

Pension – Whether an allowable expenditure

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In the present day scenario, looking at the high rate of attrition, it has become very necessary for the employers to provide various incentives to their employees in order to retain their services. One of such incentives is provision of pension to the employee after his retirement from service. In this context, it must be clearly understood that a grant of pension on retirement to employees, though not necessary but voluntary, is still made for the sound commercial purpose or business expediency, with a view to enabling the employer to retain the services of the existing and future employees and also with a view to increasing their efficiency. Therefore, the payment of pension on retirement should be treated as an allowable deduction while computing the total income of an employer-assessee.

Where a contribution for payment of pension is made by an employer to an approved superannuation fund, its deductibility is governed by section 36(1)(iv) of the Income-Tax Act, 1961 (the Act), r.w. Part-B of the Fourth Schedule to the Act – *CIT Vs. Sarabhai Sons Pvt. Ltd. [1993] 204ITR 728(Guj.)*. Where, however, contribution is made to a fund which is not yet approved or such contribution is made on *ad-hoc* basis, the payment thereof is nevertheless deductible if the contribution enures to the benefit of the employee irretrievably and is not capable of reverting to the employer in any manner. It is not necessary that there should always be a general scheme of pension to all employees. Where pension is paid to an individual employee under an agreement before his retirement or where pension is paid to the widow of a director by a mere resolution authorizing pension to him during his life time and after his death to his widow, it was enough to justify the deduction on the grounds of commercial expediency. Deduction of such person obviously will be permissible under section 37(1) of the Act.

In this regard, certain basic principles, as laid down by various legal precedents, may be summarized as follows:-

- (i) A grant of pension on retirement of employees, though not necessary but voluntary, is still made for the sound commercial purpose of enabling the employer to retain the services of the existing and future members of the staff and of increasing their efficiency and hence, the same is allowable as a deduction.
- (ii) It is well settled position in law that the payment of pension is necessary for retaining the services of the employees and for increasing their efficiency and accordingly, the same is an allowable expenditure.
- (iii) It is not, however, always necessary that there should be a general scheme of pension for all employees.

- (iv) Pension paid to the widow of a director / employee by mere resolution authorizing pension to him during his life time and after his death to his widow, is enough to justify the deduction on the ground of commercial expediency.
- (v) Neither a contract for payment, nor any expectation on the part of the employee for faithful and honest service, at the end of his employment, is necessary to justify the deduction, because compelling necessity is not a test either in the statute or otherwise for allowing an expenditure.

In support of the aforesaid principles, reliance is placed on the following judgements of the Supreme Court and High Courts.

1. *CIT Vs. Hindustan Motors Ltd. [1989] 175 ITR 411 (Cal.)*

In this case, payment of pension was made to the wife of a deceased employee. Such payment was sanctioned by a resolution of the board of directors, wherein reasons for such payment had been indicated. The Tribunal found that the aforesaid payment was made on consideration of commercial expediency.

It was held that the pension payment was admissible as business expenditure under section 37(1) of the Act. The relevant parts of the judgement are reproduced as follows:-

- (i) *In the case of Gordon Woodroffe Leather Mfg. Co. Vs. CIT [1962] 44 ITR 551 (SC), three tests have been laid down by the Supreme Court in connection with the allowability of pension or gratuity. These tests are: (a) was the payment made as a matter of practice which affected the quantum of salary; (b) was there an expectation by the employee of getting a gratuity; and (c) was the sum of money expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. These tests are not cumulative. They are alternative and independent. If any one of these tests is satisfied, the expenditure has to be allowed as revenue expenditure.*

-[pages 414 and 415 of the Report]

- (ii) *It is well settled that the legitimate business needs of an assessee must be judged from the point of view of the business. It is for the assessee to consider the business expediency and whether a particular expenditure should be incurred for the purposes of its business. Provisions for payment of pension to the widow of a deceased employee cannot be said to be either unusual or unnecessary. – [page 415 of the Report]*

In the light of the factual and legal position prevailing in the case, the aforesaid judgement may be summarized as follows:-

Though every ex gratia payment to a retired employee or to the widow of a deceased employee could not be supported on grounds of commercial expediency, in the instant case, the Tribunal had found that the pension payments to the two persons were made on considerations of commercial expediency. Further, the board of directors of the assessee company had passed a resolution sanctioning payment of pension to the wife of the deceased employee and also indicating the reasons for such payment. The benefit provided to the employee by way of pension to himself and after his death to his widow must be held to be reasonable on considerations of commercial expediency. Therefore, the pension payments were admissible business expenditure under section 37(1).

2. *Indian Overseas Bank Ltd. Vs. CIT [1967] 63 ITR 733 (Mad.)*

In this case, pension was given to an employee. There was no general scheme for pension in the case of the assessee bank. The resolution for payment of pension was passed during the service of the employee, on the condition that employee should not accept service elsewhere.

It was held that the payment of pension was made in the interest of the business and was allowable under section 10(2)(xv) of the Indian Income-Tax Act, 1922 [corresponding to section 37(1) of the Income-Tax Act, 1961]. The relevant part of the judgement on page 737 of the Report, is reproduced as follows:-

We are, however, unable to accept the view of the Tribunal on the second question. It is true that the assessee had no general scheme for payment of pension to its employees. But that is not conclusive of the question. Though there may be no pension scheme, still in exceptional cases, we do not see why a business concern may not enter into a contract of service providing for pension and properly claim deduction of pension paid. The principal question to be kept in view is whether the expenditure claimed is laid out for the purpose of the business, whether it is legitimate business expenditure and whether it is in the interests of the business. The directorate of the business itself is the best judge on that matter, for it is for them to consider the business expediency and whether a particular expenditure should be incurred for purposes of the business.

