Mysore Spinning and Manufacturing Co. Ltd. Vs Commissioner of Income Tax, Bombay City-I

Court: Bombay High Court

Date of Decision: Feb. 2, 1966

Acts Referred: Employees Provident Funds and Miscellaneous Provisions Act, 1952 â€” Section 17
Income Tax Act, 1922 â€” Section 10(2), 58K

Citation: (1966) 61 ITR 572

Hon'ble Judges: Y.S. Tambe, Acting C.J.; V.S. Desai, J

Bench: Division Bench

Advocate: N.A. Palkhivala, for the Appellant; G.N. Joshi, for the Respondent

Judgement

Tambe, Actg.C.J.

1. This is a reference at the distance of the assessee company u/s 66(1) of the Indian Income Tax Act, 1922, and the main question that arises

relates to the construction of the provisions of section 58K of the Indian Income Tax Act. The matter arise thus. We are here concerned with the

assessment year 1957-58, the accounting period being 1st March, 1956, to 28th February, 1957. The assessee is a limited company carrying on

business in the manufacture and sale of year and cloth in Bangalore. The Company started two provident funds for its employees. In the year 1941

it started provident found for the benefit of the monthly-rated employees and this found was called ""the Staff Provident Found"". In the year 1949

the company started another prevent fund or the benefit of the daily-rated employees and this was called ""the Workmen''s Provident Fund"". Both

these funds were not recognised provident founder under Chapter IX-A of the Income Tax Act. To both these provident and the assessee-

company as sell as the employees continued to contribute. Now Parliament enacted the Employees'' Provident Funds Act which came into force

on 31st October, 1952. The amounts landing to the credit of these tow fund on the date the Employees'' Provident Funds Act came into force so

far as they are referable to the contributions by the assessee-company stood as follows :

2. The assessee-company was one of the companies that came within purview of the First Schedule of the Employees'' Provident Funds Act.

hereinafter referred to as the Act. The assessee-company therefore was governed by the provisions from the of the Act. The assessee-company

applied u/s 17 for exemption from the operation of the provisions of the Act. On 1st July, 1953, the assessee-company was granted provisions

exception. The company, however, was informed that pending the grant of exemption it need not make any payment of the accumulation to the

Regional Provident Fund Commissioner, which it was required to under the Act. After certain correspondence between the assessee company and

the authorities under the Act, the Commissioner by his letter dated 20th August, 1955, informed the assessee-company that the provisional

exemption granted u/s 17 of the Act was cancelled. In accordance with the communication received by the assessee-company that the provisional

exemption grand u/s 17 of the Act was cancelled. In accordance with the communication received by the assessee-company, the amounts of

communication which were require to be transferred to the Commissioner were calculated as on 31st August, 1955, and the sum came to Rs.

14,87,000. The said sum was transferred to the Regional Provident Fund Commissioner and acknowledged by him by his letter dated 28th

March, 1956. In the aforesaid sum of Rs. 14,87,000 is included the said sum of Rs. 3,01,772-1-7 which relates to the contribution made by the

assessee-company to the two provident funds up to 31st October, 1952, and it is only with this amounts that we are here concerned.

3. The said amounts was claims as a deduction in the assessment for the assessment year 1957-58 by the assessee-company. The Income Tax

Officer disallowed the claim, in a such as according to him the transfer of the amounts to the provident fund amounted a capital expenditure and

under the provision of the section 58K of the Income Tax officer Act. The assessee-company took appeals against the order to the Appellate

Assistant Commissioner. The contention of the assessee-company was that section 58K had not application to the facts of the present case and

the assessee company was entitled to claim deduction in respect of this amount u/s 10(1) or a alternatively u/s 10(2)(xv) of the Income Tax Act.

The contention of department, on the other hand, was that section 58K of the Income Tax officer Act was allowed as a deduction, inasmuch as it

amounted to capital expenditure within the meaning of sub section (1) of section 58K of the Income Tax Act and in this view of the matter the

appeal was dismissed. The assessee-company took a further appeal to the Tribunal and reiterate the aforesaid contentions. The Judicial Member

and the Accountant Member in separate but a concurring order held that there was transfer of the fund to the trustees which came within the scope of the section 58K, that it was therefore capital expenditure within the meaning of the said provision, that there was no scope for the application of

section 10(2) (xv) as the amount was deemed to be capital expenditure and that this amount a cannot be claimed as a deduction from the

computation of the commercial profits for the a purpose of section 10(1) as it was an expenditure and not a loss.

4. On an application made under sub-section (1) of section 66 of the Tribunal has stated the case referring the following two question of law to this

court :

(1) Whether the provisions of section 58K of the Income Tax Act apply to the transfer to the sum of Rs. 3,01,772-1-7 to the Regional Provident

Fund Commissioner ?

(2) If the answer to the above question is in the negative, whether the sum of Rs. 3,01,772-1-7 is allowable as a deduction in arriving at the

commercial profits u/s 10(1) or is an allowable deduction u/s 10(2) (xv) of the Income Tax Act in the computation of the assessable business

profits ?

5. Sub-section (1) of section 58K runs :

Where an employer who maintains a provident fund (whether recognised or not) for the benefit of his employees and has not transferred the fund

or any portion of it, transfers such fund or portion o trustees in trust for the employees participating in the fund, the amount shall transferred shall be

deemed to be of the nature of capital expenditure.

