Calcutta High Court
Kedarnath Jute Manufacturing Co. ... vs Commissioner Of Income-Tax ... on 24 August, 1966
Equivalent citations: AIR 1968 Cal 19, 1968 67 ITR 56 Cal
Author: P Mukharji
Bench: P Mukharji, C Laik
JUDGMENT P.B. Mukharji, J.

1. In this Income-tax Reference under Section 66 (1) of the Indian Income-tax Act, the Tribunal referred the following question for determination by this Court.

"Whether, on the facts and 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?"

2. The facts giving rise to this ques-tion may be set out briefly. The assessee is the Kedarnath Jute Manufacturing Co Ltd. of 13 Syed Sally Lane. Calcutta. It is a public limited company doing business in jute and jute goods manufacturing. The relevant previous year ended on the 31st December 1954. It followed the mercantile system of accounting. For the assessment year the assessee revised his return by claiming a reduction of Rs 1,49,776 on account of sales tax determined to he payable on the sales account during the relevant accounting year 2-A. The assessee's total sales during the year amounted to Rs 71,01,566 The assesses disclosed a total turn over of Rs 70, 99.928 in its sales tax return for the period ending on the 31st December, 1954. The Sales-tax Act provided for exemptions in respect of sales made to registered dealers and on that principle the Sales Tax Officer excluded a sum of Rs. 39.04,492 from sales-tax on the ground that such sales were to registered dealers. The remaining balance amount of Rs 31,95,436 was held to be taxable turn over liable to sales-tax, and it is on this turn-over that thr sales-tax was determined at Rupees 1,49,776.

3. It must also be noticed here on the facts that the demand notice for the sales-tax was served on the 21st November 1957. The original return for the income-tax was filed by the assessee on the 12th January, 1956 Against the assessment of sales-tax the ussessce moved this Court by a writ. The assessee's writ petition was dismissed by the High Court on the 17th August, 1961. Then followed the certificate proceedings initiated by the Sales-tax Department for realisation of the amount of sales-tax due and the necessary certificate was forwarded to the Certificate Officer and Additional District Magistrate, 24 Parganas for necessary action While the Certificate Proceeding was pending before the Certificate authorities, income-tax assessment was taken up and completed on the 11th March. 1960 Income-lax Officer refected the assessce's claim for deduction of the sales-tax on the ground that the assessee had denied its liability to pay the sales-tax and was contesting its liability to pay not only by the writ petition which was dismissed but also by objections to the Certficate Proceedings which are pending. It must also be noted as a fact that the assessee was found to have made no provision with regard to the liability for sales-tax in its books.

4. The assessee appealed from the order of the income-tax Officer to the Appellate Assistant Commissioner who rejected the as-sessee's appeal on the same ground as the Income-tax Officer on the 5th September, 1960. Thereafter the assessee appealed to the Tribunal Before the Tribunal the assessec's contention was that the legal liability for sales-tax accrued when the sales were made and

therefore although the quantification of the tax came later yet because the liability to the sales-tax related to business profits of the previous year, deduction for the sales-tax should have been allowed during the relevant assessment year.

5. The Tribunal rejected the asscssee'a appeal. Reasons of the Tribunal for such rejection were that although the assessee followed the mercantile svstem of accounl ing yet even under that svstem of accountancy only that expenditure was permissible deduction which was in the nature of accrued liability But in this case the liability to sales-tax under the West Bengal Sales Act was an unascertained liability which the Tribunal described as "amorphous liability depending on the application of the provisions of the Sales-tax in the facts of the assessee's case.

6. The assessee can only succeed in its claim for deduction in the facts and circumstances of this case on the basis of Section 10 of the Income Tax Act The relevant section under which the assessee can claim this deduction for sales tax is obviously Section 10(2) (xv) of the Income-tax Act which permits allowance for "any expenditure (not being an allowance of the nature described in any of the Clauses (1) to (xiv) inclusive, and not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

7. Assuming, without deciding, that expenditure in Section 10(2) (xv) of the Act as above includes sales tax when it has to be examined in the facts of this particular case whether such tax answers the requirements of the Statute that in this case the Sales Tax is an "expenditure" and 'laid out or expended" as used in the above section. These words "expenditure", 'laid out' and expended' on appropriate construction in this context can only mean tax already paid, or arranged to be paid. A tax such as sales tax not only not paid but disputed cannot come within the meaning of those words used in lection 10(2) (xv) of the Act. Apart from this question of construction of the statute and the words used there it is also in accord with communscnse. What happens when a sales tax, imposed but not paid and objected to under legal proceed ings is yet claimed by the assessee as deduction from income tax? On what ground is the assessee basing his claim to deduct the sales tax which he has not paid and which he is disputing both as to its quantum and as to its validity? To allow such exemption from income tax might lead to the situation that he gets a deduction from income-tax and yet ultimately he succeeds in establishing that the sales tax was neither payable nor valid as against him In such a case he will get a benefit in the vear concerned withoul deser ving it. This is not the only consequence. The more serious consequence will be that the Income-tax authorities will be faced with the numerous possible claims for deduction on such or cognate grounds whose ultimate incidence is indeterminate both as regards its quantum as well as its validity In the opinion of this Court such a situation rannoi be allowed to emerge

