

(1989) 03 MAD CK 0002

In the Madras High Court

Case No : Writ Petitions No's. 75 and 76 of 1979

TRIPLICANE PERMANENT FUND LTD.

APPELLANT

Vs

COMMISSIONER OF Income Tax AND ANOTHER.

RESPONDENT

Date of Decision : 27-03-1989

Acts Referred:

Income Tax Act, 1961 — Section 264
Payment of Gratuity Act, 1972 — Section 4(2)

Citation : (1989) 78 CTR 173 : (1989) 179 ITR 492 : (1989) 45 TAXMAN 15

Hon'ble Judges : Thanikkachalam, J; Thanikachalam, J

Bench : Division Bench

Judgement

THANIKACHALAM J. - These two writ petitions are filed praying for the issue of a writ of certiorarified mandamus or any other appropriate

writ, direction or order to call for the records relating to the petitioner in C. No. 1241 (55-56) of 1977 T. N. II on the file of the Commissioner of

Income Tax, Tamil Nadu II, Madras - 34 (the first respondent herein), and to quash the order passed therein dated January 19, 1978, confirming

the disallowance of the contribution made to the approved gratuity fund to the extent of Rs. 20,299 for the assessment year 1975-76 and Rs.

10,543 for the assessment year 1976-77 and, consequently, for a direction to allow the abovesaid amounts as deduction while computing the

taxable income of the petitioner in the abovesaid two assessment years.

According to the facts, the petitioner herein constituted a gratuity fund under an irrevocable deed of trust dated June 25, 1967. The gratuity fund

was created in accordance with the provisions as contemplated under Part C of the Fourth Schedule to the Income Tax Act, 1961, in order to

obtain advantage of exemption from tax with regard to the contributions to the

gratuity fund. Application for recognition of the gratuity fund was made by a letter dated November 16, 1970, to the Commissioner. By communication C. No. 207(2) of 1968 dated September 18, 1971, the Commissioner of Income Tax, Madras II, Madras-34, accorded approval to the gratuity fund with retrospective effect from June 25, 1967, which the date of the trust deed.

Consequent on such recognition, the initial contribution made by the petitioner to the gratuity fund was allowed as deduction in the assessment year

1968-69 and, thereafter, annual contributions made to the gratuity fund were allowed as deduction in the various assessment years up to and inclusive of the assessment year 1974-75.

Consequent on the promulgation of the Payment of Gratuity Act, 1972 (Central Act 39 of 1972), with effect from September 16, 1972, the

petitioner was obliged to recompute the amount available in the gratuity fund on the basis of the statutory obligation cast upon it by the said Act. As

the payment of gratuity depends upon the total length of the service of the employees and as it is based on the last drawn salary of the employees,

it became necessary to rework the amount of gratuity payable to the employees at the every year. Accordingly, the petitioner calculated the total

amount of gratuity payable to the employees as on December 31, 1974, and after deducting the amount already available in the gratuity fund, it

was found that a sum of Rs. 24,460 will have to be contributed to the gratuity fund in order to comply with the Payment of Gratuity Act. The

petitioner, accordingly, made payment of this amount to the gratuity fund. Similarly, for the accounting year ending on December 31, 1975, the

petitioner made a contribution of Rs. 14,933 to the gratuity fund, the amount being calculated on the same basis as made in the prior year.

Accordingly, in the assessment for the assessment years 1975-76 and 1976-77, the petitioner claimed deduction of the sums of Rs. 24,460 and

Rs. 14,933, respectively, contributed by it to the gratuity fund. However, the Income Tax Officer, Company Circle II(1), Madras-6, the second

respondent herein in his order dated June 29, 1977, allowed only a sum of Rs. 4,161 in the assessment year 1975-76 and Rs. 4,390 in the

assessment year 1976-77 and disallowed the balance of Rs. 20,299 for the assessment year 1975-76 and Rs. 10,543 for the assessment year

1976-77, respectively. Accordingly to the Income Tax Officer, the second respondent herein, under rule 103 of the Income Tax Rules, only

ordinary annual contribution could be allowed as deductions in the year and this should be within the limits of 8-1/3% of the salary of each

employee for that year.

