Saurashtra Cement and Chemical Industries Ltd. Vs Commissioner of Income Tax

Court: Gujarat High Court

Date of Decision: Oct. 12, 1994

Acts Referred: Income Tax Act, 1961 â€" Section 10(2), 37, 37(1), 37(2B), 4

Citation: (1994) 122 CTR 329 : (1995) 213 ITR 523

Hon'ble Judges: Susantha Chatterjee, J; Rajesh Balia, J

Bench: Division Bench

Advocate: D.M. Mehta, for the Appellant; Mihir Thakor, for the Respondent

Judgement

Rajesh Balia, J.
The Income Tax Appellate Tribunal, Ahmedabad Bench ""A"" (hereinafter referred to as ""the Tribunal""), at the instance of

the assessee has referred the following questions for the opinion of the High Court :

1. Whether the Tribunal was justified in law in confirming the disallowance of Rs. 17,475 out of consultancy fees u/s 80VV of the Act ?

2. Whether the Tribunal was justified in law in disallowing the claim for interest paid u/s 220 of the Income Tax Act holding that the same was not

allowable deduction for the purpose of business of the assessee ?

3. Whether the Tribunal was justified in holding that a sum of Rs. 8,048 incurred by Shri K. N. Mehta and Shri D. N. Mehta, directors of the

assessee-company was disallowable as entertainment expenditure within the meaning of section 37(2B) of the Act ?

4. Whether, in the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the assessee was not entitled to

deduction of surtax liability of Rs. 2,79,057 as expenditure for the purpose of business ?

5. Whether, on the facts and in the circumstance of the case, the Tribunal was justified in law in holding that the expenditure of Rs. 39,823 was not

allowable in the year in question on the ground that the liability has arisen in the years 1968-69 to 1973-74 ?

2. Question No. 1 relates to the allowance of expenditure in respect of getting legal opinion in various matters as well as counsel fee in respect of

various matters relating to determination of the assessee''s liability under the Income Tax Act, 1961 (hereinafter referred to as ""the Act""), before

the authorities under the Act or before the High Court, detailed in the order of the Tribunal.

3. The Tribunal has upheld the order of the Income Tax Officer restricting the claim of the assessee for the deduction to a sum of Rs. 5,000 out of

the claim of Rs. 22,475 for consultancy fees and/or counsel fees.

4. Section 80VV of the Act reads as under :

80VV. In computing the total income of an assessee, there shall be allowed by way of deduction any expenditure incurred by him in the previous

year in respect of any proceedings before any Income Tax authority or the Appellate Tribunal or any court relating to the determination of any

liability under this Act, by way of tax, penalty or interest :

Provided that no deduction under this section shall, in any case, exceed in the aggregate five thousand rupees.

5. A close scrutiny of section 80VV leads us to the conclusion that the upper limit of allowance as deduction u/s 80VV of the Act relates to any

one case of determination of liability under the Act by way of tax, penalty or interest independently during the relevant previous year and not a total

expenditure incurred during one previous years. The expenses which are allowable u/s 80VV of the Act have nexus with any proceedings relating

to the determination of any liability under the Act by way of tax, penalty or interest which are before the Income Tax authorities or the Appellate

Tribunal or any court. Any expenditure incurred before the hierarchy of the authorities of the Income Tax Department and the courts relating to the

determination of liability under the Act for a particular assessment year constitutes the subject of the proviso. It must be remembered that the unit

of determination of liability under the Act is the assessment year relevant to a previous years, while the deduction of such expenditure is allowable

in the previous years in which the same has been incurred by the assessee but it is not essential that such expenses must be related to the

determination of liability for the previous year in question. Expenses incurred by the assessee in any previous year may relate to any other one or

more previous year or years and in each case determination of liability may be separate under the Act. Therefore, in our opinion, the only

reasonable interpretation of section 80VV of the Act is to construe the limit of Rs. 5,000 to any one proceeding for the determination of any

liability relating to a particular assessment year and not to the expenses incurred in one previous year.

