(1997) 225 ITR 970

Madras High Court

Case No: T.C. No. 816 of 1984 (Reference No. 731 of 1984)

Commissioner of Income Tax		APPELLANT
	Vs	
English Electric Company of India Limited.		RESPONDENT

Date of Decision: March 17, 1996

Acts Referred:

- Income Tax Act, 1961 - Section 28
- Wealth Tax Act, 1957 - Section 2

Citation: (1997) 225 ITR 970

Hon'ble Judges: N.V. Balasubramanian, J; K.A. Thanikkachalam, J

Bench: Division Bench

Advocate: Deokinandan, S.V. Subramanian, for the Appellant; K.M.L. Majele and Uttam Reddy, for the Respondent

Judgement

K.A. Thanikkachalam J.

1. At the instance of the Department, the Tribunal referred the following question for the opinion of this court, u/s 256(1) of the Income Tax Act, 1961, hereinafter referred to as the "Act" :

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the provision for excise duty is accrued liability of the year 1977-78 and that it should be allowed as a deduction even though the provision included the duty payable in respect of goods manufactured in the earlier years ?"

2. The assessee is a company engaged in the manufacture of electrical equipment. It was manufacturing ceramic fuse bodies, which are in turn used in the manufacture of HRC fuse links. The assessee had been manufacturing this item from 1968 onwards. At that

time, the Central excise authorities tested some samples of the fuse bodies, but did not pursue the matter further and determined that those goods were not liable to excise duty. In November, 1973, the Central excise authorities revived their claim and demanded that the assessee should take out a licence and pay duty on HRC fuse links. Though the assessee challenged this demand and was successful, in November, 1976, the assessee was advised that ceramic fuse bodies were themselves liable to excise duty. This advice was given on the basis of an observation made to that effect by the High Court in the litigation, which is in The English Electric Co. of India Ltd. Vs. The Superintendent, Central Excise and Others, . Thereafter the assessee felt that it would be most appropriate and advisable to take out a licence for the manufacture of the particular component and subjecting it to excise duty. The assessee applied for a licence and it was issued on February 1, 1977. On being required to furnish the quantities of fuse bodies manufactured and cleared since its inception, with the view to levy duty, by a letter, dated March 16, 1977, the assessee furnished the required particulars in June, 1977, and in July, 1977, the excise authorities demanded a sum of Rs. 5,98,895 from the assessee towards the duty payable on the goods it manufactured for the period from 1973 to 1977. This duty was worked out by adopting a rate of 25 per cent. The assessee then moved the High Court praying that the rate of duty should be 15 per cent. and not 25 per cent. In the said proceedings, the High Court also granted stay and during the pendency of the petition, the excise authorities themselves reduced the rate to 15 per cent. Accordingly, the demand was revised to Rs. 3.79 lakhs. Thereafter, the High Court directed the matter to be disposed of in the usual course by the appellate authorities. An appeal was then filed before the Appellate Collector contending that since the excise authorities were aware from 1968 onwards of the manufacture of ceramic fuse bodies by the assessee, the retrospective demand made by them from 1973 was not in order. The Appellate Collector accepted this argument and directed that the demand for the period of one year only should be made from the assessee. Thereafter the assessee preferred a revision petition against the order of the Appellate Collector, which was pending at that time.

3. Under these circumstances, while closing the accounts for the year ended March 31, 1977, which is the year relevant for the year under reference, the assessee made a provision in the accounts for a sum of Rs. 5,75,000 as payable towards excise duty and claimed the same as a deduction. Both the Income Tax Officer and the Commissioner of Income Tax (Appeals) disallowed the claim. Both of them took the view that since the demand from the Central excise authorities was received only in July, 1977, that is after the accounting year had ended, no legally enforceable demand arose in the accounting year which could be allowed as a deduction. The events that took place and which forced the assessee to provide for Rs. 5,75,000 were placed before the authorities below, but this was not considered by them. Aggrieved, the assessee filed an appeal before the Appellate Tribunal. The Tribunal took the view that the assessee was entitled to the deduction. The argument advanced before the Tribunal was that even though the demand was received on July 11, 1977, i.e., after the accounting year had ended, because the accounts were open, the assessee could make a provision in its accounts.

