Allahabad High Court
Allahabad Woollen Mills (P.) Ltd. vs Commissioner Of Income-Tax, U. P. on 9 September, 1966
Equivalent citations: 1967 64 ITR 548 All
JUDGMENT MANCHANDA J. - This is a case stated under section 66 (1) of the Income-tax Act, 1922, hereinafter referred to as the Act. The question referred is :

"Whether, on the facts and in the circumstances of the case, the sum of Rs. 4,796 paid to the Regional Provident Fund Commissioner is an allowable deduction in the accounts for the assessment year 1961-62 ?"

The material facts are these. The assessee is a limited company. The relevant assessment year is 1961-62, the previous year being the period, April 1, 1960, to March 31, 1961. For the relevant assessment year, the assessee claimed an allowance of Rs. 4,796, being the contribution made by it under the Employees Provident Funds Act (19 of 1952) in respect of the period, 18th April, 1956, to November, 1958. The amount was disallowed on the ground that it was not an expenditure incurred in the relevant year. The assessee went up in appeal and contended that it was only in the relevant accounting year that the assessee, as an employer, was compelled to make the contribution by an order of the Regional Provident Fund Commissioner constituted under Act 19 of 1952. The Appellate Assistant Commissioner, however, held that the liability arose from the 18th April, 1956, onwards and the amount should have been claimed in the earlier assessment years.

On appeal, the Tribunal fairly and properly conceded that the liability to contribute under Act 19 of 1952 was being disputed by the assessee, who bona fide believed that the provisions of Act 19 of 1952 did not apply to it as it had not 50 or more "employees" within the meaning of that Act. The liability to contribute was not discovered by any inspector under the Act. It was on the 18th November, 1958, that the assessee had itself filled in a "pro forma" stating that the provisions of Act 19 of 1952 did not apply till the 31st August, 1958, as the number of persons employed was only 49, but as three more person had since been employed, therefore, the scheme under Act 19 of 1952 applied to it from the 2nd November, 1958. A telegram dated 12th September, 1959, was received from the Regional Provident Fund Commissioner, Kanpur, which made a reference from the Regional Provident Fund Commissioner, Kanpur, which made a reference a communication dated the 6th August, requiring the assessee to "start provident fund deduction at 6.25 per cent. from the wages of eligible employees from the date of re-start of the factory. Further instructions to follow." The telegram was confirmed by a letter dated the 12th of September, 1959, directing the assessee "to start provident fund deductions immediately under telegraphic information to this office". This letter was replied to on the 21st September, 1959, informing the Commissioner, "We have enforced the Provident Fund Scheme of the Central Government in the company with effect from 1st September, 1959, and the first deduction of contribution on account of the fund will take place on or after the 1st October, 1959, when the wages and the salaries to the workers for the month of September, 1959, will be discharged." On the 21st September 1959, a resolution was also passed by the company which reads : "As the number of workers in the company has now increased to above fifty, the Provident Fund Scheme, 1952, of the Central Government be and is hereby enforced in the company as approved and directed by the Regional Provident Fund Commissioner, U. P., in his communication No. 5217/E.P.F./9/RC, dated the 12th/17th September, 1959, with immediate effect from 1st September,

1959." Up to this stage there seems to have been no dispute that the Act 19 of 1952 was not applicable before the 1st September, 1959, to the assessee-company. For the Regional Commissioner, it was pointed out that on an inspection of the provident fund records of the factory on the 31st December, 1959, it was found that on the 18th April, 1956, the following staff was employed :

Factory Manager .....

Muster roll in Form 12 .....

Watch and Wards .....

Clerical staff .....

He pointed out that "as the factory employed 51 persons on the above date, and as the strength of the employees of the factory has always remained 50 or more persons, thereafter the Regional Provident Fund Commissioner had decided that the factory was covered under section 1(3)(a) of the Employees Provident Funds Act, 1952, with effect from April 18, 1956." This appears to have been a decision given under section 13(2) of Act 19 of 1952. Thereupon, a representation was made in connection with the enforcement of the scheme under the Act. It was reiterated that the assessee bona fide believed that it was working with less than 50 employees and as such it was not required to collect any contribution from its employees and as such it was not required to collect any contribution from its employees, nor had it made any such collections. An exemption from payment was therefore sought. Ultimately, by a letter dated the 27th May, 1960, the full exemption claimed was not granted but the assessee was permitted under the third proviso of paragraph 32 of the Employees Provident Fund Scheme, 1952, to recover the employees share of contribution for the said period from their subsequent wages in eighteen monthly installments.

