Supreme Court of India
Commissioner Of Income Tax vs Kalinga Tubes Ltd on 8 January, 1996
Bench: B.P. Jeevan Reddy, S.B. Majmudar

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                CASE NO.:
Appeal (civil)  1396 of 1996

PETITIONER:
COMMISSIONER OF INCOME TAX

RESPONDENT:
KALINGA TUBES LTD.

DATE OF JUDGMENT: 08/01/1996

BENCH:
B.P. JEEVAN REDDY & S.B. MAJMUDAR

JUDGMENT:
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JUDGEMENT 1996 (1) SCR 197 The Judgment of the Court was delivered by S.B, MAJMUDAR, J. Leave granted.

By consent of learned Advocates of both the sides the appeal is finally heard and is being disposed by this judgment. The appellant Commissioner of Income Tax, has brought in challenge the judgment and order dated 13th May, 1987 passed by the High Court of Orissa at Cuttack answering the referred question under Section 256(1) of the Income-tax Act, 1961 against the Revenue and in favour of the assessee. It is the contention of the income- tax authorities that the question should be answered against the assessee. A few relevant facts centering round the question in controversy deserve to be noted at this stage.

The relevant assessment year is 1971-72. The respondent-assessee is a limited company which manufactures and sells steel tubes in the State of Orissa. During the previous year relevant to assessment year 1962-63, the assessee was liable to pay sales tax under the Central Sales Tax Act. The Sales Tax Officer Completed the assessment in respect of assessment year 1962-63 on 31st March, 1966 and demanded an additional amount of Rs. 11,02,698. The assessee unsuccessfully carried the matter in appeal and then filed second appeal before the Sales Tax Tribunal. The Tribunal by its order dated 28th May, 1970 reduced the additional demand of sales tax Rs.2,22,161. On the basis of the aforesaid order of the Tribunal, the respondent-assessee claimed deduction of the said amount as business expenditure in respect of the assessment for the previous year 1970-71 since according to the assessee the sales-tax liability was of the assessment year 1971-72.

The Income-lax Officer disallowed the said deduction in the relevant assessment year, as according to the Income-tax Officer the assessee was following mercantile system of accounting and hence the liability to pay sales tax accrued to it prior to the said year. On appeal, the appellate Commissioner allowed the said deduction holding that as the said liability became determinate and known only during that assessment year, it would be allowable for that assessment year.

The Income-Tax Tribunal reversed the finding of the Appellate Commissioner holding that the said sales tax liability was not admissible as deduction during the relevant assessment year. For that conclusion the Tribunal relied upon the decision of this Court in the case of Kedarnath Jute Manufacturing Company Limited v. Commissioner of Income-tax (Central), Calcutta, (1971) 82 ITR 363. The assessee got the following question referred under Section 256 (i) of the Income-tax Act for the opinion of the High Court:

"Whether on the facts and in the circumstances of the case, the assessee is entitled to deduction of Rs. 2,22. 161 towards the sales-tax liability for the assessment year 1971-72"

The High Court after hearing both the sides answered the question in the affirmative in favour of the assessee and against the Revenue, as noted earlier. It is this answer of the High Court that is challenged on behalf of the Revenue by the appellate Commissioner of the Income-Tax, Learned counsel for the appellant submitted that the High Court has misunderstood and misapplied the ratio of decision of this Court in Kedarnath Jute Manufacturing Co. Ltd. (supra) That once it is not in dispute that the assessee was following mercantile system of accounting. the liability to pay the central sales tax accrued to the respondent- assessee. the moment the sales, which are subject to sales tax, are made. That liability would not cease to be a liability because the assessee had taken proceedings before higher authorities for getting it reduced or wiped out so long as the contention of the assessee did not prevail. Further, the fact that the assessee had failed to debit the liability in its books of accounts did not debar him from claiming the sum as deduction. The eligibility for gelling deduction depends on the provisions of the law and not on the view which the assessee might take of his rights.

