Bharat Earth Movers vs Commissioner Of Income Tax, Karnataka on 9 August, 2000

Author: R.C. Lahoti

Bench: R.C.Lahoti, N.S.Hegde

CASE NO.:
Appeal (civil) 9271 of 1995

PETITIONER:
BHARAT EARTH MOVERS

Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAX, KARNATAKA

DATE OF JUDGMENT: 09/08/2000

BENCH:
R.C.Lahoti,N.S.Hegde

JUDGMENT:

R.C. Lahoti, J.

L.....I.....T.....T.....T.....T.....T..J Relevant to the assessment year 1978-1979 the following question of law was stated, at the instance of the Revenue, by the Income Tax Appellate Tribunal for the opinion of the High Court of Karnataka under Section 256 (1) of the Income-tax Act, 1961:-

> Whether on the facts and in the circumstances of the case the provision for meeting the liability for encashment of earned leave by the employee is an admissible deduction?
>
> The appellant company has two sets of employees. One set of employees is covered by Employees State Insurance Scheme and is generally known as staff. The other set of employees not so covered is known generally as officers. The company has floated beneficial schemes for its employees for encashment of leave. The officers are entitled to earned leave calculated at the rate of 2.5 days per month, i.e., 30 days per year. The staff (other than officers) is entitled to vacation leave calculated at the rate of 1.5 days per month, i.e., 18 days in a year. The earned leave can be accumulated upto 240 days

maximum while the vacation leave can be accumulated upto 126 days maximum. The earned leave/vacation leave can be encashed subject to the ceiling on accumulation. The officers may at their option avail the accumulated leave or in lieu of availing the leave apply for encashment whereupon they would be paid salary for the period of leave earned but not availed. So does the scheme extend facility of encashment to the staff in respect of vacation leave. Any leave earned beyond the said ceiling limit of 240/126 days cannot be accumulated and goes a waste. It can neither be availed nor encashed. The appellant company has created a fund by making a provision for meeting its libility arising on account of the accumulated earned/vacation leave. In the assessment year 1978-1979 an amount of Rs.62,25,483/- was set apart in a separate account as provision for encashment of accrued leave. It was claimed as a deduction. In the opinion of the Tribunal the assessee was entitled to such deduction. The High Court has formed a different opinion and held that the provision for accrued leave salary was a contingent liability and therefore was not a permissible deduction. The reasoning applied by the High Court is that the liability will arise only if an employee may not go on leave and instead apply for encashment. If the employee avails the leave as per his entitlement, then he would be paid salary for the period of leave and liability for encashment would not arise. The other event on the occurrence of which the employee may stake his claim is termination or retirement which again is an uncertainty. Accordingly the High Court has answered the question in the negative, that is, in favour of the Revenue and against the assessee. The assessee has come up in appeal.

Shri S.E. Dastur, the learned senior advocate for the appellant company has submitted that the liability is a certainty. Provision is made for meeting the liability to the extent of entitlement of the officers and staff to accumulate earned/vacation leave subject to the ceiling limit of 240/126 days as may be applicable. Having accumulated leave in a particular year, in the succeeding year the employee may either avail the leave or apply for its encashment. If he avails the leave then additional provision for encashment is not made in the reserve account. However, if he does not avail the leave and instead chooses to encash his entitlement, he becomes entitled to an additional number of days as accumulated leave. For example, having rendered service for 365 days in the year A an officer becomes entitled to avail leave for 30 days in the succeeding year B, provision in the leave reserve account is made in the year A for payment of an amount equivalent to 30 days salary so as to meet the claim for encashment. If he chooses to encash the leave and renders service for full 365 days in the year B, then the amount transferred to reserve is paid to him and in view of his having earned again the next entitlement for 30 days leave, provision is made therefor by transferring the appropriate amount in the reserve account. If he avails the leave then he is paid the leave salary. The leave salary is paid from the reserve. Whether the amount is paid as salary by drawing upon from the current years P&L Account or from the reserve, it would not make any difference in practice as there would be no double payment and hence no double claim for deduction. In either case the liability is certain though the period in which the liability would be incurred is not

certain inasmuch as the leave encashment can be sought for by the employee either during the years of service or at the end of the service. Subject to the ceiling every employee would either avail the leave or seek encashment and therefore the liability is a certainty; it cannot be called a contingent liability. We find substance in the submission of the learned senior counsel for the appellant.

