IN THE HIGH COURT OF JUDICATURE AT BOMBAY
CIVIL APPELLATE JURISDICTION
WRIT PETITION NO. 160 OF 2024

Anil Govind Ganu } .... ***Petitioner***

: Versus :

Innovative Technomics Pvt. Ltd.

And Ors. } .... ***Respondents***

ALONGWITH
WRIT PETITION NO. 161 OF 2024

Ashwini Anil Ganu } ... ***Petitioner***

: Versus :

Innovative Technomics Pvt. Ltd.

And Ors. } ***...Respondents***

Mr. Kiran Bapat, Senior Advocate *i/by. Mr. Gaurav Gawande and with Mr. J.M. Joshi, for the Petitioner.*

Mr. Prashant P. Kshirsagar *a/w. Mr. Aniruddha M. Sanap, i/by. Sarvadnya Legal Associate, for the Respondents.*

CORAM : SANDEEP V. MARNE, J.

Reserved On : 31 July 2024.

Pronounced On : 20 August 2024.

JUDGMENT

1) These two petitions are filed by the ex-promoters and directors of first Respondent-Company raising grievance about non-payment of gratuity. They have challenged orders passed by the Controlling Authority-cum-Labour Court dated 6 December 2018 rejecting their Application PGA Nos. 10/2015 and 11/2015. The orders of the Controlling Authority are confirmed in Appeal by the Appellate Authority-cum-Industrial Court vide judgments and orders dated 10 July 2023, which are also subject matter of challenge in the present petition.

2) Petitioners founded the Company 'Innovative Technomics Private Limited' and were its Directors. Petitioner-Anil Govind Ganu claims that during the period from 26 March 1993 to 16 October 2012, he worked for the Company as its employee. His last drawn salary was Rs.8,60,000/-. It is also claimed that Petitioner-Ashwini Anil Ganu worked for the Company from 1 January 1996 to 3 October 2010 and drew salary as an employee. Her last drawn salary was Rs.3,00,000/-. Petitioners claimed that in the annual accounts for the year ending 31 March 2012, a provision was made for payment of amount of Rs. 1,21,96,154/- towards gratuity. Petitioners transferred 100% equity stake in the Company-Innovative Technomics Private Limited in favour of the purchasers by executing Share Purchase Agreement **(SPA)** dated 20 September

2012. After execution of the SPA, Petitioners tendered their resignations on 1 October 2012. Petitioners thereafter demanded payment of outstanding gratuity from Respondents and sent legal notice dated 29 September 2015 alongwith Form No. I for outstanding gratuity amount. Petitioners thereafter filed applications bearing No. 10/2015 and 11/2015 before the Controlling Authority under the Payment of Gratuity Act-cum-Labour Court, Pune (**Controlling Authority**) for payment of gratuity. In respect of service from 26 March 1993 till 16 October 2012 and on the basis of his last drawn salary of Rs. 8,60,000/-, Petitioner-Anil Govind Ganu demanded gratuity of Rs. 94,26,923/-. Similarly, Petitioner-Ashwini Anil Ganu demanded gratuity of Rs.27,69,231/- on the strength of her service from 1 January 1996 till 3 October 2012 and last drawn salary of Rs.3,00,000/-. Both the Petitioners contended in their respective applications that during their service tenure, it was decided between them and the First Respondent-Company that Petitioners would be entitled to receive better terms of gratuity, which will be paid at actuals and that the maximum amount of cap as prescribed under the Payment of Gratuity Act, 1972 shall not be applicable in their case. The applications were resisted by the Respondents by filing written statements. Both the parties led evidence. The Controlling Authority-cum-Labour Court passed orders dated 6 December 2018 rejecting the applications filed by the Petitioners, *inter-alia*, holding that they were in control over the affairs of the Company and therefore did not fit in definition of the term '*employee*'.

3) Petitioners filed Appeal (PGA) No. 1/2019 and Appeal (PGA) No.2/2019 before the Appellate Authority-cum-Industrial Court, Pune (**Appellate Authority**) challenging the decision of the Controlling Authority. By orders dated 10 July 2023, the Appellate Authority has dismissed the Appeals filed by Petitioners. Aggrieved by the decisions of the Controlling Authority and Appellate Authority, Petitioners have filed the present petitions.

4) Mr. Bapat, the learned senior advocate appearing for Petitioners would submit that the Controlling and Appellate Authorities have failed in not appreciating that Petitioners drew wages from the First Respondent-Company and therefore clearly fit into the definition of the term 'employee' under Section 2(e) of the Payment of Gratuity Act. That every person who is employed for wages becomes an employee and that therefore once the salary slips are produced, both the Authorities ought to have treated Petitioners as employees of the First Respondent-Company. That mere functioning as Directors of the Company did not mean that they become employers or that they cease to be employees. That the employer in the present case would be the First Defendant-Company and once it is proved that Petitioners were employed for wages, mere capacity as Directors of the Company did not come in their way of drawing gratuity. Mr. Bapat would further submit that specific provision was made in the Balance Sheet for payment of gratuity to the Directors. That Respondents' witness specifically

gave admission that the said Balance Sheet was finalised before execution of the Share Purchase Agreement and that Respondents did not raise any objection to reflection of liability to pay gratuity to Petitioners while finalising the said Balance Sheet. That the witness also admitted genuineness of the salary slips. He would submit that considering the above admissions, clear case was made out for allowing the applications.

5) Mr. Bapat would further submit that under the provisions of sub-section (5) of Section 4 of the Payment of Gratuity Act, it is lawful for the employer to enter into an agreement for providing gratuity better than the one provided for in the Act. That in the present case, there was an agreement for payment of gratuity as reflected in the Balance Sheet. He would rely on judgment in ***BCH Electric Limited Versus. Pradeep Mehra***[1]**.** He would submit that Petitioners are treated as employees for the purpose of Provident Fund and that it is incomprehensible that they are not employees selectively for the purpose of payment of gratuity. That the definition of the term 'employee' in the Payment of Gratuity Act and Employees Provident Fund and Miscellaneous Provisions Act, 1952 **(PF Act)** is almost similar and that therefore once Petitioners are treated as an employee under the P.F. Act, there is no reason why they should not be treated as employees under the Payment of Gratuity Act. Relying on judgment of the Apex Court in ***Employees'***

[1] (2020) 15 SCC 262

State Insurance Corporation Versus. Venus Alloy Pvt. Ltd[2], Mr. Bapat would submit that Director is held to be covered by definition of the term 'employee' and remuneration received by director is held to be covered by the term 'wages' under the Employees State Insurance Act, 1948 (**ESI Act**), which definitions are *pari materia* with that of Payment of Gratuity Act.

6) Mr. Bapat would rely upon the judgments of this Court in ***Ramchander's Coaching Institution Pvt. Ltd. Versus. Rakesh Ramchandar Nanda***[3] in support of his contention that this Court has dealt with an almost identical case where a Director of the Company was sought to be denied gratuity by erroneously treating him as employer. That this Court held that mere absence of name of the Respondent therein in the LIC Group Gratuity Scheme procured under the provisions of Section 4A of the Payment of Gratuity Act was not a fit ground for rejection of claim for payment of gratuity. Mr. Bapat would therefore urge for setting aside the orders passed by the Controlling Authority and Appellate Authority and to allow the applications filed by the Petitioner for payment of gratuity.

7) Petitions are opposed by Mr. Kshirsagar, the learned counsel appearing for the Respondents. He would submit that Petitioners are founder Directors of the First Respondent Company who were in absolute control of its affairs. That therefore both the

[2] (2019) 14 SCC 391
[3] Company Appeal No. 65 of 2014 decided on 10 July 2015.

Courts below have correctly held them to be the employers of various other employees employed in the Company. That Petitioners selectively produced salary slips of only one month for May 2012 with a view to raise false claim for gratuity. That there is no explanation as to who appointed Petitioners, what were the terms and conditions of employment etc. No other salary slips are produced on record. The resignation shows to have been tendered is on the post of Director and there is nothing to indicate that the same was actually submitted or that any decision was taken thereon for its acceptance. So far as Balance Sheet is concerned, he would submit that even if the entries therein are to be considered, the same would, at the highest, mean that provision for gratuity is made for all Directors of the Company, which would include even future Directors and it is entirely erroneous on the part of the Petitioners to presume that the figure specified therein is for payment of gratuity exclusively for Petitioners. That it is an admitted position that the names of the Petitioners did not figure in the LIC Group Gratuity Scheme, which is clear admission of absence of capacity of Petitioners as employees. That the Balance Sheets were prepared by Petitioners themselves before the Share Purchase Agreement for raising false claim of gratuity. That Share Purchase Agreement contains specific Indemnity clause, which indemnifies the purchasers in respect of any acts or deeds committed by Petitioners prior to the closing date. Mr. Kshirsagar would submit that both the Courts below have concurrently held that Petitioners are not employees and were in fact in full control of

the Company and hence not liable to be paid gratuity. He would pray for dismissal of the petitions.

8) Rival contentions of the parties now fall for my consideration.