The High Court, on the other hand, look the view in the light of the very same decision in Kedar Nath Jute Manufacturing Co. Ltd. (supra) that the liability to pay sales tax can be said to have initially accrued when the sales were effected but till the liability had ceased, it shall be treated to have continued to accrue and that when pursuant to the Tribunal's order a fresh demand notice was served by the Sales Tax Officer on the assessee, the liability of the assessee can be said lo have accrued on receipt of such demand notice and, therefore, the assessee can claim the deduction under Section 37 of the Income Tax Act during the assessment year 1971 -11 even though the liability was of the assessment year 1962-63. It was submitted by the learned counsel for the appellant that the aforesaid view of the High Court was erroneous. That the High Court had mistead and misapplied the ratio of the decision of this Court in Kedarnath Jute Manufacturing Co. Ltd. (supra). On the other hand, learned counsel for the respondent-assessee submitted relying on the decision of this Court in income Tax Officer, Kolar and Another v. Seghu Buchiah Setty. [1964] 7 SCR 148 that the order of the Sales Tax Officer merged in the order of the ultimate appellate authority, namely, the Sales Tax Tribunal and it is only thereafter that the liability to pay sales tax could he said to have crystalized against the assessee or could be said to have accrued to the assessee. She also submitted relying on the decision of this Court in the case of State Bank of Travancore v. The Commissioner of Income-tax Kerala. AIR (1986) SC 757 that when entries are made in the books of accounts maintained as per mercantile system of accounting, it is on the accrual of the real income that entries became effective. According to the learned counsel for the respondent it is only on the issuance of the fresh demand notice by the Sales Tax Officer pursuant to the order of the Sales Tax

Tribunal that the liability to pay sales tax could be said to have accrued to the assessee and that happened in the previous year relevant to the concerned assessment year 1971-72. The High Court therefore had rightly answered the question in favour of the assessee.

Having given our anxious consideration to She rival contentions, we find that the decision of the High Court is not sustainable at all. The question is squarely covered by the decision of this Court in Kedarnath Jute Manufacturing Co. Ltd. (supra). In that case, the assessee followed mercantile system of accounting. During the relevant assessment year the assessee claimed deduction of Rs. 1,49,776 being the amount of sales tax which it was liable under the law to pay during the relevant accounting year. The income tax return was filed on 13th January, 1956. The demand notice was served by the sales tax authorities on 21st November. 1957. On 9th November, 1959, the assessee filed a revised return claiming the aforesaid deduction. The assessee had challenged the order by which the demand for such tax had been raised, before higher authorities, as it was contesting its liability to the extent it had been determined. The Income Tax Officer completed the assessment on 11th March, 1960 before any final decision was given to the proceedings relating to the assessment of sales tax. According to the Income Tax Officer, the assessee was not entitled to claim the deduction of the aforesaid amount of sales tax inasmuch as it had denied its liability to pay that amount, The Appellate Assistant Commissioner confirmed the order of the Income Tax Officer, The Income Tax Officer's aforesaid order was confirmed in the hierarchy of proceedings upto the Tribunal and also before the High Court in reference proceedings. The aforesaid view of the High Court was upturned by this Court in the decision of Kedarnath Jute Manufacturing Co. Ltd. (supra) wherein this Court made following pertinent observations:

"Now under all sales tax laws including the statute with which we are concerned, the moment a dealer makes either purchases or sales which are subject to taxation, the obligation to pay the tax arises and taxability is attracted. Although that liability cannot be enforced till the quantification is affected by assessment proceedings, the liabittly for payment of tax is independent of the assessment. It is significant that in the present case, the liability had even been quantified and a demand had been created in the sum of Rs. 1,49,776 by means of the notice dated 21st November, 1957, during the pendency of the assessment proceedings before the Income Tax Officer and before the finalisation of the assessment. It is not possible to comprehend how the liability would cease to be one because the assessee had taken proceedings before higher authorities for getting it reduced or wiped out so long as the contention of the assessee did not prevail with regard to the quantum of liability etc. An assessee who follows the mercantile system of accounting is entitled to deduct from the profits and gains of the business such liability which had accrued during the period for which the profits and gains were being computed. It can again not be disputed that the liability to payment of sales tax had accrued during the year of assessment even though it had to be discharged an a future date. In Pope The king Match Factory v. Commissioner of Income- tax. a demand for excise duty was served on the assessee and though he was objecting to and seeking to get the order of the Collector of Excise reversed. He debited that amount in his accounts on the last day of his accounting year and claimed that amount as a deductible allowance on the ground that he was keeping his accounts on the mercantile basis. The Madras High Court had no difficulty in holding that the assessee had incurred an enforceable legal liability on and from the date on which he received the Collector's demand for payment and that his endeavour to get out of that liability by