The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain.

In Metal Box Company of India Ltd. Vs. Their Workmen (1969) 73 ITR 53 the appellant company estimated its liability under two gratuity schemes framed by the company and the amount of liability was deducted from the gross receipts in the P&L account. The company had worked out on an actuarial valuation its estimated liability and made provision for such liability not all at once but spread over a number of years. The practice followed by the company was that every year the company worked out the additional liability incurred by it on the employees putting in every additional year of service. The gratuity was payable on the termination of an employees service either due to retirement, death or termination of service - the exact time of occurrence of the latter two events being not determinable with exactitude before hand. A few principles were laid down by this court, the relevant of which for our purpose are extracted and reproduced as under :- (i) For 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 principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid; (ii) Just as receipts, though not actual receipts but accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business; (iii) A condition subsequent, the fulfillment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability; (iv) A trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated.

So is the view taken in Calcutta Co. Ltd. Vs. Commissioner of Income-Tax, West Bengal (1959) 37 ITR 1 wherein this court has held that the liability on the assessee having been imported, the liability

would be an accrued liability and would not convert into a conditional one merely because the liability was to be discharged at a future date. There may be some difficulty in the estimation thereof but that would not convert the accrued liability into a conditional one; it was always open to the tax authorities concerned to arrive at a proper estimate of the liability having regard to all the circumstances of the case.

Applying the above-said settled principles to the facts of the case at hand we are satisfied that provision made by the appellant company for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by employees of the company, inclusive of the officers and the staff, subject to the ceiling on accumulation as applicable on the relevant date, is entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The liability is not a contingent liability. The High Court was not right in taking the view to the contrary.

The appeal is allowed. The judgment under appeal is set aside. The question referred by the Tribunal to the High Court is answered in the affirmative, i.e. in favour of the assessee and against the Revenue.

Before parting we would like to observe that when this appeal came up for hearing on 24.3.1999 we felt some difficulty in proceeding to answer the question arising for decision because the orders of the authorities below and of the Tribunal did not indicate how the leave account was operated by the appellants and leave salary provision was made. To appreciate the facts correctly and in that light to settle the law we had directed the Income Tax Appellate Tribunal to frame a supplementary statement of case based on books of account and other relevant contemporaneous records of the appellant which direction was to be complied with within a period of six months. The hearing was adjourned sine die. After a lapse of sixteen months the matter was listed before the court on 20.7.2000. The only communication received by this court from the Tribunal was a letter dated 20th June, 2000 asking for another six months time to submit the supplementary statement of case which prayer being unreasonable, was declined. Under Section 258 of the Income Tax Act, 1961, the High Court or the Supreme Court have been empowered to call for supplementary statement of case when they find the one already before it not satisfactory. Article 144 of the Constitution obliges all authorities, civil and judicial, in the territory of India to act in aid of Supreme Court. Failure to comply with the directions of this court by the Tribunal has to be deplored. We expect the Tribunal to be more responsive and more sensitive to the directions of this Court. We leave this aspect in this case by making only this observation.

We have culled out the necessary facts stated in the earlier part of this judgment from the statement of facts filed by the assessee appellant before the Income-Tax Appellate Tribunal. The correctness of the requisite factual information relating to the leave encashment scheme, as stated in the said statement, does not appear to have been disputed before the Tribunal and was not disputed before this court too.

. . .. .J. (S.P.Bharucha)