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Cit Vs. Kanpur Textiles Ltd.

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Court : Allahabad

Decided On : Aug-31-2004

Reported in : [2005]143TAXMAN274(All)

Appeal No. : IT Reference No. 15 of 1982 31 August 2004

Appellant : Cit

Respondent : Kanpur Textiles Ltd.

Advocate for Pet/Ap. : A.N. Mahajan *for the Revenue* R.S. Agarwal *for the Assessee*

Judgement :
ORDER

R.K. Agrawal, J.

The Income Tax Appellate Tribunal, Allahabad has referred the following questions of law under section 256(2) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act) for opinion to this court:-

'1. Whether on the facts and in the circumstances of the case, the Tribunal was in law justified in holding that the liability of gratuity amounting to Rs. 16,45,092 relating to past years accrued in the accounting year relevant to the assessment year 1972-73 and was, therefore, an allowable deduction for that assessment

year?

2. Whether on the facts and in the circumstances of the case when the system of accounting of the assessee was mercantile and when Dr. Sampurnanand Award of 1961 was extended by the U.P. Government year after year, the Tribunal was justified in law in holding that the liability, of Rs. 16,45,092 relating to the past years arose for the first time in the assessment year 1972-73?

3. Whether the Tribunal having found that the assessee-company had failed to claim the liability for gratuity for the past year was justified in law in holding that it was not debarred from claiming the liability of earlier years in the assessment year 1972-73?

4. Whether on the facts and in the circumstances of the case, when the provisions of section 36(1)(v) of the Income Tax Act, 1961, provisions as contained in Part C of Schedule IV of the Income Tax Act, 1961 and the rules relating thereto were not complied with, the Tribunal was in law justified in allowing the claim of gratuity of Rs. 16,45,092 in the assessment year 1972-73

5. Whether on the facts and in the circumstances of the case, when the provisions of section 36(1)(v) of the Income Tax Act, 1961, provisions as contained in Part C of Schedule IV of the Income Tax Act, 1961 and the rules relating thereto were not complied with, the Tribunal was in law justified in allowing the claim of gratuity of Rs. 12,45,428 in the assessment year 1972-73?

6. Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the interest paid to the Income-tax department was an allowable deduction under the Income Tax Act?'

2. Briefly stated, the facts giving rise to the present reference are as follows:-

The reference relates to the assessment year 1972-73, the previous year. being the financial year. The respondent assessee is a pubic limited company incorporated under the Companies Act. It is engaged in manufacturing of cotton textile goods. A part of its products are exported to various countries. For the assessment year 1972-73, the respondent assessee claimed the following amount

of retirement gratuity as deduction while computing its profit and loss:

(i) in respect of the years prior to the accounting year under consideration Rs. 16,45,092;

(ii) in respect of the accounting year under consideration Rs. 12,45,428 and

(iii) actually paid and debited to the profit and loss account - Rs. 1,66,495.

The assessing officer found that the respondent assessee was making payment of gratuity to its employees on the basis of the Cawnpore Cotton Textiles Industries Workmen's Gratuity Scheme which became effective from 14-8-1961, published by the U.P. Government under section 6(3) of the UP. Industrial Disputes Act, 1947, popularly known as Dr. Sampurnanand Award. He also noticed that the provisions of Dr. Sampurnanand Award, 1961 was substantially the same as those contained in the U.P. Government Notification No. 4268, dated 19-11-1971, and the Payment of Gratuity Act, 1972. However, he allowed the claim of the respondent assessee only for Rs. 1,66,495 in respect of gratuity actually paid anddebited to the profit and loss account as in the earlier years. The assessing officer had rejected the claim in respect of remaining two amounts on the ground that the liability accrued from year to year in the past and not in the accounting year under consideration under Dr. Sampurnanand Award of 1961. Further, there was no approved gratuity fund created under irrevocable trust as laid down under the Act or the Rules made thereunder and the conditions laid down in section 36(1)(v), IV Schedule and the Income Tax Rules were not. fulfilled. He further held that the assessee had been regularly following the system of claiming deduction on payment basis and no bona fide reason for deviation therefrom could be established. He was further of the opinion that not only an irrevocable trust was to be created, the fund has also to be invested in the manner provided in the Income Tax Rules.

Further, during the assessment year in question the respondent assessee has paid a sum of Rs. 41,490 as interest to the Income Tax Department. It, however, disclosed an amount of Rs. 13,030 only. The balance amount of Rs. 28,460 was disallowed by the assessing officer and was added to its income.

