# Shree Sajjan Mills Ltd vs Commissioner Of Income Tax, M.P. Bhopal ... on 8 October, 1985

## Equivalent citations: 1986 AIR 484, 1985 SCR SUPL. (3) 593, AIR 1986 SUPREME COURT 484, 1986 TAX. L. R. 48, (1985) 23 TAXMAN 37, 1985 (19) TAX LAW REV 341, 1985 42 ITJ 1109, 1986 SCC (TAX) 82, 1986 UPTC 786, (1987) JAB LJ 176, 1985 TAXATION 79 (3) 173, (1985) 156 ITR 585, 1985 (4) SCC 590, (1985) 49 CURTAXREP 193, (1986) 2 SUPREME 45

## Author: Sabyasachi Mukharji

## Bench: Sabyasachi Mukharji, V.D. Tulzapurkar, Misra Rangnath

PETITIONER:
SHREE SAJJAN MILLS LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAX, M.P. BHOPAL AND ANR.

DATE OF JUDGMENT08/10/1985

BENCH:
MUKHARJI, SABYASACHI (J)
BENCH:
MUKHARJI, SABYASACHI (J)
TULZAPURKAR, V.D.
MISRA RANGNATH

CITATION:
1986 AIR 484 1985 SCR Supl. (3) 593
1985 SCC (4) 590 1985 SCALE (2)737
CITATOR INFO :
RF 1987 SC1143 (8)
R 1987 SC1770 (3)

ACT:
Income Tax Act 1961, ss. 40A (7), 36 (1) (v) and 37 (1) Deduction - Payment of Gratuity - Whether deduction can be claimed under any other provision under the head "business or profession" without complying with the requirements of s. 40A (7) (b) - Distinction between an actual liability in praesenti and a liability de futuro explained.

Interpretation of statutes - Taxing statutes - Principle of reasonable construction - Applicability of -

Words and Phrases - "Provision" - Meaning of.

HEADNOTE:

The appellant-assessee is a public limited company. The relevant assessment year in C.A. No. 4222 of 1984 is 1973-74. With the coming into force of the Payment of Gratuity Act, 1972 with effect from 16th September 1972 a statutory liability was created on the assessee to pay gratuity to its employees and the appellant arranged for actuarial determination of its liability. Pending determination of such an actuarial valuation, the assessee made a provision of Rs. 20 lacs against the total accruing liability till the date of the preparation of the balance sheet. At the time of filing of the return of income for the assessment 1973-74, the assessee added back this provision for gratuity amounting to Rs. 20 lacs and claimed deduction of the total liability of Rs. 48,59,431 which was the actuarial determination of liability on the ground that the provisions of s.40A (7) of the Income Tax Act 1961 were not applicable.

The Income-Tax Officer disallowed the claim on the ground that there was non-compliance with the requirements of section 40A (7) of the Act, and allowed deduction only to the extent of actual payment which came to Rs. 24,366 towards payment of gratuity to the employees during the relevant accounting year.

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Against the aforesaid order of the Income-tax Officer, an appeal was preferred before the Appellate Assistant Commissioner who held that provisions of section 40A (7) did not constitute any bar to the assessees claim for deduction u/s 37 of the Act as the assessee had not made any provision in its books in respect of the amount of gratuity determined actuarially and the provision of Rs. 20 lacs had also been added back in the statement of income. The Appellate Assistant Commissioner, however, allowed deduction of Rs. 30,25,662 on this head which according to him constituted the assessees liability for the relevant accounting year.

The Revenue appealed to the Tribunal which held that the sum of Rs. 20 lacs could not be allowed as deduction, but, the balance of Rs. 28,59,431 for which no provision was made in the books was allowable under section 37(1) of the Act.

In the reference to the High Court under section 256(1) of the Act at the instance of the Revenue, it was held that the tribunal was not justified in allowing the deduction of Rs. 28,59,431 under section 37 of the Act out of the total Rs. 48,59,431 made by the assessee towards liability for gratuity on the ground that in view of the non-obstante clause in section 40A of the Act, no deduction was permissible under section 37 for the assessee's liability for payment of gratuity to its employees without complying with the provisions of sub-section (7)(a) of Section 40A of

the Act. A similar question of law arose in the other appeal where the appellant - assessee is the same.

Dismissing the appeals to this Court,

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HELD: l(i) Payment of gratuity as commonly understood is the payment made to the employee by the employer on his retirement or termination of his service for any reason. It is made voluntarily by the employer as a regular practice or pressure of trade or business either under an agreement with the employees or on the understanding of the trade and after the enactment of the Payment of Gratuity Act, 1972 which came into force on 16th September, 1972 as a Statutory liability under the said Act. Although payment of gratuity is made on retirement or termination of service, it was not for the service rendered during the year in which the payment is made but it is made in consideration of the entire length of service and its ascertainment and computation depend upon several factors. [608 H; 609 A-B]

1(ii) The right to receive the payment accrued to the employees on their retirement or termination of their services

