
(1990) 07 RAJ CK 0010

In the Rajasthan High Court

Case No : Wealth-tax Reference No. 26 and 42 of 1980

Seth Mukund Das Rathi

APPELLANT

Vs

Commissioner of Wealth-tax

RESPONDENT

Date of Decision : 03-07-1990

Acts Referred:

Income Tax Act, 1961 — Section 40A
Payment of Gratuity Act, 1972 — Section 4, 7
Wealth Tax Rules, 1957 — Rule 1D

Citation : (1990) 87 CTR 43 : (1991) 188 ITR 518

Hon'ble Judges : K.C. Agrawal, C.J;N.C. Kochar, J

Bench : Division Bench

Advocate : Ranka, for the Appellant;

Judgement

K.C. Agrawal, C.J.—By the reference application filed u/s 27 of the Wealth-tax Act, 1957, Seth Mukund Das Rathi, the assessee, required the Tribunal to refer to the High Court of Judicature for Rajasthan at Jaipur, three questions which were enumerated in the application. The application was allowed partly and the following question was referred by the Tribunal to the High Court for its opinion :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in not allowing deduction for the gratuity liability amounting to Rs. 12,79,000 from the total assets of the company as per balance-sheet as on December 31, 1972, while valuing the unquoted equity shares of M/s. Krishna Mills Ltd., Beawar, in accordance with Rule 1D of the Wealth-tax Rules, 1957 ?"

2. The reference application pertained to the wealth-tax assessment for the year 1974-75. The valuation date was October 26, 1973. The reference application was concerned with regard to the enhancement of the net wealth of Rs. 92,609.

3. The background in which the controversy arose was about the valuation of equity shares of Krishna Mills Limited, which was a public limited company. The number of shares held by the assessee on the valuation date was 254. These

shares were not quoted on the stock exchange. Their value, therefore, was to be determined in accordance with Rule 1D of the Wealth-tax Rules, 1957. The said rule, at the relevant time, read as under :

"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."

4. According to the assessee, the value per share worked out was Rs. 897.60, whereas, according to the Wealth-tax Officer, the value per share came to Rs. 1,262.20. The difference was caused solely by the provision for gratuity appearing on the liabilities side of the balance-sheet of Krishna Mills Limited. The balance-sheet as on December 21, 1972, showed the amount of such provision at Rs. 15 lakhs. The Wealth-tax Officer ignored the provision for gratuity completely and redetermined the value per share, as already, stated, at Rs. 1,262.30. The Wealth-tax Officer ignored the provision for gratuity as he found that Sub-clause (f) of Clause (ii) of Explanation II of the said Rules specifically prohibited deduction representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares. The Explanation relied upon is as under :

"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."

5. For the view he took, the Wealth-tax Officer relied on the decision of the Supreme Court in *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, . The Wealth-tax Officer held, on the basis of this decision, that the provision for gratuity was a contingent liability. He derived support" from a later decision of the Supreme Court in the case of *Bombay Dyeing and Manufacturing Co. Ltd. Vs. Commissioner of Wealth Tax, Bombay*,

6. Against the order of the Wealth-tax Officer, the assessee preferred an appeal to the Appellate Assistant Commissioner on the ground that the provision for gratuity could not be held to be a contingent liability. The assessee claimed, in the appeal, that the gratuity amount had been quantified on a scientific basis by an expert valuer at the figure of Rs. 12.79 lakhs and the amount was duly

accounted for in the books of account of the assessee and, therefore, it was a definite and ascertained liability and could not have been treated as a contingent one. The Appellate Assistant Commissioner held that the Wealth-tax Officer rightly treated the provision for gratuity as a contingent liability.

7. On an interpretation of the various sections of the Payment of Gratuity Act, 1972, the Appellate Assistant Commissioner held that the liability for payment of gratuity did not accrue or arise from year to year but arose or accrued on certain happenings only. For these reasons, the view of the Appellate Assistant Commissioner was that the liability on account of gratuity could be treated only as a contingent liability and could not be deducted from the assets for the purposes of valuation of shares.