preferring appeals could not in any way detract from or retard the efficacy of the liability which had been imposed upon him by the competent excise authority. In our judgment, the above decision lays down the law correctly,"

The aforesaid decision, therefore, squarely lays down the legal proposition that when the assesses is following mercantile system of accounting, in case of sales tax payable by the assessee, the liability to pay sales tax would accrue the moment the dealer made sales, which are subject to sales tax. At that stage the obligation to pay the tax arises. Raising of dispute in this connection before the higher authorities would be irrelevant. In the present case. She liability to pay the central sales tax arose or accrued on the basis of mercantile system of accounting followed by the assessee, during the previous relevant year 1962-63. It is a fact that the assessment for that year was completed by the Sales Tax Officer on 31.3.1966. However, in mercantile-system of accounting, liability to pay the quantified sales tax dues as per order of Sales Tax Officer can be said lo have accrued to the assessee for the relevant assessment year 1962-63. It is true that the assessee challenged the same and ultimately got the liability to pay the sales tax for the assessment year 1962-63. reduced in second appeal before the Sales Tax Tribunal on 28.5.1970 to Rs. 2,22,161. But that would not affect the accrual of liability to pay sales lax on the basis of mercantile system of accounting. It was submitted by the learned counsel for the respondent - assessee that if such entire deduction of Rs. 11,02.698 was sought for by the assessee during .the assessment year 1962-63 and ultimately as held by the Tribunal the liability was reduced to Rs. 2,22,161 an incongruous situation would have arisen. Such a contention cannot be countenanced for the simple reason that if ultimately the tax liability is reduced and if in retrospect it was found that during the relevant assessment year the assessee had claimed a large amount of deduction by way of business expenditure the difference of the amount wrongly claimed and allowed in earlier relevant assessment year could always be added back in the assessment of the relevant subsequent assessment year. It is obvious that in no case, the assessee who was following mercantile system of accounting could have claimed deduction for payment of central sales tax dues for assessment year, 1962-63 in the assessment year 1971-72, It is difficult to appreciate how the High Court persuaded itself to come to the conclusion that because fresh demand notice was given by the Sales-tax Officer pursuant to the decision of the Sales- tax Tribunal the amount covered by the demand notice could be claimed by way of deduction on accrual basis during the assessment year 1971-72 or that such liability could be treated to have accrued in that year. This finding of the High Court runs counter to the ratio of the decision of this Court in Kedarnath Jute Manufacturing Co. Ltd. (supra). Reliance placed by the learned counsel of the respondent on the decision of this Court in Income Tax Officer, Kolar and Anr, [1964] 7 SCR 148 is also of no avail as even if it is held that the order of the Sales Tax Officer had merged in the order of Sales Tax Tribunal that would not have any impact on the decision as to when the liability to pay sales tax had accrued to the assessee on mercantile system of accounting and in which relevant assessment year the claim for deduction under Section 37 of the Income Tax Act could have been made by the assessee. Similarly, decision of this court in State Bank of Travancore (supra) is also of no avail to the assessee. The question with which we are concerned in the present case is not covered by ratio of the said decision and on the contrary it is squarely covered by ratio of the decision in Kedar Nath Jute Manufacturing Co. Ltd. (supra).

In the result, this appeal succeeds and is allowed. The answer given by the High Court is set aside. The referred question is answered in the negative in favour of the Revenue and against the assessee. There will be no order as to costs.