IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT:

THE HONOURABLE MR.JUSTICE K.VINOD CHANDRAN
&
THE HONOURABLE MR. JUSTICE ASHOK MENON

MONDAY, THE 6TH DAY OF AUGUST 2018 / 15TH SRAVANA, 1940

ITA.No. 27 of 2011

AGAINST THE ORDER/JUDGMENT IN ITA 981/2008 of I.T.A.TRIBUNAL,COCHIN BENCH
DATED 20-08-2010

APPELLANT(S):

M/S.NORTRANS MARINE SERVICES PVT.LTD.
(NOW KNOWN AS TRANS ASIAN)
CHITTOOR, PALAKKAD.

BY ADV.SRI.SAJI VARGHESE

RESPONDENT(S):

THE ASSISTANT COMMISSIONER OF INCOME TAX,
CIRCLE-1(3), RAVIPURAM P.O,
COCHIN-682 015.

R BY ADVS. SRI.P.K.R.MENON,SR.COUNSEL, GOI(TAXES)
SRI.JOSE JOSEPH, SC, FOR INCOME TAX

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD ON 06-08-2018,
THE COURT ON THE SAME DAY DELIVERED THE FOLLOWING:

DG

APPENDIX

PETITIONER'S EXHIBITS:

ANNEXURE A:	COPY OF ORDER U/S.143(3) DATED 27.12.2007 FOR THE ASSESSMENT YEAR 2005-06.
ANNEXURE B:	COPY OF THE ORDER DATED 27.08.08 OF THE COMMISSIONER OF INCOME TAX (APPEALS).
ANNEXURE C:	COPY OF THE ORDER OF THE INCOME TAX APPELLATE TRIBUNAL, COCHIN BENCH IN ITA NO.981/COCH/08.

RESPONDENT'S EXHIBITS: NIL

True Copy

P.A to Judge

K.VINOD CHANDRAN &
ASHOK MENON, JJ.

I.T.A.No.27 of 2011

Dated this the 6th day of August, 2018

J U D G M E N T

K.Vinod Chandran,J.

The question of law framed is as follows:

> "Whether on the facts and in the circumstances of the case the Tribunal was right in law in holding that the initial contribution to approved gratuity fund in respect of employees taken over; for the period they were employed with the previous employer, on the basis of contract of employment entered into at the time of take over, is not an allowable deduction either u/s.36(1) (v) r.w.Rules 104 or u/s.37 of the Act."

2. We have heard Sri.R.Vijayaraghavan, the learned Counsel appearing for the assessee/appellant and Sri.P.K.Ravindranatha Menon, the learned Senior Counsel appearing for the Revenue.

3. On facts, suffice it to say that the assessee company took over the business of one Trans Asian Shipping Services Pvt.Ltd. The company which was taken over had been exclusively carrying on the agency of Norasia Lines (Malta) Ltd. When the business was taken over, the employees of the earlier company was also taken over on specific agreement as

to continuation of service without any break, as also statutory benefits including gratuity. The appellant/assessee on take over, framed a group gratuity scheme and formed a trust, for which approval was obtained from the Commissioner of Income Tax. The assessee company took out a policy from the Life Insurance Corporation of India to indemnify the gratuity payments of the retiring employees and a sum of ₹47,75,849/- was paid on 29.03.2005. The assessee claimed deduction under Section 36 (1) (v) of the Income Tax Act. The Assessing Officer applied Rule 104 of the Income Tax Rules and computed the initial contribution at ₹32,90,843/- and disallowed the excess claim of ₹14,85,006/-. This dis-allowance was made since the disallowed amounts were contributed for the prior years, when the employees were not employed under the present appellant/assessee. The First Appellate Authority and the Tribunal concurred with the Assessing Officer, against which the appeal is filed on the question of law as raised herein above.

4. The learned counsel for the appellant had specifically placed reliance on **Commissioner of Income Tax v. Textool Co.Ltd. [(2013) 263 CTR 257(SC)]** and a Division Bench decision of this Court reported in **Commissioner of Income**

Tax v. Pratap Cashew Co.(P) Ltd. [(1979) 116 ITR 733]. The learned Senior Counsel for the Department argues that Rule 104 creates an impediment in accounting the past service with another employer. The rule only enables the contribution made by an employer to its employees and there cannot be an inclusion of the contribution made for the previous years, since the employees in those previous years were under another employer. Rule 104 was not noticed by the earlier Division Bench, is the specific contention raised.

5. **Pratap Cashew Pvt. Ltd** ***(supra)*** was a more or less identical situation of a take over of business of three companies; by the assessee as running concerns with all existing rights and liabilities. The workmen employed in the three factories were to be retained in service on the same terms and conditions treating their services as continuous and uninterrupted and the assessee also had the liability to pay compensation or benefits to the employees on their retrenchment or retirement as if they have been continuously employed without any interruption by the transfer of the management. The State came out with an ordinance and then an enactment providing for gratuity to all employees at the time of severance of their employment by whatever means if

