 0015

In the Madras High Court

Case No : Tax Cases No's. 376 and 377 of 1978

Commissioner of Income Tax

APPELLANT

Vs

Sarada Binding Works

RESPONDENT

Date of Decision : 30-08-1983

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1985) 152 ITR 520

Hon'ble Judges : V. Ratnam, J;G. Ramanujam, J

Bench : Division Bench

Advocate : J. Jayaraman and Nalini Chidambaram, for the Appellant; M. Uttama Reddy, for the Respondent

Judgement

Ramanujam, J.—The assessee, in this case, is a registered firm. During the accounting period ending with March 31, 1972, the assessee did

business in the name of Sardar binding works as also in the name of Chandamama Publications. By an agreement entered into between the

assessee, represented by its managing partner, B. Viswanatha Reddy, and another partnership called Chandamama Publications, represented by

its managing partner, B. Nagi Reddy, the assessee gave up possession of all the assets and liabilities, as detailed in the schedule to the agreement,

in Chandamama Publications. On a settlement of the assets and liabilities as described in the schedule to the agreement, the excess of liabilities over

assets came to Rs. 67, 687 and the assessee paid the said sum to the transferee who succeeded to the business of Chandamama Publications. One

of the clauses in the agreement was that all the employees in that business would become employees of the transferee on terms no less favourable

to them with continuity of service. The liabilities as worked out in the schedule

included an amount of Rs. 80,309, which was a provision for gratuity due to the employees of the business taken over by the transferee. The assessee claimed as deduction provision for gratuity of Rs. 68,380 relating to Sarada Binding Works as also 80,309 relating to Chandamama Publications.

2. Both these amounts were disallowed by the ITO on the ground that they were not admissible as a deduction. The assessee appealed to the

AAC, contending that, in view of the decision in *Tata Iron and Steel Co. Ltd. Vs. D.V. Bapat*, Income Tax Officer, Companies Circle I(2),

Bombay and Another, , the provision for gratuity made on an actuarial basis would be an admissible deduction. The AAC found on the basis of the

certificates produced by the assessee and on the basis of the actuarial valuation, that the liability to gratuity as on March 31, 1971, was Rs. 63,923

and as on March 31, 1972, was Rs. 1,54,178, the difference being Rs. 90,255. The AAC, therefore, felt that the sum of Rs. 90,255 represented

the incremental gratuity liability relating to the year in question and that it should be allowed as a deduction.

3. The assessee filed an appeal before the Tribunal contending that the full claim of gratuity, as provided in the accounts, of Rs. 1,48,689 should be

allowed as a deduction or the entire gratuity payable on March 31, 1972, as determined actuarially of Rs. 1,54,178 should be allowed as a

deduction against Rs. 90,255, allowed by the AAC. The Revenue also filed an appeal against the decision of the AAC allowing the deduction

towards the incremental liability of Rs. 90, 225, contending that the incremental liability was only a contingent liability and that, therefore, nothing

should be allowed as a deduction. Thus, the Revenue sought for restoration of the amount of Rs. 90,255, allowed as a deduction by the AAC.

4. The Tribunal after considering the rival contentions came to the conclusion that to the extent of the incremental gratuity liability, a deduction had

to be allowed and this would be applicable to the gratuity payable to the employees of Sarada Binding Works subject to the verification of the

quantum. The Tribunal also held that so far as the gratuity liability amount paid by the assessee to Chandamama Publications towards the gratuity

liability in respect of employees transferred as per the agreement is concerned, which has to be paid to them as and when the actual liability arose,

it should be allowed as a deduction.

5. The Revenue feeling aggrieved by the Tribunal's decision has obtained a reference on the following two questions :

(1) Whether, on the facts and in circumstances of the case, the Tribunal was right in holding that the incremental gratuity liability payable to the

employees was an admissible deduction for the assessment year 1972-73 ?

(2) Whether the Tribunal was right, on the facts and in the circumstances of the case, in directing the deduction of gratuity liability of Rs. 80,309

(subject to verification of the figures) as stated in paragraph 7 of the Tribunal's order ?