Against the orders of the second respondent, the petitioner filed revision petitions to the Commissioner of Income Tax, Tamil Nadu-II, Madras-34

who is the first respondent herein, u/s 264 of the Income Tax Act, 1961, and connected, inter alia, that section 36(1)(v) of the Income Tax Act,

1961, which provides for the deduction of any sum paid by the assessee as an employer by way of contribution towards any approved gratuity

fund created by it for the exclusive benefit of its employees under an irrevocable trust does not restrict the amount of contribution and hence rules

103 and 104 which seek to restrict the contribution beyond the scope of the section are ultra vires.

The petitioner further submitted before the first respondent that the excess payment in so far as it has been laid out wholly and exclusively for the

purpose of business will have to be allowed as a deduction u/s 37. It was also contended that the Payment of Gratuity Act, 1972, having cast a

statutory obligation on every employer to make payment of gratuity on a particular basis, the contribution so made to the gratuity fund in

accordance with such statutory requirement will have to be allowed as a deduction and the provisions of the Gratuity Act, the Income Tax Act and

the Rules made thereunder should be construed harmoniously. Lastly, it was submitted that the Department of Company Affairs, New Delhi,

having directed the companies to ascertain the gratuity liability and make suitable provisions in the companies accounts, there is no justification for

denying the relief of deduction and the provisions of the Income Tax Act should be so constructed as not to deprive the company of the benefit of

the deduction.

By his order in C. 1241 (55-56) of 1977-TN-11, dated January 19, 1978, the Commissioner of Income Tax, the first respondent herein, rejected

the various contentions raised by the petitioner and dismissed the revision petitions.

According to the first respondent, as a creature of the statute, he could not go

into the validity of rules 103 and 104, since the rules have the same statutory force as that of the sections in the Income Tax Act. Therefore, the Department is bound to follow and apply the rules. The first respondent pointed out that the plain meaning of the said section was that the contributions can only be 8-1/3% of the employees salary for each year. The first respondent further pointed out that once the contributions have to be considered u/s 36, section 37 will not apply. According to the first respondent, the Income Tax Rules do not permit the revision of the initial contribution consequent on the applicability of the provisions u/s 4(2) of the Payment of Gratuity Act. It was also pointed out that the liability that is stated to have arisen consequent on the Payment of Gratuity Act, 1972, arose on September 16, 1972, relevant for the assessment year 1973-74 and hence the liability cannot be allowed in the assessment years under consideration. For this purpose, the first respondent relied on the decisions of the Kerala High Court in L.J. Patel and Company Vs. Commissioner of Income Tax, and CIT v. Kerala Nut Food Co. [1978] 111 ITR 252 as well as the decision of the Supreme Court in The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, . The first respondent lastly pointed out that the circular issued by the Department of Company Affairs has no bearing on the point at issue and in any case the circular referred only to the accounting procedure and did not constitute any authority for the proposition that the amount disallowed in the instant case should be allowed as an admissible deduction under the Income Tax Act, 1961. Thus, ultimately, the first respondent rejected the revision applications filed by the petitioner and, accordingly, the orders passed by the second respondent were confirmed. It is under these circumstances that the above said writ petitions are filed. Before this court, learned counsel appearing for the petitioner submitted that section 36(1)(v) of the Income Tax Act, 1961, permits deduction of any sum paid by an employer by way of contribution towards an approved gratuity fund created by it for the exclusive benefit of its employees under an irrevocable trust. This section does not contemplate any restriction on the amount of deduction and only provides that all amounts paid to the approved gratuity fund will be allowed as a deduction. In such circumstances, the respondents herein are not justified in their view that

payments made in excess of the contribution contemplated under rule 103 cannot be allowed as a deduction. He further contended that it is not correct to say that rule 103 imposes a restriction on the amount of contribution to be allowed as deduction. A reading of rule 103 clearly points out that it only provides a limit for the ordinary annual contribution to be made by an employer to the approved gratuity fund. But it does not contemplate that only that amount will be allowed as a deduction and hence the order of the first respondent in so far as it states that rule 103 restricts the amount of deduction of the amount contributed to the gratuity fund is not justified in law. Another submission made by learned counsel was that if the interpretation given by the first respondent is tenable, then rule 103 goes beyond section 36(1)(v) and hence such a view is not acceptable.

