Polyflex (India) Pvt. Ltd vs Commissioner Of Income Tax, Karnataka on 6 September, 2002

Equivalent citations: AIR 2002 SUPREME COURT 3145, 2002 AIR SCW 3630, 2002 AIR - KANT. H. C. R. 2407, 2003 TAX. L. R. 95, 2002 (9) SRJ 61, (2002) 6 JT 528 (SC), (2002) 124 TAXMAN 373, (2002) 6 SCALE 231, 2002 (5) SLT 171, 2002 (6) SCALE 230, 2002 (3) LRI 802, 2002 (7) SCC 188, (2002) 257 ITR 343, (2002) 4 SCJ 168, (2002) 171 TAXATION 183, (2002) 6 SUPREME 210, (2002) 177 CURTAXREP 93

Author: P. Venkatarama Reddi

Bench: S. Rajendra Babu, K.G. Balakrishnan, P. Venkatarama Reddi

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           CASE NO.:
Appeal (civil)  823 of 2001

PETITIONER:
POLYFLEX (INDIA) PVT. LTD.

RESPONDENT:
COMMISSIONER OF INCOME TAX, KARNATAKA

DATE OF JUDGMENT: 06/09/2002

BENCH:
S. RAJENDRA BABU & K.G. BALAKRISHNAN & P. VENKATARAMA REDDI

JUDGMENT:
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JUDGMENT 2002 Supp(2) SCR 123 The Judgment of the Court was delivered by P. VENKATARAMA REDDI, J. In this appeal by Special Leave, the question of applicability of Section 41(1) of the Income Tax Act to the case on hand arises for consideration.

For the assessment year 1989-1990, a sum of Rs. 9,64,206 which is the amount of excise duty refunded by the department was brought to tax by invoking Section 41(1) of the Income Tax Act (for short 'Act'). It appears that the excise duty was paid in the year 1986. On appeal, the first Appellate Authority as well as CEGAT held that the goods were not liable to duty. On 20.9.1988, the excise duty was refunded. On appeal filed to the High Court, it was dismissed. Thereafter, the Excise Department filed SLP in this Court. The fate of the SLP is not known. The appellant contended before the first Appellate Authority that there was no remission or cessation of trading liability within the meaning of Section 41(1) so long as the issue was pending determination by the Supreme Court. That contention was accepted and the appeal was allowed. The appeal filed by the Income Tax Department against the said order was also dismissed. On a reference application filed by the

Commissioner of Income Tax, the Tribunal referred the following question of law for the opinion of the High Court of Karnataka:

> "Whether on the facts and in the circumstances of the case the Tribunal is right in law in holding that excise duty refund is not assessable under Section 41(1) of the I.T. Act."

The High Court held that the Tribunal was not right in holding that the refunded amount was not assessable under Section 41(1) of the Act. However, the High Court observed that the Tribunal may consider the question whether the excise duty was actually refunded to the assessee or not and pass appropriate orders in the light of its finding. This observation was made after referring to the argument of the assessee's counsel that the amount has not been received by the assessee. In coming to the conclusion that the excise duty refunded was liable to be taxed under Section 41(1) of the Act, the High Court relied on the decision of this Court in C/T. v. Thirumalaiswamy Naidu and Sons, 230 ITR 534. This view of the High Court has been questioned in this appeal.

The learned counsel for the appellant - assessee submits that the ratio of decision of this Court in Thirumalaswamy Naidu' case, on which the opinion of the High Court rests, has no application to the present case. As the question of liability to pay excise duty on the goods has not been settled finally during the assessment year in which the refund was obtained, Section 41(1) is not attracted, according to the learned counsel. It is contended, as was contended before the Appellate Authorities and the High Court, that there was no cessation of liability as per Section 41(1) as the issue was pending final adjudication and, therefore, the refunded amount does not form part of the deemed income of the year 1989-90.

It is true that in Thirumalaiswamy Naidu's case the question of interpretation or applicability of any particular limb of Section 41(1) of the Act did not specifically fall for consideration. However, this Court did make it clear that when the assessee actually made payment towards statutory levy (sales tax) and later got back the amount by way of refund as a sequel to the judgment of the High Court, it becomes a revenue receipt and in such a situation, Section 41(1) is clearly attracted. The following are the crucial observations in the judgment:

> "The entire amount of sale turnover of the assessee inclusive of the amount of tax collected was clearly includible in the assessee's taxable income. If any deduction was given from that income and later the same was refunded back to the assessee, the refund will have the character of revenue receipt. It has to be treated as a receipt on the revenue account and has to be assessed as such. The position has been placed beyond doubt by the express provisions of section 41(1) of the Income-tax Act. "

(Emphasis supplied) Though there is no elaborate discussion as regards applicability of Section 41(1) of the Act the Court did refer to and rely on that provision in support of its conclusion.

