(2000) 08 KL CK 0051

High Court Of Kerala

Case No: Income Tax R. No. 123 of 1997

Commissioner of Income Tax	APPELLANT
Vs	
Sitaram Textiles Ltd.	RESPONDENT

Date of Decision: Aug. 17, 2000

Acts Referred:

- Income Tax Act, 1961 - Section 139, 142(1), 142(2), 143, 143(1)

Citation: (2001) 248 ITR 139

Hon'ble Judges: S. Sankarasubban, J; G. Sivarajan, J

Bench: Division Bench

Advocate: P.K. Ravindranatha Menon and George K. George, for the Appellant; U.K. Ramakrishnan and S.V. Lohithakshan, for the Respondent

Judgement

S. Sankarasubban, J.
The above reference arises from I. T. A. No. 620 (Coch) of 1994. The following questions of law are referred u/s 256(1) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"):

"(1) Whether, on the facts and in the circumstances of the case and on an interpretation of the relevant provisions, the Tribunal is right in law in holding-

(i) it is only in respect of Clause (a) of Section 43B that the distinction between accrual of liability and ''any sum payable'' under such accrual was done away with under the terms of Explanation 2 to Section 43B ?

(ii) the distinction between the ''sum payable'' and the ''accrual of liability'' for such sum is maintained intact in Clause (d) as Explanation 2 is not made applicable to that clause in Section 43B ?

(2) Whether, on the facts and in the circumstances of the case and also going by the well known principles of auditing extracted in the enclosure, the Tribunal is right in law and fact in holding-

(i) Clause (d) of Section 43B as it stands cannot be invoked to form part of the prima facie adjustment meriting disallowance of deduction without having regard to the terms and conditions of the agreement governing the loan or borrowing from the public financial institutions and is not the above approach/finding against !aw and principles of auditing ?

(ii) the Assessing Officer should have rectified the assessment u/s 154 of the Income Tax Act on the petition preferred by the assessee in regard to the disallowance of interest u/s 43B(d) of the Income Tax Act ?

(3) Whether, on the facts and in the circumstances of the case, is the Tribunal-

(i) right in its interpretation of the provisions ?

(ii) right in deleting the disallowance of interest and the loan from the public financial institution ?

(iii) right in deleting the levy of additional tax referrable to such disallowance ?

(4) (a) Whether, on the facts and in the circumstances of the case, the Tribunal is right in its interpretation/understanding of column 7 of the tax audit report in Form No. 3CD read with Section 43B of the Income Tax Act ?

(b) Whether, on the facts and in the circumstances of the case, the Tribunal is right in law and fact in holding that on the basis of the information contained in column 7 of the tax audit report, it cannot be readily inferred that it referred to the items mentioned in Clause (d) of Section 43B and any inference based on that so as to invoke the provisions of the said clause for disallowing the interest on the loans from the public financial institutions must necessarily fail ?"

2. A reference is made at the instance of the Revenue. The assessment year in question is 1991-92. The assessee filed a return showing a loss of Rs. 1,44,97,339. The Assessing Officer processed the return u/s 143(1)(a) of the Act and issued an intimation determining the loss at Rs. 69,34,787. The Assessing Officer disallowed the interest debited in the profit and loss account in respect of the loans taken from the Industrial Financial Corporation of India and the Industrial Development Bank of India as the interest was not paid to the bank in the previous year u/s 43B of the Act. The Assessing Officer demanded additional tax of Rs. 6,95,755 u/s 143(1)(a) of the Act.

3. On receipt of the intimation, the assessee filed a petition u/s 154 of the Act seeking rectification of the adjustments made in the intimation and requesting for waiver of the additional tax. The above petition was rejected by the Assessing Officer. An appeal taken against that order before the Commissioner of Income Tax (Appeals) was also dismissed. The assessee took up the matter before the Tribunal as I. T. A. No. 620 (Coch) of 1994. The Tribunal held thus :