According to learned counsel for the petitioner, though the annual contribution depends upon the salary of the employee for that year, the actual contribution will have to be worked out on the basis of the total number of years of service based on the salary of that year.

As the salary of the employees are generally on the increase, it will be pertinent to note that the amount to be contributed to the approved gratuity fund will vary from year to year and will not be an exact amount relating to the salary of that particular year alone. Thus, it is submitted that the relevant provisions of the Income Tax Act should be read harmoniously in the light of the provision of the Payment of Gratuity Act, 1972, and especially in the light of the fact that at the time when gratuity is payable, it is payable on the salary last drawn by the employee, it is submitted that the correct interpretation of rule 103 be that the ordinary annual contribution by the employer to the fund should be the total amount of gratuity payable to an employee if he retires on a particular day less the amount already available to his credit in the gratuity fund. As the petitioner has contributed to the gratuity fund on the abovesaid basis, it is submitted that the petitioner is entitled to the deduction as claimed.

According to the petitioner, while sub-clause (v) of section 36(1) does not have any restriction on the amount to be allowed as a deduction in respect of the contributions made by an employer towards an approved gratuity fund, sub-clause (iv) of the same sub-section (1) of section 36

puts a restriction on the amount to be allowed in respect of the contribution made towards a recognised provident fund or an approved

superannuation fund. In such circumstances, it is submitted that the Legislature itself has not contemplated any restriction to be made on the amount

that will be allowable as deduction out of the amount contributed to the approved gratuity fund. It was further submitted that under the Payment of

Gratuity Act, there is an obligation on the part of every employer to pay gratuity to the employees and so long as the amount has been calculated in

accordance with the said Gratuity Act, the contributions will have to be allowed as a deduction, especially when section 36(1)(v) which provides

for the deduction does not envisage any restriction.

According to learned counsel for the petitioner, the provisions of section 36(1)(v) of the Income Tax Act, 1961, rule 103 of the Income Tax Rules

and the provisions of the Payment of Gratuity Act have to be read harmoniously. If, however, a conflict arose, the rule must yield to the provisions

of the Income Tax Act and the Payment of Gratuity Act.

According to learned counsel, the first respondent was not correct in saying that the additional amount contributed to the approved gratuity fund

consequent on the coming into force of the Payment of Gratuity Act, 1972, can, if at all, be considered for deduction only in the assessment year

1973-74 and not in assessment year in question. According to learned counsel, the petitioner has been reworking the amount of contribution

payable every year in accordance with the provisions of the various statutes as well as on the basis of the rules of the approved gratuity fund and

paying the amounts payable on such calculation, and hence the amount claimed is legitimately and properly liable for deduction only in the

assessment years in which they become payable and have been contributed to the approved gratuity fund. Learned counsel further submitted that

by reason of the Circular No. 13 of 1977 of the Department of Company Affairs, there is an obligation cast on every company to ascertain the

exact quantum of gratuity paid to the employees and make suitable provisions in its accounts. In these circumstances, it was submitted that so long

as such quantum has been ascertained and a provision has been made in the accounts and payment of the amount to the approved gratuity fund has

also been made, no question of disallowing any part of the amount claimed as

deduction u/s 36(1)(v) can at all arise.

Learned counsel contended that the amount disallowed have been laid out wholly and exclusively for the purpose of business of the petitioner and

hence ought to be allowed as a deduction u/s 37.

According to learned counsel, it may be that in the absence of a provision like the Payment of Gratuity Act, the matter may fall u/s 36(1)(v) alone,

but where by the mandate of the Gratuity Act, the payment is obligatory, it will be a payment wholly and exclusively laid out for the purpose of

business and payment even if made in a subsequent financial year to comply with the requirement of the statute, should be held to be an admissible

deduction u/s 37 of the Income Tax Act.

According to learned counsel, under the Payment of Gratuity Act, the amount is payable even after the prescribed period with consequences of

liability for penalty for such non-payment. It is, therefore, manifest that the amount, even if it is paid after the relevant financial year, is a payment

made pursuant to the mandate of the statute. Such a payment is necessary to meet the liability u/s 4(2) of the payment of Gratuity Act. It is,

therefore, an admissible deduction even if it is a payment not made in the previous years and the petitioner is entitled to claim the deductions in the

assessment years 1975-76 and 1976-77 corresponding to the accounting years 1973-74 and 1974-75, when the payments were actually made.