Section 41(1), as it stood at the relevant time reads as follows:

> "41(1) Profits chargeable to tax: Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee, and subsequently during any previous year the assessee has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit accruing to him, shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not."

Section 41(1) applies if the following conditions and circumstances are satisfied:

> In the assessment for the relevant year an allowance or deduction has been made in respect of any loss, expenditure or trading liability incurred by the assessee. This is the first step. Corning to the next step the assessee must have subsequently (i) obtained any amount in respect of such loss or expenditure or (ii) obtained any benefit in respect of such trading liability by way of remission or cessation thereof. In case either of these events happen, the deeming provision enacted in the closing part of sub- section (1) comes into play. Accordingly, the amount obtained by the assessee or the value of benefit accruing to him is deemed to be profits and gains of business or profession and it becomes chargeable to income-tax as the income of that previous year.
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> We are of the view, apart from what has been laid down in Thirumalaiswamy Naidu's case (supra), that the ingredients of Section 41(1) are satisfied in the instant case and, therefore, the amount of excise duty refunded becomes taxable during the year in question. This is a case in which the assessee can be said to have obtained the amount by way of refund in respect of the business expenditure incurred by it during an earlier year, for which the assessee had the benefit of deduction or allowance. Normally, the payment of certain amount to discharge the statutory levy such as sales tax, excise duty in the course of carrying on business is an expenditure. If authority is needed, we may refer to Kedar Nath Jute Manufacturing Co. v. C.I.T., 82 ITR 363 wherein this Court held that the amount of sales tax paid or payable by the assessee is an expenditure within the meaning of Section 10(ii)(xv) of the Act.
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> We are inclined to think that in a case where a statutory levy in respect of goods dealt in by the assessee is discharged and subsequently the amount paid is refunded, it is the first clause that more appropriately applies. U will not be a case of benefit accruing to him on account of cessation or remission of trading liability. U will be a case which squarely falls under the earlier clause, namely, "obtained any amount in respect of such expenditure". In other words, where expenditure is actually incurred by reason of payment of duty on goods and the deduction or allowance had been given in the assessment for earlier period, the assessee is liable to disgorge that

benefit as and when he obtains refund of the amount so paid. The consideration whether there is a possibility of the refund being set at naught on a future date will not be a relevant consideration. Once the assessee gets back the amount which was claimed and allowed as business expenditure during the earlier year, the deeming provision in Section 41(1) of the Act comes into play and it is not necessary that the Revenue should await the verdict of higher Court or Tribunal. If the Court or Tribunal upholds the levy at a later date, the assessee will not be without remedy to get back the relief.

True expenditure and trading liability may be over-lapping concepts, but the law-makers apparently intended to deal with allied concepts separately and specifically so as to make the provision as comprehensive as possible in order to effectuate the objective underlying the provision. The anatomy of the Section and the collocation of the words employed therein would suggest that the test of cessation or remission of liability has to be applied vis-a-vis trading liability and it cannot be projected into the previous clause.

The typical example of remission or cessation of trading liability is to be found in the recent decision rendered by us in Chief Commissioner of Income Tax v. Kesaria Tea Co. Ltd, [2002] 3 SCC 684. In that case the assessee made a provision in the books of account towards purchase tax liability which was in dispute. Under the impression that the dispute was finally settled with the dismissal of SLP in some other case, the assessee thought it fit to reverse the provision made earlier and accordingly 'wrote back' in its accounts the sums for which the provision was made during earlier years towards purchase tax. It was sought to be taxed by the Income-tax department treating the same as the income of the year during which such reversal of entries was made. However, the Tribunal (with which the High Court agreed) held on facts that the issue regarding the exigibility of purchase tax still remained notwithstanding the holding of the High Court on a part of the controversy relevant to the issue. Even reassessment proceedings were pending. It was, therefore, held that the liability did not cease during the year in question. This Court affirmed the view taken by the High Court of Kerala. It may be seen that unlike the present case, there was no actual refund as no amount towards purchase tax was paid but only a provision towards liability was made in the books of account. Another case which is illustrative of the point is the decision of Allahabad High Court in Rameshwar Prasad v. V.K. Arora, 141 1TR 763. In that case the assessee, who was following the mercantile system of accounting was allowed deduction in respect of its liability towards excise duty. The assessee, however, filed writ petition disputing its liability to pay the duty. During the pendency of the writ petition, the excise duty amount was deposited with the Court, The writ petition was ultimately allowed and the amount deposited by way of security was refunded to the petitioner. However, that decision of the High Court did not become final as the State went in appeal to the Supreme Court. Therefore, the assessee still treated the security deposit amount received from the Court as a possible liability and objected to its inclusion in the taxable income under Section 41