The Income-tax Appellate Tribunal took the view that as the Regional Commissioner had retrospectively applied the provisions of the Act from April 18, 1956, the liability under the Act also accrued on that date and not on the date when the Regional Commissioner had actually decided that the Act was applicable to the assessee. The Tribunal does not appear to have taken into consideration the effect of the admitted bona fide dispute as to the number of employees employed by the assessee on the accrual of liability, though the Tribunal fairly conceded that there were no mala fides on the part of the assessee. The Tribunal also did not consider the effect of section 9 of Act 19 of 1952, which makes Chapter IXA of the Income-tax Act applicable. The Tribunal proceeded on the basis that section 10 (2) (xv) of the Income-tax Act was applicable but, as the contribution to the provident fund related to the assessment year 1956-57 to 1959-60, it could not be allowed for the relevant assessment year 1960-61.

The only question which, therefore, falls to be considered is as to when can the impugned expenditure be said to have been incurred by the company in the shape of a statutory contribution

as required by Act 19 of 1952 ? It is not doubt a statutory liability imposed by the Act which is a piece of social security enactment. There are, however, certain conditions which must be fulfilled before this Act can apply. It does not apply to every employer. Section 1(3), at the relevant time, ran :

"Subject to the provisions contained in section 16, it applies -

(a) to every establishment which is a factory engaged in any industry specified in Schedule I and in which 50 or more persons are employed ....."

Therefore, there are two pre-requisite conditions before the Act can apply. One is that it should be a factory engaged in industry as set out in Schedule I, and, secondly, that the factory engaged in industry as set out in or more persons. If either of these two conditions is not fulfilled, the Act will have no application and there will be no liability under the Act. Under section 2(e), "employer" means - in relation to an establishment which is a factory, the owner or occupier and where a person has been named as a manager of the factory under clause (f) of sub-section (1) of section 7 of the Factories Act, 1948, the person so named." Sub-clause (f) to section 2 defines "employee" as any person who is employed for wages in any kind of work, manual or otherwise, in or in connection with the work of an establishment. Sub-clause (k) of section 2 defines an "occupier of a factory" as the person who has ultimate control over the affairs of the factory, and, where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory. Under section 5, the Central Government is empowered to frame the scheme of the fund. Section 9 makes a fund created under the Act, a recognised fund under the Income-tax Act, within the meaning of Chapter IXA of that Act are repugnant thereto. Section 13 deals with the powers of inspectors and section 1A, with penalties in respect of employers other than companies. Section 14A deals with offences by companies. Section 14B deals with the power to recover damages against the employer. Under section 17, power is given to the appropriate Government to exempt certain factories from the operation of the Act. Section 19A gives the power to the Government to resolve difficulties and doubts which may arise as to whether an establishment is a factory engaged, inter alia, in any industry specified in Schedule I or whether fifty or more person are employed in the establishment.

An elaborate scheme under the provisions of section 5 of the Act has been drawn up and the relevant provisions of this may briefly be noticed. Paragraph 26 makes it obligatory on all the employees to joint the fund. Paragraph 28 deals with the transfer of accumulations from existing provident funds. Paragraph 29 lays down the rate at which the employer shall contribute to the fund. Under paragraph 30, "employer shall, in the first instance, pay both the contribution payable by himself and also the contribution payable by the member." The obligation, undoubtedly, is on the employer under this paragraph to deposit not only his share of the contribution but also the employees share. Then paragraph 32 gives the employer the right to deduct from the employee what he may have had to deposit under paragraph 30. Paragraph 39 also imposes a duty on the employer to send to the Collector within 15 days of the commencement of the scheme a consolidated return. He is also required to send a return within 15 days from the close of each month and again within 15 days of the commencement of every half year. Paragraph 38 requires the employer to pay into the fund by bank draft such amount as he may have deducted from the wages of the employees together with his own contribution minus the administrative charges. The other provisions relate to nomination and

payment of the fund to the employees together with his own contribution minus the administrative charges. The other provisions relate to nomination and payment of fund to the employee but with that we are not here concerned.

