In the High Court of Judicature at Madras

Dated: 01.04.2014

Coram

The Honourable **Mrs.JUSTICE CHITRA VENKATARAMAN**
and
The Honourable **Mr.JUSTICE T.S.SIVAGNANAM**

Tax Case (Appeal) No.343 of 2007

The Commissioner of Income tax
Coimbatore.

.... Appellant

Vs.

M/s.PRICOL Limited
(Premier Instruments & Controls Limited)
1087-A, Avanashi Road,
Coimbatore – 641 037.

.... Respondent

APPEAL under Section 260A of the Income Tax Act, 1961 against the order dated 28.09.2006 made in I.T.A.No.73(Mds)/2005 on the file of the Income Tax Appellate Tribunal, Madras "D" Bench, Chennai for the assessment year 1999-2000.

For Appellant : Mr.N.V.Balaji
Standing Counsel for Income Tax

For Respondent: Mr.C.V.Rajan

J U D G M E N T

CHITRA VENKATARAMAN,J.

This Tax Case (Appeal) is filed by the Revenue as against the order of the Income Tax Appellate Tribunal for the assessment year 1999-2000. This Court admitted this Tax Case (Appeal) on the following substantial questions of law:

> "(i) Whether on the facts and in the circumstances of the case, the Income Tax Tribunal was right in holding that an amount of Rs.39,91,570/- being the provision for service weightage of the employees to be paid at the time of retirement is an allowable deduction?
>
> (ii) Whether on the facts and in the circumstances of the case, the Income Tax Tribunal was right in law in not considering that the amount paid to service weightage is neither a gratuity, nor a payment to any welfare fund and at best only a provision in the nature of a contingent liability and therefore to be disallowed?
>
> (iii) Whether on the facts and in the circumstances of the case, the Income Tax Tribunal was right in not considering Section 40(A)(9) while dealing with service weightage as it prohibits any payments towards setting

up of any fund, or trust etc. Except for the purpose of recognised provident fund or approved gratuity fund or approved superannuation fund, or if required by any law?

(iv) Whether on the facts and in the circumstances of the case, the Income Tax Tribunal was right in law in not considering Section 40A(10) which is an exception to Section 40A(9) in allowing the service weightage especially when the service weightage does not fall within the exemption categories of superannuation fund, gratuity fund or welfare fund?"

2. The assessee herein is a company, which filed its return of income admitting a total income of Rs.6,82,96,470/-. The assessee claimed deduction on a provision made as by way of retirement benefit based on service weightage of the employee. It is seen from the facts narrated that the company entered into an arrangement with the employees that on completion of every year, the services of each employee would be provided with service weightage, which would get accumulated during period of service and the same could be withdrawn by the employees at the time of retirement or termination of service. As per the Scheme, the service weightage is payable in respect of each

year of service, based on actuarial valuation on the services of the employee. Thus, according to the assessee, such valuation on actual basis was a scientific method of determination of its liability at the end of each year. In view of this actuarial valuation and scientific determination of the liability, the assessee viewed that making provision in the accounts could not be considered to be a contingent liability and hence, entitled to deduction.

3. The Assessing Officer, however, viewed that the service weightage was neither a gratuity nor a payment to any welfare fund. Being just a provision, the same could not be allowed. Aggrieved by this, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) reiterating the said contention and placed reliance on the decision of the Apex Court reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals))*** that the amount set apart to meet the liability, even though a provision, was an allowable expenditure. The first Appellate Authority viewed that even though the payment is not for gratuity or provident fund, yet, being worked out on a scientific basis on actuarial valuation, the claim could not be termed as contingent liability nor could it be termed under Section 43B(b) of the Income Tax Act. Thus

the Commissioner of Income Tax (Appeals) allowed the appeal. This was taken on appeal by the Revenue before the Income Tax Appellate Tribunal. The Tribunal viewed that the claim of the assessee was not hit by Section 40A(9) of the Income Tax Act; the decision of the Apex Court referred to above would be relevant to grant the relief to the assessee; consequently, it affirmed the order of the Commissioner of Income Tax (Appeals) and aggrieved by this, the present appeal has been preferred by the Revenue.

4. Learned Standing Counsel appearing for the Revenue contended that the Tribunal failed to consider the fact that the service weightage paid was neither a gratuity nor a payment to any welfare fund. The Tribunal also failed to consider the applicability of Section 40A(9) of the Income Tax Act to the facts of the case herein. Consequently, the order suffers from serious illegality and hence, liable to be set aside.

5. Learned Standing Counsel appearing for the Revenue took us through the provisions of Section 40A(9), 43B(b) as well as to the definition of "paid" in Section 43(2) of the Income Tax Act and submitted that the assessee was having service weightage scheme

even prior to this assessment year. Under the Scheme, on the eve of retirement, the employees would be given retirement benefits, calculated on the basis of last drawn salary and other relief for three days multiplied by the number of years of service put in, in the organisation. Evidently, the scheme is not one which falls for consideration under Section 36(1)(iv) or 36(1)(v) of the Income Tax Act. Section 40A of the Income Tax Act is a specific provision, which speaks about expenses or payment not deductible under certain circumstances. He submitted that under Section 40A(9), no deduction would be allowed in respect of any sum paid by the assessee, as an employer, towards the setting up or formation of, or as contribution to, any fund, or trust, or other institution for any purpose, the only exception being where the sum is paid for the purposes and to the extent provided by or under Clause (iv) or (iva) or (v) of sub-section (1) of Section 36, or as required by or under any other law for the time being in force. Going by Section 36 read with sub-section (2) of Section 43, the only deduction considered are the actual payment made as by way of contribution towards pension scheme, as referred to under Section 80CCD, or by way of contribution to an approved gratuity fund created under an irrevocable trust or a sum paid as an employer by way of contribution towards a recognised provident fund

or an approved superannuation fund, subject to the limit, as may be prescribed, for the purpose of recognising the Provident Fund or approved superannuation fund, as the case may be.

6. He pointed out further that Section 43B recognised certain deduction on actual payment, one of which being a sum payable by an assessee as employer, by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund in the welfare of the employees or a sum payable by an assessee as an employer in lieu of any leave at the credit of employees. Even herein, the deduction would be allowed only on actual payment irrespective of the previous year in which the liability to pay such sum was incurred by the assessee, according to the method of accounting regularly employed by the assessee, and not otherwise. In the context of specific provision in Section 43B and particularly the prohibition under Section 40A(9), he submitted that the crucial expression under Section 40A(9) are "sum paid by the assessee", as a contribution to any fund for any purpose. On the admitted fact that the provision created based on the service weightage was not on account of any of those recognised clauses, namely, Clause (iv), (iva) and (v) of Section 36(1) or in any event, the settlement between the employee union and the

employer not being one as required by or any other law for the time being in force, the claim of the assessee is directly hit by sub-section (9) of Section 40A of the Income Tax Act.

