

# CALCUTTA HIGH COURT

Peoples Engineering & Motor Works

Vs

Commissioner of Income-Tax

(Sabyasachi Mukharji and S M Guha, JJ.)

04.08.1980

## JUDGMENT

### **Sabyasachi Mukharji, J.**

1. In this reference under Section 256(2) of the I.T. Act, 1961, the following questions have been referred to this court:

"1. Whether, on the facts and in the circumstances of the case and on a true interpretation of the statutory provisions, the Tribunal was right in upholding the disallowance of the sum of Rs. 2,15,651 (Rupees two lakhs fifteen thousand six hundred and fifty-one only) which was claimed by the assessee as deductible under Section 37 of the Income-tax Act, 1961, on account of provision for payment of gratuity to the employees under the Payment of Gratuity Act, 1972 ?

2. Whether, on the facts and in the circumstances of the case, the provisions of Section 40A(7) of the Income-tax Act, 1961, had no application ?"

2. The assessee is a company and the relevant assessment year is 1973-74. Corresponding accounting period ended on 31st December, 1972. Accounts were maintained on mercantile basis. Return of income was filed on the 13th May, 1974, showing a loss of Rs. 1,58,655. The total income, however, was computed at Rs. 88,948 by the ITO in the assessment where a sum of Rs. 2,15,651, being provision for gratuity, was disallowed. The ITO had noticed that an amount of Rs. 28,649 pertaining to the period relevant to the assessment year was only allowable in the assessment. Since the claim was not based on the actuarial method, according to the ITO, he disallowed the whole amount. The assessee, however, felt aggrieved with the disallowance made in the assessment and preferred an appeal before the AAC. The AAC upheld the disallowance following certain decisions of the Supreme Court.

3. The assessee, thereafter, went up in appeal before the Tribunal. The Tribunal observed, *inter alia*, as follows:

"We have given due consideration to the rival submissions and are of the opinion that in view of the overriding provisions in Section 40A(7) of the Income-tax Act, 1961, which

was inserted with retrospective effect from 1st April, 1973, by the Finance Act, 1973, the claim of the assessee for deduction of Rs. 15,651 in the instant assessment has been rightly turned down by the authorities below. Learned counsel for the assessee admits before us categorically that the assessee had not fulfilled the provisions of Section 40A(7). In the instant case before us, the Income-tax Officer completed the relevant assessment on 25th September, 1974, and the Appellate Assistant Commissioner disposed of the appeal against the said assessment on 25th January, 1975. Hence, none of the authorities below could get an opportunity of considering the assessee's claim in the light of the provisions of Section 40A(7).

Learned counsel has raised the issue of validity of the provisions of Section 40A(7). In view of the decision of the Supreme Court in the case of K. S. Venkataraman and Co. (P.) Ltd. v. State of Madras, that an authority constituted under the Act cannot, unless expressly so authorised, question the validity of the Act or any provision thereof, we are unable to entertain the issue raised by the assessee's learned counsel. No doubt, had there been no provision like Section 40A(7) under the statute, the assessee, in our opinion, would have been entitled to the deduction of Rs. 2,15,651 which was less than the actuarial valuation of Rs. 2,42,281, but as the assessee had not fulfilled the provisions of Section 40A(7), we cannot direct the Income-tax Officer to allow the amount in dispute. In view of the Payment of Gratuity Act, 1972, a liability on account of payment of gratuity, had arisen for the assessee-company towards its employees. This was a statutory liability created by the Payment of Gratuity Act, 1972, which came into force with effect from 21st August, 1972, i.e., during the assessee's accounting period relevant to the assessment year 1973-74, with which we are concerned in the appeal. In view of our discussions above and in view of the provisions of Section 40A(7) of the Income-tax Act, 1961, the amount of Rs. 2,15,651 had been correctly disallowed in the assessment."

