
(1996) 04 KL CK 0007

In the High Court Of Kerala

Case No : Income-tax Reference No. 32 of 1992

Jacob Cherian

APPELLANT

Vs

Controller of Estate Duty

RESPONDENT

Date of Decision : 02-04-1996

Acts Referred:

Wealth Tax Rules, 1957 — Rule 1D

Citation : (1997) 224 ITR 158

Hon'ble Judges : V.V. Kamat, J;G. Sivarajan, J

Bench : Division Bench

Advocate : P.G.K. Wariyar and K.K. Ravindranath, for the Appellant; P.K.R. Menon and N.R.K. Nair, for the Respondent

Judgement

G. Sivarajan, J.—In this reference, the Income Tax Appellate Tribunal, Cochin Bench, Ernakulam, at the instance of the accountable person, has referred the following two questions for decision by this court ;

" 1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in law in holding that the gratuity liability based on actuarial valuation is not to be taken into consideration in valuing the shares of Padinjarekara Estates Ltd. as per Rule 1D of the Wealth-tax Rules, 1957, which company is following the mercantile system of accounting ?

2. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in law in holding that the deceased had right in respect of the pool payments to be received subsequent to the date of death and it was due and includible in the principal value, in spite of the fact that Padinjarekara Estate (Coorg) in which the deceased had interest, was admittedly following the cash system of accounting ?"

2. These proceedings relate to the estate of the late Mrs. Annamma Chacko, who passed away on June 25, 1980. The accountable person is her grandson. In connection with the estate duty assessment, the accountable person filed an

estate duty account declaring the principal value of the estate at Rs. 2,90,383. In the assessment, the accountable person claimed before the authority that in computing the principal value of the estate of the deceased, deduction should be given for the provision for gratuity. The assessing authority rejected the said claim. Likewise, the assessing authority also included a sum of Rs. 6,00,000 in determining the principal value of the estate of the deceased being the estimated amounts representing the coffee pool payments. Annexure-"B" to the assessment order shows that a sum of Rs. 4,25,000 is shown as provision for gratuity of the Padinjarekara Estates Ltd. The assessing authority completed the assessment by order dated May 2, 1983, determining the principal value of the estate of the deceased at Rs. 15,56,889.

3. Aggrieved by the assessment order, the accountable person took up the matter in appeal before the Appellate Controller of Estate Duty, Madras. The Appellate Controller, considering the provisions of the Estate Duty Act, 1953, held that Rule 1D of the Wealth-tax Rules will provide a safe guide for valuation of the shares and as per the said rule, the value as shown in the balance-sheet will form the basis. Regarding the allowance for provision for gratuity, the Appellate Controller followed the decision of the Madras High Court in Commissioner of Wealth-tax and Others Vs. S. Ram and Others, and held that the provision for gratuity liability made on the basis of actuarial valuation has to be allowed as a deduction from the assets while determining the market value of the shares in accordance with the provisions of Rule 1D of the Wealth-tax Rules, 1957.

4. Regarding the inclusion in the value of the estate, a sum of Rs. 6,00,000 representing estimated coffee pool payments to be received subsequent to the date of the death of the deceased, the appellate authority noted the contentions of the accountable person that the method of accounting followed by the firm, Padinjarekara Estate, was on cash basis and so the valuation could be on the basis of the method of accounting followed by the firm, no partner was entitled to make any further claim to profits due as per the method of accounting followed. The appellate authority also noted the contention of the accountable person that as on the date of death, the right of the deceased was only the right as per the accounts of the said firm and that the future income had not accrued to the deceased. It was also noted that the assessee relied on the decision of the Karnataka High Court in D.G. Graig Jones Vs. State of Karnataka, to the effect that if the Coffee Board had not declared the final dividend before the assessments were completed, the Agricultural Income Tax Officer was bound to accept reasonable estimates made by the assessee and complete the assessments since that method was throughout accepted by the Department and that this principle should not be given a go-by merely because the Coffee Board had declared dividends before the assessments were completed. The Appellate Controller accepted the contentions of the accountable person and directed that the deceased's share in the coffee pool payments received subsequent to the date of death be deleted from the assessment.

