

STANDARD MILLS CO. LTD.

v.

COMMISSIONER OF WEALTH-TAX, BOMBAY CITY

October 6, 1966

[J. C. SHAH, V. RAMASWAMI AND V. BHARGAVA, JJ.]

Wealth Tax Act (27 of 1957), ss. 2(m) and 7(2)(a)—Claim regarding deductions of estimated income tax and gratuity payable to employees under awards—If allowable.

In the computation of the net wealth of the appellant-company under s. 2(m) of the Wealth Tax Act 1957, two deductions were claimed by the company: (i) the amount of estimated income tax for the assessment year, and (ii) the amount of gratuity payable by the company to its employees under certain industrial awards.

HELD: The first claim was allowable but not the second. [776 D]

Under s. 2(m) of the Act, the Wealth Tax Officer must first determine the aggregate value of all the assets belonging to the assessee on the valuation date, and then determine the aggregate value of all the debts owed by the assessee on the valuation date. Excess of the aggregate value of the assets over the debts is the net wealth. But on the terms of the awards the liability to pay gratuity did not exist *in praesenti*: it was contingent upon the determination of employment by death, incapacity, retirement or resignation of the employee, and not before. Therefore, it was not a debt owned by the assessee on the valuation date. [772 C-D; 775 H]

Nor could the appellant-company claim the deduction under s. 7(2)(a) of the Act. The aggregate value of the assets must be computed in accordance with the provisions of s. 7. But in the aggregation of the value of all the debts owned by the assessee on the valuation date, s. 7 has not operation. Section 7 does not deal with the computation of net wealth but only with the determination of the net value of the assets as a whole. [776 A-C]

Kesoram Industries and Cotton Mills Ltd. v. Commissioner of Wealth Tax (Central) (Calcutta), [1966] 2 S.C.R. 688, followed.

Observations Contra in Commissioner of Wealth Tax, Gujarat v. Ajit Mills Ltd. 55 I.T.R. 556 and *Commissioner of Wealth Tax Gujarat v. New Rajpur Mills* 56 I.T.R. 544, disapproved.

Southern Railway of Peru v. Owen (Inspector of Taxes) [1957] A.C. 334, explained.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 1129 of 1965.

Appeal from the judgment and order dated April 15, 16, 17, 1963 of the Bombay High Court in Wealth Tax Reference No. 2 of 1961.

R. J. Kolah, N. D. Karkhanis and O. C. Mathur, for the appellant.

B. Sen, R. Ganapathy Iyer and R. N. Sachthey, for the respondent.

A The Judgment of the Court was delivered by

Shah, J. For the assessment year 1957-58 the appellant Company claimed in proceedings for assessment of wealth-tax that the following four amounts be deducted in the computation of its net wealth:

B (1) Rs. 29,44,421 in respect of income-tax liability relating to the assessment year 1957-58. This amount included Rs. 2,95,869 representing the last instalment of advance tax under s. 18A in respect of which a notice of demand had been issued.

C (2) Rs. 3,70,083 in respect of business profits tax liability.

(3) Rs. 20,23,500 in respect of proposed dividend.

(4) Rs. 25,02,675 "on account of accrued liability for gratuity to workmen and staff as per the award of Industrial Court and Labour Appellate Tribunal."

D The claim was rejected by the Wealth-tax Officer. The Appellate Assistant Commissioner accepted the claim of the appellant Company in respect of the last instalment of the advance tax for which a notice of demand had been issued, and rejected the claim in respect of the rest. The Income-tax Appellate Tribunal upheld the claim of the appellant Company in respect of the 1st, 2nd and the 4th items and rejected the claim in respect of the 3rd item.

E At the instance of the Commissioner, the following four questions were referred to the High Court of Judicature at Bombay under s. 27(1) of the Wealth-tax Act 27 of 1957:

F "(1) Whether on the facts and circumstances of this case the last instalment of advance tax in the sum of Rs. 2,95,869 paid by the assessee after the valuation date in accordance with the notice of demand dated 20-10-1956 is an admissible deduction under Sections 7(2) and 2(m) of the Wealth-tax Act for the purpose of computation of the net wealth of the assessee for the assessment year 1957-58?

G (2) Whether on the facts and circumstances of the case in computing the net wealth of the assessee under Section 7(2) read with Section 2(m) of the Wealth-tax Act the liability for income-tax and business profits tax could be allowed as a deduction?