7. As far as the expression 'sum paid' is concerned, admittedly, the claim of service weightage was shown as a provision charged on the profit of the company. The company follows mercantile system of accounting and going by Section 43(2) defining 'paid', the liability incurred amounts to 'paid'. Elaborating on the meaning of 'contribution', learned standing counsel appearing for the Revenue referred to P.Ramanatha Aiyar's Advanced Law Lexicon, 3rd Edition, Volume 1 as to the meaning of 'contribution' and submitted that the assessee had worked out its liability on actuarial basis and created a provision by charging the profits of a particular year. Going by the meaning 'contribution', any sum credited by an employer out of his own monies as by way of provision, would be contribution and as far as this case is concerned, the assessee had taken note of every individual employee's account and scientifically worked out its liability and took it to a collective account, viz., the provision made therein; hence, contributing to a common fund by charging the profit, thereby making a provision, would satisfy the second limb of Section 40A(9),

i.e, on the aspect of a contribution by the employer.

8. Placing reliance on the decision reported in ***(2010) 323 ITR 166 (M/S Vijaya Bank Va. C.I.T & ANR.),*** he further submitted that the provision made in a consolidated manner in respect of the employees in service based on an actuarial basis, thus would satisfy the requirement of Section 40A(9) of the Income Tax Act. He pointed out that in the said decision, the Supreme Court held that for claiming bad debts, it would not be necessary for any individual accounts of the debtors to be closed as written off.

9. As far as the third aspect of the provision, namely, contribution to any 'fund' or 'trust' is concerned, he submitted that making a provision in the accounts itself would amount to contributing to a fund. When the systematic accumulation by charging on the profit is admittedly there for the specific purpose of meeting out its liability on the eve of retirement of an employee, making provision in the accounts would tantamount to contribution to a fund. He referred to the decision reported in ***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.)*** and submitted that the assessee had made a provision by specifically

earmarking the portion of profit to a particular liability that it is the money of the employer which is set apart for a specific purpose and that the same is available for payment to those who retired in that particular year. He referred to the decision of the Supreme Court to emphasize the systematic accumulation of funds in the accounts as an indicator to a creation of a fund and contended that the expression 'provision' cannot be treated as just a mere accounting without a purpose. Thus, when the assessee had made the provision with a specific purpose of meeting its liability, the service weightage scheme, there, in fact, was the fund created.

10. Taking us through the VI Schedule to the Companies Act, learned Standing Counsel appearing for the Revenue pointed out that while reserve is always a head referable to the money available to a company for making investment, as far as the provision created is concerned, the sum represented the availability of funds for meeting the specific liability towards third party. Hence, such provision could only be treated as a fund set apart for a specific purpose. The fact that a named fund had not been created as is contemplated under Clauses (iv), (iva) and (v) of Section 36(1) of the Income Tax Act, would not make a provision made in the accounts as not a fund

created for a specific purpose. He pointed out that the purpose for which the provision was made, was on account of an agreement between the parties. When the assessee had thus consciously made a provision in its accounts for a particular purpose, the expression 'fund' is not to be read in a narrow sense. In other words, the provision is also a fund created for a particular purpose, namely, for payment to the employees at the time of retirement and the calculation itself is based on an actuarial basis. Hence, the making of a provision in the accounts would amount to contributing to a fund and hence hit by Section 40A(9) of the Income Tax Act.

11. Learned Standing Counsel appearing for the Revenue further submitted that even applying the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v.*** **Their Workmen)**, the provision under Section 40A(9), inserted by Finance Act, 1984 with reference to 01.4.1980, would stare at the assessee for making any claim as deduction. He submitted that it is no doubt true that the assessee could make a provision in its accounts for meeting out a specific purpose; yet, for the purpose of sub-section (9) to Section 40A, such a creation of a provision would amount to contribution to any fund. He pointed out that the decision of the

Supreme Court reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals))***, hence, has to be seen in the context of law then stood.

12. Learned counsel appearing for the assessee, however, countered this argument by placing reliance on the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v.*** **Their Workmen)** as having great relevance in the matter of deciding the issue. He referred to the decision reported in ***123 ITR 716 (CIT V. Andhra Prabha P. Ltd.)***, which referred to the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v.*** **Their Workmen)** as having relevance to income tax matters and submitted that the decision reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals))*** along with the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v.*** **Their Workmen)** would conclude the issue in favour of the assessee. He also referred to the decisions reported in ***334 ITR 341 (Commissioner of Income- tax v. Ranbaxy Laboratories Ltd.), (2010) 320 ITR 322 (Commissioner of Income-tax-IV, New Delhi, Vs. Insilco Limited)*** of the Delhi High Court and ***(2009) 314 ITR 167 (CIT V. Mc Dowell & Co. Ltd.)*** and submitted that as

held in the decision of the Delhi High Court reported in ***334 ITR 331 (Commissioner of Income- tax v. Ranbaxy Laboratories Ltd.)***, the claim of the assessee is maintainable under Section 43B(b) of the Income Tax Act. He pointed out that the Revenue does not deny the fact that the provision was made on actuarial basis on the future liability that the assessee had to face. He referred to the order of the Tribunal relating to the assessment year 2002-2003 in I.T.A.No.1088 of 2010 dated 8th October, 2010 and submitted that the Tribunal pointed out to the agreement that the assessee had with the Trade Union and that it made this provision in the accounts, the assessee was liable to make the payment as worked out in the formula and that such making of provision could not be treated as hit by Section 40A(9) of the Income Tax Act.

13. Referring to the decision of the Tribunal in the assessee's own case, which is now the subject matter of appeal before us, the Tribunal viewed that being an ascertaining liability and a provision made there for, the claim was allowed.

14. Learned counsel appearing for the assessee thus submitted that in the light of the detailed consideration by the Tribunal, the claim

of the Revenue is totally unsustainable. He also submitted that a provision made in the accounts cannot, however, be called as a fund, as had been contended by the Revenue, since the provision made was not credited to a separate account or to a fund to call it so for the purpose of attracting Section 40A(9). He submitted that the decision reported in ***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.)*** does not, in any manner, assist the Revenue to support its claim based on Section 40A(9) of the Income Tax Act. On the other hand, the decision is in favour of the assessee only. Thus, when there is no contribution to a fund, the question of invoking Section 40A(9) does not arise.

15. Referring to the decision reported in ***(2012) 349 ITR 386 (SC) (Sandur Manganese and Iron Ores Ltd. V. Commissioner of Income Tax)***, he pointed out that the said provision was inserted as a measure for countering tax avoidance. He pointed out to the discussion of the Supreme Court in paragraph Nos.6 and 7, particularly to the word 'contribution' finding place in Section 40A of the Income Tax Act with reference to the memorandum on the insertion of Section 40A(9) of the Income Tax Act. Thus, to be a 'contribution', there must be, in fact, a payment to a fund and a mere provisioning in the

accounts is not a contribution per se. So too, a fund should be established separately as an independent entity marked for a specific purpose. Thus, to be covered by Section 40A(9), there must be a setting up or formation of a trust or a fund and a contribution to such fund or a trust as a separate entity is required. Admittedly, the assessee had not set up or formed a fund or made contribution to a fund in the manner in which the said term had been understood. The requirement under the Section being a factual contribution, that the said amount should be parted to the employees account, so that, there, in fact, exists a factual contribution to a trust or a fund for invoking Section 40A(9) of the Income Tax Act.