Even otherwise, it was open to the assessee to estimate the liability and make a provision for it, because the liability to pay excise duty arose not when a demand was raised but as and when the manufacture of the excisable item took place. So the contention of the assessee was that the taxable event was the point of manufacture and not the raising of the demand. The Tribunal, accepting the assessee''s contention, held that under the Excise Act, the liability to pay duty arises as and when manufacture took place. This conclusion was arrived at on the basis of the decision of the Calcutta High Court in the case of Commissioner of Income Tax Vs. Century Enka Ltd., . In that decision it was held that in all fiscal statutes, the point of taxation is the happening or occurrence of the taxable event. In the case of excise duty, the taxable event is the production or manufacture of goods. This was also the view expressed by the Supreme Court in the decision in Shinde Brothers etc. Vs. Deputy Commissioner and Others, etc., . In this decision, the Supreme Court pointed out that the taxable event in the case of duties of excise is the manufacture of goods and the duty is not directly on the goods, but on the manufacture thereof. The Tribunal also relied upon the decision of the Supreme Court in Kesoram Industries and Cotton Mills Ltd. Vs. Commissioner of Wealth Tax, (Central) Calcutta, , wherein the Supreme Court held that a liability accrues as soon as the taxable event occurs and that liability is known as debitum in praesenti, solvendum in future. Therefore, the computation made by the taxing authorities during the course of assessment proceedings was not of any real consequence in so far as the accrual of a liability is concerned. The Tribunal also relied upon another decision of the Supreme Court in the case of The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, in order to come to the abovesaid conclusion. Further, the Tribunal, relying upon the decision of the Calcutta High Court in the case of Commissioner of Income Tax Vs. Orient Supply Syndicate, , held that when the licence was issued, the starting point for the taxable event has come into existence. Therefore, according to the Tribunal, the liability to pay duty for the goods manufactured in 1973 also arose in the year under reference. On considering these facts the Tribunal ultimately held that the liability to pay excise duty of Rs. 5,75,000 arose in the year under reference and it was an allowable deduction and it could not be said to be a contingent liability as held by the Commissioner of Income Tax (Appeals) while negativing the claim of the assessee.

4. Learned senior standing counsel appearing for the Department submitted that if the excise authorities had fixed the demand only on July 11, 1977, which was long after the accounting year had ended, no enforceable liability came upon the assessee and, consequently, the assessee was not entitled to deduction of any sum. The provision made for Rs. 5,75,000 in the accounts was made only after the demand for Rs. 5,75,000 was received, because the accounts by then happened to be kept open. Otherwise the assessee could estimate for the purpose of making the provision of Rs. 5,75,000. Nothing prevented the assessee from doing it much earlier and provide for it in the accounts in each of the respective accounting years. It is the service of demand notice on the assessee some time in July, 1977, that prompted the assessee to make the provision and

that being the starting point, the assessee is only trying to relate it back to the accounting year which in the present system of law should not be permitted. It was further submitted that as a result of various proceedings, the excise duty was levied only for a period of one year, and, therefore, that one year''s liability can be allowed when it was actually paid. The judgment in The English Electric Co. of India Ltd. Vs. The Superintendent, Central Excise and Others, , was delivered on February 12, 1975, wherein it was held that it is difficult to regard HRC fuse-link as porcelain ware merely because one of its components is made of porcelain. The whole thing, viz., HRC fuselink is a manufactured article and one of its components is porcelain. But merely because that component forms part of the finished article, that by itself will not come within entry 23B, for it must be porcelain ware as such. Hardly, HRC fuselink can be described as porcelain ware as we commonly understand the phrase. Therefore, according to learned senior standing counsel, if at all the liability arose, it arose for payment of excise duty in the assessment year 1973-74. Hence, it was submitted that the liability which arose for payment of excise duty can be allowed only in that year when the liability arose. In order to support this contention, reliance was placed upon the decision of the Supreme Court in Commissioner of Income Tax, Orissa Vs. Kalinga Tubes Ltd., , wherein the Supreme Court held that when the assessee is following the mercantile system of accounting in the 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 tax arose. The raising of a dispute in this connection before the higher authorities would be irrelevant.