On the other hand, learned standing counsel for the Department submitted that section 36(1)(v) of the Income Tax Act, 1961, will have to be read

along with the rules provide in Part C of the Fourth Schedule to the Income Tax Act, 1961, which contains provisions relating to the conditions

and formalities to be observed in the formation and maintenance of the gratuity fund. According to learned standing counsel, in order that a gratuity

fund may receive and retain approval, it shall satisfy the condition set out therein and the rules prescribed by the Board. Rule 9(1)(b) clearly

provides that the Board may make rules limiting the ordinary annual and other contributions of an employer to the fund. Pursuant to these rules, the

Board has stipulated in rule 103 of the Income Tax Rules, 1962, that the ordinary annual contribution by the employer to the fund shall not exceed

8-1/3% of the salary of each employee during each year. Similarly, in rule 104, the Board has prescribed that the initial contribution by the

employer in respect of the past services of an employee shall not exceed 8-1/3% of the employees salary for each year of his past service with the employer. There is, therefore, no substance in the contention of the petitioner that section 36(1)(v) of the Income Tax Act, 1961, does not contain any restriction.

According to learned standing counsel, section 36(1)(v) of the Income Tax Act, 1961, will have to be read harmoniously along with the other

provisions of the Income Tax Act, 1961, viz., provisions in Part C of the Fourth Schedule to the Income Tax Act, 1961, and the rules framed by

the Board. The Petitioners contention that rule 103 only provides the limit of the ordinary annual contribution to be made the employer to the

approved gratuity fund but does not contemplate that only that amount will be allowed as a deduction is incorrect and based on a wrong

interpretation of the said Rule. The said rule clearly provides that the annual contribution by the employer to the gratuity fund shall not exceed 8-

1/3% of the salary of each employee during each year.

It is further submitted that rule 9(1)(b) of Part C, Fourth Schedule, to the Income Tax Act, 1961, clearly envisages that the Board may make rules

limiting the ordinary annual and other contributions by an employer to the gratuity fund. Thus rule 103 has been framed only on the basis of the

express power conferred on the Board. In order to receive and retain the approval to the gratuity fund, it should not only satisfy the condition

provided in the said rule but also any other condition prescribed by the Board. There is no inconsistency between section 36(1)(v) of the Income

Tax Act, 1961, and rule 103 of the Income Tax Rules, 1962, inasmuch as it has been framed on the basis of the express powers conferred on the

Board under Part C of the Fourth Schedule to the Income Tax Act, 1961. Therefore, rule 103 is perfectly valid and binding upon the petitioner.

Learned standing counsel further submitted that section 36(1)(v) of the Income Tax Act, 1961, has to be read along with the rules provided in Part

C of the Fourth Schedule to the Income Tax Act, 1961, and the rules framed by the Board. Rule 103 of the Income Tax Rules, 1962, will govern

ordinary annual contribution by the employer to the gratuity fund and rule 104 will cover the initial contribution. Under rule 103, the ordinary annual

contribution must not exceed 8-1/3% of the employees salary during each year.

Under rule 104, the initial contribution must not exceed 8-1/3% of the employees salary for each year of his past service with the employer. It is submitted that in the present case, the assessee's contributions to the gratuity fund during the two accounting years relevant to the assessment years 1975-76 and 1976-77, respectively, are in the nature of annual contribution falling under rule 103 and that the Income Tax officer rightly allowed as deduction only to the extent of 8-1/3% of the salary of each employee during that year. It is, therefore, submitted that a combined reading of section 36(1)(v) of the Income Tax Act, 1961, and rule 103 made by the Board would show that the disallowance made by the Income Tax Officer is proper and in accordance with law.