6. Learned counsel appearing for the respondent, in this connection, drew the attention of the court to the decision of the Calcutta High Court in

the case of Indian Oxygen Ltd. Vs. Commissioner of Income Tax, . With utmost respect for the reasons aforesaid, we are unable to agree with the

view expressed therein about the interpretation of the expression ""in any case"" in the proviso to section 80VV.

7. It may further be noticed that, part from the interpretation which we have expressed above, a Division Bench of this court in the case of Mcgax

Ravindra Laboratories (India) Ltd. Vs. Commissioner of Income Tax, had occasion to consider the scope of operation of section 80VV of the

Act. The court, on a plain reading of the section, was of the opinion that the aforesaid provision is operative only in relation to the expenditure

incurred by an assessee in respect of the proceedings before any Income Tax authority, the Tribunal or any court but is not applicable in respect of

the expenses which are not related to any proceedings before the Income Tax authority or Tribunal or any court. Such expenses will have to be

examined and dealt with in accordance with the provisions of section 37(1) of the Act. The relevant observations read as under (at page 1013) :

... any expenditure incurred in connection with any matter other than a proceeding before the Income Tax authority or the Tribunal or any court

would not be covered by the aforesaid provisions, even if such matter is in connection with the Act. The authorities below were, therefore, right in

holding that the fees paid to C. C. Chokshi and Co., for matters other than proceedings for determination of any liability under this Act, were not

hit by provisions of section 80VV. Thus, the expenditure of Rs. 5,000 incurred for surtax assessment and fees of Rs. 2,500 paid to C. C. Chokshi

and Co. for attending to matters other than proceedings before the Income Tax authority or the Tribunal or the court were not hit by the provisions

of section 80VV.

8. In view of the aforesaid position we answer question No. 1 in the negative, i.e., in favour of the assessee and against the Revenue.

9. Question No. 2 relates to allowability of interest paid by the assessee on account of late payment of the tax u/s 220 of the Act as deducted from

its profits and gains from the business. The authorities under the Act disallowed the expenditure on the ground that such liability has not been

incurred by the assessee or such interest has not been incurred by the assessee wholly and exclusively for the purpose of business. The assessee in

this connection relied on the principles enunciated by the Supreme Court in the case of M/s. Prakash Cotton Mills Pvt. ltd. Vs. Commissioner of

Income Tax (Central), Bombay, along with the decision of the Delhi High Court in the case of Bharat Commerce and Industries Ltd. Vs. Union of

India and Others, . Mr. Mehta, the learned advocate appearing for the assessee, argued that whenever any statutory impost paid by the assessee

by way of damages or penalty or interest is claimed as an allowable expenditure u/s 37(1), the assessing authority is to examine whether the

payment of such impost is by way of penalty or is compensatory in nature. If the authority comes to the conclusion that the concerned impost is

purely compensatory in nature he is under an obligation to allow deduction u/s 37(1) of the Act. He relies on the following observations of the apex

court in the case of M/s. Prakash Cotton Mills Pvt. ltd. Vs. Commissioner of Income Tax (Central), Bombay, :

.... whenever, any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as an allowable expenditure u/s 37(1)

of the Income Tax Act, the assessing authority is required to examine the scheme of the provisions of the relevant statute providing for payment of

such impost notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. The

authority has to allow deduction u/s 37(1) of the Income Tax Act, whether such examination reveals the concerned impost to be purely

compensatory in nature .....

10. He further contended that the interest charged u/s 220 of the Act is compensatory in nature and it is not by way of penalty. He drew the

attention of the court to the following observations made by the Delhi High Court in the case of Bharat Commerce and Industries Ltd. Vs. Union of

India and Others,

The rationale behind the provisions of section 220 to levy interest on delayed payment of tax is not to penalise the party but to make a provision

for compensation for the department on the failure of the assessee to make payment on the first notice of demand.