6. So far as question No. 1 is concerned, it does not present any difficulty. It has been held by the Bombay High Court in *Tata Iron and Steel Co.*

Ltd. Vs. D.V. Bapat, Income Tax Officer, Companies Circle I(2), Bombay and Another, , that the provision for gratuity made on an actuarial

basis would be an admissible deduction. The same view has been taken by a Bench of this court in *Commissioner of Income Tax Vs. Andhra*

Prabha P. Ltd., . In that case, this court has taken the view that the liability to pay gratuity is not a contingent one and if the gratuity liability stood

calculated on a scientific and actuarial method each year, the gratuity liability accrued each year. The same view has also been taken by the

Supreme Court in *Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, .*

Having regard to the said decisions, the first question has to be answered in the affirmative and against the Revenue.

7. Then we come to the second question which relates to the allowability of the deduction claimed by the assessee in a sum of Rs. 80,309 which is

found to have been paid by the assessee to the purchaser as per the terms of the settlement for the purpose of enabling the purchaser to discharge

the assessee's gratuity liability for the period during which the employees who had been transferred to the services of the purchaser, were working

under the assessee. In this case, under the terms of the agreement, the buyer has taken over the employees of the assessee's business,

Chandamama Publications, with continuity of service and all accrued monetary benefits. So the purchaser, as part of the arrangement for sale of

the business, has taken over the gratuity liability so far accrued. The purchaser

has taken over that liability of the assessee on the assessee paying a sum of Rs. 80,309. As regards the actual amount of liability, whether it is Rs. 80,309 or not, an enquiry has been directed by the Tribunal. Thus, the question for consideration at this stage is whether the amount paid by the assessee to the bear, can be allowed as deduction.

8. It is contended by the assessee that the payment made to the purchaser for the purpose of discharging the assessee's liability to its former employees should be taken to be a payment towards his accrued gratuity liability and, therefore, it should be allowed as deduction. The Revenue, on the other hand, contends that the amount paid by the assessee to the purchaser as a consideration for the purchaser undertaking to discharge the gratuity liability to the employees, can never be said to be an actual discharge of the liability, that the payment cannot be said to be payment directly made to the employees and that, as a matter of fact, the assessee's liability to pay gratuity will only arise on a future date, when an employee's service stood terminated by death or otherwise.

9. It must be noted, in this connection, that the transferor of a business as in this case has normally got three options :

- (1) to allow the employees to continue in service in his other business, if any;
- (2) to discharge the employees on payment of retrenchment compensation, gratuity and notice-pay, etc., or;
- (3) to transfer their service along with the gratuity liability to the purchaser on his undertaking to discharge the entire gratuity liability as and when the occasion for its payment arises.

10. In this case, as per the terms of the agreement referred to above, the assessee as a transferor, has bargained with the transferee for transfer of the employees with continuity of service and with all pecuniary benefits. Since the transferee has undertaken to pay the pecuniary benefits such as gratuity payable by the assessee to the employees during the period when they were serving under it, the transferee has been paid the sum of Rs.

80,309 being the gratuity amount so far accrued. Under the terms of the agreement, the services of the employees are not terminated and the liability to pay gratuity had not actually arisen on transfer. But for the said agreement, the assessee would have been liable to pay gratuity to the employees on their transfer, as the transfer, as the transfer of their services

would amount to termination of their services under it. Though the said payment is not made directly to the employees as such, the amount is admittedly paid for discharging the assessee's liability to pay gratuity to its employees for the period ending with the date of transfer. We are of the view that such payment should be taken to be payment made to discharge the assessee's liability for gratuity and as such it has to be deducted.

11. The learned counsel for the Revenue, however, relies on a decision of the Bombay High Court in Commissioner of Income Tax, Bombay City-

I Vs. W.T. Suren and Co. Ltd., , wherein the court has held that the payment made by the transferor towards the gratuity liability in such

circumstances, as in this case, where the employees are taken over by the transferee with continuity of service, is not the payment of gratuity to

employees and, hence, it is not allowable as business expenditure under s10(2) (xv) of the Indian I.T. Act, 1922. The court has taken the view

therein that unless a payment is made to the employees direct in accordance with a gratuity scheme, the payment cannot properly be described as

a payment of gratuity, that by virtue of the employees being taken over with continuity of employment by the transferee-company, no claim could

have been made by the employees against the assessee-company, that no liability for payment of gratuity as such to the employees thus having

accrued against the assessee, the payment made by the assessee to the transferee could not be treated on the same footing as a discharge of the

liability for gratuity payable to the employees and that, therefore, the amount was not deductible under s. 10(2)(xv) of the Act. While taking that

view, the Bombay High Court has followed the decisions of this court in Stanes Motors (South India) Ltd. Vs. Commissioner of Income Tax, ,