16. Referring to the decisions of the Supreme Court reported in ***AIR 1962 SC 1821 (R.K.Dalmia and others V. The Delhi Administration) and (1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.),*** particularly to the understanding of the expression 'fund', he submitted that the decision of the Supreme Court reported in ***AIR 1962 SC 1821 (R.K.Dalmia and others V. The Delhi Administration)*** did not, in any manner, assist the Revenue's contention that a mere provisioning itself would become a fund to attract Section 40A(9) of

the Income Tax Act, when the admitted case of the Revenue is that the assessee had not created an entity to set apart the retirement benefit on the service weightage scheme to constitute as a fund or a fund identifiable with an object followed by investment therein. The decisions, in fact, go against the contentions of the Revenue. He further pointed out that in the decision reported in ***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.),*** the Supreme Court had considered the term 'fund' in the background of the Companies Act provisions too.

17. Learned counsel appearing for the assessee further pointed out that the fact of regular charging of profit in the profit and loss account, at best, could be looked at as a liability and nothing beyond. He refers to the Guidance Note on Terms Used in Financial Statements, particularly to the meaning given to 'fund', that there must be a specifically earmarked asset representing the service weightage scheme, payable to the employees. He brought to our attention the difference in the language in Section 40A(7) and 40A(9) of the Income Tax Act that under Section 40A(9) earmarking of the out goings to a particular fund is required to bring the case of the assessee under Section 40A(9). On facts thus found, the claim of the Revenue has to

be rejected.

18. Replying to the said argument, learned Standing Counsel appearing for the Revenue pointed out to the introductory part of clause 5 in the Guidance Note on Terms Used in Financial Statements and submitted that the definition of the expression 'fund' as given in the guidance note, by itself, would not decide the scope of the expression. The admitted fact that the assessee had been charging the profits regularly on actuarial basis shows that the earmarking of the funds for that particular purpose is there, in any event, the amount payable by the assessee worked out on actuarial basis on service weightage is payable to the employees on the eve of their retirement; service weightage is payable in respect of each year of service and every retirement benefit is provided for in the books of accounts on scientific basis. The scientific determination of the liability is payable on the date of retirement or termination of service. Drawal of the amount arising on accrual basis arises on the date of retirement or termination of service, thus the liability is ascertained and is a crystallized liability in respect of each year of completed service and the liability is met, in fact, on the retirement day. Thus the liability of each year accruing is charged to the profits of the company. Thus,

when a provision is made for the particular purpose, such provision would amount to contribution to a fund and hence, hit by Section 40A(9) of the Income Tax Act. He further pointed out, alternatively, even if the claim is not hit by Section 40A(9), certainly, Section 40A(7) would have relevance to the facts of the case; consequently, in any event, the provision made on the liability payable on the eve of retirement or termination is, in effect, a gratuity liability and a provision made thereon, even if there be no fund created, is not allowable in terms of Section 40A(7) of the Income Tax Act.

19. Heard learned counsel appearing for the assessee and learned Standing Counsel appearing for the Revenue and perused the materials placed before this Court.

20. The provisions under Section 40A(7), 49A(9), the definition of 'paid' under Section 43(2) and 43B, of the Income Tax Act, relevant for the purpose of deciding the case, read as under:

> **"Expenses or payments not deductible in certain circumstances.**
>
> **40A.**
>
> **……**
>
> (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 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.

Explanation.—For the removal of doubts, it is hereby declared that where any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason has been allowed as a deduction in computing the income of the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way of gratuity to any employee shall not be allowed as a deduction in computing the income of the assessee of the previous year in which the sum is so paid.

(9) No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 (21 of 1860), or other institution for any purpose,

except where such sum is so paid, for the purposes and to the extent provided by or under clause (*iv*) or clause (*iva*) or clause (*v*) of sub-section (1) of section 36, or as required by or under any other law for the time being in force.

Definitions of certain terms relevant to income from profits and gains of business or profession.

43. In sections 28 to 41 and in this section, unless the context otherwise requires

(2) "paid" means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the head "Profits and gains of business or professionCertain deductions to be only on actual payment.

Certain deductions to be only on actual payment.

43B. Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of—

.....

(*b*) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, or

..... **"**

21. As one would see, Section 43 contains the definition of

certain terms relating to income from profits and gains of business or profession. Unless the context otherwise requires, the definition relate to the provisions contained in Sections 28 to 41 of the Income Tax Act. Section 43(2) defines the definition 'paid', as actually paid or incurred according to the system of accounting adopted by the assessee on the basis of which the profits and gains are computed. Thus the definition takes note of both system of accounting, namely, cash as well as mercantile system. As far as Section 40A(9) is concerned, the said provision was inserted by the Finance Act, 1984, with effect from 01.04.1980. Circular No.387 dated 06.07.1984 (152 ITR St.10) explained the introduction of Section 40A(9), as follows:

> "16.1 Sums contributed by an employer to a recognised provident fund, an approved supernnuation fund and an approved gratuity fund are deducted in computing his taxable profits. Expenditure actually incurred on the welfare of employees is also allowed as deduction. Instances have come to notice where certain employers have created irrevocable trusts, ostensibly for the welfare of employees, and transferred to such trusts substantial amounts by way of contribution. Some of these trusts have been set up as discretionary trusts with absolute discretion to the trustees to utilise the trust property in such manner as they may think fit for the benefit of the employees without any scheme or safeguards for the proper disbursement of these funds.

Investment of trust funds has also been left to the complete discretion of the trustees. Such trusts are, therefore, intended to be used as a vehicle for tax avoidance by claiming deduction in respect of such contributions, which may even flow back to the employer in the form of deposits or investment in shares, etc.

16.2 With a view to discouraging creation of such trusts, funds, companies, association of persons, societies, etc. the Finance Act has provided that no deduction shall be allowed in the computation of taxable profits in respect of any sums paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund,trust, company, association of persons, body of individuals, or society or any other institution for any purpose, except where such sum is paid or contributed (within the limits laid down under the relevant provisions) to a recognised provident fund or an approved gratuity fund or an approved superannuation fund or for the purposes of and to the extent required by or under any other law."