11. The argument apparently appears to be facile but does not stand scrutiny of reason. The mere fact that the interest on the late payment of the

tax is compensatory does not make it an expense wholly or exclusively carried out for the purpose of business. The essence of section 37 of the

Act is that such expenses are wholly laid out or incurred for the purpose of business. If the preliminary liability to be discharged by the assessee is

not allowable as expenses laid out or incurred for the purpose of business, ordinarily the interest paid thereon also cannot be considered as

expenses laid out or incurred paid thereon also cannot be considered as expenses laid out or incurred wholly for the purpose of the business. In the

case of M/s. Prakash Cotton Mills Pvt. ltd. Vs. Commissioner of Income Tax (Central), Bombay, the Supreme Court was concerned with the

interest payable by the assessee on the demand created under the Bombay Sales Tax Act, 1959. The liability incurred on account of sales tax is

deductible and any amount paid as interest in the nature of compensation for the late payment of such liability partakes of the character the

originally liability and is allowable. So also is the interest paid on the late payment of excise duty or contribution to the provident fund. In each case,

the amount paid towards the excise duty or contribution to the provident fund are the expenses allowable to be deducted from the gross profit and,

therefore, any amount paid for compensation on delayed payment to the recipient also becomes allowable u/s 37(1) of the Act. However, in the

present case, the interest is payable on the personal liability of the assessee of the Income Tax which is a direct tax and is not a part of the business

expenditure. In this connection, it may further be noticed that interest on money borrowed for the payment of the tax was held to be not an

allowable expenditure. Reference in this connection be made to the decision of the Supreme Court in the case of Smt. Padmavati Jaikrishna Vs.

Additional Commissioner of Income Tax, Gujarat, . The Supreme Court, affirming the decision of this court in Padmavati Jaykrishna Vs.

Commissioner of Income Tax, Gujarat, disallowing the claim for deduction of interest on the amounts borrowed to pay taxes and annuity deposits,

held as under (at page 179) :

We are inclined to agree with the High Court that so far as meeting the liability of Income Tax and wealth-tax is concerned, it was indeed a

personal one and payment thereof cannot at all be said to be expenditure laid out or expended wholly and exclusively for the purpose of earning

income.

12. It may be noted that specific provision was required to be inserted in the form of section 80V for the purpose of allowing of such interest as

expenditure in the computation of profits and gains from business. But for the special provision made, interest on the capital borrowed for the

payment of tax is not allowable expenditure. If that be so on the same principle the interest paid for the late payment of tax cannot be held

allowable expenditure as the same cannot be held to be expenditure incurred wholly and exclusively for the purpose of the business. For the

aforesaid reasons, we answer question No. 2 in the affirmative, i.e., in favour of the Revenue and against the assessee.

13. Question No. 3 relates to disallowance of Rs. 8,048 incurred by the directors of the assessee-company. The Income Tax Officer has

disallowed the said expenses as falling under the head of entertainment expenditure, u/s 37(2B) of the Act. The Tribunal recorded a finding, after

going through the record, that the expenses incurred are of lavish nature and the authorities below were justified in not allowing the same as

business expenditure, that is to say, the expenses were not held to be wholly and exclusively incurred for the purpose of business. In view of that

finding, which is a finding of fact and which is not challenged before us on the grounds on which the finding can be challenged, we answer question

No. 3 in the affirmative, i.e., in favour of the Revenue and against the assessee.

14. Question No. 4 relates to the claim of the assessee for deduction of Rs. 2,79,057 on account of surtax liability has deductible expenses for the

purpose of business. It has been brought to our notice that the answer is squarely covered by a decision of this court in the case of S.L.M.

Maneklal Industries Ltd. Vs. Commissioner of Income Tax, in favour of the Revenue and against the assessee. Accordingly, question No. 4 is

answered in the affirmative, i.e., in favour of the Revenue and against the assessee.

15. Question No. 5 relates to the expenditure of Rs. 39,823 actually incurred during the previous year but was not allowed as deduction from the

profit of the previous year on the ground that the liability in respect of various expenses included in the aforesaid sum had arisen in the earlier

previous year and not in the relevant previous year and as the assessee maintained accounts on the mercantile system, the same was not allowable

as expenses of the previous year in question.