9) Petitioners claim themselves to be covered by definition of the term '*employee*' within the meaning of Section 2(e) of the Payment of Gratuity Act. The definition reads thus:

> (e) "employee" means any person (other than an apprentice) who is employed on wages, whether the terms of such employment are express or implied, in any kind or work, manual or otherwise, in or in connection with the work of a factory, mine, oilfield, plantation, port, railway company, shop or other establishment, to which this Act applies, but does not include any such person who hold a post under the Central Government or a State Government and is governed by any other Act or by any rules providing for payment of gratuity.

10) The term 'wages' is defined in Section 2(s) of the Payment of Gratuity Act as under:

> (s) "wages" means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms and conditions of his employment and which arc paid or arc payable to him in cash and includes dearness allowance but does not include any bonus, commission, house rent allowance, overtime wages and any other allowance.

11) Relying on the aforesaid definition, Mr. Bapat has contended that since Petitioners were '*employed for wages*' they are

required to be treated as employees for the purpose of application of provisions of the Payment of Gratuity Act. He has also contended that Petitioners are treated as employees for the purpose of application of provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and that therefore there is no reason why they should not be treated as employees for the purpose of application of provisions of the Payment of Gratuity Act.

12) Reliance is placed by the Petitioners on documents described as 'Pay Slips' for the month of May 2012 which are placed on record. The Pay Slips refer to Employee Numbers assigned to Petitioners as 00139 and 00141. Petitioner-Anil Ganu is shown to have been earning basic earnings of Rs.8,60,000/- from which Rs.1,03,200/- is deducted towards Provident Fund contribution and after deducting income tax, the net amount payable is shown to Rs.5,06,990/-. Similarly for Petitioner-Ashwini Ganu, basic pay is shown as Rs.3,00,000/-, HRA of Rs.15,000/-, total earnings of Rs.3,15,000/- and after deducting Provident Fund of Rs. 36,000/- in addition to income tax of Rs.87,400/-, net pay is shown as Rs.1,91,600/-.

13) Petitioners have not produced any other salary slip for the period prior to May 2012 and this aspect is strongly highlighted by Mr. Kshirsagar. By highlighting this factor, it is sought to be suggested that Pay Slips for the months of May 2012 are created only for the purpose of claiming gratuity shortly before execution of

the SPA on 20 September 2012. Similar contention is raised by Mr. Kshirsagar in respect of the entries reflected in the annual accounts. In the Balance Sheet for the year ending 31 March 2012, following entry is reflected:

D) **I**	**Long-Term Provisions** **Provision for employee benefits** Gratuity payable to Directors Leave Encashment	Rs.12,196,154/-

14) Similarly, in the Notes forming part of Balance Sheet, following remarks are made relating to retirement benefits:

j) Retirement Benefits **(AS 15):**

i. Provident Fund:

The eligible employees of the Company are entitled to receive benefits under the Provident Fund, a defined contribution plan, in which both employees and Company make monthly contribution at a specified percentage of the covered employees' salary (currently 12% of employees' basic salary).

The contributions as specified under the Law are paid and charged to the Profit & Loss Account of the year when the contribution to the Fund is due.

ii. Gratuity:

The Company has subscribed to recognised Gratuity Fund and has contributed amount towards the same during the year under review. The contribution so made has been charged to Profit & Loss Account of the year when the contribution to the Fund is due.

> **The Company has also provided for Gratuity Payable to Directors during the year.**
>
> *(emphasis added)*

15) Relying on salary slips together with the entries in the Balance Sheet, it is sought to be contended that Petitioners are not just employees, within the meaning of Payment of Gratuity Act, but a specific provision is made in the Balance Sheet for payment of gratuity to them. In fact, Mr. Bapat has gone a step further to contend that the relevant entries made in the Balance Sheet constitutes an 'agreement' within the meaning of Section 4(5) of the Payment of Gratuity Act.

16) Section 4 of the Payment of Gratuity Act provides for payment of gratuity to an employee on termination of his employment after he has rendered continuous service of atleast five years. Gratuity is payable either on superannuation or retirement or resignation or death or disablement. Sub-section (2) of Section 4 provides for quantum of Gratuity payable under which for every completed year of service, gratuity at the rate of 15 days wages is required to be paid. Under sub-section (3) of Section 4, the amount of gratuity payable to an employee is caped at Rs.10,00,000/-. However, under sub-section (5) of Section 4, right of an employee to receive better terms of gratuity under any Award or Agreement or Contract with the employer is preserved. Section 4 of the Payment of Gratuity Act, as it applied in the year 2012, is reproduced below:

4. Payment of gratuity.—

(1) Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years,—

(a) on his superannuation, or

(b) on his retirement or resignation, or

(c) on his death or disablement due to accident or disease:

Provided that the completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement:

[Provided further that in the case of death of the employee, gratuity payable to him shall be paid to his nominee or, if no nomination has been made, to his heirs, and where any such nominees or heirs is a minor, the share of such minor, shall be deposited with the controlling authority who shall invest the same for the benefit of such minor in such bank or other financial institution, as may be prescribed, until such minor attains majority.]

Explanation.—For the purposes of this section, disablement means such disablement as incapacitates an employee for the work which he was capable of performing before the accident or disease resulting in such disablement.

(2) For every completed year of service or part thereof in excess of six months, the employer shall pay gratuity to an employee at the rate of fifteen days' wages based on the rate of wages last drawn by the employee concerned:

Provided that in the case of a piece-rated employee, daily wages shall be computed on the average of the total wages received by him for a period of three months immediately preceding the termination of his employment, and, for this purpose, the wages paid for any overtime work shall not be taken into account:

Provided further that in the case of [an employee who is employed in a seasonal establishment and who is not so employed throughout the year], the employer shall pay the gratuity at the rate of seven days' wages for each season.

Explanation.—In the case of a monthly rated employee, the fifteen days' wages shall be calculated by dividing the monthly rate of wages last drawn by him by twenty-six and multiplying the quotient by fifteen.

(3) The amount of gratuity payable to an employee shall not exceed Ten lakh rupees.

(4) For the purpose of computing the gratuity payable to an employee who is employed, after his disablement, on reduced wages, his wages for the period preceding his disablement shall be taken to be the wages received by him during that period, and his wages for the period subsequent to his disablement shall be taken to be the wages as so reduced.

(5) Nothing in this section shall affect the right of an employee receive better terms of gratuity under any award or agreement or contract with the employer.

(6) Notwithstanding anything contained in sub-section (i),—

(a) the gratuity of an employee, whose services have been terminated for any act, wilful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, shall be forfeited to the extent of the damage or loss so caused;

(b) the gratuity payable to an employee may be wholly or partially forfeited—

(i) if the services of such employee have been terminated for his riotous or disorderly conduct or any other act violence on his part, or

(ii) if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

By Amendment Act, 2018 the figure 'Ten lakh rupees' has been amended as '*such amount as may be notified by the Central Government from time to time'*. Thus after 2018 amendment, sub-section (3) of Section 4 reads thus:

(3) The amount of gratuity payable to an employee shall not exceed such amount as may be notified by the Central Government from time to time.

By Notification dated 11 April 2018, the Central Government has notified that the amount of gratuity payable to an employee under the Act shall not exceed twenty lakh rupees. However, for the present case, since the claim for gratuity pertains to the year 2012, the subsequent amendment of the year 2018 and notification issued in pursuance thereof is irrelevant.

17) Thus, under Section 4 of the Payment of Gratuity Act, in normal circumstances, gratuity payable to an employee is required to be computed as 15 days wages for each completed days of service, subject to maximum amount of Rs.10,00,000/-. However, where any specific award, agreement or contract is entered into between an employee or employer for payment of higher amount of gratuity, the right of the employee to receive gratuity as per such Award, Agreement or Contract is preserved under Section 4(5).

18) In the present case, since the amount claimed by Petitioners is in excess of Rs.10,00,000/-, they have contended that there is a contract with Respondent No.1, under which Petitioners are entitled to receive gratuity. Thus, right to receive gratuity is essentially premised on existence of agreement under Section 4(5) of the Payment of Gratuity Act. Therefore, the key to the issue at hand is existence or otherwise of an agreement to pay gratuity within the meaning of Section 4(5). No doubt, section 4(5) is also applicable to an 'employee' and unless person seeking enforcement of agreement is an 'employee', jurisdiction of Controlling Authority

under the Payment of Wages Act would be unavailable and a plain claim of a person (not being an employee) to enforce specific performance of agreement for payment of amount described as gratuity may not lie before the Controlling Authority. Be that as it may. The issue of jurisdiction is not really involved in the present petitions and therefore it is not necessary to delve deeper into the same. Ordinarily therefore, the first inquiry should have been about the issue as to whether Petitioners were 'employees' of the first Respondent-Company. However, since substantially high amount of Rs. 1,21,96,154/- is claimed by both Petitioners as gratuity as compared to cap of Rs. 10,00,000/- each under Section 4(3), a slightly different approach is being adopted where I first embark upon the path to enquire about existence of agreement under Section 4(5) of the Act between the parties.

19) What is contemplated under sub-section (5) of Section 4 of the Payment of Gratuity Act is '*any award or agreement or contract with the employer*'. Admittedly the claim is not premised on existence of any Award and therefore what needs to be proved is existence of an agreement or contract. No express written agreement or contract is however produced on record, under which the first Respondent-company agreed to pay any gratuity to Petitioners. In absence of such express written contract, Petitioners contend that the entries made in the Balance Sheet for the year ending 31 March 2012 are required to be construed as an 'agreement' for payment of gratuity. The issue is whether Balance

Sheet prepared for taxation purposes would constitute an 'agreement' for payment of gratuity under section 4(5) ?