22. As is evident from the reading of the Section, the inserted provision bars deduction of any sum paid by an assessee as an employer towards the setting up or formation of, or contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860, or other

institution for any purpose, except where such sum is so paid, for the purposes and to the extent provided by or by Clause (iv), (iva) or (v) of sub-section (1) of Section 36, or as required by or under any other law for the time being in force. Thus the Section bars deduction except for the purpose specified under Clause (iv), (iva) and (v) of sub-section (1) of Section 36 or as required by or under any other law for the time being in force and even therein, deduction under the respective provision would be to the deduction provided there for or under clause (iv), (iva) and (v) of sub-section (1) of Section 36 or as required by or under any other law for the time being in force.

23. Section 36(1)(iv), (iva) and (v) contemplates payment by an assessee, as an employer, to a fund or scheme, to the extent it does not exceed 10% of the salary of the employee in the previous year. Section 36(1) (iv) is with reference to the payment to a sum towards recognised provident fund or an approved superannuation fund, subject to the limits prescribed for the purpose of recognising the provident fund or approving the superannuation fund. Section 36(1)(iva) states that in the case of contribution to a pension scheme as referred to in Section 80CCD to the extent that it does not exceed 10% of the salary of the employee in the previous years; Section

36(1)(v) states that in the case of contribution towards approved gratuity fund created by the employer for the exclusive benefit of his employees under an irrevocable trust.

24. Thus, even as a matter of deduction in respect of the above said three clauses, the deduction recognised under the Act is to the extent provided for or by under clause (iv), (iva) or (v) of sub-section (1) of Section 36, or as required under or any other law for the time being in force.

25. As far as contribution or payment to any fund, trust, company or other institution for any purpose is concerned, sub-section (9) of Section 40A categorically states that no deduction would be allowed in respect of any sum paid by the assessee towards setting up or formation of, or contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860, or other institution for any purpose, except where such sum is paid for the purposes and to the extent provided by or by Clause (iv), (iva) or (v) of sub-section (1) of Section 36, or as required by or under any other law for the time being in force.

26. Keeping this provision in the background, we may have to look at the decision of the Supreme Court reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v. Their Workmen*)** as well as the decision reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals)).***

27. Although the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v. Their Workmen)*** was not directly under the Income Tax Act, yet, the decision for income tax purpose has its relevance - vide ***123 ITR 716 (CIT V. Andhra Prabha P. Ltd.).*** The facts arising in the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v. Their Workmen)*** were that the company computed the bonus payable to its employees at 13.28% of the total wages paid to the employees by arriving at the gross profits after working out the deduction in accordance with Section 4 of the Payment of Bonus Act. The gross profit under Section 4 of the Payment of Bonus Act is to be computed in the manner laid down in the second schedule to the said Act. The assessee/company, in the computation of the gross profit, deducted depreciation as admissible under the Income Tax Act apart from certain other

deductions available. Section 6 of the Bonus Act provides that having arrived at the gross profits under Section 4 read with the 2nd Schedule, the Company is entitled to deduct therefrom depreciation admissible under Section 32(1) of the Income Tax Act, that is, such percentage on the written down value as may, in the case of each of the classes of assets, be prescribed. The employees disputed the computation made on depreciation, development rebate and the estimated liability under two gratuity schemes that the amount which could be debited was that which was actually paid and the Company was not entitled to debit in the Profit and Loss account any amount worked out by it as estimated liability. The Tribunal, therefore, was not justified in allowing the Company to debit any such amount and that the Tribunal arbitrarily fixed Rs.10 lacs and allowed wrongly that amount to be deducted; and even if such estimated liability was debitable, the appropriation amounted to a reserve and under the Bonus Act such a reserve had to be added back while working out the gross profits under the 2nd Schedule to the Act. The Tribunal passed an award partly accepting the company's claim. This resulted in the Union and the Company filing appeal before the Supreme Court. The company estimated the liability under the two gratuity schemes, worked out on an actuarial valuation and made provision for such

liability, spread over a number of years. The assessee/employer claimed that having regard to the accepted principles of commercial practice and trading, deduction of such estimated liability was permissible.

28. On the question as to whether such appropriation amounted to 'reverse or provision' and whether the assessee could deduct the estimated liability in the Profit and Loss account while working out the net profits, the Supreme Court considered Schedule VI to the Companies Act and held as follows:

> "18. That there is no rule against providing for any such contingent liability but on the contrary such a provision is permissible can be seen from the form of balance-sheet in Schedule VI to the Companies Act, 1956 where provisions for taxation, dividends. provident fund schemes, staff benefit schemes and other items for which a company is contingently liable are to be treated as current liabilities and, therefore, dubitable against the gross receipts. Schedule VI, Part 2, lays down the requirements of profit and loss account and el. 3 (ix) of it provides that a profit and loss account shall set out amongst other things the aggregate of amounts set aside or provisions made for meeting. specific liabilities, contingencies or commitments. But the contention was that though Schedule VI to the Companies Act may

permit a provision for contingent liabilities, the Income-tax Act, 1961 does not, for under sec. 36(v) the only deduction from profits and gains permissible is of a sum paid by an assessee as an employer by way of his contribution towards an' approved gratuity fund created by him for the exclusive benefits of his employees under an irrevocable trust This argument is plainly incorrect because sec. 36 deals with expenditure deductible from out of the taxable income already assessed and not with deductions which are to be made while making the P & L account. In our view, an estimated liability under gratuity schemes such as the ones before us, even if it amounts to a contingent liability and is not a debt under the Wealth Tax Act if properly ascertainable and its present value is fairly discounted is deductible from the gross receipts while preparing the P & L account. It is recognised in trading circles and we find no rule or direction in the Bonus Act which prohibits such a practice."

29. The Supreme Court further pointed out "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 Peglar's Book-keeping and Accounts, 15th ed. p. 42). An amount set aside out of profit and other surpluses, not designed to meet a liability contingency commitment or diminution in value of assets known to exist at the date of the balance-sheet is a reserve but an amount set aside out of profits and other surpluses to provide for any known liability of which the amount cannot be determined with substantial accuracy is a provision, (see William Pickles Accountancy, Second Edn., 192, Part III, cl. 7, Sch. VI to the Companies Act, 1956 which defines provision and reserve)."

30. This decision was reiterated and applied in the decision reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals)).***

31. The question as regards the deductibility of a provision for liability towards encashment of earned leave was considered by the Supreme Court in the decision reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals))***. Referring to the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v. Their Workmen*)**, the Supreme Court pointed out as follows:

> "If a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain."

32. There, the assessee company created a fund by making a provision for meeting its liability arising on account of the accumulated earned/vacation leave. This was a part of the beneficial scheme floated by the company for its employees for encashment of leave. A sum of Rs.62,25,483/-, relating to the assessment year 1978-79, was set apart in a separate account as a provision for encashment of accrued leave and the same was claimed as deduction. The High Court held that the liability would arise only if an employee did not go on leave and instead, applied for encashment. The Supreme Court pointed out that subject to a ceiling, every employee would avail the leave or seek encashment. Therefore, the liability was a certainty,

hence, it could not be called as a contingent liability.