8. The appeal filed by the assessee against the order of the Appellate Assistant Commissioner was rejected by the Tribunal. The Tribunal took the view that the liability for payment of gratuity being contingent, the Wealth-tax Officer was right in refusing deduction thereof because of Clause (ii) (f) of Explanation II to Rule 1D.

9. Against the judgment of the Tribunal, an application was filed u/s 27 of the Wealth-tax Act by the assessee at whose instance the question mentioned above was referred.

10. On behalf of the assessee, an argument raised before us was that when the provision for payment of gratuity has been made in the balance-sheet on actuarial basis representing a real and definite liability, it could not be treated as a contingent liability. A contingent liability is not necessarily one which does not occur. The date of its occurrence alone is uncertain. Its happening is deferred. In the case of payment of gratuity, certain contingencies have been provided for by the Act and, on the happenings of those contingencies, it becomes payable. If any one of those contingencies does not happen, the money continues to be in the possession of the employer.

11. The Payment of Gratuity Act, 1972, lays down a wholesome scheme for payment of gratuity. Section 4 of the Act deals with "payment of gratuity to an employee on the termination of his employment after he has rendered continuous service for not less than five years.--

(a) on his superannuation, or

(b) on his retirement or resignation, or

(c) on his death or disablement due to accident or disease.

Provided that the completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement..."

12. Section 7 lays down that gratuity would be payable on submission of a written application to the employer. This section also provides that the controlling

authority will determine the amount of gratuity payable. From the above provisions, it is established that the gratuity is payable only on the happening of certain events which have been specified above.

13. Learned counsel for the Revenue relied on *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, for his submission that the assessee is not entitled to deduction of the amount claimed by it. The relevant portion of this decision is quoted below (at p. 64 of *State of Bihar, etc. Vs. Kapil Singh, etc.*,

"In *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, , the decision turned on the question whether an estimated liability gratuity schemes framed under industrial awards amounted to debts and could be deducted while computing the net wealth. On reliance having been placed on *Southern Railway of Peru Ltd. v. Owen* [1957] 32 ITR 737 ; [1957] AC 334 (HL), a decision to which we shall presently come, the court observed at page 773 that that decision had no relevance to the question before it as the House of Lords in that decision was concerned in determining the deductibility of the present value of a liability which may arise in future in the computation of taxable income for the relevant year under the Income Tax laws. The court held, in view of the terms of Section 2 of the Wealth-tax Act, that as the liability to pay gratuity was not in prae-senti but would arise in future on the termination of service, i.e., on retirement, death or termination, the estimated liability under the schemes would not be a debt and, therefore, could not be deducted while computing the net wealth. These observations show that the court was of the view that though such a liability is a contingent liability and, therefore, not a "debt" u/s 2 of the Wealth-tax Act, it would be deductible under the Income Tax Act while computing the taxable profits. In the instant case, the question is not whether such estimated liability arising under the gratuity schemes amounts to a debt or not. The question that concerns us is whether, while working out the net profits, a trader can provide from his gross receipts his liability to pay a certain sum for every additional year of service which he receives from his employees. This, in our view, he can do, if such liability is properly ascertainable and it is possible to arrive at a proper discounted present value. Even if the liability is a contingent liability, provided its discounted present value is ascertainable, it can be taken into account. Contingent liabilities discounted and valued as necessary can be taken into account as trading expenses if they are sufficiently certain to be capable of valuation and if profits cannot be properly estimated without taking them into account. Contingent rights, if capable of valuation, can similarly be taken into account as trading receipts where it is necessary to do so in order to ascertain the true profits (see C. N. Beatti's *Elements of the Law of Income and Capital Gains Taxation*, 8th edn., p. 54)."

14. The controversy raised, before us is squarely covered by the aforesaid decision in *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, . It is true that the said decision was given when Rule 1D had not come into statute book. But, to us, it appears that the insertion of Rule 1D does not make

any difference. Rule 1D does not mitigate the effect of the decision of the Supreme Court.

15. In *Indian Molasses Co. (Private) Ltd. Vs. Commissioner of Income Tax, West Bengal*, it was laid down that (headnote) :

"The Income Tax law makes a distinction between an actual liability in praesenti and a liability de futuro which, for the time being, is only contingent. The former is deductible but not the latter."