The assessee, feeling aggrieved, preferred an appeal before the Appellate Assistant Commissioner. The Appellate Assistant Commissioner upheld the disallowance of Rs. 16,45,092 which was in respect of the years prior to the previous year under consideration holding that the method of accounting being mercantile, the claim should have been made in the earlier years. However, he held that the claim of Rs. 12,45,428 in respect of the previous year under consideration was allowable as liability for this amount accrued in the assessment year under consideration. He, however, confirmed the disallowance of interest of Rs. 28,460.

3. Both, the assessee and the revenue, preferred separate appeal before the Tribunal. The Tribunal relying upon a decision of the Gauhati High Court in the caseof CIT v. Nathmal Tolaram (1973) 88 ITR 234, allowed the assessee's claim in respect of Rs. 16,45,092. It also allowed the claim of Rs. 28,460 twvards interest. The Tribunal, however, dismissed the revenue's appeal regarding the sum of Rs. 12,45,228.

4. We have heard Sri A.N. Mahajan, the learned standing counsel for the revenue and Sri R.S. Agarwal, the leamed counsel for the assessee.

5. The learned counsel for the revenue submitted that as the respondent assessee had not created a fund for the exclusive benefit of its employees under an irrevocable trust and had not paid any amount by way of contribution to such approved gratuity fund, any amount paid towards gratuity cannot be allowed as deduction as the same does not fall within the purview of section 36(1)(v) of the Act. He further submitted that under section 2(5) of the Act 'approved gratuity fund' has been defined to mean a gratuity fund which has been and continues to be approved by the Chief Commissioner or the Commissioner in accordance with the Rules contained in Part C of the IV Schedule. According to him, as the provisions of Part C of Schedule IV has not been complied with, the payment of gratuity cannot be allowed as a deduction while computing the profit and gain of the business, Sri Mahajan further submitted that once an item of expenditure falls under section 36(1)(v) of the Act, it cannot be allowed under the residuary provision under section 37(1) of the Act. On the question of allowability of interest,

he submitted that the amount in question represented the interest paid on income tax, which is not an allowable deduction as it has not been laid out for the purposes of carrying on business. He relied upon a decision of Gujarat High Court in the case of Saurashtra Cement & Chemical Industries Ltd. v. CIT : [1995]213ITR523(Guj) .

6. The learned counsel for the respondent assessee, however, submitted that no doubt in the earlier years the respondent assessee was claiming deduction on account of gratuity on the basis of actual payment but on account of subsequent development, ie., the notification dated 19-11-1971 issued by the State Govemment, the amount of gratuity became a statutory liability which had accrued during the relevant previous year. It was quantified on a scientific basis on the actuarial report and, therefore, it has to be allowed as a deduction. He further submitted that under section 40(a)(ii) of the Act any sum paid on account of rate or tax levied on the Profits or Gains of Business, is not allowed as a deduction. The interest paid for not depositing or paying the tax would not come under the aforesaid provisions and has, therefore, been rightly allowed as a deduction by the Tribunal. He relied upon the following decisions-

(i) Metal Box Co. of India Ltd. v. Their Workmen : (1969)ILLJ785SC

(ii) Madho Mahesh Sugar Mills (P) Ltd. v. CIT (1973) 92 ITR 503

(iii) Delhi Flour Mills Co. Ltd. v. CIT : [1974]95ITR151(Delhi)

(iv) TataIron & Steel Co. Ltd. v. D.V. Bapat, ITO : [1975]101ITR292(Bom)

(v) Addl. CIT v. Lakshmi Sugar Mills 1977 UPTC 31

(vi) CIT v. Laxmi Sugar & Oils Mills Ltd. : [1978]114ITR684(All)

(vii) CIT v. Warner Hindustan Ltd : [1985]151ITR701(AP) .

7. Having heard the learned counsel for the parties, we find that the Apex Court in the case of Metal Box Co. of India Ltd. (supra) had considered the question as to whether it is legitimate in such a scheme of gratuity to estimate the liability on an actuarial valuation and deduct such estimated liability in the profit and loss account

while working out its net profits, The Apex Court has held that in the case of an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principle of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid. The Apex Court has held that estimated liability for payment of gratuity based on actuarial valuation, was a permissible deduction. It had further held that such a liability was a liability in praesen ti though payable in future and it was ascertainable. The Apex Court has further held as follows:

'... But the contention was that though Schedule VI to the Companies Act may permit a provision for contingent liabilities, the Income Tax Act, 1961, does not, for, under section 36(v), the only deduction from profits and gains permissible is of a sum paid by an assessee as an employer by way of his contribution towards an approved gratuity fund created by him for the exclusive benefits of his employees under an irrevocable trust. This argument is plainly incorrect because section 36 deals with expenditure deductible from out of the taxable income already assessed and not with deductions which are to be made while making the profit and loss account. In our view, an estimated liability under gratuity schemes such as the ones before us even if it amounts to a contingent liability and is not a debt under the Wealth Tax Act, if properly ascertainable and its present value is fairly discounted is deductible from the gross receipts while preparing the profit and loss account. ...' (p. 67)