H (3) Whether on the facts and circumstances of the case the liability in the sum of Rs. 25,02,675 which arose as a result of the awards dated 28-10-1948, 28-11-1956 and 17-10-1954 before the valuation date or any part thereof is

allowable as a deduction in determining the net wealth of the assessee under Section 7(2) read with Section 2(m) of the Wealth-tax Act ?

(4) Whether on the facts and circumstances of the case of the sum of Rs. 20,23,500 being the provision made for dividends and shown as a liability in the balance sheet of the assessee company could be allowed as a deduction in computing the net wealth of the assessee company?"

At the hearing before the High Court, the fourth question was not pressed by the appellant Company. The High Court answered the first question in the affirmative, the second question in the affirmative insofar as it related to the estimated liability of business profits tax subject to verification by the Wealth-tax Officer, and in the negative insofar as it related to the estimated liability of income-tax. The third question was answered in the negative. In this appeal the Company challenges the correctness of the answers to the second part of the second question and the third question.

The second question insofar as it relates to estimated liability for payment of income-tax needs no detailed consideration, for the answer thereto will be governed by the judgment of this Court in *Kesoram Industries and Cotton Mills Ltd. v. Commissioner of Wealth-tax (Central), Calcutta*(¹). It was held by this Court in that case that liability to pay income-tax was a present liability though the tax became payable after it was quantified in accordance with ascertainable data: there was therefore a perfected debt at any rate on the last day of the accounting year and not a contingent liability, and the amount of the provision for payment of income-tax in respect of the year of account was a "debt owed" within the meaning of s. 2(m) on the valuation date and was as such deductible in computing the net wealth. The view expressed by the High Court on the second question insofar as it relates to provision for income-tax cannot therefore be sustained and that part of the question should be answered in the affirmative.

There remains the third question. Counsel for the Company had conceded before the High Court that the liability to pay gratuity to the employees whose services were not terminated in the relevant year of account was merely contingent, since it arose on the happening of certain events such as death, physical incapacity, voluntary retirement, or resignation, and was on that account not a debt within the meaning of s. 2(m) of the Act. But it was contended before the High Court that the present value of the liability for payment of gratuity was a permissible deduction in valuing the assets of the business of the assessee under s. 7(2)(a) of the Act. The

(1) [1966] 2 S.C.R. 688 : 59 I.T.R. 767.

A High Court rejected that contention. Counsel for the Company has in this appeal contended that no such concession as is recorded in the judgment of the High Court was made, and in any event, the concession being on a question of law was not binding upon the appellant Company.

B Section 2(m) at the material time provided:

“ ‘net wealth’ means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date other than,—

(i) debts which under Section 6 are not to be taken into account;

D (ii) debts which are secured on, or which have been incurred in relation to any property in respect of which wealth-tax is not chargeable under this Act;”

By s. 3 the wealth-tax is charged for every financial year commencing on and from the first day of April, 1957 on the net wealth on the corresponding valuation date of every individual, Hindu undivided family and company at the rate or rates specified in the Schedule.

E Broadly speaking net wealth is the difference on the valuation date between the aggregate value computed in accordance with the provisions of the Act of the assets belonging to the assessee and the aggregate value of all the debts owed by the assessee. If there is no debt owed on the valuation date, it can obviously not be deducted in determining the net wealth which is liable to tax under the Wealth-tax Act.

F Apart from the concession made by counsel for the Company there is little doubt on the plain terms of the awards that the liability to pay gratuity to the employees of the appellant Company on determination of employment is a mere contingent liability which arises only when the employment of the employee is determined by death, incapacity, retirement or resignation. The relevant terms of the awards dated October 28, 1948, November 28, 1956 and October 17, 1954 are as follows:

“Gratuity should be paid.....on the following scale:—

H 1. On the death of an employee, while in service of the company or on his becoming physically or mentally incapacitated for further service—one month’s salary for each year of service.....

2. On voluntary retirement or resignation of an employee— A

After 15 years' continuous service in the company—15 months' salary.

3. On termination of his service by the Company— B

(a) After 10 years' continuous service but less than 15 years' service in the company—3/4th of one month's salary for each year of service.

(b) After 15 years' continuous service in the company—15 months' salary.