8. Mr. Mitter appearing for the assessee realised this difficulty In order to get out of this difficulty he took shelter under Section 10(2A) of the Income Tax Act which provi-des "where for the purpose of computing profits or gains under this section, an allowance or a deduction has been made in the assessment for any year in respect of any loss, expendi-ture or trading liability incurred by the asses see and. subsequently during any previous year the assesses has received, whether in cash or in any other manner whatsoever any amount in respect of such loss or expenditure or has obtained some

benefit in respect of such trading liability by way of remission or cessation thereof, the amount received by him or the value of the benefit accruing to him shall be deemed to be profits and gains of business profession or vocation and to have accrued or arisen during that previous year

9. Section 10(2-A) of the lncome-tax. Act I was relied upon by Mr. Mitter to meet the case mentioned above. It was contended by the assessee that if the ultimate liability for sales tax was decided in favour of the asses-see then the benefil of remission or deduction would he ad justed in subsequent years. We are unable to accept this interpretation and use of Section 10(2A) of the Income tax Act. The words used in that sub-section are again quite clear. The relevant words are "allowance or a deduction", "made". 'liability incurred by the assessee" "remission" and "cessation" indicate that this must be paid or liability incurred or else there is no question of "remission or "cessation" To claim deduction on the ground of sales tax without either paying it or arranging to pay it and on the contrary contesting the quantum and liability to pay it will be to go against all principles and canons; of claims for deduction It is necessary to emphasis that the primary object for the introduction of Section 10(2A) of the Income-tax Act, which is done by way of an amendment In 1955 was obviously to make the provision self-reliant and self-contained by including within its operation amounts refunded and remitted and also to remove difficulties creat-ed by the two systems of keeping accounts viz., cash and mercantile systems Reference in this connection may be made to the decisions in Commr of Income-tax, Mysore v. Lakshmamma. (1964) 52 ITR 789 at pp 796 and 800 (Mys) and Commr of Income, tax, Madras v. Tirunelveli Motor Bus Service Co. . See also the observations of Shelat C J., in the Gujrat High Court decision in Baroda Traders Ltd. v. Commissioner of Income-lax, Gujrat. (1965) 57 ITR 490 at pages 503 4 (Guj).

10. Mr. Mitter for the assessee then developed a turn in his argument that the accrual of a liability to the sales tax by the order of assessment of the Sales Tax Officer even though it is disputed and not paid was still a valid claim lor deduction on the ground and on the principle on which depreciation is allowed under the Income-tax Act. This is an attractive argument but is unsound Depreciation is specially provided in Section 10(2) (vi) of the Income Tax Act and is governed by the express provisions of this section But this attempt to extend the principle of recognising and allowing depreciation cannot be extended to the case of a sales tax determination whoso quantum and liability are disputed by the assessee In Peter Merchant Ltd. v. Stedeford. (1948) 30 Tax Cas 496 such an attempt wa.s made but was rejected by Singleton J. where the learned Judge expressly observed:

"What seems an exception is recognised where a trader purchased and still holds goods or stocks which have fallen in value No loss has been realised Loss may not occur Nevertheless, at the close of the year he is permitted to treat these goods or stocks as of their market value This exception to the general rule has never, however, been extended to the case of probable or indeed apparently inevitable loss to be incurred in the execution of future contracts entered into during the year in question and the authorities are against it."