33. Referring to the principles laid down in the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v.*** **Their Workmen)***,* the Supreme Court held that the provisions made by the assessee therein for meeting the liability incurred under the Scheme, subject to a ceiling on accumulation as applicable on the relevant date, was entitled to deduction out of the gross receipts for the accounting year during which the provision was made for the liability and that the liability was not a contingent liability. In so holding, the Supreme Court extracted the principles laid down in the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v. Their Workmen*****),** which read as under:

> "(i) For an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is paid; permissible only in case of amounts actually expended or (ii) Just as receipts, though not actual receipts but accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the

> profits and gains of the business; (iii) A condition subsequent, the fulfillment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability; (iv) A trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated. "

34. It is no doubt true that these decisions had arisen prior to the introduction of Section 40A(9) or Section 43B of the Income Tax Act. Nevertheless, the relevance of these decisions on what is 'provision', in the context of what is contained in Section 40A(9) needs to be tested. As is seen from the reading of the Section, for attracting the provision under Section 40A(9), the basic requirements are that the payment is to be by an employer towards creation of a trust, fund, company, association of persons, Societies etc. for any purpose and the payment by an assessee as an employer is towards setting up or formation of, or as a contribution to, any fund, trust, company or association of persons, body of individuals etc. Thus, the crucial words on which much of the arguments were advanced before us for the purpose of deciding the issue are "setting up or formation of, or as a

contribution to, any fund, trust etc." and "contribution for any purpose". Admittedly, the Scheme floated herein is not a one required by or under any law. Therefore, the case of the assessee would not fall for consideration under Section 36(1)(iv) or (iva) or (v) of the Income Tax Act. The definite case of the Revenue is that by making a provision in the accounts, there is a "contribution" to a "fund" and the provision itself is to be construed as 'fund'. Hence, Section 40A(9) of the Income Tax Act stands attracted.

35. For understanding the scope of the expression 'contribution', learned Standing Counsel appearing for the Revenue placed reliance on the meaning given to that expression as had been stated in P.Ramanatha Aiyar's Advanced Law Lexicon, 3rd Edition, Volume 1. The Law Lexicon referred to the meaning of the word 'contribution' as given under the Provident Funds Act (19 of 1925) and Employer's State Insurance Act (34 of 1948). The word 'contribution' is understood legally as referable to an amount credited in a provident fund as given under the Provident Fund Act; a sum of money payable by a principal employer in respect of an employee as in the case of ESI Act and for the purpose of Section 10(13)(iv) of the Income Tax Act, 1961, it is understood as an act of contributing; the payment by each

of the parties interested in any common loss or liability; amount so payable and proportionate discharge of liability. Under Schedule IV, Part A, Rule 2(c) of the Income Tax Act, 1961, 'contribution' is defined to mean any sum credited by or on behalf of any employee out of his salary, or by an employer out of his own monies, to the individual account of an employee (Refer ***Gestener Duplicators Pvt. Ltd. V. Commissioner of Income Tax, West Bengal, 117 ITR 1).*** The meaning thus ascribed to the expression 'contribution' shows that a factual contribution, in the sense, that there is, in fact, a sum credited to a specific individual account. Individual is referrable to the head of account and not to an individual employee/person.

36. Learned Standing Counsel appearing for the Revenue relied on the decision reported in ***(2010) 323 ITR 166 (M/S Vijaya Bank Va. C.I.T & ANR.)*** only to support his submission that the failure to credit the contribution to an individual account/or individual head, perse, may not be fatal to the contention of the Revenue. Strictly speaking, as pointed out by the learned Standing Counsel, we do agree that in making a provision, it is not necessary that the same should be to the credit of each and every employee; but we do agree with the submission of the assesee that in any event there must be an

identifiable separation of funds as by way of making provision towards the service weightage scheme. Thus, even if there be no sum credited to an individual account and that the provision made is on the totality of the employer's commitment to pay the service weightage to the employees on the eve of their retirement, yet, as is evident from the reading of the Section, the contribution has to be to a fund or a trust. Herein too, the expression 'fund' as given in the Law Lexicon was placed before us for our consideration. One of the definitions given therein reads as under:

> "**Fund.** An account usually of the nature of a *reserve* or a *provision* which is represented by specifically earmarked *assets*.
>
> The word 'fund' may mean actual cash resources of a particular kind (eg. money in a drawer or a bnk), or it may be a mere accountancy expression used to describe a particular category which a person uses in making up his accounts. *R.K.Dalmia v. Delhi Administration AIR 1962 SC 1821, 1834. [I.P.C. (45 of 1860) S.405, Expln.1] Allchin v. Coulthard, (1942) 2 KB 228]*
>
> Fund is a systematic accumulation of cash or any separation of assets to meet future tax liability. Only an accounting entry of an exact sum being earmarked for payment of tax liability arising at the end of the current accounting year is not a fund. *Commissioner of Income Tax v. Duncan Brothers and Co. Ltd., (1996) 8 SCC 31,*

paras 13 and 14"

37. In the decision reported in ***AIR 1962 SC 1821 (R.K.Dalmia and others V. The Delhi Administration)***, the Supreme Court dealt with the expression 'fund' and referred to the decision reported in ***(1942) 2 KB 228 (Allchin v. Coulthard).*** The decision of the Supreme Court arose in a criminal matter under Section 409 of the Indian Penal Code that the accused, as a Chairman of the Board of Directors and of the Principal Officer of the company, entrusted with the dominion over the funds of the company, committed criminal breach of trust of the funds. As to the meaning of the expression 'fund', the Supreme Court referred to the decision reported in ***(1942) 2 KB 228 (Allchin v. Coulthard)***. Here again, the decision therein related to a payment made out of a general rate fund, which consisted partly of untaxed income and partly of profits from its undertakings duly assessed to income tax. The expression considered in English decision related to "payment out of the fund".

38. Dealing with the expression 'payment out of fund' and in particular the word 'fund', which has been extracted in paragraph 59 of the decision reported in ***AIR 1962 SC 1821 (R.K.Dalmia and others V. The Delhi Administration)***, the Supreme Court extracted

the passage from the decision reported in ***(1942) 2 KB 228*** **(*Allchin v. Coulthard),*** which reads as follows:

> "The word fund' may mean actual cash resources of a particular kind (e. g., money in a drawer or a bank), or it may be a mere accountancy expression used to describe a particular category which a person uses in making up his accounts. The words 'payment out of when used in connection with the word fund' in its first meaning connote actual payment, e. g., by taking the money out of the drawer or drawing a cheque on the bank. When used in connection with the word 'fund' in its second meaning they connote that, for the purposes of the account in which the fund finds a place, the payment is debited to that fund, an operation which, of course, has no relation to the actual method of payment or the particular cash resources out of which the payment is made. Thus, if a company makes a payment out of its reserved fund an example of the second meaning of the word fund'-the actual payment is made by cheque drawn on the company's banking account, the money in which may have been derived from a number of sources."