Learned standing counsel further submitted that the Income Tax Act, 1961, is a Self-contained Act and that the Payment of Gratuity Act cannot override the provisions of the Income Tax Act, 1961. It is submitted that the interpretation placed by the petitioner on rule 103 is contrary to the literal meaning of the said rule. According to learned standing counsel, having regard to the clear and unambiguous meaning of the said rule, the petitioner cannot import the provisions of the Payment of Gratuity Act into the Income Tax Act in order to support his case for allowance of the excess amount as a deduction. Learned standing counsel further submitted that Parliament has specifically provided under rule 9(1)(b) of part C of the Fourth Schedule to the Act that the Board can make rules limiting the ordinary annual contribution and other contributions by an employer to the gratuity fund. According to learned standing counsel, the petitioner's case is that it wanted to revise the initial contribution to the gratuity fund in accordance with the Payment of Gratuity Act which came into force on September 16, 1972, and if that is so, the extra amount of contribution would qualify for deduction in the assessment year 1973-74 as the liability to pay gratuity, according to the Payment of Gratuity Act, arose during the accounting year 1972-73. It was submitted that the circular issued by the Department of Company Affairs has no relevance to the issue involved herein and that the same is not binding on the respondent.

It was further submitted that section 37 specifically excludes expenditure of the nature described in sections 30 to 36 of the Income Tax Act, 1961. Inasmuch as the contribution to the gratuity fund is dealt with by section

36(1)(v), it cannot qualify for deduction under the residuary section

37 of the Income Tax Act, 1961. It was, therefore, prayed that the writ petitions filed by the petitioner are liable to be dismissed, since there is no merit in these writ petitions.

We have heard the arguments advanced on both sides. We have already set out the facts in detail. We would straightaway deal with the issue arising in these writ petitions in the following manner.

Any contribution made by the employer to the approved gratuity fund is allowed as a permissible deduction in the computation of the employers

income from business under clause (v) of section 36. The Board has made rules which are contained in the Income Tax Rules, 1962. Rule 101

specifies the mode of investment of the trust monies. Rule 103 permits the ordinary annual contribution to be made on a reasonable basis

approved by the Commissioner so long as it does not exceed 8 1/3% of the concerned employees annual salary. Rule 104 deals with initial

contribution and stipulates that it shall not exceed 8 1/3% of the employees salary for each year of his past services with the employer.

Section 36 of the Income Tax Act, 1961, provides that any sum paid by the assessee as contribution towards an approved gratuity fund shall be

allowed as a deduction in computing his business income. The aforesaid rule 104 came into effect from April 1, 1962, and is applicable to

assessments made for the assessment year 1962-63 and subsequent years.

The language of this rule implies that the initial contribution has to be made in year which the employee is admitted to the benefit of the fund.

Section 4(2) of the Payment of Gratuity Act, 1972, states that for every completed year of service or part thereof in excess of six months, the

employer shall pay gratuity to an employee at the rate of 15 days wages based on the rate of wages last drawn by the employee concerned.

Section 14 of the Payment of Gratuity Act, 1972, provides as follows : ""The provisions of this Act or any rule made thereunder shall have effect

notwithstanding anything inconsistent therewith contained in any enactment, other than this Act or in any instrument or contract having effect by

virtue of any enactment other than this Act.

Thus, the provisions of the Payment of Gratuity Act override the provisions contained in the Income Tax Act, 1961.

Consequent on the promulgation of the Payment of Gratuity Act, 1972, with effect from September 16, 1972, the petitioner was compelled to recompute the amounts available in the gratuity fund on the basis of the statutory obligation cast on it by the said Act. As the payment of gratuity depends upon the total length of service of the employees and is based on the last drawn salary of the employees, it became necessary to rework the amount of gratuity payable to the employees at the close of every year. Accordingly, the petitioner calculated the total amount of gratuity payable to the employees as on December 31, 1974, and after deducting the amount already available in the gratuity fund, it was found that a sum of Rs. 24,460 will have to be contributed to the gratuity fund in order to comply with the provisions of the Payment of Gratuity Act. The petitioner, accordingly, remitted the payment of this amount to the gratuity fund. Similarly, on the same basis for the accounting year ended December 31, 1975, the petitioner made contribution of Rs. 14,933 to the gratuity fund. By applying rule 103 of the Income Tax Rules, the respondents allowed only 8-1/3% of salary of each employee for each year. On this basis, only a sum of Rs. 4,161 for the year 1975-76 and Rs. 4,390 for the year 1976-77 were allowed as deduction and the balance was disallowed. According to learned counsel appearing for the petitioner, since the petitioner was liable to contribute to the gratuity fund as per the provisions of the gratuity Act the entire payment made should be allowed as a deduction. If 8-1/3% is allowable, according to the petitioner, u/s 36(1)(v) of the Income Tax Act 1961, and rules 103 and 104 of the Income Tax Rules, 1962, then the balance would be allowable as expenditure laid out wholly and exclusively for the purpose of business u/s 37 of the Income Tax Act. However, learned standing counsel pointed out that if the deduction u/s 36(1)(v), then the balance cannot be allowable u/s 37, because when section 36(1)(v) is applied, then section 37 is excluded. It remains to be seen whether there are decisions to show that when the assessee made a provision on a "scientific" basis for future payment of gratuity, that is not covered by either of these clauses but was covered by the general principal and allowable as deduction u/s 28 itself. It is, however, a generally accepted view that a provision made on a scientific and actuarial basis for payment of future gratuity would be allowable on

