

**Commissioner of Income-tax, Tamil Nadu-v Vs. Sitalakshmi Mills Ltd.**

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**Court :** Chennai

**Decided On :** Dec-06-1982

**Reported in :** (1983)35CTR(Mad)100; [1983]141ITR415(Mad)

**Judge :** N.V. Balasubramanian and ;V. Ratnam, JJ.

**Acts :** [Income Tax Act, 1961](#) - Sections 28, 30, 31, 32, 33, 34, 35, 36, 37, 37(1) and 145

**Appeal No. :** Tax Case Nos. 1138,1142 and 1249 of 1979

**Appellant :** Commissioner of Income-tax, Tamil Nadu-v

**Respondent :** Sitalakshmi Mills Ltd.

**Advocate for Def. :** S.V. Subramaniam, Adv.

**Advocate for Pet/Ap. :** J. Jayaraman and ;Nalini Chidambaram, Advs.

**Judgement :**

Balasubrahmanyam, J.

1. The assesseees who figure in these tax cases are different. But the issue for our decision in each case is the same, and we dispose of it in this common judgment.

2. The issue arises this way. In the industrial establishment of each of the assesseees before us, there is a gratuity scheme for the workers and the staff. Gratuity would be payable on certain events happening, such as the employee's retirement, resignation, retrenchment or death. In this sense, the liability is said to be a 'contingent liability'. But owing to modern systems of actuarial valuation, it would be possible to ascertain the present discounted value of the employer's commitment to pay gratuity to his entire labour force as and when the time comes. This value, if ascertained on actuarial basis, would be possible to ascertain the present discounted value would register an increase. This actual increase is often called 'increment value'. According to sound principles of commercial accounting, the annual increment in the discounted value will be a proper charge which the employer can make against the year's profits. That is to say, the net profits of the year will be properly ascertained only after allowing for this charge. In the balance-sheet too, the amount will figure as a 'provision for gratuity'. The Supreme Court in Vazir Sultan's case : [1981]132ITR559(SC) , has laid down that if a provision of this kind is made for gratuity, then that would have the effect of separating the amount so provided for, from the employer has a gratuity scheme rendering him liable 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 P & L account with the incremental value of the year and also makes a provision for that amount, then the employer will be entitled to compute his net profits after deducting the figure of incremental value.

3. The Tribunal have clearly found that each of the assessee figuring in these references has charged its P & L account with the incremental value appertaining to the account year concerned, on the basis of actual valuation, in order to build up, little by little, an overall provision for its liability under the gratuity scheme. We, therefore, hold that the provision made was rightly allowed by the Tribunal as a deduction in the computation of the business income of the concerned account year of the respective assessees.

4. We, however, wish to correct an error in the Tribunal's order. The Tribunal observed that the allowance on account of provision for gratuity must be granted to the assessee under s. 37 of the I.T. Act, 1961. This is a mistaken view of s. 37. This section is a residuary provision for the allowance of business expenditure in the computation of taxable business profits. In terms, this section deals with an expenditure 'incurred' or 'laid out' by the assessee. A provision for gratuity, although it has to be charged against current profits, is not an item of expenditure strictly so called, nor is it laid out or incurred by the assessee, in the sense that money goes out. A provision for gratuity is merely a charge against profits, and as a provision, it is merely segregated from the current profits. Courts have held that allowance must be made for this provision, notwithstanding that no money goes out or is spent out by the assessee during the year, because, according to sound principles of commercial accounting, net profits will not be properly ascertained, if this provision is not made and the amount is not charged against the profits of the year's trading. The Tribunal was not, therefore, correct in laying down that the provision for gratuity is deductible under s. 37(1) of the I.T. Act.

5. Section 37(1), we said, is the residuary provision for the allowance of an item of expenditure, that is to say, where that item does not fall under any other express statutory provision relating to deduction. Mark the words '(not being expenditure described in ss. 30 to 36)' has got to be made in the computation of an assessee's profits, but the item in question does not fall within the description of any of the sections including the residuary s. 37(1). In such cases, courts used to attribute the statutory basis for the deduction to s. 28. There is no harm in referring to this section, but we would not be precise in doing so. For, s. 28 does not provide for any allowances, or even about the computation of business profits, in s. 28. In our view, it is quite unnecessary for us to seek a statutory basis for everything connected with income or everything concerned with the computation of taxable income. It is enough that we are able to find a given deduction as warranted by sound principles of commercial accounting, if they do not fall under, or are prohibited by, any of the express provision relating to business deduction. That is why, following the English scheme of taxation on business expenses, unless prohibited by the statute, we are allowable under the income-tax law. This way of stating the legal position under our taxing state may be an over-simplification but it brings out the truth that where there is no specific statutory provision for a deduction 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 provides they do not go against the grain of the income-tax statute or the fiscal concept of business income. This, we suppose, is the idea behind another express

computation provision in the I.T. Act itself, namely, s. 145, under which the assessee's method of accounting would always condition the computation of business profits provided the correct profits are properly deductible under that method. We, however, think that we must eschew from the present discussion any reference to s. 28 or even to s. 145 for upholding the claim that a provision for gratuity is a deduction item. It would, we think, be a proper way of laying down the legal position if we say that deduction of provision for gratuity has to be made on commercial principle of accounting. This is because the income-tax law has not set its face against these principles ; it only modifies them, in some respects, to cater to the peculiar needs and the exigencies of taxation.

6. We now proceed to formally enter our opinions in the references. The questions of law before us are as under :

T.C. No. 1138 of 1979 :

'Whether, on the facts and in the circumstances of the case, the assessee is entitled to deduction of Rs. 57,141, being the provision made towards gratuity liability for the assessment year 1972-73 ?' T.C. No. 1142 of 1979 :

'Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee is entitled to the deduction of the sum of Rs. 13,731 representing provision for gratuity in the assessment year 1972-73 ?' T.C. No. 1249 of 1979 : 'Whether, on the facts and in the circumstances of the case, the assessee is entitled to the deduction of Rs. 58,436 representing incremental liability to gratuity for the assessment year 1972-73 ?'

7. For the reasons earlier stated, our answer to each of these questions is in favour of the respective assessee and against the Department. There will, however, be no order as to costs.

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