4. A gratuity will not be paid to any employee who is dismissed for dishonesty or misconduct." C

The right to obtain gratuity under the awards arises only when there is determination of employment and not before. The liability does not exist *in praesenti*: it is contingent upon the determination of employment. This Court pointed out in *Kesoram Industries & Cotton Mills' case*⁽¹⁾ at p. 703: D

".....the following definition is unanimously accepted:

'debt is a sum of money which is now payable or will become payable in future by reason of a present obligation: *debitum in praesenti, solvendum in futuro.*' E

The said decisions also accept the legal position that a liability depending upon a contingency is not a debt *in praesenti* or *in futuro* till the contingency happened. But if there is a debt the fact that the amount is to be ascertained does not make it any the less a debt if the liability is certain and what remains is only the quantification of the amount. In short, a debt owed within the meaning of section 2(m) of the Wealth-tax Act can be defined as a liability to pay *in praesenti* or *in futuro* an ascertainable sum of money." F

Observations made by the High Court of Gujarat in *Commissioner of Wealth-tax, Gujarat v. Ajit Mills Ltd.*,⁽²⁾ that deduction for an amount claimed on account of liability for gratuity for workers and employees based on awards of the labour courts and agreements will be admissible deductions in the computation of the net wealth are plainly *obiter*, and in our judgment are not correct. G

The decision of the House of Lords in *Southern Railway of Peru Ltd. v. Owen (Inspector of Taxes)* ⁽³⁾ that the assessee company H

(1) [1966] 2 S.C.R. 688.

(2) 55 I.T.R. 556.

(3) [1957] A.C. 334 : 32 I.T.R. 737.

- A** was entitled to charge against each year's receipts the cost of making provision for the retirement payments which would ultimately be payable as it had the benefit of the employees' services during that year, provided the present value of the future payments could be fairly estimated, were a permissible deduction in the computation of income-tax, have in our judgment no relevance in this case. In
- B** *Southern Railway of Peru Ltd's* case⁽¹⁾ under the legislation of Peru a Company operating a railway was bound to pay its employees compensation on the termination of their services. The right to receive compensation arose on dismissal or on termination of the employment by the employer by proper notice, or on such termination by the death of the employee or on the expiry of the term of
- C** the employment. The compensation was an amount equivalent to one month's salary at the rate in force at the date of determination for every year of service. The company claimed in the computation of taxable income, under the Income-tax Act, 1918, to be entitled to charge against each year's receipts the cost of making provision for the retirement payments which would ultimately be thrown on it, calculating what sum would be required to be
- D** paid to each employee if he retired without forfeiture at the close of the year and setting aside the aggregate of what was required in so far as the year had contributed to the aggregate. It was held that the company was not entitled to make the deductions, but the company was entitled to charge against each year's receipts the cost of making provision for the retirement payments which would ultimately
- E** be payable as it had had the benefit of the employees' services during that year, provided the present value of the future payments could be fairly estimated. The question arose under the English Income-tax Act of 1918. Lord MacDermott observed at p. 345:

- “..... as a general proposition it is, I think, right to say that, in computing his taxable profits for a particular
- F** year, a trader, who is under a definite obligation to pay his employees for their services in that year an immediate payment and also a future payment in some subsequent year, may properly deduct, not only the immediate payment, but the present value of the future payment, provided such present value can be satisfactorily determined
- G** or fairly estimated.”

- Similar observations were made in the judgment of Lord Radcliffe. But the House in that case was concerned to determine the deductibility of the present value of a liability which may arise in future in the computation of taxable profits for the relevant year under the Income-tax Act. The same considerations cannot, however,
- H** apply to a case under the Wealth-tax Act, where the liability to pay wealth-tax is charged upon the net wealth of an assessee.

(1) [1957] A.C. 334 : 32 I.T.R. 737.

In *Commissioner of wealth-tax, Gujarat v. New Rajpur Mills Ltd.* (1) the assessee company claimed to deduct gratuity payable to employees under an agreement entered into with the labour associations before the valuation date. The Court in that case observed that the liability was not a debt owed by the assessee on the valuation date since the gratuity was not payable on the valuation date, but was payable only on fulfilment of the contingencies set out in those agreements. But the Court proceeded to observe that since contingent liabilities can be taken into account while computing the net wealth of the assessee under s. 7(2)(a) the liability for payment of gratuity under such agreements would have to be estimated and the estimated value of the contingent liability would be a permissible deduction in computing the net wealth of the assessee. In our view the first observation of the Court is correct, but the second is not. We will presently set out the reasons for that view.