16. Sri Ranka, learned counsel for the assessee, submitted that the liability for payment of gratuity ascertained on actuarial calculations is a liability which is in praesenti and is capable of ascertainment. This is what the Supreme Court has said, he argued, in the case of *Metal Box Company of India Ltd. Vs. Their Workmen*, The quotation relied upon is mentioned below ;

"Learned counsel for the Department then contended that the payment of gratuity is provided for in Clause (v) of Sub-section (1) of Section 36 of the Income Tax Act and it can only be allowed in accordance with that provision. That is a question which was not raised before the Tribunal. In any case, the answer to that question is plain. The present case is not governed by Section 36, which permits deduction out of the gross profits of any contribution made by an employer towards a gratuity fund created under a trust. In the present case, the amount is deductible in the computation of the gross profit itself."

17. It was held that even if the liability is a contingent liability, provided it is discounted and the present value is ascertainable, it can be taken into account. Learned counsel for the assessee contended that the allowance is not restricted to the actual payment of gratuity during the year.

18. In view of the observations of the Supreme Court in the case of *Metal Box Company of India Ltd. Vs. Their Workmen*, , it was contended before it in *Bombay Dyeing and Manufacturing Co. Ltd. Vs. Commissioner of Wealth Tax, Bombay*, , that the earlier decision of the Supreme Court regarding allowability of gratuity u/s 2 in *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, , required reconsideration. It was held by the Supreme Court that there was no conflict between the decision in *Metal Box Company of India Ltd. Vs. Their Workmen*, rendered under the Payment of Bonus Act, 1965, and the decision in the case of *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, , rendered under the Wealth-tax Act and the latter decision did not require reconsideration. The Supreme Court affirmed its earlier view that, in computing the "net wealth" of the company, the estimated liability of the company in respect of gratuity in terms of the industrial court awards for the benefits of its employees in respect of their periods of service up to the valuation date was not deductible.

19. The contention raised by learned counsel for the assessee was that, after the coming into force of the Payment of Gratuity Act, the position is different. He

urged that the provision of liability in respect of gratuity payable worked out on actuarial basis was an allowable deduction under the Income Tax Act. For this proposition, reference was made to the decision in *Tata Iron and Steel Co. Ltd. Vs. D.V. Bapat*, Income Tax Officer, Companies Circle I(2), Bombay and Another, . The Finance Act, 1976, however, has retrospectively amended Section 40A of the Income Tax Act with effect from April 1, 1973, and, as a result, the deduction in respect of provision for gratuity is available to assesseees who created before April 1, 1976, an approved gratuity fund under an irrevocable trust and transferred the prescribed admissible amount to such fund. The provision, however, does not cover the gratuity deposit made by the assessee on the basis of the State Acts prior to the assessment year 1973-74. There is no such specific and special provision under the Wealth-tax Act and, accordingly, the liability in respect of gratuity on actuarial basis will be a debt due after the coming into force of the Gratuity Act. The Kerala High Court in *Commissioner of Wealth-tax Vs. K. Gopinathan Nair*, held that even after the coming into force of the Kerala Gratuity Act, the provision for liability of gratuity was not a debt due and was not deductible u/s 2(m) of the Wealth-tax Act. The Bombay High Court also held in *Century Spg. and Mfg. Co. Ltd. Vs. Commissioner of Wealth-Tax*, , that provision for gratuity was not a debt due and was not deductible in computation of net wealth. On the basis of the Supreme Court decision in *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, it is not possible to take a view in favour of the assessee by holding that gratuity was deductible for the purpose of computing the net wealth.

20. Another difficulty in the instant case is that no evidence had been brought before the Wealth-tax Officer to establish that the techniques of making estimates on actuarial basis had been adopted by it. On the basis of the balance-sheet, the claim was made by the assessee without proving that the books of account had been prepared on actuarial basis in accordance with the principles required for.

21. For this purpose, reference may be made to page 140 of the *Compendium of Statements and Standards*, I Edn., 1986. Relevant portion of this book is as under :

"Techniques of making estimates of this nature are developed in actuarial science and the problems of estimating the liability in respect of accruing gratuity benefits and devising appropriate financial arrangements to meet such liability fall within the province of the actuary. As the actuarial estimates are based on forecasts regarding future course of events, it becomes necessary for the actuary to keep the changing experience in respect of such events under constant review and to re-examine the working of financial arrangements in the light of such review. Thus arises the need for periodical actuarial valuations."

