(2014) 08 MAD CK 0228

Madras High Court

Case No: Tax Case (Appeal) No. 585 20007

Commissioner of Income Tax	APPELLANT
Vs	
Wheels India Ltd.	RESPONDENT

Date of Decision: Aug. 11, 2014

Acts Referred:

- Constitution of India, 1950 - Article 144
- Income Tax Act, 1961 - Section 143(1)(a), 145, 258

Citation: (2014) 368 ITR 554

Hon'ble Judges: R. Sudhakar, J; G.M. Akbar Ali, J

Bench: Division Bench

Judgement

R. Sudhakar, J.
This tax case (appeal) filed by the Revenue as against the order of the Income-tax Appellate Tribunal, was admitted by this court on the following substantial question of law:

"Whether, in the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in merely applying the ratio of the Supreme Court''s judgment in the case of Bharat Earth Movers without controverting the findings of both authorities below that in the assessee''s case, there was no ascertained liability towards leave encashment?"

After hearing both sides, the following substantial question of law is framed in addition to the above substantial question of law:

"Whether the assessee is entitled to the benefit of leave encashment as a deduction in respect of the assessment year 1998-99 without estimating with reasonable certainty the said leave encashment after following the mercantile system of accounting?"

2. We have heard both the learned standing counsel appearing for the Revenue and the learned counsel appearing for the assessee on the above additional substantial question of law.

3. The brief facts are as follows:

The respondent-assessee is engaged in the business of manufacture and production of automobile wheels and ancillaries. For the assessment year 1998-99, the assessee filed return of income admitting a total income of Rs. 5,49,09,000. The said return was processed under section 143(1)(a) of the Income-tax Act and an assessment order was passed on March 12, 2004, determining the total income at Rs. 9,21,75,520. Aggrieved by the order of the Assessing Officer, the assessee went on appeal before the Commissioner of Income-tax (Appeals) in I.T.A. No. 8/2001-02. Since certain issues were not considered by the Assessing Officer, the Commissioner of Income-tax (Appeals) remanded the matter to the Assessing Officer for considering of the same on the merits. On remand, the Assessing Officer, after considering the issues, with regard to the claim on deduction of leave encashment, found that during the relevant assessment year, the assessee claimed a sum of Rs. 64,66,000 as deduction towards leave encashment benefits to the staff. According to the assessee, up to the year 1997-98, they were following the cash system of accounting and, hence, they are entitled to the benefit of leave encashment deduction. By order dated February 23, 2002, the Assessing Officer rejected the claim of the assessee holding as follows:

"4. The whole issue was examined and the following facts are brought to light. The assessee-company claims that it followed the cash system of accounting towards leave salary payments on paid basis till the assessment year 1997-98 and from thereon it follows the accrual method of accounting on a consistent basis. This is not borne out from the facts brought in the assessee''s return and balance-sheet. The assessee-company in its schedule XIV in its notes on accounts in paragraph 17 mentions that the liability towards leave encashment benefits is based on actuarial valuation not provided for and will be on cash basis. It also mentions that the actual amount towards this is not ascertained. Even in the income-tax adjustment memo, the assessee does not mentioned the exact liability towards such payment and it is submitted that it will be furnished at the time of assessment. The very fact that assessee has not provided for such amounts in the books of account and only claims such an amount (without furnishing the exact amount) by a simple statement already reveals that the assessee has not followed the accrual system of accounting.

5. The assessee was also asked to submit the leave salary policy of the company but the assessee did not provide any agreement with the labour union or any documentary evidence as to its liability towards such expenses but simply stated that it has liability to pay. The assessee-company was also asked about the method of accounting followed in later years and about the payments made from the amount claimed in the relevant assessment years. The assessee submitted that it

did not claim such amount in later years as the leave salary was paid in cash basis. Also the assessee paid the leave salary from the provision claimed in this assessment year, i.e., 1998-99 in successive three assessment years. But the amount spent towards leave salary in these years are substantially lower less than half of the amounts claimed in the assessment year 1998-99. As the amounts paid in these years comprise also the payments for that year and provision of the assessment year 1998-99, the assessee could not provide details as to how much was the amount paid for the year of payment and how much from provisions for assessment year 1998-99.

6. The assessee is a company and as per the provisions of the Companies Act it should follow the mercantile method of accounting. As per section 145 of Income-tax Act, 1961, it should follow the mercantile system on a consistent basis. As, in this assessee''s case, the assessee follows different methods for different purposes an even on leave salary consistent method is not followed, the assessee''s contention of claim is not taxable due discussions mentioned above.