Not only this authority is against Mr. Mitter's contention to extend the principle but also such it construction will lead to claims for deduction for breaches of contract or agreement where also the same argument could be advanced as Mr. Mitter was advan-cing that in law the damage gives rise to

the legal liability to pay it although the realisation of payment may mean either an indeterminate time or dependent on many contin-

gencies. A claim for deduction for sales tax cannot, therefore, be allowed on that principle, when the tax has either been paid nor provided to be paid and when its liabilitv and quantum are disputed See also the observations of Cohen L.J., in Peter Merchant's case (1948) 30 Tax Cas 496 at page 612

11. The ratio of Peter Merchant's case, (1948) 30 Tax Cas 496 has been followed in India by the Supreme Court in Indian Molasses Co. (P) Ltd v. Commissioner of Income-tax, West Bengal . It is clearly emphasised in that decision that spending and expenditure underlie the idea of "What is paid out or away and is something which is gone irretrievably." Here if that test is applied, not a penny has gone oul of the assessee's pocket on account of this sales tax for which he is claiming to deduct Rs 1,49,776 In this case the Supreme Court makes it clear that the Income-tax Law makes a distinction between an actual liability in praf-senti and a liability in future which, for the time being is only contingent. The ratio is that the former is deductible and not the latter See the observations of Hidayatullah J . at pp 73-76 of that report (ITR) = (at pp 1054 1056 of AIR) His "Lordship observed at p 78 of that report (ITR) = (at p 1058 of AIR) as follows "Expenditure is equal to expense and expense is money laid oul by calculation and intention though in many uses of the word this element may not be present as when we speak of a joke at another's expense. But the idea of spending in the sense of 'paying out or away' money is the primary meaning and it is with that meaning that we are concerned. Expenditure is thus what is "paid out Or away" and is something which is gone irretrievably.

"To be an allowance within Clause (xv) the money paid out or awav must be (a) paid oul wholly and exclusively for the purpose of the business and further (b) must not be (i) capital expenditure, (ii) personal expense or (iii) an allowance of the character described in Clauses (i) to (xiv) But whatever the character of the expenditure. It must be a paying out or awav and we are not concerned with the other qualifying aspects of sucfi expenditure stated in the clause either affirmative!!' or negatively"

12. Bv the application of this test and this standard laid down by the Supreme Court it is clear that the assessee's claim on the facts and circumstances of the case cannot succeed in deducting from income tax the amount of sales tax which the nssessee has not paid and whose quantum and validity are both disputed by the assessee.

13. Hklayatullah. J in then proceeded to discuss this question of contingency in further detail His Lordship observed again at p. 79 of that report (ITR) = (a) p. 1059 of AIR) as follows:

"To be a payment which i.s made irre-vocably there should be no possibility of the money forming, once again, a part of the funds of the assessee company. If this condition be not fulfilled and there is possibility of there being a resulting trust in favour of the companuy. then the money has not been spent, i.e., paid out or away, but the amount must be treated as set apart to meet a contingency There is a distinction between a contingent liability and a payment depending upon a contingency The question is whether in the years of ac-count, one can describe the assessee company's liability as contingent or merely depending upon a contingency. In our opinion, the liabilitv was contingent and

not merely depending upon a contingency."

14. On that principle of law laid down by the Supreme Court, the conclusion in the facts and circumstances of this case is irre-sistible that here not only the liability to the tax has become contingent but was dependent upon contingency and it will not he inappropriate to add that much of this contingent if not the whole of it, is created by the assrs-see companv itself by its acts and conduct. In conclusion, we can only refer to the following further observations of Hidayatutah J. in :--

"In our opinion, the payment was not merely contingent but the liability itself was also contingent Expenditure which is deductible for Income-tax purposes is one which is towards a liability nctuallv existing at the time, but the putting aside of money which may become expenditure on the happening of an event is not expenditure. In the present case nothing more was done in the account years The money was placed in the hands of trustees and/or the insurance company to purchase annuities of different kinds, if re quired, but to be returned if the annuities were not bought and the setting apart of the monev was not a paying out or awav of these sums irretrievably".

16. Here the case before us is stronger on the facts No transfer of any kind has been made, and not a farthing has been paid for Sales Tax There was no setting apart In fact, there was no entry made in the as sessee's books of account for such Sales Tax On this point, it is necessary to notice an argument of Mr. Mitra, for the assessee that the effect of not providing for the Sales TAX In the accounts was immaterial on the strength of the decision reported in Commissioner of Income-tax West Bengal v. Gangadhar Baner-jee, & Co (P) Ltd where at p. 184 (of ITR) -(at p 1981 of AIR) Subba Rao J. observed "But nothing prevents the parties in a suitable case to establish by cogent evidence that certain items were, either by mistake or by design, inflated or deflated or that there were some omissions".