5. Being aggrieved by the order of the Appellate Controller of Estate Duty, Madras, the Department filed an appeal before the Income Tax Appellate Tribunal, Cochin Bench, Ernakulam. Regarding determination of the market value of shares of Padinjarekara Estates Ltd., the Income Tax Appellate Tribunal held that Rule 1D of the Wealth-tax Rules has to be applied. The Appellate Tribunal then considered the question regarding the deduction of the provision for gratuity liability while determining the market value of unquoted equity shares of Padinjarekara Estates Ltd. The Appellate Tribunal observed that this question has come up for consideration before the same Bench in E. D. A. No. 15/(Coch) of 1985, dated August 29, 1989, wherein the Appellate Tribunal held that the Appellate Controller of Estate Duty is not justified in holding that the provision for gratuity is an allowable deduction while computing the principal value of the estate of the deceased. Following the said decision, the Appellate Tribunal set aside the order of the Appellate Controller on this point and restored the order of the Assistant Controller of Estate Duty.

6. Regarding the dispute relating to the deletion of estimated coffee pool payments due to the deceased, the Appellate Tribunal following the decision of the Karnataka High Court in G.M. Gopalkrishna Vs. Wealth Tax Officer, Mysore, held that the estimated sum of Rs. 6,00,000 is an asset which is includible in determining the principal value of the estate of the deceased. The Appellate Tribunal accordingly held that the deletion of the coffee pool payments due to the deceased was not proper, and set aside the order of the Appellate Controller of Estate Duty on this point and directed the Assistant Controller of Estate Duty to adopt the following direction in valuing the coffee pool points :

" That in evaluating the interest of a partner in a firm, first the net wealth of the firm has to be determined and in that process effect to the prescribed rules, namely, Rules 2A to 2G has got to be given, that in determining the net wealth of the firm Rule 2G provides that the market value of the asset not disclosed in the balance-sheet shall be taken into consideration, that the market value of the coffee point cannot be equal to the amount of dividend ultimately declared by the Coffee Board on the basis of coffee points allotted to the firm, that in determining the market value of coffee points on a valuation date, the uncertainty of the amount of dividend that might be declared by the Coffee Board shall have to be taken into consideration."

7. It is against these findings of the Income Tax Appellate Tribunal, Cochin Bench, that the accountable person has come up in reference before this court. As already pointed out, the first question for consideration in this case is as to whether the Appellate Tribunal was justified in holding that the provision for gratuity liability based on actuarial valuation is not to be taken into consideration in valuing the shares of Padinjarekara Estates Ltd. as per Rule 1D of the Wealth-tax Rules, which was following the mercantile system of accounting. As could be seen from annexure "A" at page 9 of the paper book, the provision for gratuity shown by Padinjarekara Estates Ltd. in the balance-sheet is Rs. 4,25,000. It is

not clear from the records of this case as to whether this sum of Rs. 4,25,000 shown as provision for gratuity is the amount calculated on the basis of actuarial valuation. That is why the first appellate authority has observed the legal principles applicable thereto and directed the assessing authority to verify whether this amount represents gratuity liability ascertained on actuarial valuation and if so, to deduct the said amount in the determination of the market value of the shares in accordance with Rule 1D of the Wealth-tax Rules. The Income Tax Appellate Tribunal, on the other hand, relying on its own earlier decision in E. D. A. No. 15/(Coch) of 1985 dated August 29, 1989, took the view that the provision for gratuity is not an allowable deduction. In fact we had occasion to consider this question in I. T. R. No. 166 of 1991 and by the judgment dated March 29, 1996-- John J. Chackola Vs. Controller of Estate Duty, , we held that the provision for gratuity liability made on the basis of actuarial valuation is a known and existing liability for the year in question and that it cannot be termed as a contingent liability. For arriving at the said conclusion, we applied the decision of the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, . In this case, the Supreme Court was concerned with the distinction between the two concepts "reserve" and "provision" and observed that whereas a provision is a charge against the profits to be taken into account against gross receipts in the profit and loss account, a reserve is an appropriation of profits, the asset or assets by which it is represented being retained to form part of the capital employed in the business. Dealing with such a situation, the Supreme Court considered the question regarding appropriation made for gratuity as to whether it is a provision or a reserve on the relevant date. In that context, the Supreme Court noted the contention of counsel for the assessee that no actuarial valuation had been undertaken but an ad hoc amount was appropriated or transferred to gratuity reserve and as such the same should have been treated as a reserve and included in capital computation. The Supreme Court also observed that whereas the assessee-company did urge a contention before the lower authorities that different treatments for the same item could not be given for purposes of Income Tax assessment and super profits tax assessment, the assessee-company did not clarify by placing material on record as to whether the appropriation of the amount was based on any actuarial valuation or whether it was an appropriation of an ad hoc amount, an aspect which has a vital bearing on the question whether the appropriation could be treated as a provision or a reserve. It is in that context, the Supreme Court observed that ordinarily, an appropriation to gratuity reserve will have to be regarded as a provision made for a contingent liability, for, under a scheme framed by a company, the liability to pay gratuity to its employees on determination of employment arises only when the employment of the employee is determined by death, incapacity, retirement or resignation -- an event (cessation of employment) certain to happen in the service career of every employee. It was also observed that the amount of gratuity payable is usually dependent on the employee's wages at the time of determination of his