7. The assessee''s reliance of the ratio of Bharat Earth Movers case is also rebutted as in the assessee''s case the amount is not ascertained towards the liability. Even the liability is also not accrued on definitely arisen as the assessee is not bound by any agreement for the definite payment of the sum and the assessee also has not provided any such, if it is bound to pay, in its books, thus clearly indicating that it has not accrued the liability to pay for such sum."

4. Aggrieved by the order of the Assessing Officer, the assessee, again filed an appeal before the Commissioner of Income-tax (Appeals), who did not find favour with the plea of the assessee and denied the benefit. The Commissioner of Income-tax (Appeals) guided by certain facts, as though presented by the assessee before the original authority, which clearly showed that the assessee had taken a very specific stand that the leave encashment benefit was not ascertained and, therefore, it was not quantified even on a reasonable estimate. The relevant portion of the facts submitted by the assessee and recorded by the first appellate authority, is as follows:

"6. It is seen from the notes forming part of memo of adjustment filed along with the return of income as has been extracted above in paragraph 2, that the appellant had made a claim of liability towards leave encashment only by way of that note. It had, however, not estimated any amount for the said liability. Besides, no amount either by way of provision or otherwise had been either debited to the profit and loss account or claimed in the memo of income filed along with the return of income. Even the statutory audit report dated July 29, 1998 attached with the return of income filed mentions in paragraph 2(b) as under:

''In our opinion, proper books of account as required by law have been kept by the company so far as it appears from our examination of those books subject to note

No. 17 of schedule XIV regarding accounting of (i) gratuity amounting to Rs. 340.76 lakhs; and (ii) leave encashment benefits to the staff (amount not ascertained) on cash basis instead of accrual basis.""

Note No. 17 referred to in the extract above reads as under:

"17. Liability based on actuarial valuation not provided for, which will be met on cash basis.

7. It can, thus, be seen from the above note of the statutory auditor that the appellant had been, in its books, accounting expenditure relating to gratuity and leave encashment benefits on cash basis. However, the note specifically mentions that no amount had been ascertained in respect of gratuity. It is further seen that the amount had not been ascertained even in respect of the earlier accounting year wherein the gratuity figure had been ascertained. It is, thus, clear that no amount of whatsoever nature had been provided relating to leave encashment either in the books or in the return of income in the memo of income adjustment filed along with the return of income. The impugned sum of Rs. 64,66,000 had been claimed for the first time, vide the appellant''s letter in No. Ref. FA/DC/IT/1, dated July 24, 2001 (addressed to the JCTT, Special Range II, Chennai, the relevant portion of which reads as under:

With reference to your notice dated July 17, 2001, we furnish below the following details.

1. Leave encashment benefit amounting to Rs. 64,66,000 claimed in the return of income is a statutory liability governed by the Factories Act and a contractual liability under which the assessee-company is liable to pay the amount. Reliance is placed for the above view on the decision of the Supreme Court in the case of Bharat Earth Movers. It is a statutory accrued liability and it should be allowed in computing the total income based on our claim in the return of income as per the Supreme Court decision in the case of Kedarnath Jute Manufacturing Co. Ltd.

8. The above letter had been sent only after original assessment order was passed on March 12, 2001. The appellant claimed in the letter that the amount of Rs. 64,66,000 towards leave encashment benefit had been made in the return of income which is actually not correct in view of my discussions earlier. However, the issue to be decided is whether any liability had arisen during the year under consideration towards leave encashment and if so whether it was capable of being estimated with reasonable certainty."

5. Before the Commissioner of Income-tax (Appeals), the assessee placed reliance on the decision of the Supreme Court reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, and contended that subsequent to the assessment order they had given details of the liability that arise out of leave encashment benefits and since they were following the mercantile system of

accounting, they were entitled to the said allowance. The first appellate authority, however, distinguished the decision of the Supreme Court reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, by going into certain facts, which are not disputed in the said decision of the Supreme Court relating to probable calculation of earned leave and also the decision of the Supreme Court in the case of Metal Box Company of India Ltd. Vs. Their Workmen, to come to a conclusion that the rules governing encashment of leave do not provide a method as to how the leave encashment could be ascertained. According to the Commissioner of Income-tax (Appeals), the rules lead to uncertainty and, therefore, unavailed of leave for encashment is determinable only on the contingency of the retirement or resignation, which again is an uncertainty. The Commissioner of Income-tax (Appeals), therefore, came to the conclusion that the assessee was not able to give any working for calculating the sum of Rs. 64,66,000 claimed as deduction for leave encashment either before the Assessing Officer or before the Commissioner of Income-tax (Appeals). To sum up, the findings of the Commissioner of Income-tax (Appeals) in paragraph 15, are as follows:

