1961

December 20

GORDON WOODROFFEE LEATHER MANUFACTURING CO.

v.

THE COMMISSIONER OF INCOME-TAX, MADRAS

(B. P. SINHA, C. J., J. L. KAPUR, M. HIDAYATULLAH, J. C. SHAH and J. R. MUDHOLKAR, JJ.)

Income-Tax—Gratuity—Payment of not in pursuance of any scheme but voluntarily for long and valuable services—Whether deduction can be claimed—Income-Tax Act, 1922 (11 of 1922), s. 10 (2) (xv).

The company accepted the resignation of one of its directors and in appreciation of his long valuable services to the company, paid him a gratuity of Rs. 40,000/-. This amount was claimed as a deduction under s.10(2) (xv) of the Income-tax Act which was disallowed by the Income-tax Officer, on the ground that the appellant company had no pension scheme; the payment was voluntary and that the entry in the assessee's books clearly indicated it to be a capital payment.

Held, that the payment does not fall within the provisions of s. 10(2)(xv) of the Act. The amount was paid not in pursuance of any scheme of payment of gratuities nor was it an amount which the recipient expected to be paid for long and faithful service but it was for a voluntary payment not with the object of facilitating carrying on the business of the appellant company or as a matter of commercial expediency but in recognition of long and faithful service. There was no practice in the appellant company to pay such amounts to and did not affect the quantum of salary of the recipient.

To claim a deduction under s.10(2)(xv) of the Act the proper test to apply is, was that the payment made as a matter of practice which affected the quantum of salary or was there an expectation by the employee of getting a gratuity or was the sum of money expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business.

J. P. Hancok v. *General Raversionary & Investment Co. Ltd.* (1918) 7 T. C. 358 and *J. W. Smith* v. *The Incorporated Council of Law Reporting for England and Wales*, (1914) 6 T. C. 477, REFERRED TO.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 62 of 1961.

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Gordon Woodroffee Leather Manufacturing Co.,
v.
The Commissioner of Income-tax, Madras

Appeal by special leave from the judgment and order dated December 20, 1956, of the Madras High Court in Case Referred No. 85 of 1953.

A. V. Viswanatha Sastri, R. Ganapathy Iyer and *G. Gopalakrishnan* for the appellant.

K. N. Rajagopala Sastri and *P. D. Menon* for the respondent.

1961. December 20. The Judgment of the Court was delivered by

Kapur J

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

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

of which the appellant Company was to pay Rs. 40,000/- and the Managing Agent Company the balance of Rs. 10,000/-. On April 4, 1949, this resolution of the Board of Directors was confirmed. On the same date a resolution to the same effect was passed at an Extraordinary General Meeting of the Company and before the end of its accounting year *i. e.* October 31, 1949, this amount of Rs. 40,000/- was paid to Mr. J. H. Philips.

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

Section 10(2) "Such profits or gains shall be computed after making the following allowances, namely :

.....

.....

(xv) any expenditure (not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

The amount was disallowed by the Income-tax Officer as well as by the Appellate Assistant Commissioner on the ground that the appellant Company had no pension scheme; the payment was voluntary and that the entry in the assessee's books clearly indicated it to be a capital payment. Against this order the appellant Company took an appeal to the Income-tax Appellate Tribunal which upheld the order of the Appellate Assistant Commissioner. It held that according to the resolution the gratuity was paid "for long and valuable services to the Company" ; that there was nothing to indicate that Mr. J. H. Philips had accepted a lower salary in expectation of getting a gratuity at the end of his service ; that there

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was no such practice in the appellant Company and that during the course of his service he was being remunerated at a graduated scale of salary and a commission of 2 ½% on the profits; that there was no "expectancy" that at the end of the service there would be a recompense for faithful and efficient service that he had been suitably rewarded by being given a commission on the profits "in order to whip up his enthusiasm". It was also mentioned that in the books of the appellant Company the amount had not been debited in the profit and loss account but was debited to the appropriation account thereby indicating that it was an extra payment or a payment made in the nature of a capital expense. Taking all these circumstances into consideration the Tribunal came to the conclusion that it was difficult to hold that the expenditure was not in the nature of a capital expenditure or that it was expended wholly and exclusively for the purpose of the assessee's business. At the instance of the appellant Company the case was stated to the High Court under s. 66(1) of the Income-tax Act and the following question was referred :—

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

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

was voluntary and there was no evidence to show that it was in the future interest of the business of the Company that the expenditure was incurred. The High Court observed :—

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

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

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

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its good faith was not in doubt and in support of the contention several cases were relied upon.

In our opinion on the findings as given the payment in dispute does not fall within the provisions of s. 10(2)(xv). The amount was paid not in pursuance of any scheme of payment of gratuities nor was it an amount which the recipient expected to be paid for long and faithful service but it was a voluntary payment not with the object of facilitating the carrying on of the business of the appellant Company or as a matter of commercial expediency but in recognition of long and faithful service of Mr. J. H. Philips. There was no practice in the appellant Company to pay such amounts and it did not affect the quantum of salary of the recipient. The two cases strongly relied upon by the appellant Company were *J. P. Hancok* v. *General Reversionary & Investment Company Ltd.*(1) and *J. W. Smith* v. *The Incorporated Council of Law Reporting for England and Wales*(2). In the former case the assessee Company sought to charge as a trade expense a lump sum which it had paid for the purchase for the benefit of a former actuary, of an annuity equal in amount to the pension which the Company had resolved to pay him. This was held to be an expense admissible in computing the Company's profits assessable to income-tax. But in that case it was the practice of the assessee company to grant pensions to its servants after a considerable period of service and this practice was known to the employees and affected the rate of salary paid by the Company in that the employees were willing to serve the Company at lower rates than they otherwise would have by reason of the expectation of the pension at the end of their service. In the latter case there was a practice of granting gratuities and that was the ground for holding the amount to be a proper deduction.

(1) (1918) 7 T. C. 358.
(2) (1914) 6 T. C. 477.

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

The appeal therefore fails and is dismissed with costs.

Appeal dismissed.

NEW BANK OF INDIA LTD.

v.

PEAREY LAL

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December 20.

(B. P. SINHA, C. J., J.L. KAPUR, M. HIDAYATULLAH, J. C. SHAH and J. R. MUDHOLKAR, JJ.)

Bank—Money delivered by constituent—Special instruction to await direction for deposits—If held by the bank as trustee—Scheme for settlement of bank's liabilities sanctioned—Amount, if subject to it.

The respondent delivered certain sums of money to the appellant-bank at Lahore for transmission to Calcutta, with instructions to await his directions regarding the opening of accounts for keeping the money in fixed deposit in the Calcutta Branch of the bank which was proposed to be opened in the near future. The respondent did not however give any instruction for opening any account, fixed deposit or otherwise in regard to the amounts after they reached Calcutta. Within a few days after the opening of the Calcutta branch of the bank it ceased making payments and a moratorium for a limited period was declared under an ordinance issued by the Governor General restraining the bank from making payments to its depositors. After the expiry of the period of the moratorium the Calcutta branch of the bank raised objections to the respondent's application for withdrawal of the amount