5. Learned senior standing counsel also relied upon the decision of the Karnataka High Court in Mysore Tobacco Co. Ltd. Vs. Commissioner of Income Tax, Karnataka-II, Bangalore, , wherein the Karnataka High Court held that an expenditure which can be claimed as a deduction in any assessment year should have been incurred in the relevant accounting year. The entire exercise in the computation and assessment of business profits is to arrive at the true profits of the year which are liable to tax. The unit of assessment is the year and the receipts and expenditure which have to be taken into account must relate to the accounting year. Therefore, if the expenditure of an earlier year is taken into account in a later year, the true profits of the later year cannot be determined and the result would be lopsided and unreal.

6. Reliance was also placed upon the decision of the Allahabad High Court in Saraya Sugar Mills (P.) Ltd. Vs. Commissioner of Income Tax, , wherein the Allahabad High Court held that in a case where the assessee paid rent for the last ten years in a lump sum during the current year under consideration it cannot be allowed as a deduction in that year, since the liability accrued in each of the years for which the payment was now made.

7. Reliance was also placed upon the decision of the Calcutta High Court in Commissioner of Income Tax Vs. S.P. Jaiswal Estates (P.) Ltd., , wherein the Calcutta High Court held that the liability for luxury tax accrued in the earlier years cannot be

deducted in a later year, since the luxury tax was paid in a lump sum under protest as directed by the Supreme Court.

8. Assistance was also sought from a decision of the Supreme Court in Shinde Brothers etc. Vs. Deputy Commissioner and Others, etc., , wherein the Supreme Court held as under (at page 1520) :

"These cases establish that in order to be an excise duty (a) the levy must be upon "goods"; (b) the taxable event must be the manufacture or production of goods. Further, the levy need not be imposed at the stage of production or manufacture, but may be imposed later."

9. Therefore, according to learned senior standing counsel for the Department in the present case the liability to pay excise duty arose when the goods were manufactured and the liability for payment of excise duty pertaining to a particular assessment year can be allowed only in that assessment year and the earlier liability arose during the earlier years cannot be allowed in the later assessment year simply because the assessee was contesting the levy, where the assessee followed the mercantile system of accounting.

10. On the other hand, learned counsel appearing for the assessee, while supporting the order passed by the Tribunal, and relying upon the decisions cited in the order passed by the Tribunal, submitted that even before the end of the accounting year the assessee applied for licence, i.e., on February 1, 1977, and obtained the licence before the end of the accounting year, i.e., March 31, 1977, and it was a consequence of this licence, the liability to pay excise duty arose and that, therefore, the assessee was entitled to claim deduction. According to learned counsel, the liability for Rs. 5,75,000 covered the period of manufacture. But no provision in the accounts could be made because the rate of excise duty was not determined. Had the rate been known to the assessee, it would have made a provision for it in the accounts in each of the years. Since the rate of excise duty was indeterminate, having assumed finality only in the year under appeal, the liability became quantified and it was that point of time at which the liability got quantified, that should determine the year in which the liability should be allowed as a deduction. According to learned counsel, the liability to pay excise duty arose when the assessee started to manufacture the excisable goods and there was a demand by the Excise Department to take licence for manufacture of the goods, in pursuance of that advice the licence was taken on February 1, 1977. The demand notice was issued by the Excise Department demanding a sum of Rs. 5,75,000 in July, 1977. This amount represents the excise duty payable for the period from 1973 to 1977. This was on the basis of the particulars filed by the assessee as per the requisition made by the Excise Department on March 16, 1977. The assessee was following the mercantile system of accounting and the account was kept open till March 31, 1977. Hence, the assessee made a provision for Rs. 5,75,000 demanded by the Excise Department. Therefore, the assessee made a claim for deduction of the provision made for payment Of excise duty in the assessment year 1977-78. As already pointed out, in order to support this line of argument, the

assessee relied upon the various decisions, which were cited in the order passed by the Tribunal.

