

CALCUTTA HIGH COURT

Commissioner of Income-Tax

Vs

Royal Boot House

(S P Mitra, C.J. Sabyasachi Mukherji . JJ.)

19.06.1969

JUDGMENT

Sabyasachi Mukherji, J.

1. The method of accounting followed by the assessee and accepted by the department is mercantile. For the assessment year 1961-62, the assessee had made provision in its account for the sum of Rs. 22,642 on account of the sales tax payable by the assessee. The assessee claimed deduction of the said sum in its income-tax assessment. The Income-tax Officer disallowed the claim on the ground that the amount represented a mere provision for taxes which had neither been paid nor ascertained by the sales tax authorities. The assessee preferred an appeal before the Appellate Assistant Commissioner who confirmed the order of the Income-tax Officer. Thereupon, the assessee went up in appeal before the Income-tax Appellate Tribunal. The Tribunal found that, having regard to the scheme of the Sales Tax Act, the charge is created not upon the assessment but as soon as the sales are effected. In that view of the matter and inasmuch as there was no dispute that the amount of Rs. 22,642 represented the estimated amount of sales tax payable on the sales effected by the assessee during the year, the Tribunal was of the view that the amount represented an accrued liability which the assessee had to discharge. The Tribunal, therefore, allowed the claim of the assessee for deduction.

2. On an application being made under Section 66(1) of the Indian Income-tax Act, 1922, the following question has been referred to this court:

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in allowing deduction in respect of the sum of Rs. 22,642 in the computation of the total income of the assessee for the assessment year 1961-62?"

3. It was contended by counsel for the revenue that sales tax is not deductible from the income for the purpose of payment of income-tax. It was contended that payment of sales tax was not

necessary for the purpose of carrying on the business inasmuch as sales tax was payable on the "taxable turnover" and not on all sales but on sales beyond the limits of "taxable turnover". It was further contended that the liability for payment of sales tax arises upon assessment or demand being made by the sales tax authorities. Therefore, it was urged that, on the facts of this case, as there was no assessment or demand notice, the amount representing provision made for sales tax is not to be deducted from the income of the assessee. Reliance was placed by the counsel for the revenue on the decision in *In the matter of Recols (India) Ltd.*, [1953] 4 S.T.C. 271 ; 57 C.W.N. 468 (S.B.) It was then contended that a mere legal liability would not be enough for claiming deduction in respect of the sales, tax under the Indian Income-tax Act, 1922. Reliance was placed on the case of *Kedarnath Jute Manufacturing Co. v. Commissioner of Income-tax*¹, Counsel for the revenue also relied on the decisions of *Commissioner Income-tax v. Chowringhee Sales Bureau (P.) Ltd.*², *Ikranandi Coal Co. v. Commissioner of Income-tax*³, and the unreported judgment of this court in Income-tax Reference No. 164 of 1963 (*Commissioner of income-tax v. Sinclair Murray & Co. (P.) Ltd.*⁴).

4. Counsel for the assessee, on the other hand, contended that sales tax is deductible from the income of the assessee for the purpose of payment of income-tax. It was urged that payment of sales tax is necessary for the purpose of carrying on the business of the assessee. It was urged that under Section 10(2)(xv) of the Indian Income-tax Act, 1922, the assessee is entitled to claim deduction of sales tax. It was further urged that under Section 10(1) of the Indian Income-tax Act, 1922, the amount of sales tax payable should be deducted in computing the total income of the assessee. It was also urged that, inasmuch as the sales tax created a statutory charge, there was diversion of the income of the assessee to the extent of the sales tax liability, inasmuch as the amount representing sales tax did not become income of the assessee. It was further submitted that, with reference to the various provisions of the Bengal Finance (Sales Tax) Act, 1941, and the Rules framed thereunder, the liability for the payment of sales tax arises in respect of a registered dealer on all sales effected and is not dependent upon the assessment by the sales tax authorities or any demand. In that view of the matter it was urged that, inasmuch as the assessee follows a mercantile system of accounting, it was entitled to deduction in respect of the accrued liability of the sales tax. Reliance was placed by counsel for the assessee on the decision of the Supreme Court in the case of *Keshoram Industries and Cotton Mills Ltd. v. Commissioner of Wealth-tax*, and the decision of this court in the case of *Textile Machinery Corporation Ltd. v. Commissioner of Wealth-tax*⁵,

5. In order to examine the rival contentions in this case, it would be necessary to bear in mind the following relevant facts found by the income-tax authorities and the Tribunal-

(a) The method of the assessee is mercantile.