6. The section enacts a fiction and the fiction is that the expenditure incurred by an employer in transferring the provident fund the maintained by

him for the benefit of his employees to the trustees in trust for the employees is deemed to be of the nature of capital expenditure. It is the

contention of Mr. Palkhivala, learned counsel for the assessee, that on a true constructions of the relevant provisions of the Employees'' Provident

Funds Act and the scheme framed thereunder, the transfer of provident fund maintained by the assessee to the statutory provident fund is not a

transfer within the meaning of sub section(1) of section 58K. According to Mr. Palkhivala, the transfer contemplated by sub-section (1) of section

58K is a voluntary transfer and not an involuntary transfer in obedience to the provisions of the statue. Mr. Palkhivala further contends the at any

rate the transfer of the provident fund is not to trustees in trust for the employees. In other word, the contention of Mr. Palkhivala is that no trust as

such in the legal sense has been created under the provisions of the Employees'' Provident Funds Act, 1952. Mr. Joshi, learned counsel for the

revenue, on the other hand, contends that the transfer of the fund contemplated by sub section (1) of section 58K includes a voluntary as well as an involuntary transfer. It is also the contention of Mr. Joshi that the provisions of the Employee''s Provident Funds Act creates a statutory trust and

the transfer of the fund under the provisions of the said Act is a transfer to the trusted who are enjoined with duty to hold the fund in trust of the

employees participating in the fund. The provisions of sub section (1) of section 58K have been fully compile with the expenditure incurred by the

assessee has to be treated as a capital expenditure under the said a section and, therefore, not allowable as a deduction u/s 10(2)(xv) or section

10(1) of the Income Tax Act.

7. Before we proceed to consider the relevant provisions of Chapter IX-A in which section 58K occurs and the relevant provisions of the

Employees'' Provident Funds Act and the scheme framed thereunder, it would be useful to consider what the position was prior to the introduction

of Chapter IX-A on the statute book. Section 6 of the Income Tax Act enumerates the various heads of income chargeable to Income Tax in the

manner provided in the Act. Salaries is or of the heads. Section 7 deals with salaries. Sub-section (1) of section 7 provides that profits in lieu of, or

in additions to, any salary of an assess shall be deemed to be salary due on the date when the sum s received. Explanation 2 to the said sub-section

provides that any payment due to or receive by an assessee from a provident fund, to the extent to which it does not consist of contributions by the

assessor interest on such contributions, is a profits received in lieu of salary for the purposes of this section. In other words, prove to the coming

into force of Chapter IX-A, an employee had to suffer at on the amounts it he provident fund representing the employer''s contribution to the

provident fund at the time the employee received the amount. And at the time the employers would any the said amount of the provident fund to

the employees on has retirement, it would have the character of salary of an employees. The said amount would therefore be necessarily an

allowable deduction as expenditure laid out wholly and exclusively for the business provided he had at the time of making payment deducts Income

Tax and super-tax open the amount payable at the rate representing the average of not aerates applicable thereto as was required by section 18 of

the Act.

8. Now as regards the annual contributions made by the employer and employee, both had suffered tax in the hands of the employer and employee

in their respective contributions. The employee further suffered tax at the time he received the employer''s contribution on his retirement. With a

view to given relief in respect of Income Tax to the contributions made to the provident fund moonstone by a commercial and other employers, the

Central Legislature in the year 1929 introduced on the statute book Chapter IX-A comprising of section 58A to 58M in the Income Tax Act. The

concession that had been afforded under this Act was to grant exemption from Income Tax in respect of contribution made both by the employers

and employees to a provident fund institute by an employers grand recognised by the Income Tax authorities, provided that the contribution did not

exceed a certain prescribed limit and further that the contribution together with the insurance prima paid by the employees did not exceed a certain

prescribed limit and further that the contribution together tithe insurance premier paid by the employee did not exceed a certain limit prescribed

limit prescribed in the Act. Section 58A relates to definition and clause (a) provides that a ""recognized provident fund"" means a provident fund

which has been said continues to be recognised by the Commissioner in accordance with the provision of the this Chapter. A ""contributions ""means

any sum credited by or on behalf of any employee out of his salary, or by an employer out of his own moneys, to the individual account of an

employee, but does not include any sum credited as interest. Section 58B empowers the Commissioner of Income Tax to accord recognition to

any provident fund which in his opinion satisfies the conditions prescribed in section 58C. Section 58C enumerates various conditions which have

to be satisfied by employer constituting a provident fund if he wants to get it recognised by the Income Tax Commissioner and the importance one

out of them are clauses (b), (e) and (f). Clause (b) provides that the contributions of the employees in any years shall be a definite proportion of his

salary for that year and shall be deducted by the employers from the employee''s salary in that proportion at each periodical payment of such salary

in that year, and credited to the employee''s individual account in the fund. Clause (e) provided that the fund shall be vests in to or more trustees or

the in official trustee under a trust which shall be not revocable be save with the consent of all the beneficiaries. Clause (f) provides that the

employer shall not be entitled to recover any sum whatsoever from the fund, save in the case where the employees is dismissed for misconduct or

voluntarily leaves his employment otherwise than on account of ill-health or there unavoidable case before the expiration of the term of service

specified in this behalf in the regulations of the fund. Thus it would be see that for an employer to get the provident fund constituted by him

recognised by the Income Tax Commissioner, he had to create a trust and had to vest the fund in two or more trustee or in the official trusts under

trust for the benefit of his employees. He was further required to deduct from the salary of his employees certain proportion and directly pay it to the provident fund as the contributions of his employees in addition to his own contributions. The material changes thus that had to take place

before the fund was recognised by the Income Tax authorities was the loss of proprietorship over the provident found by an employer. Unless the

employer parted with the accumulated balance of the provident fund with him and vested it is trustees, he could not get the provident fund

recognised. Section 58D relates to the power of the Income Tax Commissioner to relax the conditions in certain cases. Section 58E reads :

That portion of the annual accretion in any year to the balance at the credit of an employee participating in a recognised provident fund as the

consists of -

(a) contributions made by the employer in excess of ten per cent. of the salary of the employee, and

(b) interest credited on the balance to the credit of the employee in so far as it exceeds one-third of the salary of the employee or is allowed at a

rate exceeding the rate fixed by the Central Government in this behalf by notification in the Official Gazette,

shall be deemed to have been received by him in that year and shall be included in his total income for that year, and shall be liable to Income Tax

and super-tax.

9. Section 58F provides :

An employee shall not be liable to pay Income Tax on his own contributions to his individual account in a recognised provident fund, in so far as

the aggregate of such contributions in any year does not exceed one-fifth of his salary in that year or eight thousand rupees, which is less.