4. The fact relevant to the present purpose that emerged from this narration of facts is that there was a statutory liability created by the Payment of Gratuity Act of 1972, which came into force with effect from 21st August, 1972, during the assessee's accounting period relevant to the assessment year 1973-74, with which the Tribunal was concerned and we are concerned in this reference. The Tribunal found, as we have noticed before, that there was a valuation of Rs. 2,42,281 on the actuarial method and the Tribunal found that Section 40A(7) of the I.T. Act, 1961, would be attracted and as the condition laid down by the sub-section had not been fulfilled, on which there was no dispute, the Tribunal was unable to allow the assessee's appeal.

5. Before we proceed further, it is necessary to refer to the scheme of the Payment of Gratuity Act of 1972. The Payment of Gratuity Act of 1972 is an Act to provide for a scheme for payment of gratuity to the employees engaged in factories, mines, oil fields, plantation, ports, railway companies, shops and other establishments and for matters concerned thereof or incidental thereto. Section 4 of the Act enjoins that gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years, and there are three contingencies, viz., on his superannuation, or on his retirement or resignation, or on his death or disablement due to accident or disease. There were certain other Explanations, provisos and special requirements with which we are not directly concerned. "Under Sub-section (2) of Section 4 of the Payment of Gratuity Act it is provided that gratuity shall be payable to an employee on the termination of the employment 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 fifteen days' wages based on the rate of wages last drawn by the employees

concerned. There are also certain other provisos with which we are not concerned. Section 8 of the Act provides for recovery of gratuity. Section 9 stipulates penalty for non-payment and Section 14, upon which reliance was placed on behalf of the assessee, stipulates that 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. We need not detain ourselves with the other provisions of the Act.

6. It is necessary, as the learned advocate for the assessee drew our attention to certain provisions of the I.T. Act, 1961, to refer to those out of deference to his argument, though the scheme of the sections are quite clear. Sections 28 and 29 are under the heading " Profits and gains of business or profession" and how the computation has to be made. Other sections deal with other incomes and it would be necessary, in this connection, to refer to Section 36 in particular which provides for deductions in respect of matters dealt with in Section 28 in computing the income. We need not set out in detail Section 36. But Sub-clause (v) of Sub-section (1) of Section 36 includes "any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust " as one of the items eligible for deduction. Section 37 stipulates that any expenditure riot being expenditure of the nature described in Sections 30 to 36 including Section 36(1)(v) and not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of the business or profession shall be allowed in computing the income chargeable under the head " Profits and gains of business or profession". There are also certain exceptions with which we are not concerned directly. Under the heading "Amounts not deductible ", Section 40 stipulates that, notwithstanding anything to the contrary in Sections 30 to 39, certain expenditures shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession ". We are also not concerned with that section. Section 40A is the section with which we are directly -concerned. Sub-section (1) of Section 40A stipulates that the provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provisions of the said Act relating to the computation of income under the head "Profits and gains of business or profession". The income from profits and gains of business or profession has to be computed by allowing deductions contemplated by the different sub-clauses of Section 36 or even in respect of other items not included in the different sub-clauses of Section 36, Under Section 37, it is stipulated that any expenditure which is laid out or expended wholly and exclusively for the purposed the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". It is important to bear this aspect in mind because it is in the computation of income under the head " Profits and gains of business or profession ", either under Section 36 or Section 37, that certain deductions are allowed. There is no general law as such. Section 40A, Sub-section (1), specifically prohibits "allowance of certain expenditure or liability". Section 40A makes it clear that the provisions of that section shall have effect notwithstanding anything to the contrary contained in any other provisions of the said Act relating to the computation of income under the head "Profits and gains of business or profession " or, in other words, it means that Section 40A would have effect notwithstanding anything contained in Sections 30 to 37 of the Act including Sections 36 and 37 Section 40A, Sub-section (7), provides, inter alia, as follows :

" Subject to the provisions of Clause (b), no deduction shall be allowed in respect of any

provision (whether called as such or by any other name), made by the assessee for the payment" of gratuity to his employees on their retirement or on termination of their employment for any reason, (b) Nothing in Clause (a) shall apply in relation to-

(i) any provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year ;

