(1996) 03 KL CK 0009

In the High Court Of Kerala

Case No : Income Tax R. No. 166 of 1991

John J. Chackola — APPELLANT

Vs

Controller of Estate Duty — RESPONDENT

Date of Decision : 29-03-1996

Acts Referred:

Estate Duty Act, 1953 — Section 61
Wealth Tax Rules, 1957 — Rule 1D

Citation : (1996) 134 CTR 452 : (1996) 3 ILR (Ker) 128 : (1997) 224 ITR 34

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

Bench : Division Bench

Advocate : M.C. Sen and A. Parvathy Menon, for the Appellant; P.K.R. Menon and N.R.K. Nair, for the Respondent

Judgement

G. Sivarajan, J.—In this reference application u/s 64(1) of the Estate Duty Act, 1953, the Income Tax Appellate Tribunal, Cochin Bench, Ernakulam, at the instance of the accountable person, has referred the following three questions of law for decision by this court :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal is correct in holding that the assessment has correctly been rectified u/s 61 of the Estate Duty Act, 1953 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal is correct in holding that in spite of the decision of the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, , the decision of the Kerala High Court in Commissioner of Wealth-tax Vs. K. Gopinathan Nair, was still to be followed ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that in the valuation of the shares the liability for gratuity shown in the balance-sheet which was less than the liability on actuarial valuation was not a debt owed which was deductible ?"

2. The brief facts necessary for adjudication of the questions referred are as follows : The properties which devolved on the accountable person included certain shares in a company, namely, Chackolas Spinning and Weaving Mills. The said shares were not quoted in the market. The valuation of these unquoted shares is the subject-matter of this reference. The Assistant Controller of Estate Duty originally valued the shares held by the deceased in Chackolas Spinning and Weaving Mills by adopting the method provided under Rule 1D of the Wealth-tax Rules, 1957. While doing so, he treated the provision made by the company for gratuity as a liability. He valued the shares at the rate of Rs. 43.65 per share and the value of the shares was determined accordingly.

3. Subsequently, the Assistant Controller of Estate Duty initiated proceedings u/s 61 of the Estate Duty Act and rectified the assessment, inter alia, rejecting the claim of the accountable person that the gratuity liability being an accrued liability had been treated so at the time of completion of the original assessment.

4. Aggrieved by the said rectification of the original assessment, the accountable person took up the matter in appeal before the Appellate Controller of Estate Duty, Madras. Before the Appellate Controller, the accountable person''s representative, inter alia, relying on the decision of the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, and the decision of the Madras High Court in Commissioner of Wealth-tax and Others Vs. S. Ram and Others, contended that the provision for gratuity was not a contingent liability but a definite liability. The accountable person''s representative has also produced a certificate regarding the actuarial valuation as per which the accrued gratuity liability of the company as on June 30, 1976, computed on actuarial basis was Rs. 21,40,613 and contended that the provision for gratuity ''made in the balance-sheet was only Rs. 17,32,822 which is much less than the liability computed on actuarial basis. He further contended before the Appellate Assistant Commissioner that in view of the Supreme Court''s decision referred to above, it must be considered as settled law that gratuity liability is not a contingent liability but a definitely ascertained liability and, therefore, it has to be taken into consideration for arriving at the value of unquoted shares of the company. The Appellate Controller accepted the said contentions of the accountable person and held that the value of shares was originally computed in accordance with law and there is no justification for rectifying the said order by resort to the provisions of Section 61 of the Act.

5. Aggrieved by the said order, the Department took up the matter in appeal before the Income Tax Appellate Tribunal, Cochin Bench. Before the Income Tax Appellate Tribunal, the Department contended that the view taken by the Appellate Controller is erroneous and that the Appellate Controller has totally disregarded the decision of the Kerala High Court in the case of Commissioner of Wealth-tax Vs. K. Gopinathan Nair, . This decision according to the Department, supports the view taken by the Assistant Controller in his order u/s 61 of the Estate Duty Act and that the Appellate Controller in fact took into consideration

decisions which have no direct bearing while giving the impugned relief. The Income Tax Appellate Tribunal also considered the contentions of the accountable person that the decision of the Appellate Controller is supported by the decision of the Supreme Court in the case of Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, and Commissioner of Wealth-tax and Others Vs. S. Ram and Others, . Thereafter, the Appellate Tribunal observed that the Kerala High Court in the decision reported in Commissioner of Wealth-tax Vs. K. Gopinathan Nair, has clearly held that the provision for gratuity is a contingent liability and that the Tribunal in E. D. A. No. 15/(Coch) of 1985 dated August 29, 1989, had taken a similar view after considering the decision of the Supreme Court in the case of Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, and also the decision of the Madras High Court in Commissioner of Wealth-tax and Others Vs. S. Ram and Others, and since the order originally passed by the Assistant Controller of Estate Duty was without taking into consideration the decision of the jurisdictional High Court, there is a clear mistake apparent from the records. Accordingly, the order of the Assistant Controller of Estate Duty passed u/s 61 of the Act was restored. It is against this order of the Income Tax Appellate Tribunal, Cochin Bench, that the accountable person has come up in reference.