10. Now the combined effect of sections 58E and 58F appears to us to be that an employee does not suffer tax in respect of the contributions

made by him to the recognized provident fund up to the limit mentioned in section 58F. Tax is payable only in respect of excess. The employee

further does not suffer any tax on the yearly contributions of the employer to his account and interest thereon, provided the yearly contribution and

the rate of interest does not exceed the limits mentioned in section 58E. Section 58G deals with provision relating to exemption of accumulated

balance from Income Tax and super-tax. Section 58H provides :

The trustees of a recognized provident fund, or other person authorized by the regulations of the fund to make payment of accumulated balance

due to employees, shall, at the time an accumulated balance due to an employee is paid, deduct therefrom any Income Tax payable sub-section (3)

of section 58G and any Income Tax and super-tax payable on an employee''s total income as determined under sub-section (3) of section 58J,

and sub-sections (4) to (9) of section 18 shall apply as if the sum to be deducted were Income Tax payable under the head ''Salaries''.

11. Section 58-I relates to the maintenance of accounts of recognised provident funds. Section 58J relates to the duties cast on the authorities

concerned to make an account in a particular way of the accumulated balances received in the newly recognised provident fund and ascertain the

tax payable, if any, in respect of any part of these balances. Then comes section 58K. We have already reproduced sub-section (1) of section

58K. Sub-section(2) of section 58K runs :

When an employee participating in such fund is paid the accumulated balance due to him therefrom, any portion of such balance as represents his

share in the amount so transferred to the trustee (without addition of interest and exclusive of the employee"s contributions and interest thereon)

shall, if the employer has made effective arrangement to secure that tax shall be deducted at source from the amount of such share when paid to the

employee, be deemed to be an expenditure by the employer within the meaning of clause (xv) of sub-section (2) of section 10, incurred in the year

in which the accumulated balance due to the employee is paid.

12. It would be noticed that under sub-section (1) the expenditure incurred by an employer in transferring the accumulated balances in the

provident fund maintained by him to the trustees is deemed to be an expenditure of capital nature. Now in the accumulated balances transferred

there is also included the contributions made by the employer to the provident fund out of the his own income. He had obtained no exemption in

respect of the said amounts and had also suffered tax thereon. Sub-section (2), therefore ,provides that if the employer has made effective

arrangement to secure that the tax shall be deducted at the source from the amount of his share of contributions at the time that amount is paid to

the employee, then the he would get exemption in respect of that amount u/s 10(2) (xv) of the Act. In other words, the scheme of section 58K is

that though an employer cannot claim any allowance at the time he transfers his own accumulated contribution to the provident fund to the trustees,

he can claim exemption in respect of thereof at the time his share of contributions is paid to the employee, provided arrangements are made to

deduct from these amounts the Income Tax payable by his employee. Section 58L powers the Central Government to make rules. Section 58M

provides that Chapter IX-A shall not apply to any provident fund to which the Provident Funds Act, 1925, applies.

13. Looking at the provisions of Chapter IX-A in its entirely as well as looking at the scheme envisages by the provisions of section 58K, it

becomes apparent that the Chapter as well was the section 58K deals with the creation of the a trust by an employer for entrusting to it the provident fund maintained by him for the benefit of his employees and entrusting all the accumulated balance to the trustees to hold on trust for the

benefit of his employees and entrusting all the accumulated balance to the trustees to hold on trust for the benefit of his employees participating in

the fund. The transfer of the fund thus contemplated u/s 58K, in our opinion, is a voluntary transfer of the fund thus contemplated of the provident

fund maintained by him to the trustees to hold it in trust for the benefit of his employees. It is indeed true that the expression ""transfer"" in its wider

amplitude is capable of including a voluntary as well as an involuntary transfer. But having regard to the scheme of the Chapter as well as the

provisions of section 58K, the meaning to be given to the word ""transfer"" occurring in sub-section (1) of section 58K has to be limited to a

voluntary transfer. The provisions of sub-sections (1) and (2) of section 58K indicated that it is an integrated scheme enabling an employer, who

transfers the provident fund maintained by him to trustees, to get allowance in respect of his contributions at the time those contributions are paid to

the employee, by making ""effective arrangements to secure that the tax shall be deducted at source from the amount of such share when paid to the

employee."" The position in contemplation of the legislature is one where it is possible for an employer to make effective arrangements to secure that

the tax shall be deducted at source from the amount of such share when paid to the employee. Such a possibility can exist and can only exist when

the employer of his won volition is making a trust and is transferring the provident fund maintained by him to trustees to hold it in trust for his

employees. The meaning of the word ""transfer"" thus stood controlled by the provisions of sub-section (2) of section 58K.

14. We, therefore, hold that the transfer of the fund to trustees in trust for employees contemplated by sub-section (1) of section 58K is a

voluntary or transfer of fund to the trustees by an employer to any statutory body. We would, however, proceed on the assumption that the

transfer of the fund contemplated by sub-section (1) of section 58K also includes an involuntary transfer and proceed to consider whether in the

instant case the transfer of the said amount of Rs. 3,01,772-1-7 under the provisions of the Employees'' Provident Funds Act is a transfer to

trustees in trust for the employees within the meaning of section 58K of the Income Tax Act. In other words, we proceed to consider whether the

provisions of the Employees'' Provident Funds Act and the scheme framed thereunder creates a trust in its legal sense, or a transfer of a provident

fund by an employee to a trustee.

15. In the year 1952 to proved for institution of provident funds for employees in factories and other establishments, Parliament enacted Act XIX

of 1952, called the Employees'' Provident Funds Act. The Act was made applicable in the first instance to all the factories engaged in any industry

specified in Schedule I, in which fifty or more persons were employed. The Central Government was given the power to add to the list by

following a certain procedure prescribed in the Act. Textile was one of the industries mentioned in the First Schedule, and, therefore, the Act on

the date it was enacted became applicable to the industry run by the assessee-company. Clause (h) in section 2 provides : "" ''Fund'' means the

provident funds established under a Scheme."" Clause (j) provides : "" ''Member'' means a member of the Fund."" Clause (1) provides : "" ''Scheme''

means a scheme framed under this Act."" Section 5 empowered the Central Government to frame a scheme for the establishment of provident funds

under this Act for employees or for any class of employees and specify the factories or the class of factories to which the said Scheme shall apply.