8. This court in the case of Madho Mahesh Sugar Mills (P) Ltd. (supra) has held that though no part of the gratuity may have been payable by the assessee in any of the earlier years, the past services of the employees had cto be taken into account merely to arrive at a quantum of the liability which became payable after the notification. The liability for payment of gratuity ascertained on actuarial calculation in which all contingencies are taken into consideration, is a liability in praesenti and is capable of ascertainment and, therefore was a permissible business expenditure in the assessment year concerned.'

9. In the case of Delhi Flour Mills Co. Ltd. (supra), the Delhi High Court has followed the decision of the Apex Court in the case of Metal Box Co. of India Ltd. (supra) and of this court in the case of Madho Mahesh Sugar Mills (P) Ltd. (supra) and had held that provision made by the assessee for payment of gratuity was an allowable deduction.

10. Similar view has been taken by the Bombay High Court in the case of Tata Iron & Steel Co. Ltd. (supra); this court in the case of Lakshmi Sugar Mills (supra) and Laxmi Sugar and Oils Mills Ltd. case (supra) and the Andhra Pradesh High Court in the case of Warner Hindustan Ltd (supra).

11. The Apex Court in the case of Shree Sajjan Mills Ltd. v. CIT : 1986ECR276(SC) , has summarized the position regarding allowability of the amount of gratuity prior to the insertion of section 40A(7) in the Act by the Finance Act, 1975, with effect from 1-4-1973, as follows:

'(1) Payments of gratuity actually made to the employee on his retirement or termination of his services were expenditure incurred for the purpose of business in the year in which the payments were made and allowed under section 37 of the Act.

(2) Provision made for payment of gratuity which would become due and payable in the previous year was allowed as an expenditure of the previous year on accrued basis when mercantile system was followed by the assessee.

(3) Provision made by setting aside an advance sum every year to meet the contingent liability and gratuity as and when it accrued by way of provision for gratuity or by way of reserve or fund for gratuity was not allowed as an expenditure of the year in which such sum was set apart.

(4) Contribution made to an approved gratuity fund in the previous year was allowed as deduction under section 36(1)(v).

(5) Provision made in the profit and loss account for the estimated present value of the contingent liability properly ascertained and discounted on an accrued basis as falling on the assessee in the year of account could be deductible either under

section 28 or section 37 of the Act.' (p. 599)

12. It is not in dispute that Dr. Sampurnanand Award which was made in the year 1961 was applicable initially for a period of one year. It was extended from year to year by the State Government by a separate notification. However, after 13-9-1971, the Award was not extended and only on 18-9-1971, the State Government had issued a notification extending the Award from 14-9-1971. The amount of gratuity in question is being claimed under the notification dated 19-11-1971, Dr. Sampurnanand Award under which there was the liability for payment of the amount of gratuity, had been in force during all the previous assessment years on account of extension by the State Government every year and it came to an end on 13-9-1971 as it was not extended after 13-9-1971. However, vide notification dated 18-9-1971, it was made applicable from 14-9-1971. The scheme of gratuity framed under Dr. Sampurnanand Award as an annual affair as its operation was initially for a period of one year and had been extended every year whereas the gratuity scheme enforced on 19-11-1971, vide Notification No. 4268, dated 19-11-1971, was for a period of 3 years. The provisions of the two schemes have been found to be similar. It may be mentioned here that the Payment of Gratuity Act, 1972 came into force on 16-9-1972 and, therefore, was not in existence during the assessment year in question. Thus, the same principle regarding payment of gratuity would be applicable with the exception that liability for payment of gratuity which had accrued during the assessment in question but had not been paid to the employees being a liability in praesenti is to be allowed as a deduction while computing the profits and gains from business of the respondent. However, the amount of gratuity which relates to the earlier assessment years, had accrued in the earlier years and not in the assessment year in question and, therefore, it cannot be allowed as a deduction in this year.