20) In the present case, there is an entry in the balance sheet as on 31 March 2012 under the heading 'Non-current liability' as *'Gratuity payable to Directors*' and the amount is indicated as Rs.1,21,96152/-. There is no dispute to the position that apart from this entry, there is no contract or agreement between Petitioners and first Respondent Company to pay gratuity to them. Here, Petitioners were the only two directors at the time of finalisation of the balance sheet, which is also signed by them on 15 September 2012 i.e. 5 days before execution of the SPA. Therefore, even if any express written contract was to be executed between Petitioners and the first Respondent Company, it would have been most certainly be signed by Petitioners themselves on behalf of the Company. This aspect is being considered in latter portion of the judgment. What needs to be considered at this juncture is whether such entry would constitute an agreement within the meaning of Section 4(5) of the Payment of Gratuity Act.

21) The issue as to whether an entry reflected in balance sheet of a company can be construed as an acknowledgment of debt so as to attract Section 18 of the Limitation Act, 1963 fell for consideration before the three Judge Bench of the Apex Court in ***Asset Reconstruction Company (India) Ltd. Versus. Bishal***

Jaiswal and anr[4]. The issue before the Apex Court was however slightly different, than the one that needs to be decided in the present case, i.e. whether an entry in the balance sheet would amount to acknowledgment of debt under Section 18 of Limitation Act so as to extend the period of limitation in respect of otherwise time barred claim towards default amount for filing application under Section 7 of the Insolvency and Bankruptcy Code, 2016 (**IBC**). In case before the Apex Court, the Appellant therein had filed an application under Section 7 of IBC before the National Company Law Tribunal, Calcutta (NCLT) for default from the corporate debtor. The Appellant claimed that the default occurred on 8 November 2019 on the basis of entries made in the Balance Sheet of the corporate debtor, which, according to the Appellant, acknowledged the debt in the balance sheet. The application was admitted by NCLT holding that acknowledgment of liability by the corporate debtor in the balance sheet before expiry of three years from the date of filing of application saved the same from limitation by resorting to provisions of Section 18 of the Limitation Act. Before the National Company Law Appellate Tribunal (NCLAT), the corporate debtor relied upon Full Bench judgment of NCLAT in ***V. Padmakumar Vs. Stressed Assets Stabilisation Fund (SASF) & Anr.*** in which majority of four members had held that Balance Sheet would not amount to acknowledgment of debt for the purpose of extending limitation under Section 118 of the Limitation Act. After preliminary hearing, a Three Member Bench of NCLAT

[4] 2021 6 SCC 366

doubted the correctness of majority judgment of Full Bench and referred the case to Chairman of NCLAT to constitute Bench of coordinate strength to reconsider the judgment in ***V. Padmakumar*** case. A five member Bench of NCLAT refused to adjudicate the question referred, stating that the Reference to the Bench was itself incompetent. In the above factual background, the issue fell for Apex Court's determination. The Apex Court referred to the provisions of Section 18 of the Limitation Act relating to effect of acknowledgment in writing and formulated the question for determination as to whether entries in balance sheet made in accordance with law would amount to acknowledgment of debt for the purpose of extending the limitation under Section 18 of the Limitation Act ? The Apex Court answered the question by considering the provisions of Sections 292, 128, 129, 134, 137 of the Companies Act as well as various judgments and held as under:

> 15. In an illuminating discussion on the reach of Section 18 of the Limitation Act, including the reach of the Explanation to the said section, this Court in ***Khan Bahadur Shapoor Fredoom Mazda v. Durga Prasad Chamaria*** ["Shapoor Fredoom Mazda"], after referring to Section 19 of the Limitation Act, 1908, which corresponds to Section 18 of the 1963 Act, held:
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> > "6. It is thus clear that acknowledgment as prescribed by Section 19 merely renews debt; it does not create a new right of action. It is a mere acknowledgment of the liability in respect of the right in question; it need not be accompanied by a promise to pay either expressly or even by implication. The statement on which a plea of acknowledgment is based must relate to a present subsisting liability though the exact nature or the specific character of the said liability may not be indicated in words. Words used in the acknowledgment must, however, indicate the existence of jural relationship between the parties such as that of debtor and creditor, and it must appear that the statement is made with the

intention to admit such jural relationship. Such intention can be inferred by implication from the nature of the admission, and need not be expressed in words. If the statement is fairly clear then the intention to admit jural relationship may be implied from it. The admission in question need not be express but must be made in circumstances and in words from which the court can reasonably infer that the person making the admission intended to refer to a subsisting liability as at the date of the statement. In construing words used in the statements made in writing on which a plea of acknowledgment rests oral evidence has been expressly excluded but surrounding circumstances can always be considered. Stated generally courts lean in favour of a liberal construction of such statements though it does not mean that where no admission is made one should be inferred, or where a statement was made clearly without intending to admit the existence of jural relationship such intention could be fastened on the maker of the statement by an involved or far-fetched process of reasoning. Broadly stated that is the effect of the relevant provisions contained in Section 19, and there is really no substantial difference between the parties as to the true legal position in this matter."

20. An exhaustive judgment of the Calcutta High Court in ***Bengal Silk Mills Co. v. Ismail Golam Hossain Ariff*** ["Bengal Silk Mills"] held that an acknowledgment of liability that is made in a balance sheet can amount to an acknowledgment of debt as follows:

XXXX

21. Importantly, this judgment in Bengal Silk Mills holds that though the filing of a balance sheet is by compulsion of law, the acknowledgment of a debt is not necessarily so. In fact, it is not uncommon to have an entry in a balance sheet with notes annexed to or forming part of such balance sheet, or in the auditor's report, which must be read along with the balance sheet, indicating that such entry would not amount to an acknowledgment of debt for reasons given in the said note.

35. A perusal of the aforesaid sections would show that there is no doubt that the filing of a balance sheet in accordance with the provisions of the Companies Act is mandatory, any transgression of the same being punishable by law. However, what is of importance is that notes that are annexed to or forming part of such financial statements are expressly recognised by Section 134(7). Equally, the auditor's report may also enter caveats with regard to acknowledgments made in the books of accounts including the balance sheet. A perusal of the aforesaid would show that the statement of law contained in Bengal Silk Mills [Bengal

> Silk Mills Co. v. Ismail Golam Hossain Ariff, 1961 SCC OnLine Cal 128 : AIR 1962 Cal 115] , that there is a compulsion in law to prepare a balance sheet but no compulsion to make any particular admission, is correct in law as it would depend on the facts of each case as to whether an entry made in a balance sheet qua any particular creditor is unequivocal or has been entered into with caveats, which then has to be examined on a case by case basis to establish whether an acknowledgment of liability has, in fact, been made, thereby extending limitation under Section 18 of the Limitation Act.
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> **46**. It is, therefore, clear that the majority decision of the Full Bench in V. Padmakumar is contrary to the aforesaid catena of judgments. The minority judgment of Justice (Retd.) A.I.S. Cheema, Member (Judicial), after considering most of these judgments, has reached the correct conclusion. We, therefore, set aside the majority judgment of the Full Bench of NCLAT dated 12-3-2020.
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> **47**.NCLAT, in the impugned judgment dated 22-12-2020, has, without reconsidering the majority decision of the Full Bench in V. Padmakumar, rubber-stamped the same. We, therefore, set aside the aforesaid impugned judgment also.
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> **48**. On the facts of this case, NCLT, by its judgment dated 19-2-2020, recorded that the default in this case had been admitted by the corporate debtor, and that the signed balance sheet of the corporate debtor for the year 2016-2017 was not disputed by the corporate debtor. As a result, NCLT held that the Section 7 application was not barred by limitation, and therefore, admitted the same. We have already set aside the majority judgment of the Full Bench of NCLAT dated 12-3-2020, and the impugned judgment of NCLAT dated 22-12-2020 in paras 46 and 47. This appeal is, therefore, allowed, and the matter is remanded to NCLAT to be decided in accordance with the law laid down in our judgment.

22) Thus, in ***Asset Reconstruction Company (India) Ltd.,*** after considering various judgments on the issue of extension of limitation on account of acknowledgment of liability in the Balance Sheet of a Company, the Apex Court held that major decision of Full Bench of NCLT in ***V. Padmakumar*** did not lay down correct position of law. In short, the Apex Court held that an entry in the

balance sheet amounts to acknowledgment of debt under Section 18 of the Limitation Act and would accordingly extend the period of limitation for filing application under Section 7 of the Insolvency and Bankruptcy Code.

23) The issue before the Apex Court in ***Asset Reconstruction Company (India) Ltd.*** was about applicability of provisions of Section 18 of the Limitation Act for extension of period of limitation for filing application under Section 7 of the IBC. The effect of Section 18 of the Limitation Act is beginning of fresh period of limitation from the date on which acknowledgment of debt is made. Thus, if the amount is due to a party, which fails to file suit/proceedings for recovery thereof within the period of limitation, but the opposite party later reflects the said amount in the liability column of the Balance Sheet, reflection of such entry in the balance sheet would amount to acknowledgment of debt under Section 18 of the Limitation Act as held by the Apex Court in ***Asset Reconstruction Company (India) Ltd.*** and would result in running of fresh period of limitation from the date of the Balance Sheet.