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and the liability to pay gratuity became the accrued liability of the assessee when the employees retire or their services were terminated. Until then the right to receive gratuity is a contingent right and the liability to pay gratuity continues to be a contingent liability qua the employer. Since the amount of gratuity payable in any given year would be a variable amount depending upon the number of employees who would be entitled to receive the payment during the year, the amount being a large one in one year and a small one in another year, the employer often finds it desirable and/or convenient to set apart for future use a sum every year to meet the contingent liability as a provision for gratuity or a fund for gratuity. He might create an approved gratuity fund for the exclusive benefit of his employees under an irrevocable trust and make contributions to such fund every year. Contingent liabilities do not constitute expenditure and cannot be the subject matter of deduction even under the mercantile system of accounting. Expenditure which was deductible for income tax purposes is towards a liability actually existing at the time but setting apart money which might become expenditure on the happening of an event is not expenditure. [609 C-G]

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

1. Payments of gratuity actually made to the employee on his retirement or termination of his service were expenditure incurred for the purpose of business in the year in which the payments were made and allowed under section 37 of the Act.

2. Provision made for payment of gratuity which would become due and payable in the previous year was allowed as

an expenditure of the previous year on accrued basis when mercantile system was followed by the assessee.

3. Provision made by setting aside an advance sum every year to meet the contingent liability and gratuity as and when it accrued by way of provision for gratuity or by way of reserve or fund for gratuity was not allowed as an expenditure of the year in which such sum was set apart.

4. Contribution made to an approved gratuity fund in the previous year was allowed as deduction under section 36(1)(v).

5. Provision made in the Profit and Loss Account for the estimated present value of the contingent liability properly

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ascertained and discounted on an accrued basis as falling on the assessee in the year of account could be deductible either under Section 28 or section 37 of the Act. [610 E-H; 611 A]

1(iv) As there were several methods which the assesseeight choose to adopt in meeting his liability to pay gratuity, the treatment which he would receive under the Income-tax Act would depend upon the method adopted by him. The assessee is only under an obligation to pay gratuity when it became due ant payable. The other methods adopted by the assessee for meeting the liability for gratuity as and when it arose are provisions or arrangements mate by him at his option. It is not obligatory on him to make any such provision and if no such arrangement or provision was made, no question arose to consider its deductibility or allowance under the Act. [611 B-C]

2(i) On a plain construction of clause (a) of sub-section (7) of section 40A of the Act, it means that whatever is provided for future use by the assessee out of the gross profits of the year of account for payment of gratuity to employees on their retirement or on the termination of their services would not be allowed as deduction in the computation of profits and gains of the year of account. The provision of clause (a) was made subject to clause (b). The embargo is on deductions of amounts provided for future use in the year of account for meeting the ultimate liability to payment of gratuity. Clause (b)(i) excludes from the operation of clause (a) contribution to an approved gratuity fund any amount provided for or set apart for payment of gratuity which would be payable, during the year of account. Clause (b)(ii) deals with a situation that the assessee might provide by the spread over method and provides that such provision would be excluded from the operation of clause (a) provided the three conditions laid down by the sub-clauses are satisfied. [612 E-H]

2(ii) The expression 'provision' in clause (a) of the said sub-section has not been defined in the Act and is not used in any artificial sense but in its ordinary meaning.

This is clear from the words (whether called as such or by any other name) occurring in sub-section. 'Provision' in its ordinary sense means 'something provided for future use'. [612 D]

2(iii) Section 40A is in Chapter IV which deals with computation of total income. It is with the marginal note under the heading "expenses or payments not deductible in certain circumstances". The heading of this section is a clear indication

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that certain payment and expenses which would be otherwise deductible would not be deductible except in certain circumstances indicated in the section. This is abundantly made clear by the non-obstante expression used in sub-section (1) of section 40A. The provision of section 40A shall have effect notwithstandinganything to the contrary contained in any other provision of the Act. Payments or provisions for deduction could have been eligible for deduction or could have been deducted either under section 28 or under section 37 of the Act. But the use of the non-obstante expression makes it clear that if there is any legislative base dealing with the provisions for gratuity then the same would be applicable in spite of and notwithstanding any other provision of the Act. [608 B-E]

2(iv) Read with the marginal notes of section 40A the non-obstante clause of sub-section (1) of section 40A has an overriding effect over the provisions of any other section. Expenditures or allowances which are deductible under any other provision relating to the head 'Business or profession' will be disallowed in cases to which these provisions of the section apply. The submission of the appellant-assessee that if provision is made by the assessee for gratuity, still the same will be deductible and 8. 40A(7) will have no application, would defeat the very purpose and object of s. 40A(7) and render it nugatory. [608 E-G]

3. The principle that fiscal statutes should be strictly construed does not rule out the application of the principles of reasonable construction to give effect to the purpose or intention of any particular provisions as apparent from the scheme of the Act with the assistance of such external aids as are permissible under the law. [614 G]

Webster's English Dictionary referred to.

Vazir Sultan Tobacco Co Ltd. Etc. Etc. v. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, [1982] 1 S.C.R. 789 at 800 & 804 = 132 I.T.R. 559 at 568, Metal Box Company of India Ltd. v. Their workmen, 73 I.T.R. 53 at 67-68. and Indian Molasses Co. (P) Ltd. v. Commissioner of Income Tax, West Bengal, 37 I.T.R. 66 at pages 76 & 80. relied upon.

