(1992) 10 BOM CK 0066

Bombay High Court

Case No: Income-tax Reference No. 170 of 1977

Commissioner of Income Tax		APPELLANT
	Vs	
Raghuvanshi Mills Ltd		RESPONDENT

Date of Decision: Oct. 19, 1992

Acts Referred:

- Income Tax Act, 1961 - Section 28

Citation: (1994) 205 ITR 636

Hon'ble Judges: Sujata V. Manohar, J; B.N. Srikrishna, J

Bench: Division Bench

Advocate: Deokinandan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

Mrs. Sujata Manohar, J.
This reference pertains to the assessment year 1966-67. The following two question have been referred to us u/s 256(1) of the Income Tax Act, 1961 :

"1. Whether, on the facts and in the circumstances of the case the Tribunal was right in law in holding that the amount of Rs. 5,50,000 standing to the credit of gratuity reserve account should be included in the capital computation under the Companies (Profits) Surtax Act, 1964 ?

2. Whether, on the fact and in the circumstances of the case, the Tribunal was right in law in holding that the dividend reserve was a reserve to be included in the capital computation for the purpose of the Companies (Profits) Surtax Act, 1964 ?"

2. In the balance-sheet of the assessee-company as on March 31, 1965, there was a credit balance of Rs. 5,50,000 in the gratuity reserve account. The question is whether this amount should be treated as a reserve and included in the capital of the assessee-company for the determination of surtax payable by the company. In this connection the Tribunal has come to the conclusion that the practice which was followed throughout by the assessee-company for payment of gratuity was that, as

and when the claim of any employee for gratuity crystallised at a particular time on account of death, retirement, resignation, etc., the payment in respect of such claim was debited to the gratuity payment account and transferred to the profit and loss account and not to the gratuity reserve account. No payments at any point of time were made out of the gratuity reserve account. The reserve was seen to have been always kept intact and was also seen in fact as being used as a working fund just as any other free reserve. The Tribunal also noticed that, during the period in question, there was nothing which compelled the board of directors of the assessee-company to create any provision for gratuity. The board was free to create such a reserve and use it in any manner it thought fit. In fact the board had transferred an amount of Rs. 6 lakhs from what it stood to the credit of that serve account on April 1, 1967, to the general reserve by the resolution passed at the board''s meeting held on February 19, 1968. In view of these features of the gratuity reserve of the assessee-company, the Tribunal held that the gratuity reserve fund was not retained or earmarked for gratuity liability at all. It was in the nature of a free reserve and, hence, it has held that this amount was included in the capital computation of the company for the purposes of surtax.

3. The ratio of the decisions of our High Court in the case of Commissioner of Income Tax Vs. National Rayon Corporation Ltd., and Commissioner of Income Tax Vs. Hindustan Lever Limited, will not be attracted to the facts of the present case. The Division bench in the former case said that, ordinarily an appropriation to gratuity reserve will have to be regarded as a provision made for a contingent liability. If a company adopted a scientific method and determiners by actuarial valuation the estimated liability of the company in respect of the payment of gratuity in the relevant year and an amount is set apart for meeting such liability, then the amount set apart for that purpose will be clearly a provision. If, however, an ad hoc sum is appropriated for meeting a liability for payment of gratuity without resorting to any scientific basis, such appropriation would also be a provision.

4. In the present case, however, the amount is not set apart for meeting any liability for payment of gratuity at all. The facts of the present case show that this fund was not set apart for payment of gratuity and that it was in the nature of a free reserve. Therefore this is a case where the ratio of the decision of this court in the case of Commissioner of Income Tax Vs. Ruston and Hornsby India (Pvt.) Ltd., , will apply. The Division Bench in that case has said that an amount set aside out of profits 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. In the premises, question No. 1 is answered in the affirmative and in favour of the assessee.

5. On question No. 2, the facts are that for the relevant assessment year a sum of Rs. 6,70,000 was shown in the dividend reserve account. This amount has been utilised during the relevant assessment year for payment of dividend. It appears from the

facts as set out that the entire amount may not have been so utilised. In view of the decision in the case of Vazir Sultan Tobacco Co. Ltd., Hyderabad and Others Vs. Commissioner of Income Tax, Andhra Pradesh, Hyderabad, , the dividend reserve account which has been so utilised for payment of dividend will have to be treated as a provision and not as a reserve. If there is any excess amount in the dividend reserve account, then such excess can be treated as a reserve in the light of the above judgment. Question No. 2 is, therefore, answered as follows :

The amount in the dividend reserve account to the extent that it has been utilised for payment of dividend is a provision and cannot be included in the capital computation of the assessee-company for the purpose of the Companies (Profits) Surtax Act, 1964. Any excess amount in this account can be included in the capital computation for the above purpose.

6. When the matter goes back before the Tribunal, the Tribunal may ascertain the quantum of such excess amount, if any, according to law. Question No. 2 is answered accordingly.

7. No order as to costs.