116) No doubt, that is so. But Mr. Pal argues for the Commissioner of Income-tax that this was not a mistake or an omission but the assessee's claim here for deduction for the Sales Tax. which has not been paid but is disputed, is an "afterthought" He contends that in its original return, the assessee company itself did not claim the amount. Indeed. Mr. Pal's contention for the Commissioner of Income-tax is that this whole argument about the mercantile system of accountancy was a smoke-screen in this case because even under mercantile system of accounting, according to Mr. Pal, for the Income tax authorities, a liability incurred could not be entered in the accounts as an expenditure unless the liability had become at least an as certained sum of money. Mr. Pal criticised the assessee's position by saying that this is a round-about way of re-writing the accounts in the facts and circumstances of the case a course which was condemned by the Supreme Court in Commr. of Income-tax. Madhya Pradesh v. Swadeshi Cotton and Flour Mills (P) Ltd.. Indore, . On the basis of that authority, Mr. Pal for the taxing authorities, argues that one who follows the mercantile system of accounting, incurs a liability only when the claim, If made, is settled amicably or by industrial adjudication. There it was a case of an employer who followed mercantile system of accounting and the problem arose about the liability for profit bonus Reliance was placed for the Commissioner of Income-tax on the observation at p. 139 of that report (ITR) = (at p 1769 of MR) where Sikri J. observed :--

"We are of the opinion that this system of reopening accounts does not fit In with the scheme of the Indian Income tax Act We have already held in Commissioner of Income-tax. Madras v. Gajapathy Naidu that, as far as receipts are concerned, there can be no reopening of accounts. The same would be the position in respect of expenses."

17. On the facts, Mr. Pal's arguments are not without foundation, especially having regard to the relevant dates, the Sales Tax order of assessment and demand for payment were made on the 21st November 1967 but the revised Income-tax return to deduct the Sales Tax from the Income-tax was not filed until 9th November, 1969 Therefore, on the facts here, it cannot be said that Mr. Pal's criticism that in this case, it is not only an afterthought but also an attempt to reopen accounts, is not without foundation

18. It may not be out of place here to make a reference to a decision of the Madras High Court in Tarachand Ghanashyamdas v. Commissioner of Income-tax (Mad). (1966) 59 ITR 378 (Mad), where a sum of Rs 75000 paid to one by an assessee could not be called an expenditure, as the assessee did not pay the amount of any accrued liability but only paid it towards a contingent liability which might arise In the future or might not. It was laid down in that case very clearly that the Income-tax law did not allow as expenses all the deductions that a prudent trader would make in computing his profits.

The principle laid down in Peter Merchant's case (1948) 30 Tax Cas 496 was also followed by the Madras High Court in this decision.

19. In a recent decision in Travancore Titanium Product Ltd. v. Commissioner of Income-tax, Kerala. the question of interpretation of sec 10(2)(xv) of the Income tax Act was considered with reference In Wealth Tax. In discussing this problem, the Supreme Court expounded the law on the subject that the nature of expenditure or outgoing must be fidjudged in the light of accepted commercial practice and trading principles In order to come within Section 10(2) (xv) it is laid down by that authority of the Supreme Court decision that the expenditure must be incidental to the business and must be necessitated or justified by commercial expedient and must be directh and intimalely connected with the business and must be laid out by the taxpayer in his character as a trader. It was expressly observed there that to be a permissible deduction, there must not only be a direct and intimate connection between the expenditure and the business but also that such expenditure must not be merely as owner of assets, even if they are assets of the business of the assessee.

20. This argument leads to a more fundamental problem. Mr. Pal for the Commissioner of Income-tax has argued that this whole question of deduction for the sales tax for the purpose of income-tax has to be re-viewed According to him, the law does not really permit such deduction Having regard to the view that we have already taken of the interpretation of Section 10(2) (xv) of the Income-tax Act. it is not necessary for us to deal with this larger question That problem must await decision in an appropriate future rase At the same time it is necessary and only fair to record the arguments advanced on the point, having regard to the importance of the problem

21. The only direct authority on this question of deducibility of sales-tax for the purpose of income-tax is S.R V.G Press Co. Kurnool v. Commissioner of Excess Profits Tax, Hyderabad and Andhra. reported in 1956-30 ITR 583= (AIR 1956 Andh 222). There also the assessee maintained hooks OB the mercantile basis but in respect of sales-tax only the cash payments less recoveries were claimed as an expense annualh without any consideration for any outstanding liability or refunds due pending adjustment That case therefore, was very different on facts from the case before us But the point that we are discussing namely how far sales-tax is at all deductible for the purposes of Income tax was considered by Vlswanath Sastri J at page 589 of that report (ITR) = (at p 224 of AIR) where the following observations appear :-

"Now sales-tax is levied on sales or pur-chases of goods by Iraders and not upon the profits or gains made by them from the busi-

ness. Sales-tax is payable irrespective of any profits being earned and without such pay ment, the business of buying and felling can not be carried on. It is therefore deductible as a business expense before arriving al the taxable profits."