they had continuous service of five years. The assessee then made provision for this amount which was disallowed by the ITO. The dis-allowance was *inter alia* on the grounds of the assessee having been the employer for only two years; the liability arising only on completion of 5 years and the entrustment being only as a lessee. The Court read Section 2(a) of the Kerala Industrial Employees Payment of Gratuity Act to find that any person having ultimate control over the affairs of the company has the liability in respect of the workmen under Section 4 for payment of gratuity. Liability created by Section 4 of the Act for payment of gratuity to the workmen employed in the three factories fell upon the assessee company during the accounting year and hence the provision made for the said liability in the accounts. The defence of the revenue was negatived on the ground that it overlooks the fact that the assessee had taken over running concerns with the express stipulation that the workmen employed therein shall be continued without any interruption of service; merely for reason of the take over. The entire period of service also has to be reckoned to determine the liability arising under Section 4 of the Act was the clear finding. However the contention of the department that the provision for such liability, in the subject year, eligible for deduction, could only be to the extent of the liability which accrued in that year was refused to be considered for reason of the department having not raised that argument before any of the lower authorities and the question, hence not arising from the order of the Tribunal. Rule 104 was not noticed, presumably in that context.

6. True, Section 104 was not noticed by the Division Bench, but even if it was noticed there would not have been any change in the dictum laid down according to us, on a reading of Rule 104, which is extracted below:

> "The amount to be allowed as a deduction on account of an initial contribution which an employer may make in respect of the past services of an employee admitted to the benefits of a fund shall not exceed $8^{1}/_{3}$ per cent of the employee's salary for each year of his past service with the employer."

7. Rule 104 comes in Part XIV of the Income Tax Rules, 1962 under the head "Approved Gratuity Funds" permitting any initial contribution made by an employer to a fund constituted even in respect of past services of an employee admitted to the benefits of a fund, to the extent of $8^{1}/_{3}$ % of the employee's salary for each year of his past service with the employer. The Assessing Officer and the appellate

authorities seem to have laboured under the misapprehension that the words 'employed with the employer' would take in only the benefits accrued under a particular employer. That would be creating unnecessary impediment especially looking at the intention of the provision under Section 36(1)(v), as has been found by the Honourable Supreme Court of India in **Textool Company Ltd.** ***(supra).*** It has also to observed that the rule is intended at restricting the deduction to 8 1/3rd % of the employees salary for each year of his past service with the employer. The take over and the specific term fastening the liability to gratuity for even the past service, on the assessee, makes the assessee the employer for the past period, at least with respect to the liability for payment of gratuity.

8. ***Textool Company Ltd.*** was also concerned with the initial contributions paid directly to the Life Insurance Corporation of India for the purpose of indemnification of the liability to gratuity, payable to the retiring employees, from a trust created for the purpose approved by the Commissioner. Therein, the Hon'ble Supreme Court noticed the fact that only the initial payment was made by the employer directly to the LIC and the trust was formed later as also the approval obtained from the Commissioner subsequently. The later

contributions were made directly by the trust to the LIC. It was held that the claim made under Section 36 (1)(v) of the Income Tax Act was perfectly in order. The mere fact that payments were made directly by the employer to the LIC was held to be not a sufficient reason to deny benefit under Section 36 (1) (v). It was held so:

> "Having considered the matter in the light of the background facts, we are of the opinion that there is no merit in the appeal. True that a fiscal statute is to be construed strictly and nothing should be added or subtracted to the language employed in the Section, yet a strict construction of a provision does not rule out the application of the principles of reasonable construction to give effect to the purpose and intention of any particular provision of the Act. (See : Shri Sajjan Mills Ltd. vs. Commissioner of Income Tax, M.P. & Anr. (1985) 156 ITR 585). From a bare reading of Section 36(1) (v) of the Act, it is manifest that the real intention behind the provision is that the employer should not have any control over the funds of the irrevocable trust created exclusively for the benefit of the employees. In the instant case, it is evident from the findings recorded by the Commissioner and affirmed by the Tribunal that the assessee had absolutely no control over the fund created by the LIC for the benefit of the employees of the assessee and further all the contribution made by the assessee in the said

> fund ultimately came back to the Textool Employees Gratuity Fund, approved by the Commissioner with effect from the following previous year. Thus, the conditions stipulated in Section 36(1) (v) of the Act were satisfied. Having regard to the facts found by the Commissioner and affirmed by the Tribunal, no fault can be found with the opinion expressed by the High Court, warranting our interference."

9. We notice that the Tribunal has also relied on **CIT v. Saravana Spinning Mills Pvt.Ltd. [(293) ITR 201]** to deny the claim raised under Section 37 of the Income Tax Act. The learned counsel appearing for the appellant assessee submits that the said decision is an authority for the proposition that if there is a claim raised under Section 31 to 36, then there cannot be an alternative plea under Section 37. In the context of our finding in favour of the assessee under Section 36 (1) (v), we do not find any need to look into the decision cited by the Tribunal.

On the reasoning above, we find that the entire contributions paid by the appellant/assessee to the LIC as premium for the policy obtained for indemnification of the gratuity liability towards the employees even for the prior years, when the employees were in the employment of the Company taken over would be eligible for deduction under

Section 36(1)(v). We answer the question of law in favour of the assessee and against the Revenue. Appeal stands allowed, leaving the parties to suffer their respective costs.

Sd/-
(K.VINOD CHANDRAN, JUDGE)

Sd/-
(ASHOK MENON, JUDGE)

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P.A to Judge

DG/08.08.18