Peoples Engineering & Motor Works Ltd. v. Commissioner of Income Tax, West Bengal-II, 130 I.T.R. 174 and Commissioner of Income-tax Central-V, Calcutta v. New Swadeshi Mills of Ahmedabad Ltd" 147 I.T.R. 163 approved.

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Tata Iron & Steel Co. Ltd. v. D.V. Bapat, Income Tax Officer, Companies Circle I (2) Bombay and Anr., 101 I.T.R. 292 and C.I.T. Kerala v. High Land Produce Co. Ltd., 102 I.T.R. 803 distinguished.

Kedarnath Jute Mfg. Co. Ltd. v. Commissioner of Income-tax (Central), Calcutta , 82 I.T.R. 363 and Commissioner of Income Tax, Madras (Central) v. Andhra Prabha P. Ltd. 123 I.T.R. 760 at 772 and Swadeshi Cotton Mills Co. Ltd. v. I.T.O., 1978 112 I.T.R. 1038 (All) referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 4221- 22 (NT) of 1984.

From the Judgment and Order dated 29.11.1982 of the Madhya Pradesh High Court in Misc. Civil Case No. 240, 263 of 1980.

Soli J. Sorabjee, P.H. Parekh, P.K. Manohar and S. Ganesh for the Appellant.

V.S. Desai, Gauri Shankar ant Miss A Subhashini for the Respondents.

The Judgment of the Court was delivered by SABYASACHI MUKHARJI, J. These appeals by special leave arise from the Judgment and order of the High Court of Madhya Pradesh dated 29th November, 1982, in reference under Section 256(1) of the Income-tax Act, 1961 (hereinafter referred to as the 'Act'). The assessee is a public limited company. The related assessment year in Appeal No 4221 of 1984 is 1974-75. In Appeal No 4222 of 1984, the assessment year is 1973-74. The relevant accounting years ended on 31st March, 1974 and 31st March, 1973 respectively.

For the assessment year 1974-75, the assessee company sought to deduct a sum of Rs.18,37,727 towards the amount of gratuity payable to its employees and worked out actuarially. The break up of this liability was as follows:

- for periods ending on 31st March, 1972, 31st March, 1973 and 31st March, 1974, assessee's liability was worked out at Rs. 64,31,286. Out of this amount, provision had been made during these years to the tune of Rs. 45,93,559. No provision had been made for the balance amount of Rs. 18,37,727. The claim for deduction was set up on the ground that this liability was ascertained by actuarial valuation and was deductible under section 37(1) of the Act. The Income-tax Officer allowed the deduction of a sum of Rs. 2,65,872 only which was actually paid by the assessee and the rest was disallowed on the ground of non-compliance with the provisions of section 40A(7) of the Act. The assessee preferred an appeal but the same was dismissed by the Commissioner of Income-tax (Appeals). The assessee thereafter preferred a second appeal to the Tribunal. The Tribunal, for the reasons mentioned, held that for the assessment year relating to 1973-74, actuarially ascertained liability

for gratuity especially arising under the Payment of Gratuity Act, 1972 was an allowable detection. The Tribunal had consistently taken the view that the assessee would not be eligible for deduction under section 37 in respect of such liability to the extent of the provision made by the assessee in its account without simultaneously conforming to the requirements of section 40A(7). Where however, the actuarially determined liability was not provided for or was in excess of the provision made by the assessee in the books of account, the relevant amount could be allowed as liability under Section 37 as the provisions of section 40A(7) would not reach it.

In the assessment of 1974-75, the Tribunal referred to the facts and observed that increased liability of Rs. 15,71,855 had been claimed by the assessee without any provision made in respect thereof in the books of account. In the circumstances, they upheld the claim of the assessee for Rs. 15,71,855 and directed the Income-tax Officer to allow this sum as a liability.

At the instance of the revenue, the following questions were referred to the High Court, namely:

"(1) Whether, on the facts and in the circumstance of the case, the tribunal was right in law in allowing the deduction of Rs. 15,71,855 under Section 37 of the I.T. Act, 1961 out of the sum of Rs. 28,59,431 for which provision was made towards liability for gratuity?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that Section 40A(7) is attracted only in respect of the provision made in the books of account and that the balance liability claimed i.e. Rs.15,71,855 towards gratuity is admissible under sec. 37 of the Income Tax Act, 1961. "

and for the reasons mentioned, for the assessment year 1973- 74 which is the subject matter of the next appeal and following the said decision, the High Court held that the assessee was not entitled to deduction on account of its liability for gratuity under the Payment of Gratuity Act, 1972 without complying with the provisions of section 40A(7) of the Act and accordingly answered both the questions in the negative and against the assessee. This decision is the subject matter of Appeal No. 4221 (NT) of 1984.