The learned Judge in that case proceeded further to make the following observations at page 592 of the same report (ITR) --(at p. 225 of AIR) :--

"It cannot be disputed that the expendi-

ture in question was incurred hv the assessee in his character as a trader It cannot be sta-

ted that the payment of sales tax was made voluntarily and on grounds of commercial ex pediency without any actual necessih for such payment Sales-lax 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 direct pur pose for which the money is laid out is not the benefit of the business and the payment goes for the benefit of the state "

"The expenditure is unremunerative but is not the less a proper deduction for without such expenditure the business of purchasing and selling could not be carried on "

This decision was affirmed by the Supreme Court and reported as Commissioner of Excess Profits Tax Hyderabad v. S.R.V.G. Press Co in The affirmation, however, of the Supreme Court was not on this point which we are discussing here namely whether the pay-ment of the sales-tax is at all obligatory and necessary for the purpose of carrying on business, but on the point whether such payment must be deemed to satisfy the requirement of Rule 12 of Schedule I of the Excess Profits Tax Art and it was held hv the Supreme Court that the Excess Profit Tax officer was wrong in holding that the tax paid was in excess of the requirement of the business There the Supreme Court pointed ou! that the reason ableness of the necessity of the payment must be ascertained in the light of what might be regarded of commercially expedient and not on any legalistic consideration. There the tax was duly assessed and paid and therefore reasonableness and neces-sity must be adjudged in the light of the circumstances then prevailing and not in the light of subsequent developments The

Supreme Court. however made no pronounce-ment on whether all sales tax was at all deductible or not It must also be borne in mind that the case of S.R.V.G Press Co was a case under Excess Profit Tax Act and the rules connected therewith and was not a case for deduction under Income-tax Act.

22. The criticism of Mr. Pal for the Commissioner of Income-tax may be summarised briefly. He criticised the basic assumption made in the judgment of Viswanath Sas-tri J. that payment of sales-tax is necessary for the purpose of carrying on the business. The contention for the taxing authorities is that under the West Bengal Sales Tax Act, this Sales-tax it on the "taxable turnover" and is not on "all" sales but sales beyond the limits of "taxable turnover" which are Rs. 10,000 for one class of cases and Rs. 50,000 for another class of cases. Therefore, he contends that it is not one of those taxes which must be paid in order to carry on the business It is a tax on the business turnover which must be above the limit of "taxable turnover" It presumably means that nobody would carry on the business of sales only for loss and the fact that a trader is carrying on business above the taxable turnover means he is making a profit, for if he did not. he would not exceed the taxable turnover but remain within it In that sense it cannot be said that he cannot carry on the business of sales without payment of sales tax No doubt there is no direct reference in the Sales Tax Act either to profit or to loss and no douht Viswanath Sastri J was right in saving that sales-tax was irrespective of profit and loss. Nevertheless what has been argued is that there is an indirect and implicit recognition of profits because of the limits of Rs 50,000 and Rs 10,000 as "taxable turnover" According to Mr. Pal appearing for the Income-tax Commissioner sales-tax is not such a tax which could be railed as a prerequisite or a condition precedent for carrying on business such as the trading licence fees or the pro-fessional licence fees.

23. Mr. Pal relies on the Supreme Court decision already noticed in and specialh the de cision in Harrods (Buenos Aires) Ltd. reported in (1964) 41 Tax Cas 450. In the latter case in a proceeding for assessment of income-tax of the business the ciaim of the assessee company was to deduct the "Substituted Tax" paid to the Argentina Government was accepted by the taxing authorities on the ground that it was an expenditure without paying which the assessee company could not carry on its business at all Mr. Pal contends that this test should be strictly applied When such a tax is a condition precedent or a pre-requisite to the carrying on of the bull-ness no doubt such tax should be deductible. But where, as in the present case before this Court, it was not such a necessary pre-requisite or a condition precedent to the carrying on of the business itself but a tax above certain "taxable turnover". the legal position becomes entirely different.

24. The substitute tax in Harrod's case (1964) 41 Tax Cas 450 was such a tax that unless the company paid it. it could be put out of business altogether If we can quote again from Harrods (Buenos Aires) Ltd. v. Taylor Gooby (1964) 41 Tax Cas 450, the following observations of Danckwerts L.J. at pages 467-8 which are relevant.

"There are a number of authorities upon the question of deductible expenses and the guiding principle appears to me to be that if the expense has to be incurred for the purpose of gaining the company's profits, it is a deductible expense, on the other hand if the payment of the expenses or charges is made after the profit has been ascertained, then the expense is not deductible, because it is simply an application of the profits which have bean earned."