Commissioner of Income Tax Vs. Pathinen Grama Arya Vysya Bank Ltd., and Commissioner of Income Tax Vs. Salem Bank Ltd., . Reliance

was place by the assessee in that case on the decision of this court in Commissioner of Income Tax Vs. Sri Venkateswara Bank Ltd., and also the

Full bench decision of the Kerala High Court in Commissioner of Income Tax Vs. Standard Furniture Co. Ltd. (In Liquidation), . But the Bombay

High Court dissented from the view taken by the Full Bench of the Kerala High Court in Commissioner of Income Tax Vs. Standard Furniture Co.

Ltd. (In Liquidation), and distinguished the decision rendered by this court in

Commissioner of Income Tax Vs. Sri Venkateswara Bank Ltd., .

12. With respect we are not in a position to agree with the view taken by the Bombay High Court in Commissioner of Income Tax, Bombay City-I

Vs. W.T. Suren and Co. Ltd., , that the liability of the assessee in case to pay gratuity to its employees was merely a contingent liability which will

arise only when the employment of the employee was determined by death, retirement or resignation and that the liability did not exist in praesenti on

the date of the transfer of the business, is no longer legally tenable in view of the decision in Commissioner of Income Tax Vs. Andhra Prabha P.

Ltd., , which has categorically ruled that if the gratuity liability has been calculated on the basis of scientific and actuarial data, then such liability

could not be taken as mere contingent liability, but should be taken as accrued liability. The decision of the Bombay High Court proceeds on the

basis that the assessee's liability to pay gratuity is only contingent and is not a liability in praesenti. Admittedly, the payment made to the purchaser

was for the charge of an obligation incurred already while the business was carried on by the assessee and it was not payment made in respect of a

liability arising after the transfer or on the closure of business, as was the case in Commissioner of Income Tax, Kerala Vs. Gemini Cashew Sales

Corporation, Quilon, . In The Commissioner of Income Tax, Bombay Vs. The Mysore Spinning and Mfg. Co. Ltd., , the Supreme Court has dealt

with a case relating to a transfer of accumulated balance to the Employees' Provident funds Act, 1952. In the case, the assessee had been

maintaining two unrecognised provident funds and from the time to time the assessee and its employees made contributions to the two funds. After

the Employees' provident funds Act, 1952, came into force, the assessee were required to transfer all the accumulations in the funds to the

Employees' Provident Funds and the assessee accordingly transferred. The amount so transferred included a sum of Rs. 3,01,772 representing the

assessee's contribution to the two funds up to the date of transfer and the interest accrued thereon. The assessee claimed deduction of that amount

in computing its profits. The Revenue disallowed the deduction on the ground that since there was a transfer of the fund to trustees which came

within the scope of s. 58K of the Act, the amount has to be treated as capital expenditure and it was not a deduction allowable under s. 10[1] or

under s. 10(2)(xv). On a reference, the High Court held that the transfer was not to the trustees and that the amount was deductible under s. 10(2)

(xv). On appeal, the Supreme Court took the view that since the amount in question has been spent and paid out in the view that since the amount

of question has been spend and paid out in the relevant accounting period, it could be allowed as expenditure incurred for the purpose of the

business of the assessee under s. 10(2)(xv) and that the amount cannot be deemed to be capital expenditure under s. 58K. The said decision of

the Supreme Court, apart from supporting the assessee's stand, lays down the proposition the though the amount paid to the transfer by the

assessee in this case, represents the gratuity liability payable by the assessee in all the earlier years, it can be claimed as deduction in the year in

which the actual transfer of funds or payment was made. In Commissioner of Income Tax Vs. Andhra Prabha P. Ltd., and in COMMISSIONER

OF Income Tax, TAMIL NADU-V Vs. SRI RANILAKSHMI GINNING, SPINNING and WEAVING MILLS (P.) LTD., , this court has

clearly laid down that the deduction under s. 37 of the Act cannot be disallowed merely because the amount paid was referable to the previous

assessment years and that whether the amount paid in respect of which deduction is claimed under s. 37 relates to the current year or to the earlier

years, the same has to be allowed as deduction. As a matter of fact, in COMMISSIONER OF Income Tax, TAMIL NADU-V Vs. SRI

RANILAKSHMI GINNING, SPINNING and WEAVING MILLS (P.) LTD., , this court allowed deduction in one year in respect of the

estimated gratuity payable to the employees for all the earlier years arrived at scientifically or actuarially under and agreement entered in to by the

assessee with the labour.