Section 6 required the employer to contribute six and a quarter per cent. of the basic salary of his employee to the provident fund and also

required the employee to contribute an equal amount to the provident fund. The employee, however, was given an option to make certain

additional contributions if the Scheme so permitted. Sub-section (3) of section 6 provided :

Where under the provisions of any Scheme, board of trustees is constituted for administering the Fund, such board of trustees shall be a body

corporate under the name specified in the Scheme, having perpetual succession and a common seal and shall by the said name sue and be sued.

16. Section 8 empowered the appropriate Government to recover as arrears of land revenue if the employer failed to pay the contributions and the

amounts which he was required under the law to pay. Section 9 provided that for the purposes of the Indian Income Tax Act, 1922, the Funds

shall be deemed to be a recognised provident fund within the meaning of Chapter IX-A of that Act. Sub-section (2) of section 15 provided that on

the framing of any such scheme as is referred to in sub-section (1), the accumulations standing to the credit of the employees in the provident fund

shall, notwithstanding anything to the contrary contained in any law for the time being in force or in any deed or other instrument establishing the

provident fund but subject to the provisions, if any, contained in the Scheme, be transferred to the fund established under the Scheme and shall be

credited to the accounts of the employees entitled thereto in the fund. Schedule II to the Act enumerates the matters for which provisions may be

made in Scheme, including the constitution of boards of trustees for the administration of funds and the manner in which accumulations in any

existing provident fund shall be transferred to the fund u/s 15 and the mode of valuation of any assets which may be transferred by the employers in this behalf. The aforesaid provisions of the Act indicate that the Central Legislature has made the Act applicable to certain industries. It requires the

employers in those industries to make certain contributions of their own and the deduct from the salaries of the employees and transfer them to the

statutory provident fund on it being constituted by the scheme framed under the Act. The Act further required the employers to transfer to the

provident fund brought into existence under the scheme all the accumulated balance with it in the private provident fund which have been already

constituted by them. As we will presently show, even if an employer had created a trust in respect of the provident fund instituted by him,the

trustees also were required to transfer the balances with them to the statutory provident fund constituted under the scheme.

17. Clause (b) in paragraph 2 of the Scheme states that ""board"" means a board of trustees constituted under the Scheme. Clause (1) of paragraph

3 enumerates the manners in which the central board of trustees is constituted and it provides that, subject to the provisions herein after contained,

the fund shall vest in and the administered by the board of trustees (hereinafter referred to as the ""Central Board""). Clause (2) relates to the

constitution of the State board of trustees and clause (3) relates to transfer of certain funds by the central board to the State board. Paragraph 4

relates to the setting up of a regional committee for the State till a State board is constituted. Paragraph 5 relates to terms of office of the chairman

and trustees of the various boards. Paragraph 6 relates to the resignation of the chairman and members of the board of trustees. Paragraph 7

relates to cessation and restoration of trusteeship. Paragraph 8 relates to disqualifications for trusteeship. Paragraph 9 relates to the removal of the

trustees. Paragraph 10 relates to certain procedure that is required to be followed by members of the board if they leave India. Paragraph 11

relates to meetings. Paragraph 12 relate to notice of meetings. Paragraph 13 relates to chairman who is to preside at the mattings. Paragraph 14

relates to quorum. Paragraph 15 relates to disposal of business at the meeting. paragraph 16 relates to minutes of the meetings. Paragraph 17

provides that no act or proceeding of a board shall be rendered ineffective merely on the ground that there is a defect in its constitution. Paragraph

18 relates to the fees and allowances payable to the members. Chapter III compresses of paragraphs 19 to 25 which relate to appointment and

powers of Commissioners and other staff of the board of trustees. They are the officers who have to act under the supervision and control of the

board of trustees and the p [principal officer is the Provident Fund Commissioner. Paragraph 26 enumerates the class of employees required to join the fund as well as the employees who are entitled to join the fund. Paragraph 28 relates to the transfer of accumulations form existing

provident funds and clause (1) provides :

(1) Every authority in charge of, or entrusted with the management of, any Provident Fund in existence on the 15th day of November, 1951, the

accumulations wherein are to be transferred to the fund under subsection (2) of section 15 of the Act, shall, before the 1st day of January, 1953,

or such later date as the Board may fix in this behalf -

(i) send to the appropriate Commissioner a statement showing the amount standing to the credit of each subscriber on the date of the transfer, the

total accumulations to the crate of the subscribers generally on that date and the advances, if any, taken by the subscribers,

(ii) transfer to the fund in the manner specified in sub-paragraph (2) the total accumulations standing to the credit of the subscribers in relation to

each factory, and

(iii) transfer to the board all pass-books, books of account and other documents relating to the said accumulations.

18. Clauses (2) and (3) of paragraph 28 relate to the details as to the transfer of the funds. Clause (4) provides :

(4) The accumulations transferred to the fund in accordance with this paragraph shall be credited to the account of each of the members of the

fund, to the extent to which he may be entitled thereto having regard to the statement furnished by the authority aforesaid.

19. Clause (5) provides :

(5) When the accumulations in any such Provident Fund as is referred to in sub-paragraph (1) have been so transferred to the Fund, the

appropriate Commissioner may, by notification in the Gazette of India, declare that the subscribers of such Provident Fund have now become

members of the Fund and that the accumulations aforesaid have now become vested in the board.

20. Chapter V relates to the subsequent contributions to be paid by the employer as well as the employees. It may generally be stated that the

manner of recovery of the employee''s or member''s contribution is deduction of that contribution form his wages directly by the employer and

paying it directly to the fund by the employer. Paragraph 49 requires a separate account to be maintained called the ""Central Administration

Account"" for recovering all administrative expenses of the fund including such administrative charms as the fund may be authorised to recover.