Civil Appeal NO. 4222 (NT) of 1984 arises out of the assessment year 1973-74. The High Court observed that the assessee company had entered into agreements with the Workers Union for payment of gratuity by the 31st March, 1972. Company's practice was to account for gratuity on cash basis as and when paid. The company had made a provision in its books of account for payment of gratuity to its employees to the extent of Rs. 20,00,000 during the relevant accounting year. With the coming into force of the Payment of Gratuity Act, 1972 with effect from 16th September, 1972, a statutory liability was created of the company to pay gratuity to its employees as per the provisions of the said Act. The assessee company, therefore, arranged for actuarial quantification of its liability for gratuity to its employees. Pending the determination of such an actuarial valuation, the assessee

had made a provision of Rs. 20,00,000 Against the total accruing liability till the date of the preparation of the balance-sheet. At the time of the filing of the return of income for the assessment year 1973- 74, the assessee added back this provision for gratuity amounting to Rs. 20,00,000 and claimed the total liability of Rs. 48,59,431 which was the actuarial determination of liability arising under the Payment of Gratuity Act, 1972 in the relevant accounting year.

Before the Income-tax Officer, the assessee claimed deduction of the entire liability of Rs. 49,59,431 as determined actuarially. It was contended that the provisions of section 40A(7) of the Act were not applicable. The Income-tax Officer had disallowed the claim on the ground that there was non-compliance with the requirements of section 40(A)(7) of the Act. The Income-tax Officer allowed deduction only to the extent of actual payment made towards gratuity to the employees during the relevant accounting year. This amount came to Rs. 24,366. The assessee preferred an appeal against the Income-tax Officer, order before the Appellate Assistant Commissioner. The Appellate Assistant commissioner was of the view that provisions of section 40(A)(7) did not constitute any bar to the assessee's claim for deduction as the assessee had not made any provision in its books in respect of the amount of gratuity determined actuarially and the provision of Rs. 20,00,000 had also been added back in the statement of income. However, the Appellate Assistant Commissioner allowed deduction of Rs. 30,25,662 on this head which according to him constituted assessee's liability for the relevant accounting year.

The revenue appealed against this decision. It was contended that the assessee was not entitled to any deduction for gratuity except the amount actually paid because there was non-compliance with the statutory provisions of section 40A(7) of the Act. The Tribunal held that the total liability for gratuity actuarially determined for the accounting year was Rs. 48,59,431. However, the assessee had made a provision of Rs. 20,00,000 without complying with the requirements of section 40A(7) of the Act and, therefore, this sum of Rs. 20 lakhs could not be allowed as deduction. But the balance of Rs. 28,59,431 for which no provision was made in the books was allowable under section 37(1) of the Act.

At the instance of the revenue, the following question for this year was referred to the High Court :

> "Whether, on the facts and in the circumstances of the case, the Tribunal was justified in allowing the deduction of Rs. 28,59,431 under section 37 of the Income Tax Act, 1961 out of the total Rs, 48,59,431 made by the assessee towards liability for gratuity?"

Section 40A was inserted by the Finance Act, 1968 with effect from 1st April, 1968. It is necessary to set out the relevant provisions of section 40A:

> "40A. Expenses or payments not deductible in certain circumstances - (1) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head to the computation of income under the head "Profits and gains of business or profession".

.... .....

(7)(a) 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 -

(1) 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 b n fit 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 percent 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 percent 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."

According to the High Court, section 40A had an overriding effect on the other provisions relating to the computation of income under the head "profit" ant gains of business or profession". This meant that while computing income under the head "profits and gains of business or profession" and allowing various deductions provided for under the Act, requirements of 40A would be mandatory In respect of the matters covered thereunder. The High Court was of the view that sub-section (7) of section 40A referred to deductions on account of payment of gratuity to the employees of an assessee and section 37 which was the residuary section for allowance of expenditure would not be applicable. The High Court agreed with the view expressed by the Calcutta High Court In the case of Peoples Engineering & Motor Works Ltd. v. Commissioner of Income Tax, West Bengal - II, 130 I.T.R. 174.

The High Court was also of the view that if, therefore, an assessee claimed deduction on account of accrual of liability for gratuity, the same will be hit by the bar under sub-section (7)(a) of section

40A of the Act irrespective of the fact whether the account books of the assessee referred to the liability or not. The High Court was further of the opinion that In view of the non obstante clause in section 40A of the Act, no deduction was permissible under section 37 of the Act for the assessee's liability for payment of gratuity to its employees without complying with the provisions of sub section (7)(a) of section 40A of the Act. The question was therefore, answered in the negative and against the assessee.

On behalf of the assessee in these appeals it was submitted with reference to section 40A(7) of the Act that the said section was a provision of disallowance and but for the said section, provisions made by an assessee for payment of gratuity could be claimed as deduction under section 37 of the Act as expenditure incurred wholly and exclusively for the purpose of the assessee's business. Alternatively, It was urged that such a provision would have been claimed as deduction generally in determining the true profits ant gains of business which could be subjected to tax under section 28 of the Act. It was emphasised on behalf of the assessee that deduction in respect of gratuity could be claimed de hors section 40A(7) which in effect provided for the disallowance of the deduction in respect of gratuity in certain circumstances. therefore, it was urged on behalf of the assessee that this provision should be very strictly construed. And so construed, section 40A(7) could only apply if the assessee had made provision for payment of gratuity and only to the extent of the amount of such provision.