6. As We have already stated the company in which the deceased was holding the shares, namely, Messrs. Chackolas Spinning and Weaving Mills Ltd., made a provision for gratuity liability to employees in its balance-sheet prepared as on June 30, 1975, of a sum of Rs. 17,32,822, as could be seen from item 5(e) under the current liabilities and the provisions of the balance-sheet available at page 26 of the paper book and the liability for payment of gratuity as computed on actuarial valuation amounted to Rs. 21,40,630, as could be seen from paragraph 2 of the order of the Appellate Controller of Estate Duty, which is annexure-"B" in the paper book and the provision so made is far less than the liability as computed on actuarial basis. The accountable person''s contention before the appellate authorities as well as before this court is that the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, and other cases has taken the view that if the company has worked out its estimated liability on an actuarial valuation (i.e., discounted present value of the liability under the scheme on a scientific basis) and made a provision for such liability, the appropriation will constitute a provision representing fairly accurately a known and existing liability for the year in question and, therefore, it is clear that the liability is not a contingent one. On the other hand, the submission of the Department before the authorities and before this court is that the liability for gratuity is only a contingent liability and, therefore, it is not liable to be taken into account for determining the market value of the shares by applying Rule 1D of the Rules.

7. In view of these submissions, it is necessary for us to refer to the provisions of Rule 1D of the Wealth-tax Rules under which admittedly, these shares have been

valued by the Assistant Controller of Estate Duty. The relevant portion of the Wealth-tax Rules, 1957, is extracted below :

"1D. Market value of unquoted equity shares of companies other than investment companies and managing agency companies.--The market value of an unquoted equity share of any company, other than an investment company or a managing agency company, shall be determined as follows :

The value of all the liabilities as shown in the balance-sheet of such company shall be deducted from the value of all its assets shown in that balance-sheet. The net amount so arrived at shall be divided by the total amount of its paid-up equity share capital as shown in the balance-sheet. The resultant amount multiplied by the paid-up value of each equity share shall be the break-up value of each unquoted equity share. The market value of each such share shall be 85 per cent. of the break-up value so determined :

Provided that where, in respect of any equity share, no dividend has been paid by such company continuously for not less than three accounting years ending on the valuation date, or in a case where the accounting year of that company does not end on the valuation date, for not less than three continuous accounting years ending on a date immediately before the valuation date the market value of such share shall be as indicated in the Table below. . . .

Explanation II.--For the purposes of this rule- ....

(ii) the following amounts shown as liabilities in the balance-sheet shall not be treated as liabilities, namely :--....

(f) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares."

8. It is evident from Explanation II(ii)(f) of Rule 1D extracted above that for the purpose of Rule 1D any amount representing "contingent liabilities" other than arrears of dividends payable in respect of cumulative preference shares though shown as liabilities in the balance-sheet shall not be treated as liabilities. So, the only question for our consideration is as to whether the amount of Rs. 17,32,822 shown by Chackolas Spinning and Weaving Mills Ltd., Kalamassery, in its balance-sheet as gratuity liability to employees is a "contingent liability", which is not to be taken into consideration for the purpose of computation of the market value of shares by resort to the provisions of Rule 1D of the Rules, 1957. This is a matter, which should be considered independent of the provisions of the Wealth tax Act, Income Tax Act, or any other allied enactments even if that question arises under any of the said enactments. For those enactments have no application in deciding the question as to, whether the provision for gratuity is a contingent liability or not.