Paragraph 50 which relates to the provident fund account provides that the aggregate amount received as the employers'' and the employees''

contributions to the fund shall be credited to an account to be called the ""Provident Fund Account"". Paragraph 52 empowers the board to invest the amounts under its control in the manner specified in that paragraph. Paragraph 53 provides that subject to the provisions of the Act and of this

Scheme, the fund shall not be expended for any purpose other than for the payment of sums standing to the credit of the individual members of the

fund or to their nominees or heirs or legal representatives in accordance with the provisions of the Scheme. Paragraph 59 requires a separate

account to be opened in respect of each member, in which there shall be credited his contributions, the contributions made by the employer and

the interest credited to the account from time to time. Clause (1) of paragraph 69 authorises a member of the provident fund to withdraw the full

amount standing to his credit in the event of his retirement from service in the industry at any time after the age of superannuation, or on retirement

on account of permanent or total incapacity to work. It is not necessary to refer in detail to paragraphs 70 and 71. Suffice it to say, they relate to

payment of accumulations in the case of death of a member as well as termination of the services of a member on account of misconduct. It may be

stated that under the Scheme, the contributions made by an employer is in no event to go back to him, even when his employee who is a member

of the provident fund has been dismissed for misconduct. Clause (1) of paragraph 72 provides :

(1) When the amount standing to the credit of a member, or the balance thereof after any deduction under paragraphs 69 and 71 becomes

payable, it shall be the duty of the Commissioner to make prompt payment as provided in this Scheme. He shall close the account of the member

and give notice in writing to the person to whom the amount is payable, specifying the amount and tendering payment thereof. In case there is no

nominee in accordance with this Scheme, the Commissioner may, if the amount to the credit of the fund does not exceed Rs. 300 and if satisfied

after enquiry about the title of the claimant, pay such amount to the claimant.

21. These are all the material provisions of the Scheme to which our attention has been drawn.

22. The position that emerges on a consideration of these various paragraphs of the Scheme appears to us to be that on the framing of the Scheme

the statutory provident fund comes into existence and stands constituted. For the administration of the said statutory provident fund a board of

trustees called the Central Board of Trustees is constituted. To facilitate administration, boards of trustees state-wise or region-wise are also

allowed to be constituted and in the administration these boards are assisted by various officers who work under the control of the board, the

highest among them being the Provident Fund Commissioner. On the framing of the Scheme and the constitution of the statutory provident fund, the employers in the industries to which the Employees'' Provident Funds Act has been made applicable are required to transfer the accumulated

balances of the provident fund, if any had been maintained by them. Similarly, the trustees of the private provident fund constituted by an employer,

to whom the employer had entrusted the provident fund for the benefit of his employees, are also required to transfer the accumulated balances to

the statutory provident fund. Such employers are further required to make their own annual contributions according to the prescribed limit to the

statutory provident fund. The employers are also required to make their own annual contributions according to the prescribed limit to the statutory

provident fund. The employers are also required to deduct from the wages paid to their employees who are members of the provident fund, the

amounts equivalent to their contributions to the provident fund, the amounts equivalent to their contributions to the provident fund and forward the

same to the provident fund every year or at such intervals as may be directed. If an employer fails to transfer the accumulated balances as the case

may be or if the employer fails to transfer the accumulated balances as the case may be or if the employer fails to send annual contributions, the

amount in arrears could be recovered from the employer by the appropriate Government as arrears of land revenue. Now the board of trustees

and the officers administering the fund are required to open a provident fund account and in the provident fund account a separate account is

maintained of each member showing the balance to his credit containing the contributions of the employer and the interest accrued on the balances.

On their retirement or on their ceasing to serve on account of physical disability, the entire amount standing to their credit is payable to the

employees. Even in other cases the contributions made by the employee are payable to the employee. However, the contributions made by an

employer in their entirety are not made payable to the employee. For example, if an employee is dismissed for misconduct, paragraph 71 of the

Scheme authorises the Commissioner to forfeit to Government certain percentage of the employer''s contributions. The fund vests in the board of

trustees.

23. It has to be considered whether as a result of these provisions transfer of the accumulated balances under sub-section (2) of section 15 of the

Act read with paragraph 28 of the Scheme constitute transfer of the fund to a trustee. As already stated, it is the contention of Mr. Palkhivala that

no trust has been constituted under the Act and no transfer to the trustees as such of the accumulated balances takes place. The argument of Mr.

Palkhivala is that no doubt the board is called the board of trustees, but merely by calling them trustees, the members of the board do not become trustees in the legal sense. The board of trustees is nothing but officers appointed to administer the fund. According to him it is true that the

provident fund vests in the board and is held for the benefit of the employees, but that is only for the purposes of administration of the fund. It may

be that the obligation cast on the board of trustees is analogous to the obligations cast on trustees, but in no legal sense a trust is created or that the

board of trustees have been appointed as trustees. It is also the argument of Mr. Palkhivala that even assuming that a trust is created and the board

of trustees are the trustees under the trust, the transfer that takes place under sub-section (2) of section 15 or under paragraph 28 of the Scheme is

a transfer to the fund and it is not a transfer to the trustees. Laying emphasis on the provisions of sub-clauses (i), (ii) and (iii) of clause (1) of

paragraph 28 of the Scheme he argued that the employer is directed to transfer the accumulated balances to the fund, but he is directed to transfer

all pass-books and books of account to the board. The board and the fund are not terms interchangeably used in the Scheme, but on the other

hand the fund is recognised as a separate entity from the board. Mr. Joshi on the other hand contends that all the requirements of a legal trust have

been complied with. The fund is vested in the board of trustees. The paragraphs providing for the appointment of the board of trustees, their

removal, the manner in which they have to transact the business, are the paragraphs which are commonly found in a trust deed. All elements which

are necessary to constitute a trust in the legal sense have been fully complied with. It is indeed true that vesting of the property in a trustee is one of

the essential conditions for the formation of a trust in the legal sense. It is also true that under the provisions of the Act as well as the Scheme, the

provident fund constituted under the Scheme vests in the Central Board of Trustees. It is, however, necessary to notice that these are not the only

requirements for the constitution of a trust. In our opinion, the other essential ingredients for the constitution of a trust are reposing of confidence by

the author of the trust in the trustees for the purpose of carrying out certain desires or certain wishes or certain directions of the author of the trust

and the acceptance of those obligations by the trustee in whom confidence has been reposed by the author of the trust. In other words, for the

formation of a trust there has also to be an exchange of reposing of confidence by one in another and acceptance by the other of the obligations

arising out of the confidence reposed in him. Unless these essential ingredients are established, a trust in the legal sense does not come into being.