(b) Provision has been made by the assessee for Rs. 22,642 as being payable as sales tax on account of the sales effected during the year.

(c) There is no dispute that the said amount represents the estimated amount of sales tax payable on the sales effected by the assessee during the relevant year.

(d) Amounts realised by charging sales tax from the customers by the assessee have been included in the gross sales.

(e) The assessee has not filed quarterly returns before the sales tax authority declaring its sales and the liability to sales tax.

(f) There has been no assessment by the sales tax authority.

(g) No payment has been made by the assessee on account of the sales tax.

6. Bearing the above facts in mind, it would be necessary to examine the relevant provisions of the Bengal Finance (Sales Tax) Act, 1941. Our attention has been drawn to Section 4(2), Section 5, Section 5(2), Section 7, Section 10 and Section 11 of the said Act and the rules framed thereunder and to the forms of filing returns under the said Act. Section 4, Sub-section (2), states that every dealer to whom Sub-section (1) does not apply (with which we are not concerned in this case), shall, if his gross turnover calculated from the commencement of any year exceeds the taxable quantum at any time within such year, should be liable to pay tax under the Act on the expiry of two months from the date on which such gross turnover first exceeds the taxable quantum, on all sales effected after such expiry. Section 5(2) defines what is meant by taxable turnover. Section 7(1) enjoins that no dealer shall, while being liable to pay tax (under Section 4 of the said Act), carry on business as a dealer unless he has been registered and possesses a registration certificate. Section 10 is in the following terms :

" (1) Tax payable under this Act shall be paid in the manner hereinafter provided at such intervals as may be prescribed.

(2) Such dealers as may be required so to do by the Commissioner by notice served in the prescribed manner and every (registered or certified) dealer shall furnish such returns by such dates and to such authority as may be prescribed.

(3) Before any (registered or certified) dealer furnishes the returns required by Sub-section (2), he shall, in the prescribed manner, pay into a Government Treasury or the Reserve Bank of India the full amount of tax due from him under this Act according to such returns, and shall furnish along with the returns a receipt from such treasury or bank showing the payment of such amount.

(4) If any dealer discovers any omission or other error in any return furnished by him, he may at any time before the date prescribed for the furnishing of the next return by him furnish a revised return, and if the revised return shows a greater amount of tax to be due than was shown in the original return, it shall be accompanied by a receipt showing payment in the manner provided in Sub-section (3) of the extra amount."

7. Section 11 gives power to the Commissioner to make assessments in certain circumstances. Rule 17 and onwards framed under the Act provide different times for different categories of dealers to file returns. It is obligatory under the Act that the Treasury challans showing payment of taxes should be filed along with the returns.

8. An examination of the various provisions of the Bengal Finance (Sales Tax) Act, 1941, and the Rules framed thereunder reveals that there is an obligation on the part of every registered dealer, and one has to be a registered dealer if his sales are beyond a certain limit, to pay tax on all sales in certain specified manner. It is obligatory for such dealer to file returns either annually or quarterly or monthly, as the case may be, and the tax has to be paid prior to the filing of the returns and the sales tax authorities are entitled to make assessment and demand the balance sum from the dealer. There is also provision for enforcing payment and realisation of sales tax in case returns are not filed or payments not made in accordance with the returns filed. It appears, therefore, that the liability to pay sales tax is not dependent upon assessment or demand. The obligation is to pay the sales tax either annually, quarterly or monthly, as the case may be, under the particular rule guiding a particular dealer.