39. As is evident from the reading of the above judgement, it is clear that the expression 'fund' denotes the particular category/head and the expression 'payment' is explained on cash payment or debiting to the head of account, which is in contradistinction to actual method

of payment. In either case, be it cash or debiting for the account, the crediting has to be to the particular head. The Supreme Court decision, in any event, related to misappropriation of fund of the company in the current account of the company with a bank. The Supreme Court held that the 'funds' referred to in the charge amounted to 'property', within the meaning of Section 405 of the Indian Penal Code. Thus the discussion in the decision on the term 'funds' is about, it being money as equivalent to property and hence does not directly relate to the interpretation or understanding of the meaning of the expression 'funds'. 'Fund' in the context of Section 40A(9) of the Income Tax Act refers to money set apart for the specific purpose, the contribution to which may be either by cash remittance or by account entry transfer or a provision made therefor. Thus, as pointed out in the decision reported in ***(2003) 1 ALL ER 1168 (Myers v. Design Inc.(International) Ltd.)***, the word 'fund' is not a term of art and (like so many other words) is capable of a variety of meanings depending on the context in which it is used. Thus the Supreme Court decision reported in ***AIR 1962 SC 1821 (R.K.Dalmia and others V. The Delhi Administration)*** is not of any assistance to the Revenue in the matter of understanding the expression 'fund'.

40. In the decision reported in ***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.)***, the Supreme Court considered the meaning of the term 'fund' in the context of the provision for taxation as to whether the same was deductible from cost of excluded investments and would, therefore, augment the capital base of the company for the purposes of the Super Profits Tax Act, 1963. The decision considered the Second Schedule of the Companies (Profits) Surtax Act, 1964 and the Second Schedule of the Super Profits Tax Act, 1963. There the assessee claimed that in computation of its capital, for the purpose of Super Profits Act, 1963, provision for taxation made to the tune of Rs.16 lakhs and odd should be treated either as part of its capital under rule 1 of the Second Schedule to the Super Profits Act, 1963, or in the alternative, as a deduction from the cost of investment under clause (ii) of rule 1 of the Second Schedule to the Super Profits Tax Act, 1963. In considering the said question, the Supreme Court pointed out that in view of the decision reported in ***(1981) 132 ITR 559 (Vazir Sultan Tobacco Co. Ltd. V. CIT)***, a provision made to meet the tax liability of the current accounting year could not be considered as representing a reserve. However, whether it could be treated as a fund, hence to be deducted from the cost of the assets

required to be excluded from the capital of the company, came up for consideration before the Supreme Court. Since the exercise required computing the capital of the company, the term used in the Second Schedule, namely, 'fund' was to be interpreted and required to be looked into in the context of the balance sheet of a company and its profit and loss account and how these terms are understood in accounting parlance and in the context of the provisions of the Companies Act.

41. Referring to Schedule VI to the Companies Act, 1956, prescribing the balance sheet format, under the column "reserves and surplus", the Supreme Court pointed out to the word 'fund', referred to in relation to any 'reserve' as used only where such reserve was specifically represented by earmarked investments. The Supreme Court observed "in the present case there is no systematic accumulation of cash or any separation of assets to meet future tax liabilities. There is only an accounting entry of an exact sum being earmarked for payment of tax liability arising at the end of the current accounting year. Such a provision cannot be considered as a fund." The Supreme Court further pointed out that the term 'fund' must be applied to any sum of money available to the company including a

provision for taxation.

42. Referring to the Board's Circular No.I.P.(XV-5) of 1968 dated January 23, 1968, the Supreme Court observed that a sum of money set apart to meet unforeseen risks was considered as a 'fund'. The provision for taxation of the kind in question was not a fund either etymologically or in accounting parlance. It observed that a specific provision for an ascertained liability was not a fund within the meaning of that term in the rules in question. The Supreme Court held that such a provision for taxation could not be compared to a fund of the kind referred to in the circular.

43. The substance of the decision is that in order to be a fund, apart from systematic accumulation of cash, there must be an identified earmarked head, which would represent the liability that the company has to meet and that a mere provision made in the accounts for an ascertained liability, per se without any identifiable setting apart for the particular purpose thereof, cannot constitute a fund, as had been contended by the Revenue.

44. Learned Standing Counsel appearing for the Revenue pointed

out to the column 'reserve and surplus' in the balance sheet format, as prescribed under Schedule VI of the Companies Act and the note appended as to the use of fund in relation to any reserve as referrable to such reserve, specifically represented by earmarked investments and the absence of similar note under the caption 'provision' to emphasize his argument that 'provision' is also a 'fund' and that in the decided case viz.,***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.)***, there was no systematic accumulation and that the provisioning made always represent the liability. In the context of the actuarial valuation, such provision could be treated as fund.

45. Though it was attracting at the first blush, such a contention has to be straight away rejected in the light of what had been considered in the decision reported in ***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.).*** As is evident from the reading of the decision, a 'fund' in a normal sense the availability of funds set apart to discharge a liability. Although a provision, by itself, may refer to a known liability and is created out of profits of the company, yet, in the absence of any specific head indicating the purpose to which the amount is credited,

the mere availability of money out of the general pool, does not, by itself, created a fund. The Supreme Court pointed out a specific provision for an ascertained liability is not a fund within the meaning of the term in the rules contained in the Companies (Profits) Surtax Act, 1964. Reading Section 40A(9), we hold that to attract Section 40A(9), there must be a fund specifically available and there, in fact, is a contribution to that fund. In the absence of either of these facts, a mere making of a provision will not attract the provision under Section 40A(9) of the Income Tax Act.

46. Learned Standing Counsel appearing for the Revenue brought to our attention the balance sheet format given under Schedule VI to the Companies Act. In the context of the decision arrived at, we need not go into the Guidance Note on Terms Used in Financial Statements as to the meaning of 'fund' under Clause 6.15, which defines it as an account usually of the nature of a reserve or a provision which is represented by specifically earmarked assets.

47. As rightly pointed out by the learned counsel appearing for the assessee, even if there be an actuarial valuation, the charging of the profit as by way of a provision made, no doubt, satisfies the

requirement on the declaration of a dividend, but then, the actuarial valuation charged on the profits must find its place in the form of a creation of a separate fund identified for such purpose with systematic accumulation thereon. **The sum of money set apart to meet the scheme has to be there visibly without any probability further, either into the balance sheet entries/or the Profit and Loss account, to call it as a fund.**

48. In the context of the decision of the Supreme Court reported in ***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.)***, we hold that a mere provision made in the accounts, per se, cannot be equated to the creation of fund, the fact that every year there is a systematic accumulation to the provision already made, does not, however, satisfy the requirements of law under Section 40A(9) of the Income Tax Act. It is not denied by the Revenue that the assessee cannot pin point out any particular head created under the accounts as a sum of money available immediately for that particular purpose; the mere charging of profits towards the particular liability, does not, satisfy the Section, except beyond the requirement of making a provision, when Section 40A(9) contemplates the contribution towards the setting up or formation of a

fund and the contribution to a fund thus created for any purpose.