24) However, the judgment in ***Asset Reconstruction Company (India) Ltd.*** still does not assist the determination of issue involved in the present case, which is about entry in balance sheet amounting to existence of agreement. The Apex Court has dealt with the issue of '*acknowledgment*' of liability as

contradistinct from the concept of '*creation*' of liability. The question of '*acknowledgement*' of liability would arise only if it is created and exists. The liability must arise out of a transaction or a contract. Section 18 of the Limitation Act provides for computation of fresh period of limitation from the time an acknowledgement is signed about 'liability' in respect of '*any property or right*'. Section 18 provides thus:

> **'18. Effect of acknowledgment in writing**.—(1) Where, before the expiration of the prescribed period for a suit or application in respect of **any property or right**, an acknowledgment of **liability in respect of such property or right** has been made in writing signed by the party against whom such property or right is claimed, or by any person through whom he derives his title or liability, a fresh period of limitation shall be computed from the time when the acknowledgment was so signed.
>
> (2) Where the writing containing the acknowledgment is undated, oral evidence may be given of the time when it was signed; but subject to the provisions of the Indian Evidence Act, 1872 (1 of 1872), oral evidence of its contents shall not be received.
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> Explanation.—For the purposes of this section—
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> (a) an acknowledgment may be sufficient though it omits to specify the exact nature of the property or right, or avers that the time for payment, delivery, performance or enjoyment has not yet come or is accompanied by a refusal to pay, deliver, perform or permit to enjoy, or is coupled with a claim to set off, or is addressed to a person other than a person entitled to the property or right;
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> (b) the word "signed" means signed either personally or by an agent duly authorised in this behalf; and
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> (c) an application for the execution of a decree or order shall not be deemed to be an application in respect of any property or right.'
>
> *(emphasis and underlining added)*

25) Thus, the acknowledgment needs to be about a '*liability*' in respect of some '*right*'. Therefore mere '*acknowledgment*' would not be sufficient to prove existence of right and liability arising out of such right must be independently established. In absence of proof

of existence of '*liability in respect of a right*', mere acknowledgement through a balance sheet entry would not amount to creation of such liability. This is dealt with to some extent by the Apex Court in ***Khan Bahadur Shapoor Fredoom Mazda v. Durga Prasad Chamaria***[5], which is relied upon in para 15 of the judgment in ***Asset Reconstruction Company (India) Ltd.*** It is held in Para 6 of the judgment in ***Khan Bahadur Shapoor Fredoom Mazda*** as under:

> **6. It is thus clear that acknowledgment as prescribed by Section 19 merely renews debt; it does not create a new right of action**. It is a mere acknowledgment of the liability in respect of the right in question; it need not be accompanied by a promise to pay either expressly or even by implication. The statement on which a plea of acknowledgment is based must relate to a present subsisting liability though the exact nature or the specific character of the said liability may not be indicated in words.
>
> *(emphasis added)*

26) Thus, it cannot be stated that mere reflection of an entry in the liability column of balance sheet would amount to creation of a right which never existed. Such right will have to be independently established either through a transaction or a document in the form of a contract. In the present case, there is no underlying document in the form of a contract between Petitioners and the First Respondent-Company under which it agreed to pay gratuity to Petitioners. For the purpose of application of sub-section (5) of Section 4 of the Payment of Gratuity Act, it is necessary that existence of specific agreement or contract must be proved. In the

[5] AIR 1961 SC 1236

present case, beyond reflection of entry in the balance sheet, there appears to be no underlying document under which the First Respondent-Company agreed to pay any gratuity to Petitioners. I am therefore of the view that in absence of any underlying agreement or contract, it cannot be stated that mere entry in balance sheet would give rise to creation of liability for the First Respondent-Company to pay gratuity under the provisions of subsection (5) of Section 4 of the Payment of Gratuity Act.

27) If there is still any ambiguity about existence of an agreement for payment of gratuity by first Respondent-Company to Petitioners, the same is cleared by specific admission given by Petitioner-Anil Govind Ganu in his cross examination, wherein he stated as under:

> **'There was no agreement about gratuity amount between me and the company'**

The above admission by Petitioner-Anil Govind Ganu completely destroyed his pleaded case as under:

> 5. That during his service tenure, **it was decided and agreed** between Applicant and the Respondent No. 1 that the Applicant shall be entitled to receive better terms of gratuity, which shall be paid at actual and the maximum amount of cap, as prescribed under the Payment of Gratuity Act, 1972, shall not be applicable in his case.
>
> 6. That the amounts of gratuity to be payable to Applicant was calculated to be Rs. 94,26,923/- (Rupees Ninety Four Lakhs Twenty Six Thousand Nine Hundred and Twenty Three Only) and **in accordance**

> **with the said understanding and agreement between the Applicant and the Respondent No. 1** provisions for the same was made in the books of accounts and the same is reflected in the balance sheet of the Respondent No. 1 for the year 01st April, 2011 to 31st March, 2012.
>
> *(emphasis and underlining added)*

28) Additionally, Respondents' witness Mr. Vithaal Gulabrao Bathe has stated in his evidence as under:

> 4) I say that the Applicant and his wife transferred their ownership by selling of their shares to Innovative Industries Ltd. and Mr. Prabhakar Salunkhe and others which can be seen in the Share Purchase. Agreement. **There was no understanding or any agreement either oral or written between the Applicant and the new owners with respect to the amount of gratuity payable to the Applicant. The entries which were made in the Annual Report of financial year of the year 2011 - 2012 were made before the transfer of ownership of Innovative Technomics Pvt. Ltd. to its new owners. That as mentioned in the above said para the Applicant and his wife themselves being the Directors/Employers made the said entries for payment of gratuity in the books of account for their own personal gain, on their own accord and hence it has no legal validity in the eyes of law.** Hence the Applicant with malafide intention has suppressed various facts like reason for resignation, transfer of shares date on which entry regarding the payment of gratuity in the books of account was made etc. to mislead the Hon'ble Court.
>
> *(emphasis and underlining supplied)*

29) Mr. Bapat has strenuously relied on cross examination of Respondents' witness in which he made following statements :

> 14 ….
> I have seen balance sheet of the year 2011 and 2012. It is true to say that, **there is provision noted about gratuity of Directors in Auditors note of balance sheet**. It is true to say that, the applicant was getting salary from the respondent company. I cannot tell whether the applicant was getting pay slip or not. It is true to say that, the

> provision about gratuity of Directors in Auditors note o balance sheet was made same as the claim of the applicant.
>
> 15) It is true to say that the applicant was observing Management as Director in the company. It is true to say that before signing of Share Purchase Agreement, the applicant was observing daily management of the company. **It is true to say that the balance sheet was finalised before Share Purchase Agreement was signed. It is true to say that the company has not raised any objection for that. It is true to say that as provision of gratuity in balance-sheet was admitted to the company, hence, company has not raised any objection.** It is true to say that the payment slip Exh.U-17 is of our company. I have knowledge about all provisions of Gratuity Act.
>
> *(emphasis added)*

30) Mr. Bapat reads the above statements in cross examination of Respondents' witness to mean admission of liability to pay gratuity. I am unable to agree. The above statements are made by the witness only about the entries in the balance sheet. The statement that '*there is provision noted about gratuity of Directors in Auditors note of balance sheet*' is a statement of fact. Finalisation of balance sheet before signing of SPA or the company not raising any objection, cannot be the basis for drawing an inference that the purchasers agreed to pay gratuity to Petitioners. Further statement that '*It is true to say that as provision of gratuity in balance-sheet was admitted to the company, hence, company has not raised any objection'* again refers to mere existence of entry in the balance sheet, which was not objected to by the company. In that statement, what the witness has admitted is mere '*provision of gratuity in balance-sheet'*. The statement again refers to only balance sheet. There is no evidence to show that independent of the balance sheet, the company ever agreed to pay gratuity to Petitioners. Since it is

held that an entry in balance sheet does not create any liability in absence of an underlying contract, nothing more can be read in the above statement of the witness. On the contrary, the same witness has expressly denied existence of any agreement or contract between Petitioners and Company to pay gratuity.

31) In my view, therefore there is no agreement in the present case between Petitioners and the First Respondent Company within the meaning of sub-section (5) of Section 4 of the Payment of Gratuity Act and therefore they cannot claim gratuity by merely relying on entry in the balance sheet of the Company. It must also be observed here that the balance sheet is prepared on instructions of the Petitioners, who were in full control of the Company as on the date of finalisation of the Balance Sheet. They signed the same 5 days before execution of the SPA.