(1). The High Court held as follows:

> "The excise duty had been deposited by the petitioner in the court itself and that amount was directed to be refunded to it. The amount, therefore was refunded to the petitioner by the court and not by the State Govt. It is also not correct for the ITO to state that there is no present liability existing against the assessee. It is clear, therefore, that since the assessee followed the mercantile system of accounting, it was allowed deduction in respect of its liability to excise duty. The petitioner challenged its liability to pay the excise duty and during the pendency of the writ petition deposited the excise duty in the court. That payment was not by way of discharge of the liability but was only by way of security and when the writ petition was allowed by the court the amount was refunded to the petitioner. It was not, therefore, a case where an allowance had been made in respect of any expenditure incurred by it or reimbursement of the expenditure subsequently. It was an allowance in respect of a trading liability and in view of the fact that the decision of this court has not become final and is the subject-matter of appeals before the Supreme Court, there has been no remission or cessation of the liability so as to attract s.41 (1) of the Act"

The High Court correctly appreciated the scope of Section 41 (I) and applied the second limb of the sub-section to the fact situation. It may be noted that assessee did neither pay the excise duty to the Government nor did it get refund of duty from the concerned authority. Notwithstanding the High Court 's judgment in favour of the petitioner, the stage had not yet reached when it can be said that the liability for which allowance was given earlier ceased. The view taken by the High Court in substance is that the benefit in respect of the trading liability would accrue only when the liability definitely ceased after the termination of the proceedings in the Apex Court in favour of the petitioner. This very decision of the Allahabad High Court was relied upon by the Tribunal without appreciating the correct ratio of decision.

Our attention has been drawn by the learned counsel for the appellant to the case of Union of India v. J.K. Synthetics Ltd., 199 ITR 14. One of the points urged before the Court was whether the assessee's liability towards excise duty had ceased justifying action under Section 41 (1). This Court, while affirming the view taken by the High Court .observed thus:

> "So far as the second question is concerned, it is obvious that the liability to tax under section 41 of the Act will depend on the outcome of the appeal before this court. It is also stated that, as regards another part of the liability, the issue is pending before the Tribunal. It would, therefore, appear that no cessation of liability can be postulated until the tribunal has decided the matter"

The relevant facts are not mentioned in the judgment. The question whether the latter or earlier clause of section 41(1) applies did not arise for consideration in that case. The decision of the High Court which was the subject matter of appeal 4n this Court is reported in J.K. Synthetics Ltd., v. I.T.O., AH 105 ITR 684. From the facts stated therein it appears that there was no actual payment of duty nor any refund obtained by the assessee. The assessee-company was making provision in the

books of account in respect of excise duty payable while disputing the liability to pay duty. Deduction was allowed for various assessment years. The writ petition filed by the assessee-company contesting the demands relating to excise duty was allowed by the High Court However, the Excise Department preferred Letters Patent Appeal against the order in the writ petition. While so, based on the decision of the writ petition, the I.T.O. took steps to disallow the deduction allowed earlier and further disallowed the claim for the current year. Questioning the addition to the income of the relevant previous year, the assessee company filed writ petition which was allowed by the High Court. The facts of the case are quite close to Remeshwar Prasad's case (supra). The following observations in the judgment may be noted as they clearly reveal the fact situation in that case:

> "The company, no doubt, is still resisting the claim of the excise authorities, but this fact does not debar the company from claiming deduction on account of the excise duty being demanded from it and for which the company had made provision in its books of accounts. The company is following the mercantile system of accounting and it can legitimately claim deduction in respect of a business liability even if such liability has not been quantified or paid."

The High Court then held that the liability of the assessee as regards the payment of excise duty can no t be said to have ceased because the judgment of the Single Judge of the High Court did not attain finality.