It was emphasised that the expression 'Provision made by the assessee' is a term of accounting and signified that the assessee hat set apart the amount in his books of account for meeting the liability known to exist on the date of the balance-sheet. Consequently if no amount had been specifically set apart in the books of account of the assessee for meeting the liability of gratuity, it could not be said that there was any provision made by the assessee for the payment of gratuity. Reliance in this connection was placed on the observations of this Court in Vazir Sultan Tobacco. Ltd. etc. etc. v. Commissioner of Income Tax, Andhra Pradesh, Hydrabad, [1982] 1 S.C.R. 789 at 800 & 804 132 I.T.R. 559 at 568. at 800 & 804. It was submitted that a provision could be made only after an amount was specifically set apart in the books of account by debiting the profit and loss account for meeting a certain liability. It was then urged that the language and the scheme of the Act supported the aforesaid submission namely;

(a)that section 40A(7)(b) (ii) drew a clear distinction between 'provision made by the assessee....for payment of gratuity' and 'amount admissible as deduction on account of gratuity'. This showed clearly that the making of a claim by the assessee for deduction on account of gratuity could not be equated with the making of a provision.

(b)The words 'made by the assessee' following the word 'provision' were also very significant and clearly indicated that an amount must be set apart specifically by the assessee for meeting the liability for gratuity.

(c)If the legislature at all wanted to equate a deduction in respect of gratuity with a provision made for payment of gratuity section 40A(7) would have been worded differently, namely;

> "No deduction shall be allowed in respect of any liability for the payment of gratuity...."

(d) The expression 'provision made by the assessee' occurs in section 40A(7) no less than seven times. These words must therefore be given their due meaning and effect and could not be treated as redundant.

(e) Explanation II to section 40A(7) referred to amount being paid to an employee in a subsequent year out of the provision of gratuity. This provision was intelligible and meaningful only if 'provision' was understood to mean the setting apart of an amount in the books of account. So as to make funds available for disbursement.

(f) Section 36(1)(vii a) of the Act provided for deduction in respect of the provision for doubtful debts made by certain financial institutions. There was no doubt that 'provision' in section 36(1)(vii a) of the Act meant an amount specifically set apart in the books of account of the assessee to meet the loss on doubtful debts. The word 'provision' in section 40A(7) must also receive the same meaning, according to the assessee.

(g) Section 34(3)(a) spoke of the creation of a development rebate reserve by debiting the Profit and Loss Account and crediting the Reserve Account. Thus, the Income- tax Act itself contemplated, according to the assessee, a Reserve as an appropriation or earmarking of profits by making entries for this purpose in the books of account.

(h) The other clauses of section 40A spoke of 'expenditure' and 'allowance'. But section 40A struck a different note and used the word 'provision. Consequently 'provision' could not be equated with 'expenditure' or 'allowance' or 'deduction.

In interpreting a taxing statute, it was submitted on behalf of the assessee, equitable considerations were entirely out of place, nor could taxing statute be interpreted on any presumptions or assumptions. The Court must look squarely at the words of the statute and interpret these. It should interpret a taxing statute in the light of what was clearly expressed and it could not imply anything which was not expressed; it could not import provisions into the statute so as to supply any assumed deficiency, nor could It refuse to give effect to the plain and clear meaning of the words on the ground that strange and anomalous consequences might arise.

It was, therefore, urged on behalf of the assessee that the judgment under appeal of the High Court was erroneous for the following reasons:

> (a) that it regarded a claim for deduction of gratuity in the income-tax assessment as tantamounting to the making of a provision by the assessee in his books of account, and
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> (b) it proceeded on the unwarranted assumption that the Companies Act mandatorily required a company to make a provision for gratuity, and failure to make such a

> provision constituted a violation of the Companies Act, and such a company should not be permitted to take advantage of its own wrong.

It was submitted that there was no provision in the Companies Act or in the accounting practice making it mandatory for a company to get an actuarial valuation of its gratuity liability or to make a provision for the same in its books of account. The Company Law Board had put this matter beyond doubt under circulars on several occasions specially by Circular No. 13/77 dated 21st November, 1977, which provided that a company might either make a provision for gratuity or might merely indicate the fact of the liability for gratuity by appending a note at the foot of the accounts. Further, the Institute of Chartered Accountant had also issued a publication titled 'statement on treatment of Retirement Gratuity' which also clarified that a company need not make any provision for gratuity. These submissions were elaborated with reference to certain books on accountancy.

Our attention was drawn to the observations of this Court in the case of Metal Box Company of India Ltd. v. Their Workmen, 73 I.T.R. 53 at 67-68, which were reiterated and referred to in the decision of this Court in Vazir Sultan Tobacco Co. Ltd. v. Commissioner of Income Tax (supra). In these appeals we are not concerned with the distinction between 'provision' and 'reserves'. We are concerned with the true meaning and purport of the expression provision made by the assessee . This Court in Vazir Sultan's case observed at page 569 referring to the observations in the case of Metal Box:

> "The distinction between a provision and a reserve is in commercial accountancy fairly well known. Provisions made against anticipated losses and contingencies are charges against profits and, therefore, to be taken into account against gross receipts in the P. & L. account and the balance- sheet. On the other hand, reserves are appropriations of profits, the assets by which they are represented being retained to form part of the capital employed in the business. Provisions are usually shown in the balance-sheet by way of deductions from the assets in respect of which they are made whereas general reserves and reserve funds are shown as part of the proprietor's interest. (See Spicer and Pegler's Book keeping and Accounts, 15th Edn. p. 42)."