3. *Gordon Woodroffe Leather Manufacturing Co. Vs. CIT [1962]44 ITR 551(S.C.)*

In this case, the issue was whether the amount of gratuity paid to an employee or director on retirement was an allowable expenditure.

For our purpose, the general principles laid down by the Apex Court are relevant, in respect whereof the relevant part of the judgement on page 555 of the Report, is reproduced as follows:-

In our opinion the proper test to apply in this case is, was the payment made as a matter of practice which affected the quantum of salary or was there an expectation by the employee of getting a gratuity or was the sum of money expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business.

 The aforesaid judgement of the Apex Court has been explained by the Andhra Pradesh High Court in the case of *British India Tobacco Corporation Ltd. Vs. CIT [1971] 79 ITR 41 (A.P.)*. The relevant part of the judgement on page 45 of the Report, is reproduced as follows:-

The Supreme Court, in our opinion, did not intend to lay down that any payment made contrary to the practice prevailing as the payment of pension or gratuity should necessarily be held to be an inadmissible deduction. In our opinion, what the Supreme Court intended to lay down was that if there is such a practice it would go a long way to satisfy the main test laid down by the Supreme Court, viz., that it was not a gratuitous payment and that it was a payment on the ground of commercial expediency to facilitate the carrying on of the business.

 On the basis of the aforesaid judgements of the Supreme Court and the A.P. High Court, it may be concluded that where there was an expectation by the employee of getting pension or where the payment of pension was made on the ground of commercial expediency, in order to facilitate the carrying on of the business, the same would be an allowable deduction.

4. *CIT Vs. Lucas Indian Service Ltd.[1999] 239 ITR 429 (Mad.)*

In this case, pension was paid to the widow of a director of the company. Resolution to that effect was passed while director was still working for the assessee company, authorizing payment of pension to the director and after his death to his widow.

It was held that the payment of pension was made on grounds of commercial expediency and therefore, the same was deductible under section 37 of the Act. The relevant part judgement on pages 434 and 435 of the Report is reproduced as follows.

The Bombay High Court in the case of CIT Vs. Fairdeal Corporation Pvt. Ltd. [1977] 108 ITR 280, has held that the payment of pension is to the widow, even where there was no practice for payment of pension is allowable as business expenditure. Applying the said decisions to the facts of the case, we are of the view that the Tribunal has come to a correct conclusion that the payment was made on the basis of commercial consideration. Once it is found that the payment was made on the basis of commercial consideration, there is no difficulty in holding that the payment made to Mrs. Ghaswala is an allowable deduction under section 37 of the Act. We have already seen that two of the tests laid down by the Supreme Court in Gordon Woodroffe Leather Mfg. Co. Vs. CIT [1962] 44 ITR 551, are fully satisfied, on the facts of the case. The resolution authorizing the payment of pension shows an expectation on the part of the employee of getting the pension. Further, the pension was made out of commercial consideration and in order to facilitate the carrying on the business smoothly. It is well-settled that the tests laid down by the Supreme Court are independent or alternative and on satisfaction of any one test, the payment can be treated as a permissible deduction.

5. *W.T. Suren & Co. (P) Ltd. Vs. CIT [1971] 80 ITR 602 (Bom.)*

In this case, the company took over the business of a firm, as a going concern with its employees. There was an agreement to pay pension to some employees who had put in long service and agreed not to be connected with any competing business.

It was held that payment of pension was allowable as a deduction. The relevant observations of the Hon.High Court are to be found on pages 626 and 627 of the Report. The same may be summarized as follows.

Agreeing with the Tribunal, that the payment made to the two employees was primarily in consideration of the past services rendered by them to the firm, the business of which was taken over by the limited company and the payment was, therefore, for purposes of business and in the nature of business expenditure and did not partake of the nature of capital expenditure. All that the company was attempting to do when it put down clause (11) in the terms of the agreements with the two employees, was to protect their goodwill and defend it against possible competition.

Their capital asset and their goodwill remained exactly the same as before and there was no addition to or acquisition of those capital assets. Therefore, even assuming that this was an expenditure made to protect their capital assets, still it can be considered as a business expenditure.

6. *Sassoon J. David & Co. P. Ltd. Vs. CIT [1979] 118 ITR 261 (S.C.)*

In this case, the company terminated services of some directors and employees in order to facilitate the take over of business of the company. On termination of their services, compensation was paid to the aforesaid directors / employees. The issue under consideration was whether the payment of compensation was allowable as a business deduction. It was held that the payment of compensation was allowable as a deduction. The relevant part of the judgement on page 275 of the Report, is reproduced as follows:-

It has to be observed here that the expression “wholly and exclusively” used in section 10(2)(xv) of the Act, does not mean “necessarily”. Ordinarily, it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under section 10(2)(xv) of the Act even though there was no compelling necessity to incur such expenditure.

N.B.: The ‘Act’ here means the Indian Income-Tax Act, 1922.

Conclusion

From the aforesaid judgements of the Apex Court and the High Courts, it may be safely concluded that the payment of pension to an employee / director is an allowable deduction under section 37(1) of the Act. In this regard, it needs to be ensured that the resolution to be passed by the board of directors for the grant of pension to the employee must be properly worded.

In this context, it may also be emphasized that the aforesaid resolution of the board of directors must be passed during the currency of the service of the employee. In other words, such a resolution must be passed before the employee retires from service.

In this connection, it may also be clarified that if the board of directors so desires, pension may be made payable to an employee during his lifetime and to his wife after his death, if he predeceases his wife.

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