13. The decision in J.P. Hancock (Surveyor of Taxes) v. General Revisionary and Investment Company Limited [1981] 7 TC 358 is also

applicable to the facts of the case. In the case, the assessee made a lump sum payment to purchase annuity equal in amount to pension payable for

a former employee. The question that arose was whether the assessee could claim deduction in respect of the said lump sum payment as business

expenditure. In that case, the annuities granted by the company, which were paid under deduction of Income Tax, were payable generally out of

the company's assets and were not charged specifically upon any particular fund or property belonging to the company and, therefore, the lump

sum paid to purchase the annuity was held to be an expense incurred in the business and not in computing the company's profit assessable to

Income Tax. In *Green (H M. Inspector of Taxes) v. Cravens Railway Carriage and Wagon company Ltd.* [1951] 32 TC 359, the assessee

introduced in 1944 a staff assurance scheme, based upon a single assurance policy the annual premiums of pay certain additional annual premiums.

In 1946, the company paid a lump sum in computation of these additional premiums. The question computing the profits of the company. The court

held that the payment was proper deduction in computing the profits and that the payment was not a capital expenditure but only a revenue

expenditure admissible is deduction.

14. In the case before us, the object of paying the amount to the transfer was to get rid of the assessee's accrued liability to pay of the gratuity to

the employees referable to the period when they were in the assessee's services and such payment made to discharge the assessee's liability

should be taken as business expenditure. The facts of the present case will fall *Commissioner of Income Tax Vs. Sri Venkateswara Bank Ltd.,* . In

that, case, a bank entered into an agreement with another bank to transfer a substantial part of its business to the latter bank. Under the agreement,

the transfer-bank did not undertaken any gratuity liability arising out of the past services rendered by the employer of the transferor bank and any

such liability had to be discharged by the transferor bank itself. The transferor bank, therefore, paid a total amount of Rs. 26, 032 to its employees

as and by way of gratuity. The assessee claim allowance of this amount either under s. 37(1) or under s. 36(1)(ii) of the Act. This court held that

the amount in question, whether as a retrenchment compensation or gratuity, cannot be a sum referred to in s. 36(1)(ii) and cannot be allowed

under that provision. However, the court held that since a part of the business of the assessee had been closed down, the payment made in the

course of the business as gratuity cannot be disallowed. The payment cannot also be treated as one made at the time of the transfer of the

undertaking of the assessee and there, it should be taken as payment allowable under s. 37(1). This view has found favour with the Full Bench of

the Kerala High Court in Commissioner of Income Tax Vs. Standard Furniture Co. Ltd. (In Liquidation), .

15. The facts in Commissioner of Income Tax Vs. Salem Bank Ltd., , on which strong reliance is place by the Revenue are, on the other hand,

entirely different. In that case, there was a transfer of the entire banking business from one bank to another bank. As per the term of the agreement,

the transferee-bank agreed to pay gratuity in respect of certain employees on the basis of the gratuity scheme applicable to them. The transferor-

bank paid to the transfer-bank certain amounts to be kept as deposit so that the payment could be made as and when the occasion to pay gratuity

arose. The assessee's claim for deduction of the said amount paid to the transfer-bank as an expenditure under s. 36(1)(ii) or under s. 37 of the

Act was negated by the lower authorities but was allowed by the Tribunal. However, when the matter came up before this court, this court held

that since the liability arose in the course of carrying on banking business and as the banking business having been completely transferred, the

assessee cannot claim deduction of this amount as business either under s. 37 or under s, 36(1)(ii). In taking that view, this court has followed the

decision of the Supreme Court in Commissioner of Income Tax, Kerala Vs. Gemini Cashew Sales Corporation, Quilon, and the decision of this

court in Stanes Motors (South India) Ltd. Vs. Commissioner of Income Tax, , which are also cases of closure of business and the payment being

claimed as business expenditure after the closure of the business.

16. Therefore, after a due consideration of the matter, we answering the second question in the affirmative and against the Revenue. The direction

given by the Tribunal to verify the figures regarded the actual gratuity liability will stand. The assessee will got costs from the Revenue. Counsel's

fee Rs. 500 (one set).