It was emphasised that the concept of provision applied not only in respect of companies but also to individual assessees.

Reliance was also placed on the observations of this Court in Kedarnath Jute Mfg. Co. Ltd. v. Commissioner of Income-tax (Central), Calcutta, 82 I.T.R. 363, where it was emphasised that whether an assessee was entitled to a particular deduction or not depended on the provision of law relating thereto and not on the view that the assessee might take of his rights; nor could the existence or absence of entires in the books of account be decisive or conclusive in the matter. The assessee who was maintaining accounts on the mercantile system was fully justified in claiming deduction of the amount of sales tax which it was, under the law, liable to pay during the relevant accounting year.

Counsel was emphatic that there was no obligation cast on any assessee either by any law or even by the canons of accounting practice to make any provision in the books of account in respect of the liability to pay gratuity. Consequently, an assessee might claim as deduction in his income-tax assessment the liability in respect of gratuity even though he might not have made any provision or other entry in his books of account in respect of gratuity.

It was the assessee's case that section 40A(7) was not a complete code in respect of gratuity. Section 40A contained only a series of specific and limited disallowances. If an item of expenditure was not covered by section 40A, it was not as if it could not be claimed as deduction at all. On the contrary, if section 40A did not apply, there was no bar at all to claiming the expenditure as deduction either under section 28 or under section 37 provided it was incurred wholly and exclusively for the purpose of business. It was further submitted that section 40A(7) could not possibly be considered to be a complete code with regard to the allowance of deduction for gratuity, inter alia, because section 40A(7) merely provided for disallowance if provision of gratuity was made by the assessee. It does not say that no deduction will be allowed in respect of gratuity unless and until certain conditions were fulfilled.

Section 40A is in Chapter IV which deals with computation of total income. It is under the sub-heading of a group of sections dealing with the computation of profits and gains of business or profession. The said group of section begin with section 28 and go upto section 40D. Section 40A is with the marginal note under the heading "Expenses or payments not deductible in certain circumstances". If the marginal note or heading is any indication, and it certainly is a relevant factor to be taken into consideration in construing the ambit of the section, then these payments mentioned therein are not deductible according to the statute in certain circumstances. therefore, the heading of this section is a clear indication that certain payments and expenses which would be otherwise deductible would not be deductible except in certain circumstances indicated in the section. This is abundantly made clear by the non-obstante expression used in sub-section (1) of section 40A. As noted before, the provisions of section 40A shall have effect notwithstanding anything to the contrary contained in any other provision of the Act. Payments of deductions or provision for deduction could have been eligible for deduction or could have been deducted either under section 28 or under section 37 of the Act. But the use of the non-obstante expression makes it clear that if there is any legislative base dealing with the provisions for gratuity then the same would be applicable in spite of and notwithstanding any other provision of the Act. Read with the marginal notes of section 40A, the non- obstante clause of sub-section (l) of section 40A has an overriding effect over the provisions of any other section by providing that the provisions of the section will have effect notwithstanding anything to the contrary contained in any other provision relating to the computation of income under the head Profits and gains of business or profession . Expenditures or allowances which are deductible under any other provision relating to the head 'Business or profession' will be disallowed in cases to which these provisions of the section apply. This sub-clause was inserted by Finance Act, 1975 with retrospective effect from 1.4.1973. It is necessary to appreciate the purpose and object intended to be achieved by this sub-section in order to arrive at the true meaning of the provision.

Payment of gratuity as commonly understood is the payment made to the employee by the employer on his retirement or termination of his service for any reason. It is made voluntarily by the employer as a regular practice or pressure of trade or business either under an agreement with the employees or on the understanding of the trade and after the enactment of the Payment of Gratuity Act, 1972 which came into force on 16th September, 1972, as a statutory liability under the said Act Although payment of gratuity is made on retirement or termination of service, It was not for the service rendered during the year In which the payment is made but it is made in consideration of the entire length of service and its ascertainment and computation depend upon several factors.