9. We are, therefore, unable to accept the contention made on behalf of the revenue that liability for payment of sales tax arises either upon the assessment or demand notice. The dealer is obliged to pay sales tax according to his own calculation on all sales effected after making deductions that he is entitled to under Section 5 of the Act. If, however, the sales tax authorities are not satisfied with that return, further liability can be imposed upon the dealer by assessment. It is true that the further liability does not accrue until the assessment, but the liability on sales in its unassessed stage-appearing on the face of sales tax returns filed by the dealer arises on sales being effected. In the matter of *Recols (India) Ltd.* the question that arose was whether sales tax was to be treated as a preferential debt within the meaning under Section 230 of the Indian Companies Act and that from which date. It was held that in respect of the further sum which the sales tax authority claimed, apart from the amount that has been paid by a dealer on its return, the said sum would become due or payable when the notice of demand in respect thereof was served declaring the tax and demanding the balance. Chakravarti C.J., delivering the judgment of this court, analysed the position as has been set out at page 474 of the report. That case, however, as the learned Chief Justice noted, was not concerned with the incidents of an unpaid liability

appearing on the face of a sales tax return. In that view of the matter we are of the opinion that the said decision is no authority for the argument that no liability at all arises on sales for payment of sales tax before assessment.

10. In view of the scheme of the Sales Tax Act as discussed above, it is necessary to consider whether the assessee is entitled to deduction of sales tax under Section 10(1) or Section 10(2)(xv) of the Indian Income-tax Act, 1922. It was contended that payment of sales tax is not a precondition for carrying on of business by a dealer. It is true that a dealer of any sort is not liable to pay the sales tax but a dealer whose business turnover is above the limit prescribed by the statute cannot lawfully carry on business without paying sales tax or without making arrangement for the payment of sales tax. It is a liability which arises to an assessee in connection with his business and is directly related to his business. It is a liability which an assessee incurs in his capacity as a trader. Viewing the question from the point of view of commercial expediency we are of the opinion that discharge of the liability for the payment of sales tax is necessary for carrying on of the business and is incidental to it and as such an assessee is entitled to deduction of the sales tax if other conditions are satisfied under Section 10(2)(xv) of the Indian Income-tax Act, 1922. The question of sales tax liability came up for consideration before the Andhra Pradesh High Court in the case of *S.R.V.G. Press Co. v. Commissioner of Excess Profits Tax*⁶, Delivering the judgment of the court, Viswanatha Sastri J. observed, at page 589 of the report, as follows :

" Now sales tax is levied on sales or purchases of goods by traders and not upon the profits or gains made by them from the business. Sales tax is payable irrespective of any profits being earned and without such payment, the business of buying and selling cannot be carried on. It is, therefore, deductible as a business expense before arriving at the taxable profits."

11. Referring to the difference of language between rule 12 of Schedule I of the Excess Profits Tax Act and Section 10(2)(xv) of the Indian Income-tax Act, 1922, in the said judgment, at page 592 of the report, it has been observed as follows :

" It is no doubt true that the language of rule 12 is more stringent than the corresponding language of Section 10(2)(xv) of the Income-tax Act. It cannot be disputed that the expenditure in question was incurred by the assessee in his character as a trader. It cannot be stated that the payment of sales tax was made voluntarily and on grounds of commercial expediency without any actual necessity for such payment. Sales tax is a compulsory levy under the sanction of the legislature and there is no discretion left to the assessee as regards the extent of the payment. The payment of sales tax has no doubt the effect Of diminishing the assessee's taxable income but such payment is necessary if

the assessee is to carry on business at all and this is not a case where the assessee having a discretion so lay out money for the purpose of earning profits in a business, spends an unnecessarily large amount during the chargeable accounting period."

12. We respectfully agree with the above view as to the nature of the sales tax liability. The said decision went up in appeal to the Supreme Court] and the decision of the Andhra Pradesh High Court was affirmed on the ground that the payment of sales tax must be deemed to satisfy the requirements of Rule 12 of Schedule I of the Excess Profits Tax Act. It is true that the Supreme Court did not make any pronouncement directly on the question whether sales tax was deductible or not under the Indian Income-tax Act, 1922, but in referring to the sales tax liability Shah J., in his judgment at page 222 of the report, observed as follows :

"But the reasonableness and the necessity of the expenditure sought to be deducted in assessing excess profits tax liability must be adjudged in . the light of commercial expediency. The payments made by the assesseees were in discharge of obligations imposed lawfully and were necessary for the proper conduct of the business.