49. To accept the case of the Revenue that a provision is a fund by itself, would go against the decisions of the Supreme Court and contrary to what is legally understood on the expression of the term 'fund'.

50. On a conjoint reading of the decisions referred to above, we agree with the assessee's contention. The provision made in the accounts must find its route under a specific head, ultimately to the money set apart for the specific purpose of meeting out the liability on the service weightage scheme. On the admitted facts herein, except for mere creation of a provision in the accounts, there being no fund in fact created, the case of the assessee is not hit by Section 40A(9) of the Income Tax Act. To that end, we reject the case of the Revenue.

51. The decision of the Supreme Court reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v. Their Workmen*)**, is relevant for understanding the expression 'provision and reserve' and in the context of the facts narrated in the present case and in the light of the provision under Section 40A(9) and of the decision of the

Supreme Court reported in ***(1996) 219 ITR 121 (Commissioner of Income Tax (Appeals) V. Duncan Brothers & Co. Ltd.)***, the claim of the assessee could not be brought under Section 40A(9) of the Income Tax Act.

52. This, however, leaves us with yet another contention of the Revenue, which was seriously objected to by the assessee. Learned Standing Counsel appearing for the Revenue pointed out that even if the case is seen as not one falling under Section 40A(9), the case of the assessee would nevertheless be hit by Section 40A(7) of the Income Tax Act.

53. Learned counsel appearing for the assessee further referred to the decisions of the Delhi High Court reported in ***334 ITR 341 (Commissioner of Income- tax v. Ranbaxy Laboratories Ltd.), (2010) 320 ITR 322 (Commissioner of Income-tax-IV, New Delhi, Vs. Insilco Limited).***

54. The decision reported in ***(2010) 320 ITR 322 (Commissioner of Income-tax-IV, New Delhi, Vs. Insilco Limited)*** was a case relating to a provision for long service award

based on an actuarial calculation. The Delhi High Court considered that the claim of the assessee was admissible in the light of Circular No.47 dated 21st September, 1970 (78 ITR Statute 13). The Delhi High Court referred to the decision reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals))*** as well as the decision reported in ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v.*** **Their Workmen)** and upheld the claim of the assessee. The High Court allowed the claim holding that the provision for a liability is amenable to deduction if there is an element of certainty that it shall be incurred and it is possible to estimate the liability with reasonable certainty even though the actual quantification may not be possible.

55. A reading of the judgment of the Delhi High Court shows that the facts that the assessee evolved a scheme, whereby, employees who rendered long period of service were entitled to monetary wages at various stages of employment, equivalent to a definite period of time. Based on an actuarial calculation, a provision was made in the accounts. The claim of the assessee for deduction was upheld by the Tribunal based on the decisions reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax***

(Appeals)) and ***(1969) 73 ITR 53 (Metal Box Company of India Ltd. v. Their Workmen*)**. Thus, when there was an element of certainty and the provision was made on actuarial valuation, the Delhi High Court held that the deduction was legally allowable under the provisions of the Act.

56. The decision reported in ***334 ITR 341 (Commissioner of Income- tax v. Ranbaxy Laboratories Ltd.)*** is a decision, which considered the disallowance on the provision for pension. The Delhi High Court allowed the claim under Section 43B(b) of the Income Tax Act. The High Court accepted the case of the assessee for deduction on provision made on the pension scheme following the decision reported in ***(2000) 245 ITR 428 (Bharat Earth Movers V. Commissioner of Income Tax (Appeals))***.

57. We may point out herein that both these decisions are rendered post insertion of Section 40A(7) of the Income Tax Act. However, we find that there is no reference to the provisions contained in Section 40A(7); consequently, we cannot accept the assessee's contention placing reliance on the above-said decisions. In any event,

Section 43B(b) contemplates deduction only on payment actually made and not otherwise. The Section states that a deduction under the said provision would be allowed in computing the income referred to in Section 28 of the previous year in which such sum is actually paid by him. The second proviso relating to the claim falling under Section 43B(b) clearly points out that no deduction in respect of sum payable by the assessee as an employer by way of contribution to any superannuation fund or provident fund or gratuity fund or any other fund for the welfare of the employees, shall be allowed unless such sum has actually been paid in cash or by way of cheque or draft or by any other mode before the due date as defined in the Explanation to Section 36(1)(va). In the light of the above provision, we respectfully disagree with the decision of the Delhi High Court in this regard.

58. Short of repetition, we may extract the provisions under Section 40A(7) of the Income Tax Act , which reads as under:

"**40A.**

.....

(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 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.

Explanation.—For the removal of doubts, it is hereby declared that where any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason has been allowed as a deduction in computing the income of the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way of gratuity to any employee shall not be allowed as a deduction in computing the income of the assessee of the previous year in which the sum is so paid."

59. As is evident from the reading of the provision, Section 40A(7) negatives any claim for deduction in respect of any provision made by an assessee for payment of gratuity to an employee on the retirement or on termination of the employment for any reason. Thus, Section 40A(7)(b) states that a provision made by the assessee by way of contribution towards an approved gratuity fund or for the purpose of payment of any gratuity that has become payable during

the previous year, however, would not be hit by Section 40A(7)(a). Unlike in sub-section (9) of Section 40A of the Income Tax Act, where the said provision contemplates setting up or formation of or contribution to a fund or a trust, sub-section (7) of Section 40A deals specifically about disallowing a claim for deduction made in the accounts as regards payment of gratuity to an employee on his retirement or on termination of his employment. Although sub-Section (2) to Section 43 of the Income Tax Act defines for the purpose of Section 28 to 41 of the Income Tax Act that 'paid' means actually paid or incurred according to the method of account upon the basis of which the profits and gains are computed under the head "Profits and gains of business or profession", yet, sub-section (9) of Section 40A specifically rejects a claim for deduction in respect of any sum 'paid' by the employer/assessee towards setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 (21 of 1860), or other institution for any purpose, except where the sum is paid. Sub-section (7) of Section 40A specifically refers to the non-allowability of a claim for deduction as "any provision" made for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason.

60. Thus, one finds the marked distinction between sub-section (9) to Section 40A which considers an identifiable head like a fund or a trust to be created and a contribution there for to it for any purpose and Section 40A(7) which rejects the claim of deduction in a case where a provision is made in the accounts for payment of gratuity.