32) Having held that there is no agreement within the meaning of Section 4(5) of the Payment of Gratuity Act, the issue of Petitioners fitting into the definition of the term 'employee' becomes academic. It however must be observed here that in every case a director or managing director of a company drawing salary for work performed for the company cannot be excluded from definition of the term 'employee'. The shareholders, directors and managing directors may change in respect of the company. However, the responsibility to pay the gratuity is on the company and not on the

managing directors, directors or shareholders. In the present case also, there appears to be change in share holding pattern in respect of the first Respondent Company, where some other individuals owned 50% shares in the company till previous year ending March 2011. A director or managing director who works for the company and draws remuneration can be considered to be 'employee' of the company for various labour related legislations. It all depends on facts and circumstances of each case. The term 'employer' has been defined under Section 2(g) the Payment of Gratuity Act as under:

> (f) "**employer**" means, in relation to any establishment, factory, mine, oilfield, plantation, port, railway company or shop--
> (i) belonging to, or under the control of, the Central Government or a State Government, a person or authority appointed by the appropriate Government for the supervision and control of employees, or where no person or authority has been so appointed, the head of the Ministry or the Department concerned,
> (ii) belonging to, or under the control of, any local authority, the person appointed by such authority for the supervision and control of employees or where no person has been so appointed, the chief executive officer of the local authority,
> (iii) **in any other case, the person, who, or the authority which, has the ultimate control over the affairs of the establishment**, factory, mine, oilfield, plantation, port, railway company or shop, and where the said affairs are entrusted to any other person, whether called a manager, managing director or by any other name, such person;

33) Thus a managing director who has ultimate control over the affairs of the establishment would fall in the definition of the term 'employer' under the Payment of Gratuity Act. The Gujrat High Court had an occasion to decide the issue in ***Monitron***

Securities (Private), Ltd. Versus. Mukundial Khushalchand Dhavan[6] in which it is held as under:

> 6. **On appreciation of facts, both the authorities have found that a mere designation of "Director" was given to the respondent and he was not having any control over the management of the company and all the controls were with the Managing Director of the company.** On the aforesaid basis, it was found that the respondent was entitled to gratuity on the basis of his continuous service from 1 April, 1976 to 30 June, 1996 as there was no break in his service during that period. **It is also required to be considered that the respondent herein had no ultimate control over the affairs of management and he was, all throughout, performing his duties and was getting salary for his work.** It is not in dispute that he had never acted as a Managing Director and all the administrative decisions were in the hands of the management and therefore, simply because he signed some papers as Director, that will not disentitle him from availing of the benefits of gratuity under the Payment of Gratuity Act. **The petitioner cannot be said to be an employer/co-employer, as, even looking to the definition of "employer," if any person is having ultimate control of the affairs of the company, he can be considered as employer.** The petitioner was not having any such control in his hands and after considering the evidence on record, the authorities have come to the conclusion that the respondent was not having any such control and accordingly he was entitled to benefit of gratuity under the Payment of Gratuity Act, 1972, as an employee of the company.
>
> 8. However, so far as the instant case is concerned, the question which is required to be considered is whether the respondent was an employee of the company or not and looking to the reasoning given by both the authorities to the effect that he had no ultimate Control over the management and considering the definition of "employee" as well as "employer" given in the Act. I am of the opinion that the view taken by the authority is absolutely correct and no interference of this Court is required.

34) Thus, the question whether a director or managing director would fall in the definition of the term *'employer'* or *'employee'* would depend on facts and circumstances of each case. So far as the present case concerned, both the authorities below have concurrently held that Petitioners were in complete control of the affairs of the company. Also, under Section 2(e) of the Payment of

[6] 2000 SCC OnLine Guj 362.

Gratuity Act, the expression used is '*employed for wages*'. Therefore, someone needs to employ a person for fitting him/her in the definition of the term '*employee*'. Also under Section 7 (2) of the Act, the employer is under obligation to determine the amount of gratuity and give notice to the employee and the Controlling Authority. Section 7(3) of the Act provides that '*the employer shall arrange to pay the amount of gratuity*'. Therefore, the employer himself ordinarily cannot become an employee. In the facts of the present case, both Petitioners were not just promoters, but in fact founder promoters of the first Respondent Company. They also functioned as managing directors. As on the date of cessation of their relationship and ownership of the company, they were the only two persons fully in charge of the affairs of the Company. No other person owned company's shares at the relevant time. Though there were other shareholders upto the year 2010-11, there is nothing on record to indicate that in the balance sheets of previous years (prior to 2011-12), any provision was made for gratuity to directors. Considering the evidence on record, the Controlling and the Appellate Authorities have concurrently held that Petitioners were completely controlling the Company.

35) In this regard, reference needs to be made to the relevant Clauses of SPA. Under Clause 1.1.17 '*employee*' is distinctly defined from the term '*Promoters*' within the meaning under Clause 1.1.32. Both the terms are defined in the SPA as under :

> 1.1.17 "Employee" means either confirmed or permanent employee of the Company working as well as Persons who are under probation in accordance with the terms of appointment letters issued by the Company.
>
> 1.1.32 "Promoters" means and includes for the purpose of this Agreement Mr. Anil G. Ganu, and Ms. Ashwini A. Ganu.

36) Thus, under the SPA, both Petitioners are included in the definition of the term '*promoters*' of the First Respondent-Company. As against this, the term '*employee*' is defined to mean only confirmed and permanent employees of the Company. So far as the alleged liability created towards payment of gratuity to directors under entries in the Balance Sheet are concerned, the same would not bind the First Respondent Company or its purchasers/Directors in view of '*Entire Agreement*' clause. Clause-16.1 of the SPA which reads thus:

> 16.1 This Agreement constitutes the entire Agreement between the parties with respect to the subject matter hereof to the exclusion of and shall supersede the Term Sheet executed between the Parties and all other term sheets, agreements, arrangements, understandings and assurances, either written or oral, existing or proposed, between the Parties hereto or their Affiliates including with any Third Party relating to the subject matter hereof.

37) The '*entire agreement*' clause is always intended to incorporate the entire transaction between the parties to be governed only by the covenants of the SPA and by no other documents. If Petitioners are permitted to rely upon entries in the balance sheet for the purpose of creating a liability on purchasers

for amount of Rs.1,21,96,154/-, the same would constitute an additional liability for the purchasers towards the sellers, over and above the consideration of Rs.23 crores already paid to Petitioners under the SPA. In my view, therefore this is a clear case where Petitioners are attempting to extract additional amounts from the purchasers over and above the consideration price of Rs.23 crores.

38) Reliance is placed on resignation letters of Petitioners to buttress the claim of they being 'employees'. The resignations are shown to have been tendered by Petitioners on 1 October 2012. The Appellate Authority has doubted the genuineness of those resignation letters, by making following observations:

> 12. In his resignation letter at Exh. U-11 dated 01.10.2012, it is mentioned that said resignation was given to the Board of Directors of the respondent No.1. However, the names of Board of Directors are not given and there is no acknowledgment on said resignation letter to show as to whom and when said resignation letter was submitted. In minutes of meeting at Exh. U-11 again the names of Board of Directors are not mentioned. Even the witness of the respondents Mr. Vitthal Bathe (Exh. C-9) was not confronted with said document of minutes of meeting to prove that initial on it belongs to Chairman of the respondent No.1. In fact, in Form No. 32 at Exh. U-11 or in any other documents such as annual accounts at Exh. U-19 and share purchase agreement there is no mention of Chairman or even post of Chairman. In annual account of 2011-2012 of Exh. U-19, the applicant and his wife are shown as Board of Directors. In fact, on page No. 12 in para 10.1 of share purchase agreement it is clearly mentioned that sellers i.e. the applicant and his wife have power and authority to execute and deliver the said agreement and they are not required to obtain any consent or approval for execution of said document. It means that they having ultimate control respondent No.1 before selling the same.

39) Even otherwise, the resignation is from the office of director of the Company. It may happen that in a given case, a regular employee of the company can be designated as a director and when he resigns from the position of the director, his employment with the company does not automatically come to an end. Therefore, resignations allegedly tendered by Petitioners from position of directors cannot be a factor for presumption of their employment with the company. What is curious to know is that Petitioners had sold their entire equity stake in the Company on 20 September 2012 and closing date in the SPA was indicated as the date of signing of the agreement. Thus, Petitioners otherwise did not have any connection with the company from 20 September 2012 and therefore it is quite incomprehensible as to why they were required to resign from the position of directors of the Company on 1 October 2012. This appears to be the reason why there is no endorsement or acknowledgment on the said resignation letters and the Appellate Authority cannot entirely be faulted for doubting the genuineness of the said resignation letters.

40) Even otherwise, the relevant entry in the Balance Sheet is '*gratuity payable to Directors*' and it is difficult to interpret the said entry to mean that the same was payable only to the directors existing as on 31 March 2012 and not to the directors who functioned before 2011-12 or who became directors after execution of the SPA. As observed above there is no underlying agreement or board resolution which agreed payment of gratuity to directors.