13. There is a distinction between the actual liability in praesenti and a liability de futuro which for the time being is only contingent. The former is taxable but not the latter as held in Peter Merchant Ltd. v. Stedeford (1948) 30 Tax Cas. 496 Indian Copper Corpn. v. CIT : [1977]110ITR434(Patna) CIT v. Instrumentation Ltd. (1987) 167 ITR 3541 Standard Mills Co. Ltd. v. CIT : [1998]229ITR366(Bom) . It is also settled that an assessee who follows the mercantile system of accounting, is

entitled to claim a deduction even though the expenditure is actually not expended. It is enough if the liability for such expenditure accrues. If in law the liability accrued, this accrual will not be defeated or fail by a reason of the assessee not making entries in the books of account as held in the case of Kedarnath Juie Mfg. Co. Ltd. v. CIT : [1971]82ITR363(SC) . It is also well settled that if a business liability has definitely arisen in the accounting year, a deduction should be allowed although the liability may have to be estimated and discharged at a future date, as held in the case of Poona Electric Supply Co. Ltd. v. CIT : [1965]57ITR521(SC) , Kundan Sugar Mills v. CIT : [1977]106ITR704(All) and Metal Box Co. of India Ltd. v. Their Workmen : (1969)ILLJ785SC . At the same time, if the liability to a particular sum has been incurred during the accounting year and if otherwise the sum is allowable as a revenue expense, then whether the sum has been actually paid or not is immaterial; the liability so incurred has got to be allowed as a revenue expense, as held by the Apex Court in the case of Haji Lal Mohd. Biri Works v. CIT : [1997]224ITR591(SC) . It is also well settled that in the case of a statutory liability, the accrual depends upon the term of the statute. The quantification or ascertainment cannot postpone its accrual to the extent of admitted liability, as held in the case of CIT v. L.H. Sugar Factory & Oil Mills (P) Ltd. (1978) CTR (All.) 211 CIT v. Swadeshi Mining & Mfg. Co. Ltd. : [1978]112ITR276(Cal) CIT v. Swadeshi Mining & Mfg. Co. Ltd. : [1979]118ITR975(Cal) CIT v. Shri Sarvaraya Sugars Ltd. : [1987]163ITR429(AP) CIT v. Aggarwal Rice & General Mills CIT v. Ram Chand Kanshi Ram Where a statute imposes liability with retrospective effect such liability, even or past years accrues in the accounting year wherein the statute first comes into operation, as held by the Calcutta High Court in the case of CIT v. West Ghusick Coal Co. Ltd. : [1981]129ITR62(Cal) . Further it is not in all cases correct to say that a statutory liability created in a particular year becomes liability for deduction in that year under the mercantile system of accounting. It depends on the facts and circumstances of the case and on statutory provisions in that regard, as held by the Calcutta High Court in the case of CIT v. Padmavati Raje Cotton Mills Ltd. : [1993]203ITR375(Cal) . In the aforesaid case an ordinance levying market fees was promulgated on 15-5-1980. The demand for the market fees relating to earlier years was made during the accounting year relevant to the assessment year

1983-84. On these facts, it has been held that though the statutory liability was created in the year 1980, the said liability became real and enforceable when the demand was made. Therefore, the assessee was held entitled to deduction in respect of such demand for the assessment year 1983-84.

14. Thus, applying the principles laid down by the Apex Court in the aforementioned cases the amount of gratuity can be deducted either under section 28 or section 37 of the Act. Further, the contribution made to an approved gratuity fund is only allowable under section 36(1)(v) of the Act. Thus, the Tribunal was justified in allowing the amount of Rs. 12,45,428, being the amount of gratuity, as deduction for the assessment year in question as the said liability has been ascertained on actuard calculation and it is a liability in praesenti and was a permissible business expenditure. However, the Tribunal was not justified in allowing the suni of Rs. 16,45,092 towards gratuity as the said liability did not accrue in the previous year relevant to the assessment year in question and related to the earlier years when Dr. Sampumanand Award was in force.

15. So far the question of allowance of interest of Rs. 28,460 is concerned it may be mentioned here that under section 37 of the Act an expenditure laid out or expended wholly or exclusively for the purpose of business which is not of the nature described under sections 33 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee, is allowable while computing the income chargeable under the head Profits and Gains of Business or Profession. Section 40(a)(ii) of the Act, however, provides that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession, shall not be deducted in computing the income chargeable under the head Profits and Gains of Business or Profession. Section 40 of the Act opens with a non obstante clause. It specifically refers to notwithstanding anything to the contrary in sections 33 to 38. Even otherwise, income-tax is not deductible as business expenses from the business profit as it is merely a State share of the profits as held in Ashton v. Att. Gen. (1906) AC 10LC v. G.B. Ollivant (1945) 13 ITR (Suppl.) 23 IR v. Dowdall 33 TC 259 Allen v. Farquharson 17 TC 59.