"15. It appears to me that the appellant itself is in difficulty to know whether any such liability has arisen during the year. It is evident from note No. 17 of the notes on account forming part of the annual accounts that the appellant has not been able to ascertain any liability in this regard not only during this year but also in the previous year. Non-ascertainment of the liability possibly has forced the appellant to adopt the cash method of accounting for this purpose even though it is statutorily required to follow the mercantile system of accounting. The observation is reinforced from the fact that as far as the gratuity is concerned the appellant has been able to estimate a provision in this regard though not made again on account of cash system of accounting for this purpose as well. This provision has been estimated not only for the current year but also for the previous accounting year. To sum up, I hold that there is no substance in the claim of the appellant to seek deduction of Rs. 64,66,000 towards the provision of leave encashment benefits to its employees."

6. Accordingly, the Commissioner of Income-tax (Appeals) dismissed the appeal. Against which, the assessee filed an appeal before the Income-tax Appellate Tribunal. The Tribunal by a cryptic order, allowed the appeal just by referring to the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, . The order of the Tribunal is extracted as such for better clarity:

"This appeal by the assessee is against the order of the Commissioner of Income-tax (Appeals)-IV, Chennai, dated March 25, 2003.

2. The only ground in this appeal is that the learned Commissioner of Income-tax (Appeals) erred in confirming the disallowance of leave encashment benefit to the tune of Rs. 64.66 lakhs.

3. After hearing both the parties and perusal of the material placed on record, we find that this issue is covered in favour of the assessee by the judgment of the hon''ble Supreme Court in the case of Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, wherein it was held as follows (page 432):

''. . . that the provision made by the assessee-company for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by the employees of the company, inclusive of the officers and the staff, subject to the ceiling on accumulation as applicable on the relevant date, was entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The liability was not a contingent liability.''

4. Respectfully following the above ratio, we allow the deduction claimed by the assessee on account of leave encashment benefit.

5. In the result the appeal filed by the assessee is allowed."

7. Aggrieved by the order of the Tribunal the Revenue has preferred the present appeal before this court.

8. Learned standing counsel appearing for the Revenue submits that even though both the lower authorities have held in favour of the Revenue, the Tribunal, without going into the facts of the case, merely following the decision of the Supreme Court reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, , allowed by the appeal filed by the assessee. The assessee, without even making a provision for contingent liability, had claimed deduction towards leave encashment. Hence, the decision followed by the Tribunal does not apply to the facts of the present case. Also, the Commissioner of Income-tax (Appeals) held that the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, is distinguishable from the facts of the present case. Hence, the order of the Tribunal may be set aside.

9. Per contra, learned counsel appearing for the assessee submits that the assessee had followed the cash system of accounting up to 1997-98 and, thereafter, they are following the mercantile system of accounting. Hence, they are entitled to avail of the benefit of leave encashment deduction. However, the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, squarely applies to the facts of the present case and, hence, the Tribunal has rightly followed it. In support of his contention he relied on the decision reported in Commissioner of Income Tax Vs. Panasonic Home Appliances, , wherein this court, while considering the issue on the provision for encashment of leave, followed the decision of the Supreme Court reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, and held in favour of the assessee.

10. Heard learned standing counsel appearing for the Revenue and the learned counsel appearing for the assessee and perused the materials placed before this court.

11. Before we go further in this case, we are emboldened to state the way in which the appeal has been disposed of by the Income-tax Appellate Tribunal; We need to bring to the attention of the Tribunal the following observation of the Supreme Court in the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, :

"Before parting we would like to observe that when this appeal came up for hearing on March 24, 1999, we felt some difficulty in proceeding to answer the question arising for decision because the orders of the authorities below and of the Tribunal did not indicate how the leave account was operated by the appellants and leave salary provision was made. To appreciate the facts correctly and in that light to settle the law we had directed the Income-tax Appellate Tribunal to frame a supplementary statement of case based on books of account and other relevant contemporaneous records of the appellant which direction was to be complied with within a period of six months. The hearing was adjourned sine die. After a lapse of sixteen months the matter was listed before the court on Jury 20, 2000. The only communication received by this court from the Tribunal was a letter dated June 20, 2000, asking for another six months time to submit the supplementary statement of case which prayer being unreasonable, was declined. Under section 258 of the Income-tax Act, 1961, the High Court or the Supreme Court have been empowered to call for a supplementary statement of case when they find the one already before it not satisfactory. Article 144 of the Constitution obliges all authorities, civil and judicial, in the territory of India to act in aid of the Supreme Court. Failure to comply with the directions of this court by the Tribunal has to be deplored. We expect the Tribunal to be more responsive and more sensitive to the directions of this court. We leave this aspect in this case by making only this observation.
We have culled out the necessary facts stated in the earlier part of this judgment from the statement of facts filed by the assessee-appellant before the Income-tax Appellate Tribunal. The correctness of the requisite factual information relating to the leave encashment scheme, as stated in the said statement, does not appear to have been disputed before the Tribunal and was not disputed before this court too."