"In my opinion the present case falls within the principle of Smith v. Lion Brewery. The substitute tax was something which the company was compelled to pay if it was to carry on business in Argentina and if it could not carry on business in Argentina, it could not earn profits. Consequently it was an expense which was necessarily incurred by it in order to carry on its trade and was wholly and exclusively laid out or expended for the purpose of the trade nf the company "

24A. Even there the test was applied that the tax had to be paid before any claim for deduction could arise. The same view was expressed by Diplock L. J at page 469 in the same report of Harrod's case in (1964) 41 Tax Cas 450.

25. Mr. Pal does not stop there. He draws our attention to the preamble of the Bengal Finance (Sales Tax) Act 1941 which expressh mentions that such Act is intended to provide "an addition to the revenue of Bengal" If it is an "addition" to the Revenue of the State whether it is of Bengal or of the Union then to make the law that this addi tional revenue will mean deduction from the other revenue of the State will lead to a self defeating situation. If what is paid for sales tax reduces the income-tax, then really there is no addition to the revenue Mr. Mitra. how ever, contends for the assessee that this addi-tion to the revenue is of this State whereas income-tax is of the Union. That argument does not impress us. Tn the first place thr state is one in India. and to accept Mr. Mitra's proposition as a sufficient answer will be to permit states to make inroads upon the Union or federal tax. Even then Mr. Mitra's argument will lose its force if instead of considering the State Sales Tax Act which we are doing the problems would have arisen in connection with the Central Sales Tax Act. Then faxes under that statute would no longer mean additional revenue to the Union because the income-tax will be reduced accordingly. It leads to the situation where what the right hand gets the left hand has to give away.

26. Important mid fundamental as this question is we do not wish to express any opinion on this point because we are satisfied that the question on the present Reference before us can be answered on the interpretation of Section 10 of the Income-tax Art

27. It would be necessary to consider another branch of the argument advanced by Mr. Mitter for the assessee That argument is based on the distinction between payability and legal liability Mr. Mitter's contention is that the payability or payment of the sales tax is not the test by which its deductibility from the Income-tax la to be judged. He relied on the Special Bench decisions of this High Court in the matter of Recols (India) Ltd. reported in (1953) 4 S. T. C 271 (Cal) and specially the observations made at pages 281 and 282 of that report where it is said "To my mind it is clear that the tax becomes really payable as such only at that point of time when fhe tax is declared to be payable and the balance outstanding demand' ed".

The difficult of Mr. Mitter about this decision ts that it was not a case under the Indian Income-tax Act at all. It was a case where the only question that came to be determined was "whether sales tax is to be treated as a preferential debt within the meaning of Section 230 of the Indian Companies Act. from the date of demand or the date when the sales price is received or any other date."

Neither on the facts nor on principles that case can help Mr. Mitter's contention having regard to the language of Section 10 (2) (xv) of the Indian Income-tax Act which we have quoted and considered above.

27A. Then Mr. Mitter for the assessee fell back upon the decision of the Supreme Court in Commissions of Income-tax, Bombay v. Abdullabhai Ahdulkadar (1961) 41 I.T.R. 545 (AIR 1961 SC 701) That no doubt was an Income-tax Act case and under Section 10 thereof. The passage on which Mr. Mitter relied is from the judgmenl of Kapur J., at pages 549 50 of that report (ITR) : (at p. 704 of AIR) which is as follows "The result is that when a claim is made for a deduction for which there is no specific provision in Section 10(2) whether it is admissible or not will depend on whether having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and to be incidental to it.

That passage is to be read in the circumstances of that case where the employment of agents was incidental to the carrying on of the business and it was observed that it logically followed that the losses which were incidental to such employment were also incidental to the carrying on of the business" This case again is of little help to the assessee This really is a passage where Kapur, J. was explaining the observations made by Ven-kalarama Aiyyar J in Radridns Daga v. Commissioner of Income-tax .

28. For the purposes of claiming a deduction under Section 10(2) (xv) of the Indian Income-tax Act mere legal liability is in our view of the interpretation and construction of such section as indicated above not enough There has to be an 'expenditure' in the first place and it must be in fact 'laid out' or "expended" wholly or exclusively for the purpose of such business Mr. Mitter for the assessee further pursued this point by trying to attract us with another decision. That decision is of the Supreme Court in Calcutta Co.