The alternative plea that under s. 7(2)(a) of the Act the appellant Company is entitled to claim deduction even if it cannot do so under s. 2(m) has, in our judgment, no force. Section 7 deals with the manner of valuation of assets. It provides insofar as it is material:

“(1) The value of any asset, other than cash, for the purposes of this Act, shall be estimated to be the price which in the opinion of the Wealth-tax Officer it would fetch if sold in the open market on the valuation date.

(2) Notwithstanding anything contained in sub-section (1),—

(a) where the assessee is carrying on a business for which accounts are maintained by him regularly the Wealth-tax Officer may, instead of determining separately the value of each asset held by the assessee in such business, determine the net value of the assets of the business as a whole having regard to the balance-sheet of such business as on the valuation date and making such adjustments therein as the circumstances of the case may require;”

Section 7 falls in Ch. II which deals with the charge of wealth-tax and assets subject to such charge: it is intended to provide machinery for determination of the value of assets. It was observed in the minority judgment in *Kesoram Industries & Cotton Mills* case(2) at p.717 :

“By the first sub-section the Wealth-tax Officer is authorised to estimate, for the purpose of determining the

(1) 56 I.T.R. 544.

(2) [1966] 2 S.C.R. 688 : 59 I.T.R. 767.

A value of any asset, the price which it would fetch, if sold in the open market on the valuation date. But this rule in the case of a running business may often be inconvenient and may not yield a true estimate of the net value of the total assets of the business. The legislature has therefore provided in sub-section (2)(a) that where the assessee is carrying

B on a business for which accounts are maintained by him regularly, the Wealth-tax Officer may determine the net value of the assets of the business as a whole, having regard to the balance-sheet of such business as on the valuation date and make such adjustments therein as the circumstances of the case may require. But the power conferred upon the tax officer by section 7(2) is to arrive at a valuation

C of the assets, and not to arrive at the net wealth of the assessee. Section 7(2) merely provides machinery in certain special cases for valuation of assets, and it is from the aggregate valuation of assets that the net wealth chargeable to tax may be ascertained. The power conferred upon the tax officer to make adjustments as the circumstances of the case may require is also for the purpose of arriving at the true value of the assets of the business. Sub-section (2)(a) of section 7 contemplates the determination of the net value of the assets having regard to the balance-sheet and after making such adjustment as the circumstances of the case may require. It does not contemplate determination of the net wealth, because net wealth can only be determined from the net value of the assets by making appropriate deductions for debts owed by the assessee.

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F The argument raised by counsel for the assessee is that substantially section 7(2) is a definition section, which extends, for the purposes of the Act, the definition of the 'net wealth' of assessee carrying on business. There is no warrant for this argument in the language used in section 7(2). Counsel was unable to suggest any rational explanation why, if what he contends was the intention, Parliament should have adopted this somewhat roundabout way of incorporating a definition of net wealth in a section dealing with valuation of assets."

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H The majority of the Court did not express any opinion on this question. From the terms of s. 2(m) it appears clear that the tax officer must first determine the aggregate value of all the assets belonging to the assessee on the valuation date, and then determine the aggregate value of all the debts owed by the assessee on the valuation date. Excess of the aggregate value of the assets over the debts is the net wealth. The aggregate value of the assets must be

computed in accordance with the provisions of s. 7. But in the aggregation of the value of all the debts owed by the assessee on the valuation date, s. 7 has no operation. A

In holding in *New Rajpur Mills'* case⁽¹⁾ that a contingent liability can be taken into account while computing the net wealth of the assessee under s. 7(2) (a), in our judgment, the true function of s. 7(2)(a) of the Wealth-tax Act was not appreciated. Section 7 does not deal with the computation of net wealth. It deals with the computation of the aggregate value of the assets. Under s. 7 the Wealth-tax Officer is competent, where the assessee is carrying on business of which accounts are maintained regularly, to determine the net value of the assets of the business as a whole. But in doing so he determines the value of the assets of the business as a whole, and not the net wealth of the business. B
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The appeal therefore is partially allowed. Insofar as the claim relates to deduction of estimated income-tax for the assessment year, the answer will be in favour of the appellant-company, and in so far as the claim relates to deduction of gratuity payable to the employees of the company, the answer will be in the negative. There will be no order as to costs in this appeal. D

V.P.S.

Appeal allowed in part.

(1) 56 I.T.R. 544.