12. In the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, the apex court has crystallised the law, which reads as follows (page 431):

"The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty

though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain."

13. In the abovesaid decision, the Supreme Court relied upon the earlier decision of the Supreme Court in the case of Metal Box Company of India Ltd. Vs. Their Workmen, . However, we find that the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, does not apply to the facts of the present case.

14. We find that the assessee filed the return of income attaching the statutory audit report dated July 29, 1998, wherein, in paragraph 2(b), it was mentioned that note No. 17 of schedule XIV regarding accounting of (i) gratuity amounting to Rs. 340.76 lakhs; and (ii) leave encashment benefits to the staff (amount not ascertained) clearly mentioned that the same was on cash basis instead of accrual basis. Hence, it is clearly established that the assessee was able to quantify the gratuity amount payable at 340.76 lakhs as at March 31, 1998, and 302.80 lakhs as on March 31, 1997. However, leave encashment benefits was stated to be not ascertained. It is also to be noted that for the previous assessment year they have followed the cash system of accounting and since they have switched over to the mercantile system of accounting from the accounting year 1998-99, they should have estimated the encashment benefits with reasonable certainty based on the relevant data available, which they failed to do at the first instance. Further, the assessee, in order to overcome this difficulty, pursuant to the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, , which was rendered on August 9, 2000, vide letter dated July 24, 2001, which has already been referred to supra, determined the leave encashment benefit at Rs. 64,66,000 stating that it is a statutory liability. It is to be noted that the assessee had not filed any working sheet for calculation of the said amount and there was no basis for arriving at that figure.

15. In the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, , the Supreme Court referred to the decision reported in Metal Box Company of India Ltd. Vs. Their Workmen, , and held that a few principles were laid down by this court, the relevant of which for our purpose are extracted and reproduced. For easy reference, the same is extracted below (page 431 of 245 ITR):

"(i) for an assessee maintaining his accounts on the mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in the case of amounts actually expended or paid;

(ii) just as receipts, though not actual receipts but accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business;

(iii) a condition subsequent, the fulfillment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability; and

(iv) a trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated."

16. From a reading of the abovesaid decision, it is clear that since the asses-see in this case is following the mercantile system of accounting from the accounting year 1998-99, they should have determined the leave encashment amount on the basis of the accepted principles of commercial practice and accountancy. Even though they may not be in a position to give the accurate details but that does not allow the assessee to claim a figure in an arbitrary manner without there being any supportive material. We find that the Commissioner of Income-tax (Appeals) in this case has discussed the rules governing encashment in paragraph 13 of the order to hold that the rules does not lead to uncertainty on the quantum of leave encashment.

17. In view of the vagueness in the nature of the leave encashment benefits as claimed by the assessee, we hold that the assessee is not entitled to claim deduction on the leave encashment, which was rightly rejected by the Assessing Officer as well as the Commissioner of Income-tax (Appeals). The decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, and the law settled therein will not enure to the benefit of the assessee herein, as we find that there could be an estimation with reasonable certainty though no actual quantification is required. In this case, there is no attempt on the part of the assessee to satisfy the requirements except placing reliance on the said decision. It is to be noted that for the relevant assessment year, the assessee has been inconsistent in his plea that for the benefit of leave encashment deduction, they are following cash system of accounting and for the rest, they are following the mercantile system of accounting. We, therefore, accept the stand taken by the Revenue. We also deprecate the Tribunal for passing a non-speaking order without going into the facts of the case.

18. In so far as the decision relied on by the learned counsel appearing for the assessee reported in Commissioner of Income Tax Vs. Panasonic Home Appliances, is concerned, in view of the divergent stand taken by the assessee, we are unable to extend any benefit to the assessee on the basis of the said decision. For the foregoing reasons, we pass the following order:

(i) On the questions of law framed, we are of the view that the Tribunal was not justified in passing a cryptic order by just following the decision reported in Bharat Earth Movers Vs. Commissioner of Income Tax, Karnataka, , which is not applicable to the facts of the present case;

(ii) Consequently, the order of the Tribunal dated July 28, 2006, is set aside.

In the result, this tax case (appeal) is allowed. No costs.