Ltd. v. Commissioner of Income-tax. West Bengal, . He relied on the quotation from Simon on Income-tax, second edition, volume II, at p. 204 on accrued liability which the Supreme Court mentioned in these terms at page 6 of that report (TTR) : (at p 1170 of AIR) :

"In cases, however, where an actual liability exists, as in the case with accrued expenses, a deduction is allowable : and this is not affected by the fact that the amount of the liability and the deduction will substantially have to be varied. A liability, the amount of which is deductible for income-tax pur-puses, is one which is actually existing at the time of making the deduction, and is distinct from the type of liability accruing in (1948) 30 Tax Cas 496. which although allowable on accountancy principles, is not deductible for the purposes of income-tax." At page 10 of that report (ITR) :(al p 1172 of AIR) the Supreme Court further made certain observations on which Mr. Mitter relied and which perhaps inspired Mr. Milter's argu-ment on thesp grounds :

"Even under Section 10 (2) of the Income tax Act, it might possibly be urged that the word "expended" was capable of being interpreted as 'expendable' or 'to be expended' at least in a case where a liability to incur the said expenses had been actually incurred by the assessee who adopted the mercantile sys-tem of accounting "

We have already noticed the subsequent decisions of the Supreme Court and specially the observations of Hidayatullah J of the Supreme Court interpreting the words "expenditure" and "expended", have not accepted the dictum of the Calcutta Company's case . If we confine the dicta in , to the facts of that case, it will be clear that even the above principle was mentioned only in connection with an accrued liability of a very different nature and character altogether There the liability was entered into the books of the assessee company and secondly, the assessee undertook to discharge that liability Neither is this entered in the facts of the present case before us, nor has the assessee in the present case before us undertaken to discharge this liability but on the contrary has disputed and questioned both the liability and the quan-tum of the sales tax in disputes Besides, in the case of the Calcutta Co. Ltd the appellant bought lands and sold them in plots fit for building purposes undertaking to develop them by laying out roads, drains etc and when the plots were sold the purchasers paid only a portion of the purchase price and undertook to pay the balance in instalments and the appellant in its turn undertook to carry out the development. It was held on the facts that such undertaking to carry out the de velopment was unconditional and therefore the undertaking imported a liability on the appellant. It was also held as fact that the accrued liability was not converted into a conditional liability. Those facts radically distinguish the instant case before us.

29. Finally Mr. Mitter for the assessee argues that even apart from the express allowances granted by Section 10(2) of the Income-tax Act other allowances can be imported by means of construction and interpretation of the words "profits" or 'gains" in Section 10(1). In other words, his argument is that even though the claim for the deduction of unpaid and disputed sales tax from the income-tax cannot, strictly come within the words of the language of Section 10(2) (xv) of the Act, nevertheless, the same could be deducted impliedly by a process of interpretation of Section 10 (1) of the Income-tax Act. It is a very seductive argument This Court, however, finds it difficult to accept the correctness of this contention Section 10 is one whole section The section along with its sub sections and vari-ous clauses thereof are to be read together. and not in separate water-tight compartments. It will be a wrong construction to separate 10(1) completely from 10(2) of the Income-tax Act. Section 10 comes under Ch. III dealing with Taxable Income under the Income-tax Act. It is the special Section on the head of the business as a "head" of income chargeable to income-tax its Sub-section (1). therefore, says that the tax shall be payable by the assessee under the head "profits and gains of business. profession or vocation" Sub-section (2) that follows is not a different subject but continues the subject raised in Sub-section (1) of Section 10 and lays down that such profits or gains shall be computed after making the "following allowances' The "following allowances" are set out serially in Sub-clauses (1) to (xv) in great meticulous details and no in vague generalities Prima facie, therefore, to introduce other implied allowances not mentioned in the long list of sub-clauses from (i) to (XT would be clearly against the Statute Therefore when Section 10(2) says that such profits shall be computed after making the "following al-lowances". then either the allowance claimed has to be found within the four corners of Sub-section (2) of Section 10 and its various sub-clauses or else they would not be allowances permissible in computing the profits or gains Various types of allowances are mentioned in these 15 sub-clauses of Sub-section (2) of Section 10 They include such variety of allowances as rent, repairs, insurance, depreciation, destruction and many other matters. It is also not that these different clauses do not mention about rates or taxes They do. Special mention is made of sums paid oa account of land revenue or local rates or

municipal rates as in Sub-clause (ix) but these allowances as stated in these detailet sub-clauses do not mention that a Sales Tax either paid or to be payable is a permissible allowance under Section 10(2) of the Indian Income-tax Act.