Why gratuity is claimed selectively by Petitioners is also not explained when Mr. P. R. Deo and Mrs. R. P. Deo were not just 50% shareholders but also directors of the company. They have apparently resigned as directors during the year 2011-12. In clause 12.4 of the SPA, they are described promoters and shareholders of the company, relevant part whereof reads thus:

> The Company has not entered into any deed of disassociation with Mr. Prafulla R. Deo and Ms. Madhuvanti Deo, **the erstwhile promoters and directors of the Company.**
>
> *(emphasis added)*

41) Also, there are two separate heads in entry No.13 under head '*Employee Benefits Expenses*' of '*Salary and Wages*' against which figure of Rs. 34,675,975.06/- is reflected as against a separate and distinct entry '*Directors Remuneration*' under Clause 15(3) against which the figure of Rs.4,01,02,481/- is indicated. This is another factor to indicate that what is drawn by the Petitioners is not salary or wages, but merely Director's Remuneration. Again, the so-called monthly salary figures of Rs.8,60,000/- and Rs.3,15,000/- (annual amount of Rs. 1,41,00,000/-) does not match with the figure of director's remuneration of Rs. 4,01,02,481/-. Mr. Kshirsagar has accused Petitioners of deliberately making the entry of gratuity in the balance sheet to extract more amount from purchasers after execution of SPA. He has drawn my attention to 'Profit and Loss Statement' for the year ending on 31 March 2011 in which the company is shown to have suffered net losses of Rs. 3,44,22,916.33/-

during that year. The total revenues of the company during 2011-12 were Rs. 35.60 crores against the expenses it incurred of Rs. 39.51 crores. On the contrary during the previous years, the company had earned net profit of Rs. 2.09 crores. He has questioned as to how a company, who had suffered losses, can ever agree for creation of fresh liability on itself towards gratuity to directors of Rs. 1.21 crores, when no such provision was made in previous years when company was earning profits ? After being queried as to whether Petitioners could produce the balance sheet for previous year for Court's perusal, Mr. Bapat has expressed inability. Therefore, selective production of pay-slip of only one month and more importantly non-production of balance sheet of previous year makes the entire claim of Petitioners highly doubtful.

42) Also, it is an admitted position that under the Group Gratuity Scheme purchased by the first Respondent-Company as required under Section 4A of the Payment of Gratuity Act, list of employees is submitted and that the said list does not contain Petitioners' names. Mr. Kshirsagar has placed on record the renewed Group Gratuity Insurance Policy No. 638644 with annual renewal date of 1 February 2013 in which names of 57 employees of the first Respondent-Company, figures of their salaries, total accumulated gratuity, life cover etc. is indicated. Admittedly, Petitioners' names are not reflected in the said list. This is yet another factor to infer that Petitioners were never treated as employees of the company.

43) In support of his plea that Petitioners were '*employees*', Mr. Bapat has relied upon judgment of the Apex Court in ***Venus Alloy Private Limited*** (supra) in which the issue was about company's liability to make contribution to Employees State Insurance Corporation (**ESIC**) in respect of the remuneration paid to its directors. In that case, the company was covered under the provisions of the Employees State Insurance Act, 1948 and had been depositing the amount of contribution with reference to the wages paid to some of its employees. In the inspection carried out by the ESIC, it was observed that contribution was not made in respect of the remuneration paid to its directors. Therefore, order was passed demanding such contribution from the company which was questioned by the company raising a plea that its directors did not fall under the category of 'employees'. In the above factual background, the Apex Court considered the issue as to whether director of a company would fall in the exhaustive definition of the term 'employee' under subsection (9) of Section 2 of the E.S.I. Act and held in paras-7, 8, 11, 12, 13, 14 and 15 as under:

> 7. For determination of the question involved, appropriate it would be to take note of the exhaustive definition of "employee" as contained in sub-section (9) of Section 2 of the ESI Act that reads as under:
>
> "2. (9) "employee" means any person employed for wages in or in connection with the work of a factory or establishment to which this Act applies and—
>
> (i) who is directly employed by the principal employer on any work of, or incidental or preliminary to or connected with the work of, the factory or establishment, whether such work is done by the employee in the factory or establishment or elsewhere; or
>
> (ii) who is employed by or through an immediate employer on the premises of the factory or establishment or under the supervision of the principal employer or his agent on work which is ordinarily part of the

work of the factory or establishment or which is preliminary to the work carried on in or incidental to the purpose of the factory or establishment; or

(iii) whose services are temporarily lent or let on hire to the principal employer by the person with whom the person whose services are so lent or let on hire has entered into a contract of service;

and includes any person employed for wages on any work connected with the administration of the factory or establishment or any part, department or branch thereof or with the purchase of raw materials for, or the distribution or sale of the products of, the factory or establishment or any person engaged as an apprentice, not being an apprentice engaged under the Apprentices Act, 1961 (52 of 1961), [and includes such person engaged as apprentice whose training period is extended to any length of time] [Note : The expressions in parenthesis were substituted by Act 18 of 2010 w.e.f. 1-6-2010 in place of the expressions "or under the standing orders of the establishment".] but does not include—

(a) any member of the Indian naval, military or air forces; or

(b) any person so employed whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government:

Provided that an employee whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government at any time after (and not before) the beginning of the contribution period, shall continue to be an employee until the end of that period;"

8. The expression "wages" is defined in sub-section (22) of Section 2 of the ESI Act in the following terms:

"2. (22) "wages" means all remuneration paid or payable, in cash to an employee, if the terms of the contract of employment, express or implied, were fulfilled and includes any payment to an employee in respect of any period of authorised leave, lock-out, strike which is not illegal or lay-off and other additional remuneration, if any paid at intervals not exceeding two months, but does not include—

(a) any contribution paid by the employer to any pension fund or provident fund, or under this Act;

(b) any travelling allowance or the value of any travelling concession;

(c) any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment; or

(d) any gratuity payable on discharge;"

11. This Court also approved the interpretation of relevant provisions of the ESI Act by the Karnataka High Court in the following : (Apex Engg. case [ESI Corpn. v. Apex Engg. (P) Ltd., (1998) 1 SCC 86 : 1998 SCC (L&S) 178 : (1997) 77 FLR 878] , SCC p. 97, para 13)

> "13. A Division Bench of the Karnataka High Court in ESI Corpn. v. Margarine and Refined Oils Ltd. [ESI Corpn. v. Margarine and Refined Oils Ltd., 1983 SCC OnLine Kar 245 : (1983) 2 LLN 918 : 1984 Lab IC 844] took the view which has commanded (sic commended) to us in the present proceedings. It was held by the High Court that the Managing Director of a private limited company was an employee as defined by Section 2 sub-section (9) of the Act. In this connection it was observed by the High Court that a company is a legal person and a corporate entity and as such it can employ one of its Directors as Managing Director. The Managing Director of the company covered by the Act becomes an employee of the company within the meaning of Section 2(9) of the Act and the remuneration paid to him for the functions he discharges as Managing Director would amount to wages as defined under Section 2(22) of the Act for the purpose of calculating employees' contribution. The aforesaid decision of the High Court correctly interprets the relevant provisions of the Act."

12. After a survey of the other cited decisions, this Court held as under : (Apex Engg. case [ESI Corpn. v. Apex Engg. (P) Ltd., (1998) 1 SCC 86 : 1998 SCC (L&S) 178 : (1997) 77 FLR 878] , SCC p. 100, para 19)

> "19. As a result of the aforesaid discussion it must be held that the Division Bench of the High Court in the impugned judgment [ESI Corpn. v. Apex Engg. (P) Ltd., 1987 SCC OnLine Bom 136 : 1990 Mah LJ 501 : (1990) 2 Mah LR 850] had erred in taking the view, on the facts of the present case, that Shri Dhanwate as Managing Director of the company was not an employee within the meaning of Section 2 sub-section (9) of the Act. On the other hand, it must be held that he was an employee of the company and as such could be added to the list of the remaining 19 employees so as to make a total of 20 for covering the establishment under Section 2 sub-section (12) of the Act which defines "factory" to mean,
>
> 'any premises including the precincts thereof—
>
> (a) … or
>
> (b) whereon twenty or more persons are employed or were employed for wages on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power or is ordinarily so carried on,'."

13. We are clearly of the view that what has been observed and held by this Court in Apex Engg., in relation to the Managing Director of a company, applies with greater force in relation to a Director of the Company, if he is paid the remuneration for discharge of the duties entrusted to him.

14. It is noticed that in the present case, the appellant Corporation in its impugned order dated 6-4-2005 specifically asserted that the Directors of the Company were paid remuneration at the rate of Rs 3000 p.m. and they were falling within the definition of "employee" under the ESI Act and hence, contribution was payable in regard to the amount paid to them. Interestingly,

> even while seeking to challenge the aforesaid order dated 6-4-2005 by way of proceedings under Section 75 of the ESI Act, the respondent Company chose not to lead any evidence before the Court. Hence, there was nothing on record to displace the facts asserted on behalf of the appellant Corporation in its order dated 6-4-2005; rather the factual assertions in the said order remained uncontroverted. The order dated 6-4-2005 had been questioned by the respondent Company only on the contention that the Directors do not fall within the category of "employee" but no attempt was made to show as to how and why the remuneration paid to its Directors would not fall within the purview of "wages" as per the meaning assigned by sub-section (22) of Section 2 of the ESI Act?
>
> 15. The ESI Court cursorily attempted to distinguish the decision of this Court in Apex Engg. only with reference to the fact that therein, the amount was being received by the Managing Director. The High Court, on the other hand, overlooked the said decision of this Court and relied only on the decisions of the Bombay High Court though the propositions in the referred decisions of the Bombay High Court stood effectively overruled by the decision in Apex Engg. where this Court held in no uncertain terms that the High Court was in error in taking the view that the Managing Director of the Company was not an employee within the meaning of Section 2(9) of the ESI Act. The said decision directly applies to the present case and we have no hesitation in concluding that the High Court in the present case has been in error in assuming that the Director of a company, who had been receiving remuneration for discharge of duties assigned to him, may not fall within the definition of an employee for the purpose of the ESI Act. There had been no reason to interfere with the order dated 6-4-2005 as issued by the appellant Corporation.