"There is always a distinction between accrual of liability and payability of such liability. Accrual of liability may precede in point of time the discharge of such liability. The substance of Section 43B is that deduction should be allowed not on the basis of the accrual of liability, but on the basis of discharge of such liability by way of payment. If this distinction between the term ''accrual'' and the term ''payable'' is kept in view it is apparent that Explanation 2 which has the effect of synchronising the accrual of liability with payability of such liability is confined only to Clause (a) of Section 43B, viz., in respect of the sums payable by way of tax, duty, cess or fee and it does not extend to Clause (d) in respect of any sum payable as interest on loan or borrowing from any public financial insti- tutions. Therefore, it is only in respect of Clause (a) of Section 43B that the distinction between accrual of liability and ''any sum payable'' under such accrual was done away with under the terms of Explanation 2 to Section 43B. On the other hand, the distinction between the ''sum payable'' and the ''accrual of liability'' for such sum is maintained intact in Clause (d) as Explanation 2 is not made applicable to that clause in Section 43B. If this distinction is kept in view, it would not be difficult for one to conclude that because the liability had accrued, the assessee was justified in debiting the profit and loss account in respect of the amount of interest on the loan or borrowing from the public financial institutions. A corollary of this distinction is that merely because the amount has been debited in the profit and loss account, as a result of accrual of liability, it cannot be immediately inferred that such liability represented the ''amount payable'' during the year. In fact, a close reading of Clause (d) of Section 43B is a pointer to the fact that the sum payable by way of interest on a loan or borrowing from public financial institutions should become payable in accordance with the terms and conditions of the agreement governing such loan or borrowing. Therefore, unless there was information about the agreement governing such loan or borrowing, and unless from such information it is gathered that the sum has become payable during the accounting year, Clause (d) of Section 43B cannot be invoked off-hand."

4. Thus, the Tribunal was of the view that since there was nothing in the return to show that the interest has become payable, it was not proper on the part of the Assessing Officer to exercise his power u/s 143(1)(a) of the Act,

5. Shri P.K. Ravindranatha Menon, senior counsel appearing for the Revenue contended that u/s 43B(d) of the Act, deductions in respect of any sum payable by the assessee as interest on any loan or borrowing from any public financial institution, in accordance with the terms and conditions of the agreement governing such loan or borrowing shall be allowed only if the sum is actually paid by him. He further contended that the assessee was following the mercantile system and hence, as soon as the interest accrued, it was shown on the debit side. The assessee is not entitled to deduction unless the amount is paid. He further submitted that in the audit report itself, it has been clearly stated that the amounts have not been paid. u/s 143(1)(a) of the Act, the Assessing Officer is entitled, on the basis of the

information available in the return, to disallow any loss, deductions or allowance, if it is impermissible. In this case, according to counsel, a mere look at the return and the audit report will show that the deductions in respect of interest were impermissible without making a further enquiry.

6. Learned counsel for the assessee Shri Lohitakshan contended that Section 143(1)(a) of the Act enables the Assessing Officer to disallow any deductions only if it is prima facie impermissible. He contended that on the basis of the return and without any further enquiry, it cannot be found that deductions were impermissible. Further, he contended that a mere debit in the profit and loss account on the basis of accrual of liability is not sufficient evidence to show that the amount has become payable during the previous year.

7. Since there was doubt as to whether in the audit report it was shown that the amount had been paid or not, we called for the files. In annexure-V to the audit report, it is stated thus : "Interest debited to profit and loss account but not paid during the year". Items Nos. 3 and 4 are the interest to the Industrial Financial Corporation of India and the Industrial Development Bank of India. Thus, from the audit report itself it is clear that the amount is not paid. Section 143 of the Act lays down the procedure after the return is filed u/s 139 or in response to a notice under Sub-section (1) of Section 142. Sub-clause (i) of Section 143 of the Act states that if any tax or interest is found due on the basis of the return, after adjustment of any tax deducted at source, any advance tax paid or any amount paid otherwise by way of tax or interest, then, without prejudice to Sub-section (2), the Assessing Officer shall send an intimation to the assessee specifying the sum payable. This intimation is deemed as demand u/s 156 of the Act. It further states that on scrutiny, if it is found that any refund is due to the assessee, it shall be granted to the assessee. The section further lays down the procedure to be adopted by the Assessing Officer in computing the tax or interest payable. If the Assessing Officer finds that there is any arithmetical error in the return, he can rectify the arithmetical error and intimate the assessee the tax due after the rectification or refund any amount due to the assessee as per the scrutiny. He can also look into and find out prima facie whether deductions, allowance or relief are admissible and then, the Assessing Officer can allow the same in spite of the fact that it was not claimed. Here also, intimation has to be sent to the assessee. The third circumstance is where it is found that any loss, deductions, allowance or relief claimed in the return are prima facie impermissible, then, it can be disallowed.

8. Thus, Section 143(1)(a) of the Act enables the Assessing Officer to compute the tax or interest on the basis of the claim made by the assessee and on the basis of the records in the return. It may so happen that the assessee would not have claimed any deduction. But then, the Assessing Officer can give that deduction and compute the tax as per deduction. In that circumstance, sometimes amounts may be due to the assessee. It may also happen that certain deduction or depreciation would have

