Gordon Woodroffe Leather Manufacturing Company

Vs

Commissioner of Income-Tax, Madras

Civil Appeal No. 62 of 1961

(CJI B. P. Sinha, J. C. Shah, J. L. Kapur, M. Hidayatullah, J. R. Mudholkar JJ)

20.12.1961

JUDGMENT

KAPUR J. –

This appeal by special leave is directed against the judgment and order of the High Court of Judicature at Madras. The appellant is the assessee and the respondent is the Commissioner of Income-tax and the question raised is as to the applicability of section 10 (2) (xv) of the Indian Income-tax Act to a gratuity paid by the appellant to one of its officers on his retirement from service.

The appeal relates to the assessment year 1950-51. M/s. Gordon Woodroffee & Co. (Madras) Ltd., was incorporated as a private limited company in 1922 and became the managing agent of a public limited company M/s. Gordon Woodroffee Leather Manufacturing company Ltd., which is the assessee. One J. H. Philips was employed in the managing agent company from 1922 to 1935 and from 1935 he became an employee of the appellant company and became its director from 1940. On March 22, 1949, he wrote a letter to the appellant company expressing his intention to resign from the board of the company as from April 4, 1949, upon his retirement from the employment of the company and requested that his resignation be accepted. On March 24, 1949, the board of directors of the appellant company passed a resolution that his resignation be accepted and in appreciation of his long and valuable services to the company he be paid a gratuity of Rs. 50,000 out of which the appellant company was to pay Rs. 40,000 and the managing agent c

This amount was claimed as a deduction under section 10 (2) (xv) of the Income-tax Act which reads :

> "10. (2) Such Profits or gains shall be computed after making the following allowances, namely :-
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> (xv) any expenditure (not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure of personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

The amount was disallowed by the Income-tax Officer as well as by the Appellant company had no pension scheme; the payment was voluntary and that the entry in the assessee's books clearly indicated it to be a capital payment. Against this order the appellant company took an appeal to the Income-tax Appellate Tribunal which upheld the order of the Appellate Assistant Commissioner. It

held that according to the resolution the gratuity was paid "for long and valuable services to the company", that there was nothing to indicate that Mr. J. H. Philips had accepted a lower salary in expectation of getting a gratuity at the end of his service; that there was no such practice in the appellant company and that during the course of his service he was being remunerated at a graduated scale of salary and a commission of 2 1/2% on the profits; that there was no "expectancy" that at the end of the service there would be a recompense for faithful and efficient service; that he had been suitably rewarded by being given a commission on the profits "in order to whip up his enthusiasm". It was also mentioned that in the books of the appellant company the amount had not been debited in the profit and loss account but was debited to the appropriation account thereby indicating that it was an extra payment or a payment made in the nature of a capital expense. Taking all these circumstances into consideration the Tribunal came to the conclusion that it was difficult to hold that the expenditure was not in the nature of a capital expenditure or that it was expended wholly and exclusively for the purpose of the assessee's business. At the instant of the appellant company the case was stated to the High Court under section 66 (1) of the Income-tax Act and the following question was referred :

> "Whether the sum of Rs. 40,000 paid to Mr. J. H. Philips on his retirement from the service of the company was not an admissible deduction under section 10 (2) (xv) of the Income-tax Act, 1922 ?"

The High Court answered the question against the appellant company. It held that in order that section 10 (2) (xv) be applicable it had to be proved that the amount was laid out or expended wholly and exclusively for purposes of the company's business. In this case the amount was paid on retirement and for valuable service rendered by Mr. J. H. Philips; there was no evidence that his expected to receive this amount or the company contemplated its payment at any time before; the payment was voluntary and there was no evidence to show that it was in the future interest of the business of the company that the expenditure was Incurred. The High Court observed :

> "In the case of payment of a gratuity to a retiring employee in recognition of his past services, with nothing more, cannot, in our opinion, satisfy they requirements of section 10 (2) (xv), even if those requirements are judged from the view point of commercial expediency, as it always should be when a claim arises under section 10 (2) (xv). Was there any connection between the purpose of the payment and the further conduct of the business of the assessee ? These are the tests to be satisfied before it could be said that in paying the gratuity money was laid out or expended wholly and exclusively for the purpose of the business of the company. These tests the assessee did not satisfy in this case."

Against this judgment and order the appellant company has brought this appeal by special leave.

It was argued on behalf of the appellant that the amount had been paid as a matter of commercial expediency and in the interest of the company as an inducement to other employees that if they rendered service in a similar manner with efficiency and honesty they would be similarly rewarded. Decisive test, it was submitted, was whether such payments of gratuity were likely in future also and was the payment made as an incentive to the employees to give their best to the employer and if it was so then the payment was a matter of commercial prudence. It was also submitted that the company had acted not with any oblique motive and its good faith was not in doubt, and in support of the contention several cases were relied upon.

In our opinion on the findings as given the payment in dispute does not fall within the provisions of section 10 (2) (xv). The amount was paid not in pursuance of any scheme of payment of gratuities nor was it an amount which the recipient expected to be paid for long and faithful service but it was a voluntary payment not with the object of facilitating the carrying on of the business of the appellant company or as a matter of commercial expediency but in recognition of long and faithful service of Mr. J. H. Philips. There was no practice in the appellant company to pay such amount and it did not affect the quantum of salary of the recipient. The two cases strongly relied upon by the appellant company were J. P. Hancock v. General Reversionary and Investment Company Ltd. and J. W. Smith v. Incorporated Council of Law Reporting for England and Wales. In the former case the assessee company sought to charge as a trade expense a lump sum which it had paid for the purchase, for the benefit of former actuary, of

In our opinion the proper test to apply in this case is, was the payment made as a matter of practice which affected the quantum of salary or was there an expectation by the employee of getting a gratuity or was the sum of money expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. But this has not been shown and therefore the amount claimed is not a deductible items under section 10 (2) (xv).

The appeal therefore fails and is dismissed with costs.

Appeal dismissed.

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