Kedarnath Jute Mfg. Co. Ltd.

Vs

Commissioner of Income-Tax (Central), Calcutta

Civil Appeal No. 1899 of 1967

(K. S. Hegde, A. N. Grover JJ)

17.08.1971

JUDGMENT

GROVER J. –

This is an appeal by special leave from the judgment of the Calcutta High Court in an income-tax reference.

The assessee, who is the appellant, is a public limited company doing the business of jute and manufacturing of jute goods. The method of accounting followed by the assessee is the mercantile system. During the assessment year 1955-56 (the previous year ended on 31st December, 1954), the assessee claimed a deduction of Rs. 1,49,776, on account of sales tax determined to be payable by the sales tax authorities on the sales made by the assessee during the aforesaid previous year. The sequence of dates may be maintained. The income-tax return was filed on 13th January, 1956. The demand notice was served by the sales tax authorities on the 21st November, 1957. On 9th November, 1959, the assessee filed a revised return claiming the aforesaid deduction. The assessee had taken the order by which the demand for such tax had been created to the higher departmental authorities, as it was contesting its liability to the extent that had been determined. The Income-tax Officer, however, completed the assessment on 11th March, 1960, before any final decision was given in the proceedings relating to the assessment of sales tax. According to the Income-tax Officer, the assessee was not entitled to claim the deduction of the aforesaid amount of sales tax inasmuch as it had denied its liability to pay that amount and had made up provision in its books with regard to the payment of that amount. The Appellate Assistant Commissioner confirmed the order of the Income-tax Officer. The Appellate tribunal dismissed the appeal of the assessee. The following question of law was referred by the tribunal for the opinion of the High Court :

> "Whether, on the facts and in the circumstances of the case, the amount of Rs. 1,49,776, which was claimed by the assessee as a deduction on account of sales tax, was deductible as a business expense?"

The High Court was of the opinion that unpaid and disputed sales tad liability could not form the basis of a claim for deduction for the purposes of income-tax. The reasoning of the High Court mainly was that for the purpose of claiming a deduction under section 10(2) (xv) of the Income-tax Act, 1922 (hereinafter called "the Act"), mere legal liability was not enough. There had to be an expenditure in the first place and it must be laid out or expended wholly and exclusively for the purpose of such business. The High Court further held that unpaid and disputed sales tax could not be validly deducted in the computation of business income even under section 10(1) of the Act.

It has been submitted on behalf of the assessee that sales tax paid or unpaid would be admissible deduction under section 10(2) (xv) as well as under section 10(1). It is pointed out that if the method of accounting adopted by the assessee is cash system, it would quality for deduction only in the year in which it has been actually paid. If the method of accounting is the mercantile system, then the deduction will be permissible in the year to which the liability relates irrespective of the point of time when the liability has actually been discharged. Section 10(5) provides that in sub-section (2) "paid" means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the section. The argument proceeds that in order therefore, that sales tax may qualify for deduction under section 10(2) (xv), it has to be in the nature of an "expenditure" which has either been actually paid during the year of account or for the payment of which the liability has been incurred in the accounting year, according as the method of accounting followed by the assessee is cash system or mercantile system. It is indisputable that the amount of sales tax paid or payable by the assessee is an "expenditure" within the meaning of section 10(2) (xv). The amount in question was thus a kind of expenditure about which there can be no doubt that it had been laid out or expended wholly or exclusively for the purpose of business carried on by the assessee.

The submission on behalf of the assessee in the alternative is that apart from valid deductibility of sales tax as an expenditure under section 10(2) (xv) of the act, it is a permissible deduction even under section 10(1). The profits of a business which are to be assessed to tax must be real profits and they have to be ascertained on ordinary principles of commercial trading and commercial accounting. Where an assessee is under a liability or is bound to make certain payment from the gross receipts, the profits and gains can only be the net amount after such an amount is deducted from the gross profits or receipts.

In Commissioner of Income-tax v. Royal Boot House, it was held that where the assessee followed the mercantile system of accounting and, without disputing the liability to pay the sales tax, had made a provision for its payment in its account even though he had not actually paid the tax over to the authorities, the assessee was entitled to deduction irrespective of the provision for sales tax from his income under section 10(2) (xv) of the Act. It was point doubt that under the providence of the sales tax statutes, the liability to pay the tax was not dependent upon assessment or demand but was an obligation to pay the tax either annually, quarterly or monthly, as the case might be. This case was and has been sought to be distinguished by the revenue on the ground that the liability to pay the sales tax had not been disputed and the assessee had made a provision for its payment in its account. As will be presently seen this distinction is without substance and does not affect the true legal position.

Now under all sales tax laws including the statute with which we are concerned, the moment a dealer makes either purchases or sales which are subject to taxation, the obligation to pay the tax arises and taxability is attracted. Although that liability cannot be enforced till the quantification is effected by assessment proceedings, the liability for payment of tax is independent of the assessment. It is significant that in the present case, the liability had even been quantified and a demand had been created in the sum of Rs. 1,49,776 by means of the notice dated 21st November, 1957, during the pendency of the assessment proceedings before the Income-tax Officer and before the finalisation of the assessment. It is not possible to comprehend how the liability would cease to be one because the assessee had taken proceedings before higher authorities for getting it reduced or wiped out so long as the contention of the assessee did not prevail with regard to the quantum of liability, etc. An assessee who follows the mercantile system of accounting is entitled to deduct from the profits and gains of the business such liability which had accrue during the period for which the

profits and gains were being computed. It can again not be disputed that the liability to payment of sales tax had accrued during the year of assessment even though it had to be discharged at a future date. In Pope The King Match Factory v. Commissioner of Income-tax, a demand for excise duty was served on the assessee and though he was objecting to it and seeking to get the order of the Collector of Excise reversed, he debited that amount in his accounts on the last day of his accounting year and claimed that amount as a deductible allowance on the ground that he was keeping his accounts on the mercantile basis. The Madras High Court had no difficulty in holding that the assessee had incurred an enforceable legal liability on and from the date on which he received the Collector's demand for payment and that his endeavour to get out of that liability by preferring appeals could not in any way detract from or retard the efficacy of the liability which had been imposed upon him by the competent excise authority. In our judgment, the above decision lays down the law correctly.

The main contention of the learned Solicitor-General is that the assessee failed to debit the liability in its books of accounts and, therefore, 10(1) or under section 10(2) (xv) of the act. We are wholly unable to appreciate the suggestion that if an assessee under some misapprehension or mistake fails to make an entry in the books of account and although, under the law, a deduction must be allowed by the Income-tax Officer, the allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter. The assessee who was maintaining accounts on the mercantile system was fully justified in claiming deduction of the sum of Rs. 1,49,776 being the amount of sales tax which it was liable under the law to pay during the relevant accounting year. It may be added that the liability remained intact even after the assessee had taken appeals to higher authorities or courts which failed. The appeal is consequently allowed and the judgment of the High Court is set aside. The question which was referred is answered in favour of the assessee and against the revenue. The assessee will be entitled to costs in this court and in the High Court.

Appeal allowed.

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