The right to receive the payment accrued to the employees on their retirement or termination of their services and the liability to pay gratuity became the accrued liability of the assessee when the employees retired or their services, were terminated. Until then the right to receive gratuity is a contingent right and the liability to pay gratuity continues to be a contingent ability qua the employer. An employer might pay gratuity when the employee retires or his service is terminated and claim the payment made as an expenditure incurred for the purpose of business under section 37. He might, if he followed the mercantile system, provide for the payment of gratuity which became payable during the previous year and claim it as an expenditure on the accrued basis under section 37 of the said Act. Since the amount of gratuity payable in any given year would be a variable amount depending upon the number of employees who would be entitled to receive the payment during the year, the amount being a large one in one year and a small one in another year, the employer often finds it desirable and/or convenient to set apart for future use a sum every year to meet the contingent liability as a provision for gratuity or a fund for gratuity. He might create an approved gratuity fund for the exclusive benefit of his employees under an irrevocable trust and make contributions to such fund every year. Contingent liabilities do not constitute expenditure and can not be the subject matter of deduction even under the mercantile system of accounting. Expenditure which was deductible for income tax purposes is towards a liability actually existing at the time but setting apart money which might become expenditure on the happening of an event is not expenditure. (See in this connection the observations of this Court in Indian molasses Co. (P) Ltd., v. Commissioner of Income-tax, West Bengal), 37 I.T.R. 66 at pages 76 & 80. A distinction is often made 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.

Amounts set apart by way of provision or by way of a reserve or fund to meet the liability of gratuity as and when it becomes payable will not be deductible allowance or expenditure. Where, however, an approved gratuity fund is created for the exclusive benefit of the employees under an irrevocable trust, contribution made to the fund during the year of account will be allowed to be deducted under section 36(1)(v), In Metal Box Company of India v. Their Workmen (supra), this Court held that contingent liabilities discounted and valued as necessary could be taken into account as trading expenses if these were sufficiently certain to be capable of being valued. An estimated liability under a gratuity scheme even if it amounted to a contingent liability if properly ascertainable and its present value was fairly discounted was deductible from the gross profits while preparing the profit and loss account. In view of this decision and other decisions that followed it, lt became permissible for an assessee if he so chose to provide in his profits and loss account for the estimated liability under a gratuity scheme by ascertaining its present value on accrued basis and claiming it as an

ascertained liability to be deducted in the computation of the profits and gains of the previous year.

It would thus be apparent from the analysis aforesaid that the position till the provisions of section 40A(7) were inserted in the Act in 1973 was as follows :-

> (1) Payments of gratuity actually made to the employee on his retirement or termination of his services were expenditure incurred for the purpose of business in the year in which the payments were made and allowed under section 37 of the Act.
>
> (2) Provisions made for payment of gratuity which would become due and payable in the previous year was allowed as an expenditure of the previous year on accrued basis when mercantile system was followed by the assessee. (3) Provisions made by setting aside an advance sum every year to meet the contingent liability and gratuity as and when it accrued by way of provision for gratuity or by way of reserve or fund for gratuity was not allowed as an expenditure of the year in which such sum was set apart. (4) Contribution made to an approved gratuity fund in the previous year was allowed as deduction under section 36(1)(v).
>
> (5) Provision made in the Profit and Loss Account for the estimated present value of the contingent liability properly ascertained and discounted on an accrued basis as falling on the assessee in the year of account could be deductible either under section 28 of section 37 of the Act.

As there were several methods which the assessee might choose to adopt in meeting his liability to pay gratuity, the treatment which he would receive under the Income-tax Act would depend upon the method adopted by him. The assessee is only under an obligation to pay gratuity when it became due and payable. The other methods adopted by the assessee for meeting the liability for gratuity as and when it arose are provisions or arrangements made by him at his option. It is not obligatory on him to make any such provision and if no such arrangement or provision was made, no question arose to consider its deductibility or allowance under the Act.

The intention of the legislature in enacting the provision of section 40(A)(7) would be apparent from the notes on clauses of the amendment where in paragraph 46, after referring to the provisions of section 37(1) and section 36(1)(v) of the Act, it was observed (98 I.T.R. Statutes p. 194), inter alia, as follows :-

> "A reading of these two provisions clearly shows that the intention has always been that deduction in respect of gratuities should be allowed either in the year in which the gratuity is actually paid or in the year in which contributions are made to an approved gratuity fund. A doubt has been expressed that the relevant provisions, as presently worded, do not secure the underlying objective and that a provision made by a taxpayer in his accounts in respect of estimated service gratuity payable to employees will be deductible in computing the taxable income in a case where the provision has been made on a scientific basis in the form of an actuarial valuation. In

> order to remove uncertainty in the matter, it is proposed to specifically provide in the law that no deduction will be allowed, in the computation of profits and gains of a business or profession, in respect of any reserve created or provision made for the payment of gratuity to the employees on retirement or on termination of employment for any reason. This restriction will, however, not apply in relation to a provision made for the purpose of payment of a sum by way of contribution towards an approved gratuity fund that has become payable during the relevant account year, on for the purpose of meeting actual liability in respect of payment of gratuity to the employees that has arisen during such year."