general principles u/s 28 itself. The Allahabad High Court in the case of Swadeshi Cotton Mills Co. Ltd. Vs. Income Tax Officer, "A" Ward, held

that contribution towards gratuity is permissible business expenditure. The contention of the Department that the payment of gratuity is provided for

in clause (v) of sub-section (1) of section 36 and, therefore, it can only be allowed in accordance with that provision was repelled by saying that

the amount was already deductible u/s 28 while computing the gross profit. Similar view was also taken 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, , by the Delhi High Court in Dalmia Dadri

Cement Ltd. v. CIT [1980] 126, by the Karnataka High Court in Mysore Tobacco Co. Ltd. Vs. Commissioner of Income Tax, Karnataka-II,

Bangalore, . The Kerala High Court in Commissioner of Income Tax Vs. Standard Furniture Co. Ltd. (In Liquidation), has clarified that the mere

fact that a claim would not fall within section 36 would not automatically make it unsustainable under other provisions of the Act.

It also remains to be seen whether section 40A would have effect notwithstanding anything contained in sections 30 to 37 including sections 36

and 37. Where, however, the contribution was of a special nature inasmuch as the entire provision for gratuity was liability in praesenti capable of

ascertainment and not a contingent liability, it was held in Commissioner of Income Tax (Central-I) Vs. Eastern Spinning Mills Ltd., and

Commissioner of Income Tax Vs. National Insurance Co. of India, that the same was a permissible deduction u/s 37 notwithstanding that it was

not covered by clause (v) of sub-section (1) of section 36. While considering a question of similar nature, the Allahabad High Court in Addl.

Commissioner of Income Tax Vs. Balrampur Raj Electric Supply Co., confirmed the following view taken by the Tribunal (headnote) :

Rule 104 of the Income Tax Rules, 1962, read with section 37(1) of the Income Tax Act, 1961, only laid down the limit and did not provide for

the exact amount allowable towards payment of gratuity, that the salary paid to the employee in the year in which the provision was made was the

relevant factor that even if the assessee had made any excess contribution, it was allowable under sections 37(1) of section 28(i), since the

assessee followed the mercantile system of accounting and the payments were made for business purposes in the capacity as a trader.

In a similar situation in Commissioner of Income Tax (Central), Madras Vs. Mettur Spinning Mills, , this High Court held as under (headnote) :

As the gratuity provision was based on actuarial valuation, it was a proper charge against the profits and was properly deductible u/s 37.

So also in Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, , the Supreme

Court had occasion to discuss, in general terms, the nature of a provision for gratuity as under (at p. 992 of 140 ITR) :

Where a portion of the profits is set aside as a provision for gratuity to the employees and that provision is strictly based on an actuarial valuation

of the employers commitment towards gratuity liability, such a provision made out of current profits will be a proper charge against these profits,

notwithstanding that no liability actually arises and the liability remains only contingent during the year.

While dealing with this issue in Commissioner of Income Tax, Tamil Nadu-V Vs. Sitalakshmi Mills Ltd., , this High Court took the following view

(headnote) :

Where there is no specific statutory provision for deduction of a certain item in the computation of taxable business profits, it does not mean that

the item goes without any deduction at all, but the question will have to be resolved on the basis of commercial accounting principles provided they

do not go against the grain of the Income Tax statute, or the fiscal concept of business income.