(ii) any provision made by the assessee for the previous year relevant to any assessment year commencing on or after the 1st day of April, 1973, but before the 1st day of April, 1976, to the extent the amount of such provision does not exceed the admissible amount, if the following conditions are fulfilled, namely :--

(1) the provision is made in accordance with an actuarial valuation of the ascertainable liability of the assessee for payment of gratuity to his employees on their retirement or on termination of their employment for any reason ;

(2) the assessee creates an approved gratuity fund for the exclusive benefit of his employees under an irrevocable trust, the application for the approval of the fund having been made before the 1st day of January, 1976 ; and (3) a sum equal to at least fifty per cent. of the admissible amount, or where any amount has been utilised out of such provision for the purpose of payment of any gratuity before the creation of the approved gratuity fund, a sum equal to at least fifty per cent. of the admissible amount as reduced by the amount so utilised, is paid by the assessee by way of contribution to the approved gratuity fund before the 1st day of April, 1976, and the balance of the admissible amount or, as the case may be, the balance of the admissible amount as reduced by the amount so utilised, is paid by the assessee by way of such contribution before the 1st day of April, 1977,"

7. We are leaving out the Explanations which are not necessary for our present purpose. Therefore, Sub-section 7(a) stipulates that subject to the provisions of Clause (b) no deduction shall be allowed in respect of any provision, whether called as such or by any other name, made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason. But, in order to attract Clause (a), the conditions under Clause (b) are required to be fulfilled. Now, it is a common case that though the condition contemplated by Clause (b) of Sub-clause (ii)(1) has been fulfilled, the other two requirements have not been fulfilled.

8. Learned advocate for the assessee drew our attention to the observations in *Crates on Statute Law*, 7th edn., at pp. 97 and 100, where it was observed that the courts were entitled and indeed bound, when considering the terms of any provision, to construe them, in case of conflict, in such manner which is consistent with what is reasonable. It is undoubtedly a salutary principle to be followed. Had it been necessary for us to decide this case on such a conflict we would certainly have adhered to that well-known dictum. Learned advocate for the assessee emphasised that the liability accrued under the Payment of Gratuity Act and the deduction imposed under Section 4 of the Payment of Gratuity Act of 1972 was a statutory liability which was created for the first time in the year in question. This position was also indisputable. Learned advocate for the assessee further emphasised that other deductions contemplated by Section 28 to 37 of the I.T. Act, 1961, in the computation of the income under the head "profits or gains of business" was either directly a liability or liabilities arising under other provisions. But, in this case, the statute had used the expression, as the learned advocate tried to emphasize, that the provisions of the Payment of Gratuity Act would have effect notwithstanding anything inconsistent therewith

contained in any enactment. So, it was emphasized that, irrespective of the provisions of the I.T. Act, the statutory liability created by the Payment of Gratuity Act, 1972, must prevail and should be allowed as a deduction.

9. The payment of gratuity is a statutory liability created for those who are earning income from the business profits and gains by carrying on business or profession or by carrying out adventure or trade which are of the same nature. The computation of such income and the deductions to be allowed must be guided by the provisions of the I.T. Act and those are categorical with what are the deductions to be allowed and these deductions are provided in Section 30 and Section 37 and, notwithstanding these deductions, it is specifically provided under Section 40A that certain conditions are to be fulfilled for payment of gratuity. Gratuity, being one of the deductions, normally can be said to have arisen for carrying on the business, which is specifically excluded, and there is no question of conflict in this regard. But, only harmonious consideration should be allowed as a deduction for a specific item (sic.) The Tribunal dealt with a specific item required for such allowance and which, it is admitted in this case, has not been fulfilled.

10. In that view of the matter, we are of the opinion, that the Tribunal was right in its conclusion. Question No. 1 is, therefore, answered in the affirmative and in favour of the revenue and, so far as question No. 2 is concerned, we hold that Section 40A(7) of the I.T. Act, 1961, is applicable and as the conditions had not been fulfilled, the assessee was not entitled to the deductions.

11. In the facts and circumstances, each party will pay and bear its own costs.

**Sudhindha Mohan Guha, J.**

**12. I agree.**