61. As far as the expression 'gratuity' is concerned, there is no definition of what 'gratuity' is, even under the Payment of Gratuity Act; yet, a monetary relief to an employee at the time of his retirement or termination of service is treated as 'gratuity'. Section 4 of the Payment of Gratuity Act enjoins on the employer to pay gratuity to an employee on the termination of his employment after he has rendered continuous service for not less than 5 years on the employee attaining superannuation or retirement or resignation or on his death or disablement or due to accident or disease. The payment of gratuity itself is calculated based on the number of years of service put in by the employee, calculated at the rate of 15 days wages based on the rate of wages last drawn by the employee concerned.

62. A reading of the provisions of the Payment of Gratuity Act

shows that it is a complete code containing detailed provisions covering all the essential features of a scheme for payment of gratuity. In the decision reported in ***(2004) 1 SCC 755 = AIR 2004 SC 1426 (Ahmedabad Pvt. Primary Teachers' Assn. V. Administrative Officer),*** the Supreme Court held that gratuity in its etymological sense is a gift, especially for services rendered, or return for favours received. The Apex Court pointed out that the main purpose and concept of gratuity is to help the workman after retirement, whether retirement is a result of rules of superannuation or physical disablement or impairment of vital part of the body. The expression 'gratuity' itself suggests that it is a gratuitous payment given to an employee on discharge, superannuation or death. Gratuity is an amount paid unconnected with any consideration and not resting upon it and has to be considered as something given freely, voluntarily or without recompense. It is a sort of financial assistance to tide over post-retiral hardships and inconveniences.

63. In the background of the meaning given to the word 'gratuity', when we look into the agreement between the employee union and the employer, we find that the scheme seems to be in vogue for quite sometime even before this accounting year relevant to this

assessment year and as far as the relevant assessment year under consideration is concerned, the scheme which had come into existence from 01.01.1997 would be relevant. As per this, at the time of retirement or superannuation or relieving from his employment, an employee shall be entitled to a payment based on the service weightage, the payment being the last drawn salary multiplied by 3 days and the number of years put in by the employee. Admittedly, the scheme is not a recognised one, but one reached as per the agreement between the parties. It is not denied by the assessee that a provision was made in the accounts as regards the gratuity payable based on the service weightage. Being a provision made for payment of gratuity to the employees on the retirement or termination of their employment, the claim stands clearly hit by Section 40A(7)(a) of the Income Tax Act.

64. Learned counsel appearing for the assessee submitted that in the grounds of appeal filed before this Court, the Department had contended that service weightage is neither a gratuity, nor a payment to any welfare fund and at best constitute only a provision which is to be disallowed. A question of law to that end was also raised as to whether on the facts and in the circumstances of the case, the Income

Tax Tribunal was right in law in not considering that the amount paid to service weightage is neither a gratuity, nor a payment to any welfare fund and at best only a provision in the nature of a contingent liability and therefore to be disallowed? In the background of the ground thus raised, learned counsel appearing for the assessee submitted that it is not open to the Revenue to contend otherwise to somehow bring the case of the assessee under one of the clauses under Section 40A of the Income Tax Act. Thus, learned counsel submitted that it is not open to the Revenue to go against what had been raised as a question in the grounds of appeal before this Court.

65. It is no doubt true that the Revenue had contended in the grounds of appeal that it was neither a gratuity nor a payment made to any welfare fund and would constitute only a provision and that the focus throughout was only on Section 40A(9). Section 260A of the Income Tax Act deals with the appeal to the High Court. Sub-section(6) to Section 260A states that the High Court may determine any issue which has not been determined by the Appellate Tribunal or has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in sub-section (1) of Section 260A. Sub-section (1) of Section 260A states that an appeal

shall lie to the High Court from every order passed in appeal by the Appellate Tribunal before the date of establishment of the National Tax Tribunal, if the High Court is satisfied that the case involves a substantial question of law. Sub-section (4) provides that the appeal shall be heard only on the question so formulated. The proviso therein states that it, however, would not take take away or abridge the power of the Court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

66. Reading the above said provisions and the issues raised before this Court, we find that the grounds taken by itself automatically cannot stand in the way of this Court considering the legal issue on the claim of deduction on the provision made by the assessee as to whether it would be covered by Section 40A(9) or under any other provisions of the Act, which includes Section 40A(7) too. It is no doubt true that neither the Assessing Officer nor in the course of the assessment proceedings or before any other authority, the issue was tested on the provisions of Section 40A(7). However, when the question of deductibility is a matter of dispute and being a pure question of law, on the facts found, we have no hesitation in

holding that this Court has the jurisdiction to consider the applicability of Section 40A(7) too to the facts of the case.

67. The decision of the Apex Court reported in ***(2013) 358 ITR 252 (SC) (Commissioner of Income -Tax V. Mastex Ltd.)*** resolves the issue on the scope of jurisdiction under Section 260A of the Income Tax Act. The Apex Court observed "we are afraid that the Revenue is under some misconception. The proviso following the main provision of section 260A(4) of the Act states that nothing stated in sub-section (4), i.e., "The appeal shall be heard only on the question so formulation" shall be deemed to take away or abridge the power of the court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question. The High Court's power to frame substantial question(s) of law at the time of hearing of the appeal other than the questions on which appeal has been admitted remains under section 260A(4). This power is subject, however, to two conditions, (one) the court must be satisfied that appeal involves such questions, and (two) the court has to record reasons therefor."

68. In the light of the provisions under Section 260A of the

Income Tax Act on the extent of jurisdiction of this Court to decide the question of law arising on the facts stated, we hold that what was created was admittedly only a provision in the books of accounts, hence, not a fund or a contribution to a fund to be considered under Section 40A(9) of the Income Tax Act; the only other provision, which would hit the claim of the assessee herein would be Section 40A(7) of the Income Tax Act. Thus, going by Section 40A(7) of the Income Tax Act, on the facts admitted, we hold that the assessee's claim for deduction is hit by Section 40A(7) of the Income Tax Act. The provision had been in the statute book with effect from 01.04.1973, inserted by Finance Act 1975, subsequently substituted by Finance Act, 1999, with effect from 1.4.2000. The provision as is relevant to the assessment year under consideration is one what prevailed prior to the substitution by Finance Act, 1999, effective from 1.4.2000.

69. In the light of our discussion, apart from the question of law raised, the question of law which has to be formulated for deciding the issue is as to "whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in granting the relief under Section 40A(9) when such claim is hit by Section 40A(7) of the Income Tax Act?"

70. For the reasons that we have given in the preceding paragraphs, even though the assessee succeeds on the applicability of Section 40A(9) of the Income Tax Act, the case of the assessee fails in view of Section 40A(7) of the Income Tax Act. Consequently, the order of the Income Tax Appellate Tribunal is set aside and this Tax Case (Appeal) stands allowed. No costs.

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To

1. The Income Tax Appellate Tribunal, Madras "D" Bench, Chennai
2. The Commissioner of Income Tax (Appeals) I, Coimbatore.
3. The Assistant Commissioner of Income Tax, Company Circle-IV(1), Coimbatore.