44) Relying on the judgment in ***Venus Alloy Private Limited*** (supra), Mr. Bapat has contended that since definition of the term '*employee*' and '*wages*' under both the enactments being same, the ratio of the judgment holding directors of a company as employees must apply to the present case. I am unable to agree. Firstly, it is not even Petitioners' case that they were covered by definition of the term '*employee*' within the meaning of ESI Act and that any contribution was made to ESIC in respect of the remuneration paid to them. The column '*ESI No.*' in the payslip is blank. Thus Petitioners were not treated as employees within the

meaning of ESI Act. The reliance on judgment in ***Venus Alloy Private Limited,*** far from assisting Petitioners' case, actually militates against them.

45) Also, the scheme under the ESI Act is entirely different where the establishments covered under the ESI Act are required to make contribution to the Employees State Insurance Fund held and administered by ESIC for payment of benefits and provision of medical treatment to the insured persons. The wages paid to an employee forms the unit in respect of which the contribution is to be made under the Act. The definition of the term '*wages*' under the ESI Act includes '*remuneration*' also. The term '*employer*' is not even defined in the ESI Act. The scheme of both the enactments are also entirely different. In any case, Petitioners are not treated as '*employees*' within the meaning of ESI Act nor have they made contributions on the basis of remuneration earned by them to the Employee State Insurance Fund. In that view of the matter, the judgment in ***Venus Alloy Private Limited*** cannot be selectively relied upon by Petitioners in absence of evidence to show that contributions were made to the fund in respect of the remuneration earned by them.

46) Mr. Bapat has also relied upon judgment of the Apex Court in ***BCH Electric Limited*** (supra) which in my view has no application to the issue involved in the present case. The judgment deals with the issue of right of an employee to receive better terms

of gratuity under Section 4(5) of the Act as compared to the statutory limit of Rs.10,00,000/- imposed under Section 4(3) of the Act. This is not the issue involved in the present case and therefore it is not necessary to delve deeper into that aspect.

47) For answering the issue at hand, provisions of Section 4A of the Payment of Gratuity Act also need to be considered. Section 4A is introduced by amending Act of 1987 for providing compulsory insurance for liability towards payment of gratuity. Section 4A provides thus:

> **4A. Compulsory insurance**.
>
> (1) With effect from such date as may be notified by the appropriate Government in this behalf, every employer, other than an employer or an establishment belonging to, or under the control of, the Central Government or a State Government, shall, subject to the provisions of sub-section (2), obtain an insurance in the manner prescribed, for his liability for payment towards the gratuity under this Act, from the Life Insurance Corporation of India established under the Life Insurance Corporation of India Act, 1956 (31 of 1956) or any other prescribed insurer:
> Provided that different dates may be appointed for different establishments or class of establishments or for different areas.
> **(2) The appropriate Government may, subject to such conditions as may be prescribed, exempt every employer who had already established an approved gratuity fund in respect of his employees and who desires to continue such arrangement, and every employer employing five hundred or more persons who establishes an approved gratuity fund in the manner prescribed from the provisions of sub-section (1).**
> (3) For the purpose of effectively implementing the provisions of this section, every employer shall within such time as may be prescribed get his establishment registered with the controlling authority in the prescribed manner and no employer shall be registered under the provisions of this section unless he has taken an insurance referred to in sub-section (1) or has established an approved gratuity fund referred to in sub-section (2).

> (4) The appropriate Government may, by notification, make rules to give effect to the provisions of this section and such rules may provide for the composition of the Board of Trustees of the approved gratuity fund and for the recovery by the controlling authority of the amount of the gratuity payable to an employee from the Life Insurance Corporation of India or any other insurer with whom an insurance has been taken under sub-section (1), or as the case may be, the Board of Trustees of the approved gratuity fund.
> (5) Where an employer fails to make any payment by way of premium to the insurance referred to in sub-section (1) or by way of contribution to an approved gratuity fund referred to in sub-section (2), he shall be liable to pay the amount of gratuity due under this Act (including interest, if any, for delayed payments) forthwith to the controlling authority.
> (6) Whoever contravenes the provisions of sub-section (5) shall be punishable with fine which may extend to ten thousand rupees and in the case of a continuing offence with a further fine which may extend to one thousand rupees for each day during which the offence continues.
> **Explanation.-- In this section approved gratuity fund shall have the same meaning as in clause (5) of section 2 of the Income-tax Act, 1961 (43 of 1961).**
>
> *(emphasis added)*

48) Thus under Section 4A of Payment of Gratuity Act, every employer is required to obtain insurance from the Life Insurance Corporation of India towards his liability for payment towards gratuity under the Act. Sub-section (2) of Section 4A exempts the employers who had already established '*approved gratuity fund*' and who desire to continue the arrangement and also the employer who employs more than 500 employees and who establishes such '*approved gratuity fund*'. Under Explanation to Section 4A, '*approved gratuity fund*' is the one which is established under Section 2(5) of the Income Tax Act, 1961. Sub-section (5) of Section 2 of the Income Tax Act defines the term 'approved gratuity fund' as under:

> (5)"**approved gratuity fund**" means a gratuity fund which has been and continues to be approved by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in accordance with the rules contained in Part C of the Fourth Schedule

49) Part XIV of the Income Tax Rules, 1962 deals with '*gratuity funds*' and Rule 102 deals with admission of Directors to a gratuity fund and provides thus:

> **Admission of directors to a fund.**
>
> 102. Where the employer is a company as defined in clause (i) of sub-section (1) of section 3 of the Companies Act, 1956 (1 of 1956), a director of the company may be admitted to the benefits of the fund only if he is a wholetime bona fide employee of the company and does not beneficially own shares in the company carrying more than five per cent of the total voting power.

50) Thus *qua* gratuity fund established as per the provisions of Income Tax Act and Rules and which is recognised for exemption under Section 4A of Payment of Gratuity Act, a director who owns shares carrying more than 5% of total voting power is specifically excluded from being admitted to the gratuity fund. Thus, conjoint reading of Section 4A of the Payment of Gratuity Act, Section 2(5) of the Income Tax Act and Rule 102 of the Income Tax Rules would indicate that in respect of those employers who have already established '*approved gratuity fund*', such employer is not under statutory obligation to obtain insurance from Life Insurance Corporation of India for his liability for payment of gratuity. In respect of such employers who have obtained 'approved gratuity fund', its directors owning shares in a company carrying more than 5% of the total voting power cannot be admitted to such '*approved*

gratuity fund'. When in respect of a company which has set up 'approved gratuity fund', its director having more than 5% voting power cannot be admitted to such approved gratuity fund and therefore cannot be paid gratuity, I do not see any reason why director of a Company who is statutorily obliged to obtain insurance under Section 4A(1) of Payment of Gratuity Act from the Life Insurance Corporation of India should be placed at an higher pedestal for payment of gratuity. Section 4A of Payment of Gratuity Act recognizes two classes of employers, viz. i) employers who have set up '*approved gratuity fund*' and ii) employers who are mandatorily required to obtain insurance from the Life Insurance Corporation of India. In the first category of companies, directors having more than 5% voting power, cannot be paid gratuity. Therefore, there is no reason why the directors of second category of companies, should be made entitled for payment of gratuity. Mere procurement of an Insurance policy from Life Insurance Corporation under Section 4A(1) would not place the directors of such company on higher pedestal in comparison to the companies who have set up '*approved gratuity fund*'. In my view, therefore since both the Petitioners had more than 5% voting power, they cannot be paid gratuity under the provisions of the Payment of Gratuity Act.

51) Mr. Bapat has contended that Petitioners are treated as '*employees*' for provident fund and that the definition of '*employee*' under the PF Act is similar to the one under the Payment of

Gratuity Act. In my view it is not necessary to delve deeper into this aspect since Petitioners' claim is for payment of gratuity on the basis of agreement under Section 4(5) of the Act, which has been negatived.