13. In the case of Travancore Titanium Products Ltd. v. Commissioner of Income-tax, , the Supreme Court held that :

"In determining whether an amount expended by the assessee is deductible under Section 10(2)(xv) of the Indian Income-tax Act, 1922, the nature of the expenditure or outgoing must be adjudged in the light of accepted commercial practice and trading principles. The expenditure must be incidental to the business and must be necessitated or justified by commercial expediency. It must be directly and intimately connected with the business and must be laid out by the taxpayer in his character as a trader. To be a permissible deduction, there must be a direct and intimate connection between the expenditure and the business, that is to say, between the expenditure and the character of the assessee as a trader and not as owner of assets even if they are assets of the business."

14. Bearing the above principles in mind, in view of the nature of the sales tax liability, we are of the opinion that in respect of that liability, if the other conditions are satisfied, the assessee is entitled to deduction inasmuch as the said liability is incurred by the assessee in the capacity of a trader and is 'directly and intimately connected with his business.

15. The next question that required consideration, therefore, is, whether an assessee, who maintains the mercantile system of accounting, is entitled to deduction on the facts and circumstances of this case in view of the liability incurred for the payment of sales tax. It was urged on behalf of the revenue that a merely legal liability is not sufficient to claim deduction

under Section 20(2)(xv) of the Indian Income-tax Act, 1922. It was submitted that in order to be entitled to deduction monies must actually be spent or arrangement for the payment must be made and that, counsel for the revenue urged, cannot be done, according to him, unless there is an assessment and demand notice is issued. We are unable to agree. We have discussed the nature of the liability under the Bengal Finance (Sales Tax) Act, 1941. In the case of *Keshav Mills Ltd. v. Commissioner of Income-tax*⁷, Rose J., in his judgment at page 244 of the report, observed as follows :

"Now in the present case the method of accounting was the mercantile system. The essential difference between this and the cash basis system is that in the latter actual receipts and disbursements are taken into account. In the former, sums which are due to the business are entered on the credit side immediately they are legally due and before they are actually received and expenditures are entered the moment a legal liability to pay arises and before the actual disbursements."

16. The said observations of Bose J. were approved by the Supreme Court. in the case of *Calcutta Company Ltd. v. Commissioner of Income-tax*, and in the case of *Commissioner of Income-tax v. Swadeshi Cotton and Flour Mills Private Ltd.*⁸, *the case of Kesoram Industries and Cotton Mills Ltd. v. Commissioner of Wealth-tax* the Supreme Court has held that a liability to pay income-tax was a present liability though the tax became payable after it was quantified in accordance with the ascertainable data. There was therefore a perfected debt at any rate on the last day of the accounting year. The amount of provision for payment of income-tax and super-tax made by a company was, therefore, a "debt owed" within the meaning of Section 2(m) of the Wealth-tax Act, 1957, and as such deductible in computing the net wealth of an assessee. In the case of *Textile Machinery Corporation Ltd. v. Commissioner of Wealth-tax*, Banerjee J., delivering the judgment of this court, held that in view of Section 4 of the Bengal Finance (Sales Tax) Act, 1941, if a provision is made for payment of taxes under the Bengal Finance (Sales Tax) Act, 1941, it stands on the same footing as provision made for income-tax liability and it is a debt. In view of the fact that the assessee follows a mercantile system of accounting and in view of the fact that the assessee has not disputed the liability to pay the sales tax but on the other hand has made a provision for its payments in its accounts and in view of the nature of the liability created in respect of the sales tax, we are, therefore, of the opinion that the assessee is entitled to deduction in respect of the provision made for payment of sales tax from the income of the assessee under Section 10(2)(xv) of the Indian Income-tax Act, 1922.

17. The facts of the case of *Kedarnath Jute Manufacturing Co. Ltd v. Commissioner of Income-tax*, on which much reliance was placed by counsel for the revenue, were entirely different. There what had happened was that for the accounting year ended on 31st December, 1954, the