11. We have heard learned senior standing counsel appearing for the Department as well as learned counsel appearing for the assessee.

12. The point for consideration is, whether, on the facts and in the circumstances of the case, the liability to pay the excise duty had accrued or not under the statute. If under the statute the liability had accrued merely because it had not been quantified or merely because the demand notice had not been served, it could not be said that the liability had not accrued because they become irrelevant for determining accrual of liability, even though they become relevant for the purpose of quantification and recovery of the money.

13. Quantification and recovery of money due under the Act should not be confused with the accrual of a liability. If under the system of accounting the liability accrued, then the assessee is entitled to deduction. In the present case, the assessee was following the mercantile system of accounting. The assessee in its accounts for the year ended March 31, 1977, which is the relevant year under appeal, made a provision in its accounts for a sum of Rs. 5,75,000 towards excise duty and claimed the same as a deduction. The Department disallowed the claim on the ground that the demand from the Excise Department was received only in June, 1977, after the accounting year was over and consequently no demand arose in the accounting year, which could be allowed as a deduction. According to the Department, the deduction could be allowed at the time of actual payment.

14. From 1968 the assessee is manufacturing ceramic fuse bodies used as a component in the manufacture of HRC fuse links. The excise authorities have made an attempt to levy excise duty on this item of manufacture but appears to have dropped the matter having apparently been satisfied that the items produced are not dutiable. Again in November, 1973, the excise authorities revived their claim an a demanded that the assessee should take out a licence and pay duty on HRC fuse links. The assessee challenged this demand and it was held that fuse links were not subjected to duty merely on the ground that they contained ceramic fuse bodies. However, in November, 1976, the assessee was advised that ceramic fuse bodies were themselves liable to duty based upon the observation made to that effect by the High Court in The English Electric Co. of India Ltd. Vs. The Superintendent, Central Excise and Others, . Thereafter the assessee applied for a licence and secured it on February 1, 1977. On March 16, 1977, the excise authorities required the assessee to file particulars about the number of fuse bodies manufactured and cleared since its inception with a view to levy duty. The required particulars were furnished to the excise authorities in June, 1977. In July, 1977, the excise authorities demanded a sum of Rs. 5,98,895 from the assessee, representing the duty payable for the period from 1973, to 1977, working it out on the basis of 25 per cent. This was later on reduced to 15 per cent. As a consequence, the demand was revised to Rs. 3.79 lakhs. Again, as per the judgment of the High Court, the assessee approached

the appellate authority. In the appeal filed by the assessee, the appellate authority sustained the demand for one year. It is in this background, the assessee in its accounts for the year ended March 31, 1977, made a provision in its accounts for a sum of Rs. 5,75,000 towards excise duty and claimed the same as deduction. The Calcutta High Court in Commissioner of Income Tax Vs. Century Enka Ltd., , held that in all fiscal statutes, there will be three stages : the first is a charge is created, which may also be described as a declaration of liability indicating what would be liable to taxation. The second stage is the quantification of that liability in the form of an assessment. The third stage is the recovery. Thus, in fiscal statutes, the point of taxation is on the happening or occurrence of the taxable event. Different enactments may provide different kinds of taxable events. The Central Excises and Salt Act imposes duty on the production or manufacture of goods.