Though, the conclusion of the High Court which was affirmed by this Court cannot be legally faulted, we cannot however approve of the following analysis of the Section occurring in the judgment: "in short, what this provision means is that if an assesee has been allowed a deduction in the computation of its total income of any liability on account of loss or expenditure and if, subsequently, the liability of the assessee on account of such loss or expenditure is remitted or ceases, that part of the liability which is remitted or ceases shall be treated to be the income of the assessee of the previous year in which such remission or cessation takes place." The High Court proceeded on the assumption that the words 'remission and cessation thereof could be transposed into the first clause which speaks of obtaining any amount in respect of loss or expenditure. The High Court could have merely said that the trading liability provided for in the books of account and for which deduction was allowed earlier did not cease in view of the pendency of the dispute. Instead, the High Court referred to the expression "loss or expenditure" occurring in the first limb'. As the assessee company did not obtain any amount by way of refund on excise duty account, the first clause of Section 41(1) will not be applicable; it is only the latter part that applies in which case the remission or cessation of liability would assume importance. However, in the present case, as discussed above, it is the first clause that squarely applies but not the second one. Whether there was cessation or remission of liability would be an irrelevant line of enquiry here. The correct way of understanding Section 41(1) would be to read the latter clause -"some benefit in respect of such trading liability by way of remission or cessation thereof as a distinct and self-contained provision. To read the phrase "by way of remission or cessation thereof as governing the previous clause as well, i.e. "obtained any amount in respect of such loss or expenditure", would be doing violence to the language and structure of the provision. That apart, the operation of the provision which is

designed to have widest amplitude will get constricted and truncated by reason of such interpretation. Learned counsel for the appellant has also relied on a decision of the Gujarat High Court V.T. Audyogik Sahakari Mandi Ltd. v. C.I.T., 242 ITR 627. That decision prima fade supports the appellant. The learned Judges proceeded on the basis that in all situations falling under section 41(1) the test whether there was remission or cessation of trading liability has to be applied, and therefore, concluded that even if the amount of refund is received, section 41(1) cannot be invoked so long as there is no final decision on the question of legality of levy. To reach such a conclusion, the decision in J. K. Synthetics's case (supra) and Rameshwar Prasad's case (supra) were relied upon. We have already explained the ratio of those decisions. Another case on which strong reliance was placed by the learned Judges is the judgment of the Full Bench in C.I.T. v. Bharat Iron and Steel Industries, 199 ITR 67. In the said Full Bench decision, though the discussion by and large proceeded on right lines, we find that the actual decision reached in the concluding para is based on a wrong interpretation of the provision. The Full Bench was of the view that the assessee's claim for refund of excise duty was in jeopardy in view of the pending revisional proceeding although the assessee obtained refund. The assessee received the refund of excise duty on 8.8.1975. The High Court took the view that the assessee obtained the refund only on 30.4.1976 when the proposed revision was withdrawn. It was therefore held that the refunded amount became includible in the assessee' s total income for the assessment year 1976-1977 under section 41(1) of the Act, but not for the assessment year 1974-1975. The expression obtained any amount' was virtually given an interpretation which is contrary to its plain meaning. However, it must be noted that the High Court rightly avoided reference to the expression' remission or cessation thereof.

With respect, we are unable to accept the view taken by Gujarat High Court in the two decisions afore- mentioned as correct.

The decision of Karnataka High Court in K.G. Subramanyam v. C.l.T., 195 ITR 199 is quite apposite in the context of present case. The State of Karnataka levied 'litre fee' which is in the nature of a duty of excise. The levy was challenged by the assessee. Pending such challenge, the assessee paid the litre fee which was allowed as deduction while computing the assessee' s income. Later on the levy of litre fee was declared as unconstitutional and the fee collected was refunded to the assessee. Relying on Section 41 (1), the refunded amount was subjected to tax treating it as income of the year during which refund was obtained. The Tribunal and the High Court held that Section 41 (I) was attracted and the Revenue was well justified in assessing the same. The High Court held that the payment in discharge of statutory liability incurred while earning the income is an expenditure and even if it is possible in some cases that such payment is liable to be excluded from the income as a liability incurred in the course of trade, it does not detract from its character as expenditure. It was, therefore, held, "We have no hesitation that the deduction given to the assessee in respect of the litre fee paid by him was by way of an expenditure, therefore, the amounts refunded on the levy being held unconstitutional were the amounts received by him in respect of the said expenditure and such receipts are liable to be taxed under section 41 (1)"

> The High Court observed that on the facts of that case, the question of cessation or remission of liability did not arise for consideration at all. We are in agreement with the view expressed by the Karnataka High Court.

In the light of the above discussion we find no merit in the appeal, though we must say that the order under appeal is cryptic and the short reasoning recorded therein is inaccurate. The appeal is dismissed without costs.