30. Of more significant consideration is the fact that this Section 10 contains i

dictionary for the meaning of the word paid in connection with Sub-section (2) of
"In Sub-section (2) 'paid' means actually paid or incurred according to the method of

That seems to indicate that here again 'paid' means '"actually" paid or incurred, no doubt according to the method of accounting followed for computing profits or gains but then such computation must be under this section. If that meaning is to be taken for interpretation of Section 10(2) and we are of opinion that that is the meaning when the section itself says so, then an unpaid and dis-puted Sales Tax cannot form the basis of a claim for deduction from the Income-tax.

31. No doubt Section 10(1) of the In come-tax Act makes the tax payable on pro-fits of a business Equally no doubt, "profit" s what is to be calculated For that purpose. naturally a tax which is a condition precedent on a condition pre-requisite for the carrying on of any business at all. is to be deducted, and such deduction is not by way of an allowance spell out of the different Sub-clauses, (1) to (xv) of Section 10(2) of the Income Tax Act. bill is implicit in the nature and concept of the word 'profits" or 'gains" In Section 10(1) of the Act That would in elude such taxes as a professional tax or a trade tax the payment of which is a condition precedent before a person is allowed to carry on such trade or profession as al-ready discussed In Harrod's case, reported in (1964) 41 Tax Cas 450, dealing with what is known as the substitute tax

32. A good deal of learning has been used in the argument in this case on the subject of the method of accounting for the assessee. No stone was left unturned to Impress upon this Court that the assessee's system of accounting was the mercantile system of account. It almost ran as a magic word throughout the arguments for the asses-cee Equally insistent was the argument on the other side for the Revenue authorities that it made no difference on the facts and principles involved in this case Having regard to the view that we have taken of the interpretation of Section 10 of the Income-tax Act we do not venture in this case to discuss the system of accounting in great detail. Normally under Section 13 of the Income-tax Act the assessee's regular method of accounting determines the mode of computing his taxable income. But it must he emphasised that the method of accounting cannot invent fact or create new ranges of taxable income or enlarge or restrict the ambit of taxation. The method of accounting still remains the method of accounting which basically and Fundamentally must mean the method of computation of the income but the method of such computation cannot derogate from the provisions of the charging sections. As has been pointed out that the charge on income accruing or received in India imposed by Section 4(1) of the Income-tax Act could not be avoided by any method ot accounting nor the changeability of income received in India under Section 4(i)(a) of the Act be avoid-ed on the ground that the assessee's regular method of accounting was mercantile as pointed by the Supreme Court in Keshao Mills Ltd. v.

Commissioner of Income-tax, Bombay . After all mercantile system of accounting is not something very mysterious, It is only a method of accounting by which profit and loss are calculated after taking in-!o account all income and all expenditure relating In the period, whether such income had been actually received or not or expenditure actually incurred or not In a recent decision of the Supreme Court in Nslini Kant Ambalal Mody v. S.A.L Narayan Row. there is some discussion on this mercantile system of accounting As we are of the opinion that an unpaid and disputed sales tax cannot form a claim for deduction from income-tax we are of the view that the method of accounting cannot make it other-wise If payment or arrangemenl to pay the tax is the test fo be applied as laid down by the decision of Ihe Supreme Court discussed earlier in this judgment, then tht year for which the deduction can be claimed is the year when the sales tax has either been paid or arranged to be paid We are of the view that no useful purpose would be served in pursuing this point of mercantile system of accounting any further for the facts and purposes of this Reference

33. We can conclude with a reference to the observation of the Lord President Cooper in Commr of Inland Revenue v. NIddrie and Benhar Coal Co. Ltd., (1981) S3 Tax Cas 244 al p. 253 where the learned Lord said. "One thing is plain, that not on" penny was paid by the respondents for demurrage at any time during the 40 years that the claims were being made, and I am unable to discover any basis for the conclusion that Pound 7,000 was constructively expended by the Coal Company as a revenue expenditure to enable them In earn the profits which are broughl into computation for tax" Borrowing that expression from Ihe learned Lord, here is a claim by the assesses in the instant case to claim a deduction for sales tax assessed in 1957 but for which not a penny has been paid in the last 9 yean and far from being paid every step has been taken out only to contest the liability but alio the quantum and in fact the dispute is still pending in full force before the Certificate Authorities To allow such a claim as deduction from the Income-tax would be, to allow a claim which the learned Lord Cooper described as "constructively expended "

34. Having regard to the view we have taken it is unnecessary to discuss other cases cited by the tribunal.

36. For the reasons stated above our answer to the question asked is in the negative and we hold that the amount of Rs. 1,49,776 claimed by the assessee as a deduction on account of tales tax it not deductible as a business expense in the facts and circumstances of this case. The Commissioner would get the costa of this reference. Certified for two counsel.

Laik, J.

37. I agree