A cursory survey of the provisions of the Act and the Scheme makes one matter clear and that is that if the Act applies, then it is undoubtedly the obligation of the employer in the first instance to deposit not only his contribution but the contribution of his employees into the fund very month. This, however, is subject to the overriding condition that the Act applies. If there is a bona fide dispute that the number of "employees" employed is less than fifty, then, until that dispute is settled, it will not be possible to say that a liability to make a deposit is settled, it will not be possible to say that a liability to make a deposit in the fund had accrued. In the instant case, a dispute, undoubtedly, was raised and it was asserted that it was only after the 31st October, 1958, that the employees had for the first time exceeded the figure of 49. Until that dispute was determined by a competent authority, there was no liability to make any deposit under the Act. Can it then be said, on the facts and circumstances of this case, that the liability had irrevocably been incurred on the 18th April, 1956, as claimed by the department, merely because an inspector reported some are later that on that date fifty-one employees were shown to have been employed by the assessee ? No oppportunity appears to have been given to the assessee to show in a very marginal case, such as this, as to whether the manager or any of the others really were "employees" within the meaning of that word as given in section 2(f) read with section 2(k) of Act 19 of 1952. The inspectors report was certainly not sacrosanct. The matter had to be determined and decided and that decision was only given by the Regional Commissioner on the 17th February, 1960. The impugned payment into the fund was made thereafter during the relevant year of account and the outgoing or expenditure, in these circumstances, can legitimately be held to have been incurred only in that year of account and not at any earlier point of time. The liability to pay the amount under the Act was, therefore, only irrevocably incurred by the assessee during the relevant year of account.

The instant case would fall to be decided by applying the ratio of the Supreme Court decision in Commissioner of Income-tax v. Swadeshi Cotton and Flour Mills Private Ltd., where it was laid down that, even under the mercantile system of accounting a, bonus only becomes payable when the matter is amicably settled or when it has been determined by industrial adjudication. The ratio of the decision in Commissioner of Income-tax v. Gajapathy Naidu would also be applicable. In that case the question was as to in which year the impugned income had accrued to the assessee. The assessee had supplied bread to a Government hospital under a contract during the period, April, 1948, to March 31, 1949 (assessment year 1949-50), and there was dispute as to the amount due to him. This was ultimately settled and the amount received in the accounting year 1950-51, relevant to the assessment year 1951-52. The department insisted that the income accrued in the year when the bread was supplied, i.e., 1949-50. The Supreme Court, however, held that, as there was a dispute, the year in which the income would accrue would be the year when the dispute was settled and not at any earlier stage. The same principle would apply to the accrual of a liability of the incurring of an expenditure. In Kanpur Tannery Ltd. v. Commissioner of Income-tax, this court held that the deficiency in the payment of insurance premia under section 7 of the War Risks Goods Insurance Ordinance, 1940, relating to the stock-in-trade of an earlier year, was an allowable deduction in the year in which the deficiency in premia was actually determined and paid and not, as the department

insisted, in the accounting year in which the instance premia statutorily ought to have been paid. It was three pointed out that "even under the mercantile system of accounting a liability incurred cannot be entered in the account as expenditure unless the liability incurred cannot be entered in the account as expenditure unless the liability incurred cannot be entered in the account as expenditure unless the liability has become an ascertained sum of money. Until ascertained, the liability no doubt exists but proceedings have yet to be taken in some way or other to determine the exact amount."

There is a decision of the Bombay High Court in Mysore Spinning and Manufacturing Co. Ltd. v. Commissioner of Income-tax, which would appear to support, in some measure, the view that we are taking. It was there held that the provisions of section 58K and 10 (4) (c) of the Income-tax Act were not applicable as the employers contribution to the fund, under Act 19 of 1952, was not voluntary but under compulsion and the employers contribution to the provident fund, under Act 19 of 1952, was allowable on general principles under section 10 (2) (xv) and further that the expenditure and an expenditure to meet the liability accruing in that year is allowable under section 10 (2) (xv) of the Act.

Mr. Gulati, the learned standing counsel, relied upon Calcutta Co. Ltd. v. Commissioner of Income-tax, for the proposition that, if there was a liability, it would accrue regardless of there being any dispute. The case, however, does not, in any way, advance that proposition. The question there was, whether the assessee who had sold certain plots and had undertaken to develop those plots within six months from the dates of the deeds of sale, could deduct such estimated expenditure on development of those plots under section 10 (2) (xv) of the Act. The department had contended that such an expenditure was only contingent. But this was repelled by the Supreme Court and it was held that liability had accrued and the assessee had a right to estimate such expenditure which he considered he was bound to incurred under the agreement entered into.

For the reasons given above, we would answer the question referred in the affirmative and in favour of the assessee. The reference is answered accordingly. The respondent will pay the costs of the assessee which we assess at Rs. 250. Counsels fee is also assessed at Rs. 250.

Question answered in favour of the assessee.