22. No question has been referred to us on this controversy. Hence, we are unable to uphold the assessee's claim on this ground.

23. For the purpose of Sub-clause (f) of Clause (ii) of Explanation II to Rule 1D of the Wealth-tax Rules, the term "contingent liability" has to be given a general meaning and the decision given on the interpretation of Section 40A of the Income Tax Act is of no avail. The objects and purposes of the various sections of the Income Tax Act on which those decisions have been given are different from those of Rule 1D of the Wealth-tax Rules. It has been said in *Goodyear India Ltd., Gedore (India) Pvt. Ltd., Kelvinator of India Ltd. and the Food Corporation of India and Another Vs. State of Haryana and Another*,

"it has been said and said on numerous occasions that fiscal laws must be strictly construed, words must say what they mean, nothing should be presumed or implied, these must say so. The true test must always be the language used."

24. The language used in Sub-clause (f) of Clause (ii) of Explanation II to Rule 1D leaves no room for doubt for taking external aid to interpret it. This is also a settled law that where more than one construction is possible, that which preserves its workability and efficacy is to be preferred to the one which would render it otiose or sterile. We have already pointed out above that the object of the valuation of unquoted shares for which a specific provision has been made is to govern the interpretation of the decision on the controversy before us. We cannot take the help of the Supreme Court given in *CIT v. Hindustan Lever Ltd.* [1966] 60 ITR 700, where the controversy was with regard to the interpretation of the Companies (Profits) Surtax Act and the Income Tax Act.

25. Learned counsel for the assessee referred to the Madras High Court decision in the case of *Commissioner of Wealth-tax Vs. Ranganayaki Gopalan and Others*, . In this case, the question was whether, for the purpose of ascertaining the value of the equity shares, the contribution to the assessee company's employees' gratuity fund could be deducted. In this case also, the Revenue had contended that the liability to provide the sum of Rs. 19,11,620 was a contingent liability and, therefore, it could not be deducted from the total value of the assets for the purpose of finding out the break-up value of the shares. Counsel for the Revenue relied upon the Supreme Court decision in the case of *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, Their Lordships, however, distinguished the case before them from the case of *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, , stating at p. 532 of 92 ITR) : "But, in the present case, in our opinion, the interposition of a trust and vesting the gratuity fund in the trustees makes a difference." Their Lordships did accept the view expressed in the case of *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, , that the liability for gratuity is a contingent liability but held that the provision was deductible in view of the special circumstances of the case. We would reproduce below the observations occurring at page 532 :

"Learned counsel for the Revenue submitted that the liability to provide the sum of Rs. 19,11,620 was a contingent liability and in fact it was stated as such in the company's balance-sheet as on June 30, 1961, and, that, therefore, this amount cannot be deducted from the total value of the assets for the purpose of finding

out the break-up value of the shares. In this connection, learned counsel also relied on the decision of the Supreme Court in *Standard Mills Co. Ltd. Vs. Commissioner of Wealth-tax, Bombay City*, That was a case where the assessee-company in proceedings for assessment of wealth-tax claimed deduction, among other things, in respect of a sum of Rs. 25,02,675 on account of accrued liability for gratuity to workmen and staff as per the award of the industrial court and the Labour Appellate Tribunal. The Supreme Court held that on the plain terms of the award the liability to pay gratuity to the employees of the appellate-company on determination of employment is a mere contingent liability which arises only when the employment of the employee is determined by death, incapacity, retirement or resignation and that the amount claimed cannot be deducted as a debt in computing the net wealth of the assessee. But, in the present case, in our opinion, the interposition of a trust and vesting the gratuity fund in the trustees makes a difference."

26. In the present case, the controversy is different. Creation of a trust and vesting the gratuity fund in the trustees in the Madras case *Commissioner of Wealth-tax Vs. Ranganayaki Gopalan and Others*, makes a difference.

27. For what we have said above, we answer the question in the affirmative by deciding the same in favour of the Revenue and against the assessee. The Revenue would be entitled to get its costs, which is assessed at Rs. 500.