been claimed in the return. But they would not be admissible on the basis of the Act, Here also, the Assessing Officer is entitled to disallow such deduction or allowance, if it is found that it is inadmissible. But what the section stresses is that the Assessing Officer should find out whether the deduction is admissible or inadmissible only on the basis of the information given in the return. He cannot travel outside the return and come to the conclusion that a particular deduction is admissible or inadmissible. The word "prima facie" in Section 143 is a relevant one. The adjustment can be given only, if prima facie, it is found that it is admissible or inadmissible. u/s 143(1)(a), provision is made for charging additional tax on the increased amount, which may be found due as per intimation. As the law stands, the Income Tax Officer can disallow a claim for deduction only if he is satisfied, on the basis of the material which is before him that the assessee is not entitled to such a deduction. This is strengthened by the use of the phrase "prima facie inadmissible". If anything more is read into the power to make adjustments u/s 143(1)(a), such power would be grossly arbitrary and unreasonable. As already stated, the audit report filed along with the return will show that the interest payable to the Industrial Financial Corporation and the Industrial Development Bank of India has been debited in the profit and loss account and therefore, it is stated that the above amount has not been paid.

9. The next question is, on the basis of this, whether the Income Tax Officer can hold that the deduction is not possible u/s 43B of the Act. Section 43B of the Act states as follows :

"43B. Certain deductions to be only on actual payment.-Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of-

(a) any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or

(b) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employee, or

(c) any sum referred to in Clause (ii) of Sub-section (1) of Section 36, or

(d) any sum payable by the assessee as interest on any loan or borrowing from any public financial institution, in accordance with the terms and conditions of the agreement governing such loan or borrowing,

shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in Section 28 of that previous year in which such sum is actually paid by him."

10. One of us, Sivarajan J., had occasion to deal with the scope of Section 43B of the Act in the decision reported in Damodar Electronics and Controls Vs. Commissioner of Income Tax, . In the above decision, it was observed thus (headnote) :

"Section 43B of the Income Tax Act, 1961, was inserted by the Finance Act, 1983, with effect from 1st April, 1984. In respect of the items set out in the four clauses of the said section, it virtually supersedes the provisions of Section 145 and provides that deduction shall be allowed only on the basis of actual payment, irrespective of the method of accounting adopted by the assessee. So, from the assessment year 1984-85, even in the case of an assessee who is following the mercantile system of accounting, a liability which accrued during the accounting period relevant to the assessment year in question is not liable to be deducted in the computation of the profits of the assessee unless the provisions of Section 43B of the Act are complied with."

11. The Tribunal, on the basis of Explanation 2 to Section 43B, attempted to carve out the distinction between incurring the liability and payment of the same. Explanation 2 to Section 43B of the Act says that so far as Clause (a) is concerned, viz., with respect to tax, duty, cess or fee, "any sum payable" means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law. According to us, Explanation 2 is only with regard to Clause (a) of Section 43B and it has no application to the other clauses in the section. Explanation 2 was inserted because of the decisions by certain courts that for the tax which is payable after the close of the relevant accounting year, the section did not apply. According to us, u/s 43B(d) of the Act, the assessee cannot claim the benefit of deduction of liability mentioned in Clause (d) in a year where the amount is not paid. It is not further necessary to find out whether, even though liability has been incurred, it was payable in that year. We also do not approve the distinction made by the Tribunal on the basis of the entries in column 7 of the tax audit report in Form No. 3CD to come to the conclusion that it cannot be readily inferred whether the amount was payable or not.

12. Learned counsel for the assessee then contended that Section 43B(d) refers to the payment of interest in accordance with the terms of the agreement governing such loan or borrowing. The contention of counsel is that the terms and conditions of the agreement have to be looked into before coming to the conclusion whether the amount was payable in a particular year or not. He further contended that since the agreement was not before him, the Assessing Officer was wrong in prima facie holding that the deduction is not admissible. According to us, this contention cannot be accepted. When the assessee himself has stated in the audit report filed along with the return that the amount was not paid, there was no further duty on the part of the Assessing Officer to find out whether as per the agreement, interest was payable during the previous year. According to us, such a construction will be doing

injustice to Section 43B of the Act.

13. Section 43B of the Act has been brought into force to see that the assesses, who incurred statutory liability, should not get the benefit of deduction without payment of the same. If this principle is kept in mind, there will be no difficulty in coming to the conclusion that if the amounts mentioned in Section 43B are not paid during the previous year, the assessee will not be entitled to deduction. Hence, we are of the view that the Assessing Officer was correct in disallowing the deduction made by him with regard to interest u/s 43B(d) of the Act.

14. Accordingly, we answer the questions of law as follows :

Regarding question No. (1), Clause (i), we answer in the positive and in favour of the Department. Regarding question No. (1), Clause (ii), we answer in the negative and in favour of the Department. Regarding question No. (2), Clause (i), we answer the question in favour of the Department and in the negative. Regarding question No. (2), Clause (ii), we answer the question in favour of the Department and against the assessee. According to us, questions Nos. (3) and (4) are facets of questions Nos. (1) and (2) and they are covered by our answers to questions Nos. (1) and (2).