While considering the incremental liability arising in the matter of contribution made to the gratuity fund, this court, in the case of Commissioner of

Income Tax, Tamil Nadu-II Vs. Madras Rubber Factory Limited: (No. 2), , restated the legal position on this point as under :

As pointed out by this court in Commissioner of Income Tax, Tamil Nadu-V Vs. Sitalakshmi Mills Ltd., , it has now become well established that

where an employer has a gratuity scheme rendering him liable to pay gratuity to workmen and where having regard to the liability which might arise

under the scheme, the employer obtains a scientific actuarial calculation under which the present discounted value of the gratuity liability is

ascertained and where the employer charges his profit and loss account with incremental value of the year and also makes a provision for that

amount, the employer will be entitled to compute his net profits after deduction the employer will be entitled to compute his net profits after

deduction the figure of incremental liability. That the assessee will be entitled to deduct the incremental liability for payment of gratuity during the

accounting year, if he had made a claim on the basis of actuarial valuation, is clear from the decision of the Supreme Court in Vazir Sultan Tobacco

Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, .

A similar question also arose before this court in the case of Commissioner of Income Tax Vs. Andhra Prabha P. Ltd., , wherein it was held as

under (headnote) :

That section 36(1)(v) of the Act provided for deduction of any amount actually paid by way of contribution to an approved gratuity fund created

by the employer while section 40A(7) introduced by the Finance Act, 1975, with effect from April 1, 1973, prohibited deduction of a provision for

gratuity, the prohibition, however, not extending to, (a) provision for contribution to approved gratuity fund, or (b) provision for payment of gratuity

for which a liability has arisen during the year. These two provisions did not cover the case where a provision was made for a future payment on a

scientific method of calculation. The present claim being of a provision made for a future payment calculated on scientific basis, the amount was not

covered by any of the specific provisions of the statute and hence was allowable in the computation of the profits u/s 28 itself.

This decision was confirmed by the Supreme Court in Commissioner of Income Tax, Madras Vs. Andhra Prabha P. Ltd., . The Supreme Court in

Commissioner of Income Tax, Madras Vs. Andhra Prabha P. Ltd., , pointed out that the legal position on this has been analysed by this court in its

recent decisions, in Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, . Thus, the Supreme Court, in 156 ITR

585, after considering all the prior decisions, on this point, summarised the legal position as under (headnote p.587) :

The position till the provisions of section 40A(7) were inserted in the Act in 1973 was as follows :

(1) Payment of gratuity actually made to the employee on his retirement or termination of his services was expenditure incurred for the purpose of

business in the year in which the payments were made and allowed u/s 37 of the Act.

Even after the introduction of the provisions of section 40A(7) in the Act in 1973, there is no change in the legal position so far as the actual

payment of gratuity is concerned. Hence the actual payment made towards gratuity liability is allowable in the year in which it is paid.

In view of the judicial pronouncements cited supra and on a careful consideration of facts arising in this writ petitions, it is not possible to accept the

arguments advanced on behalf of the respondents that contribution made towards gratuity fund is allowable only to the extent of 8-1/3% of the

employees salary for each year. So also the argument advanced by learned standing counsel that the excessive contribution made towards gratuity

liability beyond 8-1/3% cannot be allowed u/s 37 is also not acceptable. Similarly, the contention raised by learned standing counsel that the

liability to contribute to the gratuity fund according to the Gratuity Act arose when the Gratuity Act came into force and hence the same cannot be

allowed in the assessment years 1975-76 and 1976-77, when the actual payment was made, also cannot be accepted.

In that view of the matter, we quash the order passed by the first respondent herein, the Commissioner of Income Tax, Tamil Nadu II, Madras-34

in C.S. No. 1241 (55-56) of 1977 dated January 19, 1978, and direct the respondents to allow further sums of Rs. 20,299 in the assessment year

1975-76 and Rs. 10,543 in the assessment year 1976-77 as claimed by the petitioner.

Accordingly, the writ petitions are allowed with costs. Counsels fee Rs. 500.