16. Interest on account of deficiency in payment of advance tax or on account of delay in payment of tax or in the filing of the return of income, on the money borrowed for payment of income-tax is neither deductible as business expenses under section 37 nor as interest on borrowings under section 36(1)(iii) of the Act, as held in the case of Aruna Mills Ltd. v. CIT : [1957]31ITR153(Bom) Balmer Lawrie & Co. Ltd. v. CIT : [1960]39ITR751(Cal) Maharajadhiraj Sir Kameshwar Singh v. CIT : [1961]42ITR774(Patna) ; Mannalal Ratan lal v. CIT : [1965]58ITR84(Cal) CIT v. Oriental Carpet Mfrs. (India) (P) Ltd. Gopaldas Dahyabhai Lavsi v. CIT : [1977]108ITR531(Guj) Waldies Ltd. v. CIT : [1977]110ITR577(Cal) National Engg. Industries Ltd. v. CIT : [1978]113ITR252(Cal) Kishinchand Chellaram v. CIT : [1978]114ITR654(Bom) CIT v. Om Prakash Behl CIT v. International Instruments (P) Ltd. : [1983]144ITR936(KAR) Smt. Padmavati Jaikrishna v. Addl. CIT (1987) 166 ITR 176 3 CIT v. Ghiatkopar Estate & Finance Corpn. (P) Ltd. : [1989]177ITR222(Bom) FederalBank Ltd. v. CIT (1989) 180 ITR 371 Assam Forest Products (P) Ltd. v. CIT Orient General Industries Ltd. v. CIT : [1994]209ITR490(Cal) and Bharat Commerce & Industries Ltd. v. CIT : [1998]230ITR733(SC)

17. In the case of Saurashtra Cement & Chemical Industries Ltd. (supra), the Gujarat High Court has held that the interest paid on late payment of income-tax is not an allowable deduction. it has held as follows:

'The argument apparently appears to be facile but does not stand scrutiny of reason. The mere fact that the interest on the late payment of the tax is compensatory does not make it an expense wholly or exclusively carried out for the purpose of business. The essence of section 37 of the Act is that such expenses are wholly laid out or incurred for the purpose of business. If the preliminary liability to be discharged by the assessee is not allowable as expenses laid out or incurred for the purpose of business, ordinarily the interest paid thereon also cannot be considered as expenses laid out or incurred wholly for the purpose of the business.... However, in the present case, the interest is payable on the personal liability of the assessee of the income-tax which is a direct tax and is not

a part of the business expenditure. In this connection, it may further be noticed that interest on money borrowed for the payment of the tax was held to be not an allowable expenditure. Reference in this connection be made to the decision of the Supreme Court in the case of Padmavati Jaikrishna (Smt) v. AddL. CIT : [1987]166ITR176(SC) . The Supreme Court affirming the decision of this court in Padmavati Jaikrishna (Smt.) v. CIT : [1975]101ITR153(Guj) disallowing the claim for deduction of interest on the amounts borrowed to pay taxes and annuity deposits held as under (at page 179):

'We are inclined to agree with the High Court that so far as meeting the liability of income-tax and wealth-tax is concerned it was indeed a personal one and payment thereof cannot at all be said to be expenditure laid out or expended wholly or exclusively for the purpose of earning income.'

'It may be noted that specific provision was required to be inserted in the form of section 80V for the purpose of allowing of such interest as expenditure in the computation of profits and gains from business. But for the special provision made, interest on the capital borrowed for the payment of tax is not allowable expenditure. If that be so on the same principal the interest paid for the late payment of tax cannot be held allowable expenditure as the same cannot be held to be expenditure incurred wholly or exclusively for the purpose of the business...' (p. 529)

18. We are in respectful agreement with the principles laid down in the aforementioned cases and are of the considered view that interest on late payment of income-tax is not an allowable deduction while computing the profits and gains from business or profession. In view of the foregoing discussions, we are of considered opinion that the interest on late payment of income-tax/ advance tax or self-assessment tax or any other direct tax cannot be allowed as a deduction.

19. In view of the foregoing discussions, our answer to the question Nos. 1 to 3 and 6 are in the negative, i.e., in favour of the revenue and against the assessee and our answer to question No. 5 is in the affirmative i.e., in favour of the assessee and against the revenue. So far question No. 4 is concerned the amount

of Rs. 16,45,092 was not allowable in the assessment year 1972-73. However, there was no bar during the assessment year 1972-73 for claiming the deduction of gratuity under section 37 of the Act even if the conditions of section 36(i)(v) of the Act have not been complied with. Thus, our answer to question No. 4 is also in the negative, i.e., in favour of the revenue and against the assessee. In view of the divided success, the parties shall bear their own costs.

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