9. The Department''s consistent case is that provision for gratuity is only a contingent liability and, therefore, it is not liable to be taken into account for the purpose of Rule 1D of the Wealth-tax Rules. In support of the said contention,

the Department relied on the decision of this court in Commissioner of Wealth-tax Vs. K. Gopinathan Nair, That was a case where this court was concerned with the question as to whether the provision for payment of gratuity payable under the statute to an employee on his retirement, death, etc., was a "debt" within the meaning of Section 2(m) of the Wealth-tax Act. In that context, this court relied on the decision of the Supreme Court in Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City, . The facts of the said case, according to this court were similar to the facts in the case concerned and held that the provision for payment of gratuity is not a "debt" within the meaning of Section 2(m) of the Wealth-tax Act. On the other hand, counsel for the accountable person relied on the decision of the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, . That was a case arising under the Super Profits Tax Act, 1963. There, the questions raised are whether the amounts retained or appropriated or set apart by the concerned company by way of making provision : (a) for taxation, (b) for retirement gratuity (underlining* ours) and (c) for proposed dividends from out of the profits and other surpluses could be considered as other reserves within the meaning of Rule 1 of the Second Schedule to the Super Profits Tax Act, 1963, for inclusion in the capital computation of the company for the purpose of levying super profits tax ? In that context, the Supreme Court considered 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 profits 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 the 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". As could be seen from the above, the Supreme Court has noted these settled principles for the consideration by the Tribunal of the question which was being remitted by the Supreme Court in that appeal. Therefore, it is clear from the above observations of the Supreme Court that if the company, namely, Chackolas Spinning and Weaving Mills Ltd., Kalamassery, had set apart a sum of Rs. 17,32,822 by adopting the method of actuarial valuation, it has to be regarded as a provision for a known and existing liability, the quantification thereon has to be made later. If the said provision is towards a known and existing liability, though it is payable at a future date, it can never be characterised as a contingent liability. It is only a liability, which has already been accrued for the year in question. As we have already noticed, the decision of this court in Commissioner of Wealth-tax Vs. K. Gopinathan Nair, was not concerned with the situation like the present one where the question of estimation of liability for gratuity on actuarial valuation was in issue. In other words, this court was not concerned with a situation where the provision is made in respect of gratuity computed on the basis of actuarial valuation. On the other hand, the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, was directly concerned with the question for the purpose of deciding as to whether a provision for gratuity made on the basis of actuarial valuation is a provision or a reserve. The Supreme Court held that if the provision for gratuity liability is made on the basis of actuarial valuation, it is taken out of the purview of contingent liability and will be placed in the category of known and existing liability.

10. In view of the decision of the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, we are of the view that the provision for gratuity made by Chackolas Spinning and Weaving Mills Ltd., Kalamassery, in the balance-sheet being much less than the liability, which has been ascertained on actuarial valuation, as is evident from the certificate produced before the Appellate Controller, is not towards a contingent liability and, therefore, the Assistant Controller of Estate Duty was not justified in thinking that he had committed a mistake while determining the market value of unquoted shares in the said company by taking into account the provision for gratuity also. In other words, we are of the view that there was no mistake in the original order of assessment warranting invocation of the provisions of Section 61 of the Estate Duty Act and rectifying

the said assessment on this ground.

11. Learned counsel appearing for the Department very strenuously contended relying on the decisions of the Supreme Court in Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City, ; Bombay Dyeing and Manufacturing Co. Ltd. Vs. Commissioner of Wealth Tax, Bombay, and also the decision in P. Sathrughan Pillai Vs. Commissioner of Wealth Tax, all in support of the position that the liability for payment of gratuity is a contingent liability and that the decisions rendered in the context of the Income Tax Act have no relevance for consideration of the question under the Wealth-tax Act.

12. As we have already stated at the outset, for the consideration of the question involved in this case, namely, whether the provision for payment of gratuity is a contingent liability, it is no matter whether the question has arisen under the Income Tax Act, Wealth-tax Act or any other allied enactments.

13. In view of the categoric finding of the Supreme Court in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, , we are of the definite view that provision for payment of gratuity made on the basis of actuarial valuation is an existing liability and that it is a liability in presents though the payment of the said amount is at a future date. In view of the categoric finding by the Supreme Court, it is unnecessary for us to dwell on the various decisions relied on by counsel for the Revenue.

14. Another contention taken by the senior counsel appearing for the Department is that, at any rate, in view of the provisions of Section 40A(7) of the Income Tax Act, which is applicable for the period from April 1, 1973, provision for gratuity liability even if it is an accrued liability still it is not an allowable deduction under the Income Tax Act since the company did not satisfy the three conditions specified in Sub-clause (b) thereof.

15. As already stated the provisions of the Income Tax Act have no relevance in determining the question whether the provision for gratuity is a contingent liability or not. For the above reasons, this contention also has no merit.

16. We accordingly answer the questions referred to us in the following manner. We answer the first question in the negative, i.e., against the Revenue and in favour of the accountable person. In view of our answer to question No. 1, we decline to answer questions Nos. 2 and 3, which, according to us, are unnecessary for the purpose of this case.

17. 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, for passing consequential orders.