16. From the statement of the case and the order of the Tribunal it appears that the contention of the assessee was that the expenditure in dispute

was incurred in the year under consideration because they were quantified in the previous year concerned and the Commissioner of Income Tax

(Appeals) rest contended by saying that when the expenses related to the earlier accounting years how each of these expenses could be quantified

in the year of consideration. The Tribunal affirmed the disallowance by observing that there is no dispute that the assessee-company maintained its

books of account on mercantile basis. It was observed that if that is so there was no justification in claiming these expenses for the assessment year

under appeal. Having considered the materials on record, we do not find any justification for the disallowance of the claim of the assessee on such

an abstract proposition. Merely because an expense relates to a transaction of an earlier year it does not become a liability payable in the earlier

year unless it can be said that the liability was determined and crystallized in the year in question on the basis of maintaining accounts on the

mercantile basis. In each case where the accounts are maintained on the mercantile basis it has to be found in respect of any claim, whether such

liability was crystallized and quantified during there previous year so as to be required to be adjusted in the books of account of that previous year.

If any liability, though relating to the earlier year, depends upon making a demand and its acceptance by the assessee and such liability has been

actually claimed and paid in the later previous years it cannot be disallowed as deduction merely on the basis the accounts are maintained on

mercantile basis and that it relates to a transaction of the previous year. The true profits and gains of a previous year are required to be computed

for the purpose of determining tax liability. The basis of taxing income is accrual of income as well as actual receipt. If for want of necessary

material crystallizing the expenditure is not in existence in respect of which such income or expenses relate, the mercantile system does not call for

adjustment in the books of account on estimate basis. It is actually known income or expenses, the right to receive or the liability to pay which has

come to be crystallized, which is to be taken into account under the mercantile system of maintaining books of account. An estimated income or

liability, which is yet to be crystallized, can only be adjusted as a contingency item but not as an accrued income or liability of that year. To

illustrate, we find from the details of the expenses that certain expenses related to the fees paid to the experts, out-of-pocket expenses incurred by

the consultation firm and discharge of liability on account of demurrage claimed by the port authorities. Such items without investigation into the

facts about the crystallization of such dues cannot be disallowed merely on the ground that they relate to transactions pertaining to an earlier

accounting year. In this connection, it is useful to refer to a decision of the Gauhati High Court in the case of CIT v. Nathmal Tolaram [1973] 88

ITR 234 which was a case arising under the Indian Income Tax Act, 1922, as to the interpretation of section 10(2) (xv) which is corresponding to

section 37(1) of the 1961 Act. The question related to the claim of deduction on account of the sales tax liability paid during the year 1957-58,

whereas the liability related to the accounting year 1949-50. The Division Bench in that case observed as under (at page 238) :

Under section 4 of the Income Tax Act, the income that accrues or arises during any previous year alone is to be taken note of. There is,

therefore, a bar to include any income that accrues or arises outside the previous year subject to the deeming provisions in the Act. There is,

however, no express bar in law, nor one by necessary implication, restricting the power of the Income Tax Officer to exclude the expenditure laid

out or expended u/s 10(2)(xv) of the Act. We are, therefore, unable to accede to the submission of learned counsel for the Department.

Section 10(2)(xv), shorn of other details for our purpose, provides for making allowances of any expenditure ''laid out'' or ''expended''. The words

''laid out'' are with reference to the mercantile system while the word ''expended'' is with regard to the cash system. Once there was the sales tax

demand in this case, which was an enforceable liability and as such a real expenditure, for which the assessee laid out the amount by debiting his

account in the accounting year which was also the year of demand of the Department, deduction can be legitimately claimed u/s 10(2)(xv). Here is

a case where there is no doubt about the genuineness of the expenditure. There is also the compulsiveness in the sales tax demand which can be

ignored only at the peril of the assessee. This expenditure had never been taken note of the earlier years for the reason or the other. In the absence

of any legal bar in the way of the assessee claiming this expenditure in the year of demand for which provision has already been made in the

accounting year, deduction u/s 10(2)(xv) is permissible in law and has been rightly allowed by the Tribunal.

17. We are in respectful agreement with the said view expressed by the Gauhati High Court. We, therefore, answer question No. 5 in the negative,

i.e., in favour of the assessee and against the Revenue.

18. This reference accordingly stands disposed of with no order as to costs.