52) What remains now is to deal with the judgment of this Court in ***Ramchander's Coaching Institution Pvt. Ltd***. (supra) on which strenuous reliance is placed on behalf of the Petitioners. According to Mr. Bapat, the judgment virtually covers the present case. The judgment, according to Mr. Bapat, deals with twin issues of (i) right of director of a company to receive gratuity under Section 4(5) of the Payment of Gratuity Act and (ii) mere absence of director's name in list of employees in LIC's group gratuity scheme not affecting such right. In ***Ramchander's Coaching Institution Pvt. Ltd***., Company Petition was filed by Appellant No. 2 therein alleging acts of operation and mismanagement in the affairs of Appellant No.1-Company. During pendency of the Company Petition, parties arrived at a mutual settlement, pursuant to which consent terms were filed, which provided for exit of Respondent therein from the First Appellant Company and Appellant No. 2 remaining in exclusive charge and control of its management and affairs. As a part of the settlement, the Consent Terms specifically provided for payment of gratuity and provident fund to Respondent No.2. While Provident Fund was duly paid to him, gratuity was not paid and, in this background, the Respondent applied for directions

before the Company Law Board for payment of gratuity '*in pursuance of the Consent Terms*'. The application was opposed by the Appellants *inter-alia* on the ground that Respondent was an employer rather than employee within the meaning of Payment of Gratuity Act and the payments made to him were in the nature of Director's remuneration and not wages within the meaning of the Act. In the above factual background, this Court held as under :

> 5. …. The Act provides for payment of gratuity for every completed year of service or part thereof in excess of six months at the rate of fifteen days' wages based on the rate of wages last drawn by the employee concerned. The Act also provides for compulsory insurance for the employer's liability of payment of gratuity under the Act. Such insurance has to be obtained from the LIC. It is the case of the Appellants that the first Appellant company has obtained such insurance and that there is a scheme of gratuity prepared in that behalf. The scheme is in the form of a trust deed between the employer, i.e. the first Appellant company, and the trustees. This trust deed has various clauses which inter alia include the definition of employees, which is in the following terms:
>
> > ""**Employees"** shall mean the employees participating in the Gratuity Fund other than personal and domestic servants and shall be deemed to include the Directors who are wholetime bonafide employee of the Company and do not beneficially own shares in the Company carrying more than 5% voting rights in the Company."
>
> The submission is that the Respondent, being a director of the company carrying more than 5% voting rights in the company (he admittedly has 33.33% shareholding in the company), is not entitled to be treated as an employee under this scheme even if he be a whole-time bona fide employee of the company. This argument has no force for two reasons. Firstly, any scheme made by an employer for the purposes of compulsory insurance under Section 4-A of the Act is not exhaustive of the rights and liabilities of the parties concerning payment of gratuity. In fact, sub-section (5) of Section 4 of the Act, which deals with payment of gratuity, makes

it clear that nothing in that section shall affect the right of an employee to receive better terms of gratuity under any award or agreement or contract with the employer. Even if an employee does not fall within the meaning of the definition provided in the trust deed prepared for the purposes for Section 4-A of the Act, nothing prevents an employer company from entering into any agreement with an employee for payment of gratuity. For this purpose, the 'employee' means any person who is employed for wages in or in connection with the work of any establishment in accordance with the definition in the Act noted above and 'wages' means all emoluments earned by an employee also as noted above. Appellant No.1 ran an establishment to which the Act applied; the Respondent was employed with Appellant No.1 and received regular emoluments. There is no reason why he should not be treated as an employee for the purposes of the Act. There is no reason to import the definition of 'employee' under the trust deed for this purpose. That definition, providing for not more than 5% voting rights for a director employee, may be relevant for the purposes of compulsory insurance under Section 4-A of the Act, but does not generally govern the meaning of the word 'employee' for the purposes of gratuity payable under the Act. **Nothing therefore prevents Appellant No.1 company from entering into a separate contract for payment of gratuity with a whole-time employee who has been holding more than 5 per cent voting rights in the company. Secondly, it has been brought out on record by the Respondent before the CLB that whereas there were suitable provisions made towards the company's liability to pay gratuity to the employees including whole time directors prior to the scheme, i.e. till the year 2001, with effect from the year 2001 an appropriate provision was made by depositing suitable amounts towards gratuity payable to the employees including the Respondent with the LIC.** There is an admitted document on record in this behalf, namely, the letter dated 3 January 2014 addressed by the LIC that the total accumulation value of gratuity payable to the Respondent as on 1 November 2012 was Rs.10 lakh as per the scheme rules. This was in response to a query addressed by the Respondent to the LIC under Master Policy No. GGCA/658728 taken by the Appellant company from the LIC in relation to gratuity payable by it to its employees. Then, there are also other documents on record which show that the Respondent was actually included in the gratuity scheme and policy taken from the LIC in connection with the scheme. There is a letter addressed by Appellant No.1 to the Respondent on 30 November 2012, writing to him about the former having forwarded

his request for payment of gratuity to the LIC - Group Gratuity Scheme. There is also another letter on record, namely, letter dated 1 November 2011 addressed by Appellant No.1 to the LIC in connection with the Group Gratuity Scheme giving a list of its employees on its payroll as on 1 November 2011. This list shows the name of the Respondent as an employee with salary of Rs.2 lakh per month as part of the Gratuity Scheme. This clearly shows that not only was the Respondent entitled to receive gratuity but that suitable provisions were made throughout towards payment of such gratuity. The last clinching evidence in this behalf is the consent terms themselves where there is an unequivocal admission of liability to pay gratuity to the Respondent coupled with a promise to pay the same.

6 As for the argument that disputes between an employer and an employee concerning payment of gratuity, either regarding admissibility of such payment or as regards the quantum of such payment, can only be entertained by the authorities under the Act, it is pertinent to note that this is not a case for payment of gratuity under an application made under the Act. Here is a case where the parties have solemnly agreed on the aspect of the admissibility of the payment of gratuity. Under the consent terms filed before the CLB, it was agreed and confirmed that gratuity shall be paid to the Respondent on account of his resignation from the first Appellant company within two months from the date of handing over of the management by the Respondent. There is no need to take the dispute before the authorities under the Act. **This is rather a case for enforcement of consent terms filed before the CLB.** There cannot possibly be any dispute as to the admissibility of the liability, and as far as the question of quantum is concerned, even that hardly admits of any dispute since the approved balance sheet of the company for the year ending 31 March 2012 is on record (annexed to the consent terms) and this balance sheet discloses that the Respondent's last drawn salary was Rs.24 lakhs per annum. On the basis of this last drawn salary and an admitted liability to pay gratuity, working out of the quantum of gratuity payable was a ministerial exercise, which in the facts of the case, the CLB was entitled to undertake.

53) Thus, in ***Ramchander's Coaching Institution Pvt. Ltd.*** this Court allowed claim for gratuity towards enforcement of Consent Terms filed before the Company Law Board. This Court

noticed that in addition to Consent Terms filed before the Company Law Board, specific provision was made by depositing suitable amounts towards gratuity payable to employees (including the Respondent) with LIC. Thus under the Group Gratuity Scheme purchased under the provisions of Section 4A of the Act, the amounts were deposited for payment of gratuity to Respondent therein. There was a letter addressed by LIC indicating the accumulated amount of gratuity payable to Respondent as Rs.10,00,000/-. Furthermore, the company had addressed a letter to the LIC in connection with Group Gratuity Scheme alongwith list of its employees on payroll, which reflected Respondent's name. It is in the light of the above unique facts of the case that this Court upheld the claim for gratuity in ***Ramchander's Coaching Institution Pvt. Ltd.*** in respect of Respondent, who also happened to be company's director. The said judgment cannot be cited in support of an absolute proposition that in every case, director of a company automatically becomes an employee under the Payment of Gratuity Act or that gratuity is payable to all directors, in absence of an agreement.

54) Mr. Bapat has contended that ***Ramchander's Coaching Institution Pvt. Ltd.*** answers the issue of right of director to receive gratuity despite possession of more than 5% voting power. In my view, this court has allowed gratuity claim of Respondent therein only due to factor of (i) consent terms agreeing to pay gratuity, (ii) name of director actually included in list of employees in LIC group

gratuity scheme and (iii) deposit of amounts by the company for the director in LIC's scheme. It is in the light of these unique facts that this Court repelled the objection of directors with 5% voting power not fitting in the definition of the term 'employee' under the trust deed for LIC group gratuity scheme. In the present case none of the three factors as indicated above in ***Ramchander's Coaching Institution Pvt. Ltd.*** are present viz. (i) there is no agreement to pay gratuity (ii) names of Petitioners are not included in list of employees of LIC Group Gratuity Scheme (iii) no contribution is made in such scheme for Petitioners. Thus the decision in ***Ramchander's Coaching Institution Pvt. Ltd.*** rendered in facts of that case, would have no application in the present case.

55) As observed above, this is not a simple case of two directors quitting the company and claiming gratuity towards the services rendered by them for the company. This is a case where Petitioners were owners of entire share capital of the company, they sold their stake for Rs. 23 crores on 20 September 2012. The company had reported losses of Rs. 3.44 crores as on 31 March 2012. In this factual background, an entry made by Petitioner themselves in the balance sheet of the company on 15 September 2012 (five days before execution of SPA) is made basis for claiming gratuity of Rs. 1.21 crores. The claim puts an additional burden on purchasers over and above the purchase price of Rs. 23 crores. There is no underlying agreement for payment of gratuity to directors to support the stray entry in the balance sheet. There is nothing of

record to indicate that the previous directors (Mr. and Mrs. Deo) who owned 50% stake in the company during financial year 2010-11, were paid any gratuity. Petitioners' names do not figure in the list of employees for whom gratuity is insured by purchasing insurance policy from LIC under Section 4A of the Act. Even then, if a specific agreement was to be produced for payment of better terms of gratuity under Section 4(5) of the Act, the claim of Petitioners could have been awarded. Mere entry in the balance sheet created for the first time by Petitioners, who were in complete control of the company on that date, that too 5 days before sale of their stake in the company, cannot amount to agreement under provisions of section 4(5) of the Payment of Gratuity Act. Petitioners' claim for gratuity is thus totally untenable and has rightly been rejected by the Controlling and Appellate Authorities.

56) After considering the overall conspectus of the case, I am of the view that no interference is warranted in the order passed by the Controlling Authority and the Appellate Authority. The Writ Petitions must fail and are accordingly **dismissed** without any order as to costs.

NEETA SHAILESH SAWANT

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[SANDEEP V. MARNE, J.]