assessee was assessed to a sales tax of Rs. 1,49,776 and the consequent demand notice was served on November 21, 1957. After the assessee's writ petition against the assessment was dismissed by the High Court, the recovery proceedings were taken to which also the assessee raised objections. The original return for income-tax for the same period was filed on the 12th June, 1956, and a revised return claiming to deduct this sum was filed on 9th November, 1959. The assessee, who was following the mercantile system of accounting, had not made any provision with regard to this liability to sales tax in its books. The assessment was completed on 11th March, 1960 ; the Income-tax Officer rejected the claim of the assessee for deduction on the ground that the assessee had denied its liability to sales tax and was contesting its liability in the writ petition as also in the certificate proceedings which were pending. The appeal to the Appellate Assistant Commissioner and the Tribunal were also dismissed. It was held by the High Court, on a reference, that the amount was not deductible as business expense. The question whether sales tax was deductible in computation of the income under the Indian Income-tax Act was left open and the court did not express any opinion on that point. Assuming that it was deductible, the court came to the conclusion that on the facts of that case the said sum was not deductible. The court was of the opinion that, as the claim of the assessee was a disputed liability both as to its quantum and its validity, and as the assessee has made no provision or arrangement for its payment, it cannot be deducted either under Section 10(1) or under Section 10(2)(xv) of the Indian Income-tax Act, 1922. As mentioned hereinbefore the facts of the instant case are entirely different. There is no dispute that provision has been made for the sales tax liability by the assessee in its account. There is no evidence that the assessee is disputing either the quantum or the validity of the sales tax liability. The case of Commissioner of Income-tax v. Chowringhee Sates Bureau P. Ltd. was also concerned with an entirely different set of facts. There what had happened was that the assessee, who carried', on the business of actioneers, collected from the purchasers in auction, in addition to the price of the goods, the sales tax payable to the State under the Bengal Sales Tax Act. The amount collected as sales tax was separately shown in the memo granted to the purchasers and was also credited to a separate account in the books, pending a decision of the Supreme Court as to whether an auctioneer was a dealer and was liable to pay sales tax to the State. The department contended that the receipts by way of sales tax were receipts bearing the same character as receipts from the assessee's trade itself and that such receipts did not change their character by being credited to a separate account other than trading account.

18. The Tribunal, on the contrary, held that as the amount of sales tax was collected by the assessee, not as its profits or gains, but merely for the purpose of making It over to the State in due time, if it was found liable, it did not belong to the assessee either in the shape of a trading receipt or in the shape of gain. On a reference, the High Court held the amounts collected as sales

tax were an integral part of the commercial transaction of sales by auction carried on by the assessee and when they were received, they were the moneys of the assessee and remained thereafter the moneys of the assessee as its trading receipts and the Income-tax Officer was justified in bringing the amounts to tax. The liability to return the moneys was not the criterion for determining the question whether the amount received was a trading receipt or not. It was further held that, if, ultimately, the assessee was found liable to pay sales tax to the State Government the amounts so paid would be allowed as a deduction in the year of payment. Similarly, it was held that if the assessee refunded the moneys to the purchasers at the auctions, then such refunds would also be allowed as deduction in the year in which they are made. It was found by the court that the assessee was contesting the liability to pay the sales tax on the ground that it was not a dealer within the meaning of the said Act. The court was mainly concerned with whether the sales tax realised by an assessee form part of the trading receipts of the assessee.

19. The court was not concerned with the question that after it became part of the trading receipts of the assessee, if the liability is not disputed by an assessee, then whether in view of the provisions of the Bengal Finance (Sales Tax) Act, 1941, an assessee, who follows the mercantile system of accounting is entitled to deduction in respect of the same. In the case of Commissioner of Income-tax v. Sinclair Murray & Co. Ltd., the question of deduction in respect of the liability for sales tax under Section 10(2)(xv) of the Indian Income-tax Act, 1922, for an assessee who follows the mercantile system of accounting and has made provision for payment of sales tax, did not fall for consideration, similar is the position with the case of Ikranandi Coal Co. v. Commissioner of Income-tax.

20. In the view we have taken it is not necessary for us to deal with the alternative argument made on behalf of the assessee as to whether the amount provided for sales tax was deductible under Section 10(1) of the Indian Income-tax Act, 1922.

21. In the premises the question referred to this court must be answered in the affirmative and in favour of the assessee. The Commissioner of Income-tax will pay the costs of this reference.

Sankar Prasad Mitra, J.

22. I agree.

Cases Referred.

- 1[1968] 67 I.T.R. 56
- 2 [1969] 71 I.T.R. 131
- 3[1968] 69 I.T.R. 438
- 4 [1970] 75 I.T.R. 494
- 5[1968] 67 I.T.R. 122

6[1956] 30 I.T.R. 583

7[1953] 24 I.T.R. 230 (S.C.)

8[1964] 54 I.T.R. 134 (S.C.)