employment and the number of years of service put in by him and the liability accrues and enhances with the completion of every year of service ; but the company can work out on an actuarial valuation its estimated liability and make a provision for such liability not all at once but spread over a number of years. Then, the Supreme Court observed that "it is clear that if by adopting such scientific method any appropriation is made such appropriation will constitute a provision representing fairly accurately a known and existing liability for the year in question". It is following the said observations of the Supreme Court that this court in I. T. R. No. 166 of 1991- John J. Chackola Vs. Controller of Estate Duty, , held that the provision for payment of gratuity made on the basis of actuarial valuation is an existing liability and that it is a liability in praesenti, though the payment of the amount is at a future date and therefore it cannot be said to be a contingent liability.

8. Accordingly, we hold that if the provision for gratuity is made on the basis of an actuarial valuation, the said amount is liable to be deducted in the computation of market value as per Rule 1D of the Wealth-tax Rules.

9. Having regard to the fact that there is no material on record to show that the sum of Rs. 4,25,000 shown by Padinjarekara Estates Ltd. in its accounts as provision for gratuity has been made based on an actuarial valuation, we would uphold the course adopted by the Appellate Controller in directing the Assistant Controller of Estate Duty to verify whether this provision for payment of gratuity is made on the basis of actuarial valuation and to allow deduction to the extent it represents provision for gratuity made on the basis of an actuarial valuation. In fact this is what the Supreme Court has also done in the decision in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, of the report.

10. The next question is regarding the inclusion of a sum of Rs. 6,00,000 as the estimated value of the pool payments due to Padinjarekara Estate, Coorg, a partnership-firm in which the deceased was a partner. The assessing authority included the said amount as the estimated coffee pool payments (subject to revision) as due to the firm as on the date of death of the deceased. The Appellate Controller deleted the same but the Appellate Tribunal held that the right to receive the coffee pool payments had accrued to the deceased before the death and that it is an asset.

11. We have considered the matter independently. We are of the view that the Income Tax Appellate Tribunal was justified in including the value of the coffee pool payments in the principal value of the estate of the deceased. It is clear from the contentions urged on behalf of the accountable person that the coffee had been pooled in favour of the Coffee Board prior to the date of death of the deceased and that the firm in which the deceased was a partner had acquired the right to receive the value of the coffee pool before the date of death of the deceased. It cannot be disputed that the right thus accrued to the firm for getting the value of the coffee so pooled, is property which could be said to pass

on the date of death of the deceased. So, the deceased's share in the right to receive the value of the coffee pool is liable to be included in the principal value of the estate of the deceased.

12. The only further aspect to be considered in the circumstances of this case that the amount was received only after the date of death of the deceased is as to how this right to receive the amount representing the coffee pool payment is to be valued as on the valuation date. As already stated, the assessing authority had adopted a sum of Rs. 6,00,000 as the estimated value of the coffee pool, of course, subject to revision on actual disbursement of the amount by the Coffee Board.

13. It is relevant to note that the Appellate Tribunal itself has given directions to the Assistant Controller of Estate Duty in regard to such estimation. It is also relevant to note that such directions are in tune with the principles laid down by the Supreme Court in regard to the estimation of the value in *Mrs. Khorshed Shapoor Chenai and Others Vs. Assistant Controller of Estate Duty, Andhra Pradesh and Others*, where the Supreme Court has observed that the assessing authority will have to estimate the value having regard to the peculiar nature of the property, its marketability and the surrounding circumstances including the risk or hazard of litigation looming large at the relevant date. We do not find any error or illegality in the findings of the Appellate Tribunal on this point.

14. We accordingly answer the first question referred in the negative, i.e., against the Revenue and in favour of the assessee. But, we make it clear that since there is no material on record to show that a sum of Rs. 4,25,000 towards provision for gratuity liability made in the accounts of Padinjarekara Estates Ltd. was made on the basis of an actuarial valuation, it is for the assessing authority to verify whether the said amount represents the estimate made on the basis of an actuarial valuation and if so, to allow the claim to the extent it represents the estimate made on the actuarial valuation. For that purpose, it is necessary that the Tribunal should remand the matter to the assessing authority. We answer question No. 2 in the affirmative, i.e., in favour of the Revenue and against the assessee.

15. A copy of this judgment under the seal of this court and the signature of the Registrar shall be sent to the Income Tax Appellate Tribunal, Cochin Bench.