24. Mr. Joshi argued that a valid trust could come into existence even by a statute and he referred us to paragraphs 1346 and 1370 in volume 38

of Halsbury''s Laws of England, third edition. Paragraph 1346 is in the following terms :

When a person has property or rights which he holds or is bound to exercise for or on behalf of another or others, or for the accomplishment of

some particular purpose or particular purposes, he is said to hold the property or rights in trust for that other or those others, or for that purpose or

those purposes, and he is called a trustee.

25. Paragraph 1370 is in the following terms :

Trusts are either, (1) express trusts, which are created by the actual terms of some instrument or declaration, or which by some enactment are

expressly imposed on persons in relation to some property vested in them, whether or not they are already trustees of that property, or (2) trusts

arising by operation of law (other than express trusts imposed by enactment).

26. He also referred us to the following passage in Underhill''s Law of Trust and Trustees, page 9, eleventh edition :

Article 3. - Definitions of Express and Constructive Trusts. - Trusts either arise under statute or are created :

(i) intentionally by the act of the settlor, in which case they are called express trusts, or

(ii) by implication of a court of equity where the legal title to property is in one person, and the equitable right to the beneficial enjoyment thereof is

in another, in which case they are called constructive trusts.

27. In our opinion, none of these two passages take the matter any further in ascertaining whether under the Employees'' Provident Funds Act or

the Scheme framed thereunder the trust in its strict sense has been created. The passages both in Halsbury and in Underhill only indicate that the

provisions of certain enactments may give rise to a constructive trust casting certain enactments may give rise to a constructive trust casting certain

obligations on certain persons which are in the nature of a trust. The question to be considered here is whether a trust in its legal sense has been

constituted under the Act or the Scheme framed thereunder. We have already stated that one of the essential requirements for formation of a trust

in a legal sense is reposing of confidence by one in another and the other accepting the obligations arising out of the confidence for the benefit of

certain other persons. No provision in the Act or the Scheme indicates that this essential requirement for the constitution of a valid trust has been

complied with. The second essential condition, in our opinion, is entrustment of the property at the time of the constitution of the trust by the settlor

or the author of the trust to the trustees in whom he places confidence. None of the provisions either of the Act or of the Scheme show that this

element has been fulfilled. We have already referred to the relevant provisions of the Act as well as the Scheme. At the time the Act was passed

neither the fund was in existence not the board of trustees had been constituted. The Act only empowered the Central Government to frame a

Scheme. The Scheme when framed constituted the fund. The initial contributions to the fund are by the employers and the fund vests in the board of trustees. The further contributions made are also by the employer and the employees. Thus is would be seen that the property which is administered by the board of trustees was the property of the employer and the employees. That property under the provisions of the Act is required to be transferred to the statutory fund which vests in the board of trustees. In the circumstances it cannot be said that the vesting of the property in the board is the result of any confidence reposed in them by the owners of the property, viz., the employers and the employees. On the other hand, the real position appears to be that as a result of the statute, persons, whether they like it or not, are compelled to contribute to the fund and thus a fund comes into existence. It is that fund which, as a result of the Scheme framed under the legislation, gets vested in the board of trustees for the purpose of administration of the fund in accordance with the provisions of the Act and the Scheme. These being the provisions, in our opinion a trust in its true sense has not been constituted by the Act or the Scheme.

28. The other argument of Mr. Palkhivala that the transfer of Rs. 3,01,772-1-7 by the assessee-company to the fund is not a transfer to the trustee, is also not without substance. It is indeed true that the provident fund constituted under the Scheme vests in the trustees, but that does nor mean that every transfer of accumulations made to the prevent fund stands vested in the broad of trustees prior to the assassin of a notification in the Gazette of India in respect thereof. On the other hand, the Scheme envisaged in paragraph 28 and in particular the provisions of clause (5) thereof, indicates that after the accumulated balance have been transferred to the fund, the Commissioner has to issue a notification in the Gazette of India declaring that the subscriber of a provident fund have now become members of the statutory provident fund have now become vested in the board. The provisions show that it is only after the notification mentioned in clause (5) of paragraph 28 of the Scheme that the accumulations transferred to the fund vest in the board of trustees. It necessarily follows that at the date the accumulations are transferred, the transfer is not to the trustees but to the fund.

29. For reasons stated above, in our opinion the transfer contemplated by sub-section (1) of section 58K of the Act is a voluntary transfer and not compulsory or involuntary transfer of the fund as a result of the provision of the Act. In our opinion, also, no trust as such has been created under the Act or the scheme framed thereunder, nor is there any element of transfer of the fund by the assessee-company to trustees as such involved in

the transfer of accumulated balances of Rs, 3,01,772-1-7 to the Regional Provident Fund Commissioner.

30. Our answer to other first question is in the negative and this brings us to the second question.

31. Mr. Palkhivala contented that the assessee-company is entitled to claim deduction to the said sum of Rs. 3 lakhs and odd in the conniption of

the profits for the assessment year under sub-section (1) of the section 10 or under clause (xv) of sub-section (2) of section 10 of the Income Tax

Act. The argument advanced by Mr. Palkhivala, however, was principally on the provisions of section 10(2) (xv). Sub-section (1) of section 10

provides that the tax shall be payable by an assessee in respect of profits or gains of any business. Sub-section (2) provides the manner in which

such profits are to be computed after certain allowances mention in clauses (i) to (xv) of sub-section (2). Clauses (xv) provides :

any expenditure (... not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and excluded

for the purpose of such business, profession or vocation.