This intention and the purpose of the legislature was carried into effect by inserting sub-section (7) in section 40A by ensuring the overriding effect over the other provisions of the Act. Therefore, in interpreting or in trying to find out the meaning of that provision, one should, if possible and in this case lt is not at all straining, give effect to that intention and not to make a nonsense of that intention. Clause (a) of the said sub- section provides that no deduction will 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 termination of their services for any reason. The expression 'provision' has not been defined in the Act ant lt is not used in any artificial sense but in its ordinary meaning. This 18 clear from the words (whether called as such or by any other name) occurring in sub-section. According to Webster, 'provision' in its ordinary sense means 'something provided for future use' On a plain construction of clause (a) of sub-section (7) of section 40A of the Act, what it means is that whatever is provided for future use by the assessee out of the gross profits of the year of account for payment of gratuity to employees on their retirement or on the termination of their services would not be allowed as deduction in the computation of profits and gains of the year of account. The provision of clause (a) was made subject to clause (b). The embargo is on deductions of amounts provided for future use in the year of account for meeting the ultimate liability to payment of gratuity. Clause (b) (i) excludes from the operation of clause (a) contribution to an approved gratuity fund and amount provided for or set apart for payment of gratuity which would be payable during the year of account. Clause (b)(ii) deals with a situation that the assessee might provide by the spread-over method and provides that such provision would be excluded from the operation of clause (a) provided the three conditions laid down by the sub-clauses are satisfied.

The submission of the assessee is that if no provision is made by the assessee for gratuity, still the same will be deductible and section 40A(7) will have no application, would defeat the very purpose and object of section 40A(7) and render it nugatory. The interpretation as suggested by the assessee would entitle the assessee who made no provision to claim deduction whereas an assessee who made a provision would not get deduction unless the requirements laid down in the sub-section are fulfilled. This interpretation, if accepted, will lead to a curious result, and if one may venture to say an absurd result, and even where the assessee has not chosen to adopt the spread-over method and has not provided for the present value of the contingent liability attributable to the year of account by charging it on the profits of the year, the assessee would still be entitled to claim as deduction from the gross profits of the year the said estimated liability which he could have provided for but he has not chosen to do so.

Where the intention of the legislature in enacting the provision in question was to put an embargo on the deduction, the interpretation suggested by the assessee defeats that purpose.

Kedarnath Jute Mfg. CD. Ltd. v. C.I.T. referred to hereinbefore dealt with a different situation. The accrual of sales-tax liability in that case did not depend on the option of the assessee to make or not to make it for the year. The case of Bombay High Court in Tata Iron & Steel Co. Ltd. v. D.V. Bapat, Income-tax Officer, Companies Circle I (2), Bombay and Anr., 101 I.T.R. 292, was a case on which reliance was placed on behalf of the assessee where provision was made but was a case before the enactment of section 40A(7) arising out of the assessment year 1972-73. Similarly C.I.T. Kerala v. High Land Produce Co. Ltd., 102 I.T.R. 803, another decision relied on by the assessee was, where a provision was made. It arose out of the assessment year 1970-71 before the enactment of section 40A(7). These are the cases upon which the assessee had relied. Another case upon which the assessee relied was Swadeshi Cotton Mills Co. Ltd. v. Income-Tax Officer, Special Circle 'A' Ward, Kanpur (supra). This case arose out of assessment year 1973-74 to which the provision of section 40A(7) was applicable. The Allahabad High Court how- ever took the view that bar created by the said provision did not apply since the conditions laid down had to be fulfilled in future. It did not take into consideration the provision of section 155(13) of the Act. Madras High Court in Commissioner of Income-Tax, Madras (Central) v. Andhra Prabha P. Ltd., 123 I.T.R. 760 at 772, has doubted the decision of the Allahabad High Court in 112 I.T.R. 1038 and further observed that the question of deductibility of a claim for gratuity liability could not be allowed on general principles under any provisions of the Act.

The aforesaid difficulties in accepting the contentions urged on behalf of the assessee were highlighted by the Calcutta High Court in the case of Peoples Engineering & Motor Works Ltd. v Commissioner of Income-Tax West Bengal- II, (supra). It was pointed out that payment of gratuity was a statutory liability created under the Payment of Gratuity Act, 1972. It could normally be said to have arisen for the carrying on of business. However, for gratuity to be deductible under the Act, must fulfil the conditions laid down in section 40A(7). The deduction could not be allowed on general principles under any other section of the Act because sub-section (1) of section 40A makes it clear that the provisions of the section shall have effect notwith standing anything to the contrary contained in any other provision of the 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 notwith standing anything contained in sections 30 to 39 of the Act.
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> This position was again reiterated by the Calcutta High Court in the case of Commissioner of Income Tax, Central-V, Calcutta v. New Swadeshi Mills of Ahmedabad Ltd., 147 I.T.R, 163, where it was explained at page 172 of the report that prohibition in section 40A(7) was on deduction in respect of any provision (whether called as such or by any other name) made by the assessee for the payment of gratuity. The amplitude of the section was indicated by the use of the expression "whether called as such or by any other name." It was further reiterated that the interpretation suggested on behalf of the assessee would lead to a conclusion which

would be extra-ordinary and repugnant to commonsense. It will also cause grave injustice to the assessees who have been prudent enough to set apart a sum for payment of gratuity.

The principle that fiscal statutes should be strictly construed does not rule out the application of the principles of reasonable construction to give effect to the purpose or intention of any particular provision as apparent from the scheme of the Act, with the assistance of such external aids as are permissible under the law.

For the aforesaid reasons, it is not possible to accept the assessee's contentions. The questions referred to the High Court were therefore rightly answered in negative by the High Court, The appeals, accordingly, fail and are dismissed with costs.

M.L.A. Appeals dismissed.