15. In order to appreciate the liability under the Central excise, it is necessary to refer to certain provisions of the Central Excises and Salt Act, 1944. Section 3 provides that there shall be levied and collected in such manner as may be prescribed duties of excise on all excisable goods other H than salt which are produced or manufactured in India, and a duty on salt manufactured in, or imported by land into, any part of India as, and at the rates set forth in the First Schedule. Rule 7, which is in Chapter III which deals with levy and refund of and exemption from duty, provides for the recovery of duty. Rule 9 of the said Rules deals with the time and manner of payment of duty. Rule 9A deals with the provision of data for determination of duty and tariff valuation.

16. The Calcutta High Court in the above cited decision ultimately came to the conclusion that the taxable event under the Central Excises and Salt Act, 1944, is on the manufacture or production of excisable goods irrespective of or independent of future user, either in the manufacture of further goods or in the sale of the said goods. In the case of Union of India (UOI) Vs. Delhi Cloth and General Mills, , the Supreme Court emphasised that excise duty was on the manufacture of goods and not on the sale.

17. In the case of Shinde Brothers etc. Vs. Deputy Commissioner and Others, etc., , the Supreme Court referred to the decision of the Full Bench in the case of In re : Bill to Amend section 20 of the Sea Customs Act, 1878, AIR 1963 SC 1760, wherein it was observed by the Full Bench of the Supreme Court as under (page 1776) :

"This will show that the taxable event in the case of duties of excise is the manufacture of goods and the duty is not directly on the goods but on the manufacture thereof.

The Supreme Court in the case of Kesoram Industries and Cotton Mills Ltd. Vs. Commissioner of Wealth Tax, (Central) Calcutta, , while dealing with the question of what is the meaning of "debt owed", u/s 2(m) of the Wealth-tax Act, 1957, referred to the decision of the Supreme Court in the case of Kalwa Devadattam and Others Vs. The Union of India (UOI) and Others, , and held that under the Indian Income Tax Act, 1922, the liability to pay Income Tax arises on the accrual of the income, and not from the

computation made by the taxing authorities in the course of assessment proceedings; it arises at a point of time not later than the close of the year of account.

In The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, , the Supreme Court held that the moment a dealer might either purchase or sell goods which were subject to taxation, the obligation to pay the tax would arise and the liability was attracted, although that liability could not be enforced till the quantification was effected by the assessment proceedings; the liability for payment of tax was independent of the assessment. The Supreme Court accordingly held that in that case the assessee was entitled to deduction of the sales tax liability in computing its total income under the Income Tax Act.

In Commissioner of Income Tax Vs. Orient Supply Syndicate, , the Calcutta High Court held that it is not in all cases correct to say that a statutory liability discharged in a particular year became eligible for deduction in the year in question under the mercantile system of accounting. It depends on the facts and circumstances of the case and on the statutory provisions.

In Commissioner of Income Tax Vs. Kesoram Industries and Cotton Mills Ltd., , the Calcutta High Court, while considering liability arising on the basis of notice issued by the Excise Department, held that the excise duty liability arose on the basis of show-cause notices issued by the Central Excise Department and hence the excise duty liability demanded by the notice is deductible in the assessment year under consideration when the demand notice was issued.

In Commissioner of Income Tax Vs. India Foils Ltd., , the Calcutta High Court held that the exemption from excise duty was granted by the notification effective from January 5, 1981. Accordingly, the goods manufactured and cleared prior to the said notification were liable to duty. It was not correct to contend that since the goods were not manufactured during the relevant previous year, the assessee was not entitled to deduction of excise duty. In this case, the show cause-cum-demand notice was issued during the relevant previous year and, accordingly, the demand, although earlier disputed, became real and enforceable and, therefore, the same is allowable as deduction in the previous year in question.

In Saurashtra Cement and Chemical Industries Ltd. Vs. Commissioner of Income Tax, , the Gujarat High Court held that : "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 crystallised in the year in question on the basis of maintaining accounts on the mercantile basis".