32. Before the Tribunal it was no in dispute that the aforesaid expenditure of Rs. 3 lakhs and odd was wholly and exclusively laid out for the

assessee''s business. It had, however, been contented on behalf of the revenue that the expenditure was of a capital nature and therefore not

admissible as an allowance under sub-section (2) of section 10. In paragraph 14 of his order the Judicial Member observed :

The fact that this amount can be said to be wholly and exclusively laid out for the appellant''s business has not been and cannot be in dispute.

Therefore, the only question that is to be considered is whether it is not a capital expenditure.

33. The Judicial Member took view that as the provision of section 58K were applicable, the expenditure had to be deemed to be of a capital

nature and therefore was not a permissible allowance u/s allowance u/s 10(2) (xv). In paragraph 15 the learned Member observes :

If the amount had been directly paid to the employees it would be deductible, commercial expediency in making this payment not having been

disputed. Indeed in a case like this commercial expendency cannot be disputed because there is a statue which requires this payment. Hence, but

for section 58K this will be revenue expenditure. Section 58K creates a statutory fiction which fully covers this case.

34. On this aspect of the case, the learned Accountant Member also had taken a similar view. This is what he observes in paragraph 12 of his

order :

It is not the Income Tax Officer''s that the spending of the sum of Rs. 3 Lakh in the account year which the assessee-company claimed to deduct

u/s 10(2) (xv) is as matter of fact and really and real an expenditure n the nature of capital expenditure; what the Income Tax Officer said was that the sum so spent "shall be seemed to be of the nature of capital expenditure" because of the legal fiction created by the provisions of section

58K(1). Hence, it would be fallacious to examine the nature of the spending of the use of Rs. 3 lakhs odd by applying the tests laid down in several

judicial pronouncements; for they relate to the determination of the real nature of that expenditure and not its fictional created by a statute for

certain purpose.

35. We have already said that in our opinion sub-section (1) of section 58K has no application. It necessary follows that the fiction enacted in the

said sub-section (1) is not attracted to the aforesaid expenditure of Rs. 3 lakhs and odd. As already pointed out, the Income Tax Officer had not

contended before the Tribunal that even apart from the provisions of section 58K(1) the expenditure in its real nature was a capital expenditure.

On the other hand, the stand was that though it was not capital in nature, by reason of the provisions of section 58K(1) or had to be deemed to be

a capital nature. That being the position, in our opinion, the answer to the second question also will have to be in favour of the assessee.

36. Mr. Joshi, however, contend that the aforesaid expenditure is not an expenditure properly deductible against the profits of the year. According

to Mr. Joshi the allowance climbable u/s 10(2) (XV) is confined to expenditure relating to the carrying on of business of that year of account and it

is only that expenditure which could be deducted against the profits of that year. The expenditure incurred in transferring Rs. 3 lakhs and odd to the

statutory provident funds has no relation to the carrying on the business of that year. It represented accumulated balances of expenditure incurred

in the various previous years and it is only these accumulated balances that have been transferred by the assessee to the statutory provident fund.

In support he read out certain observation of the Lord Chancellor at page 191 in Atherton v. British Insulated and Helsby Cables Ltd. and certain

observations of Lord Atkinson at page 199. Mr. Joshi also argued that it amounted to a transfer of an asset by an assessee to the provident fund

and not an expenditure. Mr. Joshi also supported his argument by placing reliance on the provisions of clause (c) of sub-section (4) of section 10.

37. The material part reads :

.... nothing in clause (XV) of sub-section (2) shall be deemed to authorised -....

(c) any allowance in respect of a payment to a provident or other fund established for the benefit of employees unless the employer has made

effective arrangement to secure that tax shall be deducted at source from any payments made from the fund which are taxable under the head

"Salaries".

38. It is the argument of Mr. Joshi that the said provisions indicates that the payments to the provident fund, relating to which exemption could be

claimed, are only the annual payments to the provident fund and not transferred accumulated balances. According to him the assessee-company

could have settled the provident fund on trust after satisfying the conditions of section 58C of the Act and having got it recognised under the

provisions of section 58B of the Act and could have claimed annually deduction in respect of the contribution made by it to be fund. It not having

done so, cannot now ask for deduction when he is required to transfer the accumulated balances to the statutory provident fund. With respect, we

find any limitation in the language of clause (XV) to restrict the expenditure mentioned therein to an expenditure relating to the carrying on of the

business in that year. All that is said is, it must be an expenditure incurred in that year and it must be an amount expended wholly and exclusively

for the purpose of the business of the assessee. The limitations mentioned in this clause are, it should not be an expenditure which is covered by or

which falls under clause (i) to (xiv) of sub-section (2) of section 10 and it should not be an expenditure of a capital nature or personal expenses of

the assessee. There is no further limitation that the expenditure must necessarily be an expenditure required for the purposes of carrying on the

business of that year. There would be ample authority to show that an expenditure incurred to meet any liability of the business occurring in that

year is an expenditure wholly and exclusively laid put for the purposes of the business and therefore allowable u/s 10(2)(xv). Sub-section (2) of

section 15 of the Employees'' Provident Funds Act as well as paragraph 28 of the Scheme framed thereunder require the assessee to transfer the

accumulated balances in his hands to the to the statutory provident fund. That liability accrued undoubtedly on the framing of the scheme. The Act

came into force on the 4th March, 1952, and the Scheme was published in the Official Gazette on 2nd September, 1952. But for the exercise

granted u/s 17 to the assessee, the liability would have accrued in the assessment year 1953-54. Section 17 of the Act empowered the appropriate

government to grant exemption from the operation of all or any of the provisions of this Act or any scheme and subject to such conditions as may

be specified in the notification. In exercise of this power a provisional exemption had been granted to the assessee-company and it was informed

that pending the grant of exemption it need not make any payment of the accumulations to the Regional Provident Fund Commissioner. It was later

that the assessee-company was informed by the Provident Fund Commissioner by his dated 20th August, 1955, that the exemption would be withdrawn. The calculation was then made of the accumulated balances and then transferred to the Regional Provident Fund Commissioner on

19th/20th March, 1956. On the withdrawal of the exemption and on ascertaining the accumulated balances which the assessee-company had to

transfer, the liability to transfer the assessment year with which we are concerned. That being the position, the expenditure of Rs. 3 lakhs and odd

which forms part of the total amount of Rs. 14,87,000 is an expenditure incurred to meet the statutory liability accruing in that year and it therefore

would be a permissible deduction.

39. The observations on which reliance has been placed by Mr. Joshi also, in our opinion, when understood in the context of the facts of the case,

do not carry the case of the revenue any further. Facts in that case were : The respondent-company had claimed a deduction in computing its

profits for Income Tax purposes of a lump sum of pounds 31,784 which it had contributed irrevocably as the nucleus of a pension fund established

by a trust deed for the benefit of its clerical and technical salaried staff. The said sum had been actuarially ascertained to be necessary to enable

past years of services of the then existing staff to rank for pension. The question that fell for consideration was whether the expenditure was capital

or revenue in nature. The observations read by Mr. Joshi at page 191 are in the following terms :

With reference to the provision last mentioned, and to the similar injunction contained in rule 1 of Case I, it has been pointed out on several

occasions...... that the Act does not contain any express allowance enumeration of deductions; and that effect can only be given to the provisions

by holding that, when a deduction is proper to be made in order to ascertain the balance of profits and gains for any year, it ought to be made

notwithstanding the First Rule applicable to Case I and section 159, provided that it is not prohibited by the terms of the Act and Rules. From this

it follows that in determining whether a particular item may or may not be deducted from profits, it is necessary first it inquire whether the deduction

is expressly prohibited by the Act, and then, if it is not so prohibited, to consider whether it is of such a nature that it is proper to be charges against

the incomings in a computation of the balance of profits and gains for the year.

40. On the concluding part of the said observations Mr. Joshi placed strong reliance. His argument is two-fold. First he says that the allowance of

this expenditure is prohibited u/s 10(4) (c) of the Income Tax Act. Secondly, he contends that it is not a proper deduction. With the first part of his

argument we will deal with later when we proceed to consider the provisions of section 10(4) (c). We have not, however, been able to understand how, from these observations, it could be inferred that the expenditure would not be a proper expenditure in the year. As pointed out above, there

was a statutory liability accruing in that year. If that liability had not been paid, coercive process u/s 8 of the Act would have been taken against the

assessee. The payment had to be made if the assessee was desirous of continuing his business. There was no alternative before him. The only

alternative was to ask for exemption from the operation of the Scheme. That he had done. But the exemption was not granted to him. The

observations at page 199 which Mr. Joshi read are in the following terms :

It is difficult to see on what principle the company are, for the purposes of the assessment of Income Tax for the year in which the payment was

made, entitled to deduct it from their profits and gains for that year, since it cannot, I think, be regarded as forming part of the cost by which those

profits and gains have been acquired....

41. The observations undoubtedly indicate that the expenditure incurred for earning the profits of the year is an allowable deduction, but that does

not mean that that is the only permissible deduction. Other observations on that page itself indicate that the expenditure though not incurred for the

purposes of earning profits in the year such as expenditure to meet the assessee''s business liability are allowable as deductions. These observations

thus, in our opinion, do not carry the case of the revenue any further.

42. Turning to the provisions of section 10(4) (c), it does not say in terms that it has application only to the yearly contributions to the provident

fund. There is, therefore, no warrant to restrict it only to the yearly contributions to the provident fund and not to the transfer of accumulated

balances in the hands of the employer to the provident fund. Further, the terms of clause (c) of sub-section (4) of section 10 indicate that the

arrangement that has to be made at the time of payment of the provident fund is to secure that tax shall be deducted at source from any payment

made from the fund which are taxable under the head ""salaries"". It thus postulates two things : that the payments received by an employee from the

provident fund are taxable under the head ""salaries"". The second thing it postulates securing the payment of tax. If these two conditions are not

satisfied, clause (c) of sub-section (4) of section 10 does not come into operation. It is not in dispute that the employer''s contributions when

received by an employee on retirement would be taxable in his hands as salary. One condition, therefore, is fulfilled. It is the argument of Mr. Joshi

that it was, therefore, necessary for the assessee to have made effective arrangements to secure that tax shall be deducted at source from the payments made from the provident fund. Referring to paragraph 72 of the Scheme, Mr. Joshi argues that the board of trustees are directed to pay

the entire accumulations at the credit of the employee to him without making any deductions. Thus no effective arrangements had been made for

deduction the tax at source at the time the payment is made to the employee from the provident fund. The provisions of section 10(4) (c) therefore

operate as a bar on the claim made by the assessee for deduction of the said amount. It is indeed true that no provision has been made in

paragraph 72 for deduction of any tax. But the argument advanced overlooks that the fund constituted under the Act by reason of the provisions of

section 9 of the Act is a recognised provident fund within the meaning of Chapter IX-A of the Act. Section 58H, which forms part of Chapter IX-

A, enjoins a duty non the trustees of a recognised provident fund to deduct tax payable from the accumulated balances. The statutory provident

fund being a recognised provident fund, it casts a duty on the trustees of the statutory provident fund that they shall at the time when an

accumulated balance due to an employee is paid, deduct therefrom the Income Tax payable. The statute itself thus having made a provision for

deducting the Income Tax at source in section 58H, there was no necessity of making separate provision in respect thereof in paragraph 72 of the

Scheme. The position thus that emerges is that the expenditure of Rs. 3 lakhs and odd incurred by the assessee-company is to meet the statutory

liability of making contributions to the provident fund. In respect of these contributions effective arrangement has been made by reason of the

provisions section 58H for deducting at source the tax payable thereon. It therefore cannot be said that it was necessary for the assessee to have

made any such arrangement at the time it transferred the accumulated balance to the provident fund. That being the position, it cannot be said that

there is any non-compliance of clause (c) of sub-section (4) of section 10. The assessee-company, in our opinion, therefore is entitled to claim

deduction of the said expenditure u/s 10(2) (xv).

43. Our answer to the second question therefore will have to be in the affirmative.

44. In the result, we answer the first question in the negative and the second question in the affirmative.

45. The Commissioner shall pay the costs of the assessee.

46. Questions answered accordingly.