18. In ABAD FISHERIES Vs. COMMISSIONER OF Income Tax. (AND VICE VERSA)., , the Kerala High Court held that a provision in the accounts made by an assessee following the mercantile system of accounting for liability to sales tax (although disputed)

is yet liable to be allowed as business expenditure, if there is a bona fide reasonable apprehension on the part of the assessee that the amount will become payable. The question to be considered is whether on the date on which the provision was made in the accounts, the assessee could have had a reasonable apprehension of the liability being cast on it.

19. It is clear in the present case that the liability to pay central excise arises as soon as the assessee manufactured or produced the excisable items. It could not provide for the liability in the accounts because of the difficulty in ascertaining the rate of duty. Till a licence was applied for on February 1, 1977, there was a genuine doubt in the minds of both the assessee and the Excise Department as to the dutiability of the goods manufactured. It was only when the assessee based upon the observations made by the High Court, applied to the excise authorities for a licence and when the licence was granted, that the liability to pay excise duty not only got cleared but crystallised. Therefore, when the application of the assessee for the issue of a licence on February 1, 1977, the doubts that till then existed in the minds of the Department and the assessee got cleared and the liability to pay duty on excisable goods arose and that arising was in the accounting year relevant for the assessment year under consideration. If the settled law is that the liability to pay excise duty arose, no sooner the excisable commodity was manufactured or produced, since the commodity in this case was produced from 1973 onwards, the liability to pay excise duty subsisted from that date and if that were so, the liability to the earlier period could not be allowed as a deduction in the year under consideration, but it is only a liability relating to this year under consideration. In the earlier years, the assessee started manufacturing goods right from the year 1968 and the excise authorities had examined this aspect and came to the bona fide conclusion that these were not liable to duty. They again revived the matter some time in November, 1973, which the assessee successfully contested. During that time as per law prevailing the assessee is not liable to excise duty. When that was the law, the assessee cannot be expected to have incurred a liability to pay excise duty on the items it manufactured. But it was in November, 1976, that the assessee was advised that since ceramic fuse bodies were themselves liable to duty and since there was an observation to that effect in the judgment of the High Court, the assessee subjected itself to levy of duty by applying for licence and since that event took place in February, 1977, which is the relevant year under consideration, the Tribunal came to the conclusion that the liability to pay excise duty arose only in February, 1977, even though the manufacture was earlier to that period. In the earlier period, the assessee was entertaining only an honest. doubt as to the levy of duty. Since the liability under law had accrued, consequently, the assessee made a provision in the accounts and in that case the liability related to that period. The assessee contested the liability and succeeded and therefore it can be said that under the law, no liability had accrued. Subsequent subjection to levy of duty therefore alone can be taken as the starting point. On February 1, 1977, the assessee applied for a licence. The amount of provision made is a matter of calculation. The assessee had the advantage of knowing it correctly on the basis of subsequent events. As a matter of fact, the claim

made by the assessee now turned out to be more than the actual claim because the assessee made a provision in the accounts on the basis that the rate of duty was 25 per cent., which was later on reduced to 15 per cent. on which basis the demand was about Rs. 3 1/2 lakhs. It was also brought to our notice that later on the appellate authority reduced the liability only for one year. Since the matter is proceeding on the footing that the assessee had incurred a liability under the statute to pay excise duty and the assessee had a reasonable belief about the rate of duty, the Tribunal was of the opinion that the assessee is entitled to the deduction for the entire sum for which provision was made in the accounts, subject to the other provisions of the law, which could be invoked if the assessee had obtained any benefit by way of cessation or remission or otherwise in subsequent years in respect of this provision. The Tribunal was, therefore, correct in its view that the amount of Rs. 5,75,000 was in the nature of accrued liability in the year under consideration and, therefore, it is allowable as deduction.

20. The reasons given by the Tribunal for allowing Rs. 5,75,000 as deduction in the year under consideration appear to be very sound and, therefore, we see no infirmity in the order passed by the Tribunal on this aspect. Accordingly, we answer the question referred to us in the affirmative and against the Department. No costs.