Bengal Enamel Works Ltd. Vs Commissioner of Income Tax

Court: Calcutta High Court

Date of Decision: May 20, 1953

Acts Referred: Factories Act, 1934 â€" Section 49B, 49C
Factories Rules â€" Rule 12, 15, 17
Income Tax Act, 1961 â€" Section 10(5), 66(2)

Citation: (1955) 2 ILR (Cal) 13

Hon'ble Judges: Chakravartti, C.J; Lahiri, J

Bench: Division Bench

Advocate: Surendra Nath Basu, for the Appellant;E.R. Meyer, for the Respondent

Final Decision: Allowed

Judgement

Chakravartti, C.J.
This is a Reference by the Calcutta Bench of the income tax Appellate Tribunal of the following question of law:

Whether in the facts and circumstances of this case, the sum of Rs. 6,800 can be rightly charged as an expense to the accounts of this year.

2. By ""this year"", the Tribunal apparently meant the accounting year relative to the assessment year 1947-48. It is much to be regretted that the

question should have been framed in that indefinite, if not careless, form.

3. The Assessee, the Bengal Enamel Works, Limited, is a company and keeps its accounts in the mercantile method. For the calendar year 1946,

which was the relevant accounting year, it was assessed to tax mostly on the profits and gains of business and, in fact, there was little else which

contributed to its taxable profits. The Assessee asked for a deduction of Rs. 6,800 which it had debited to its expenses account and claimed that

this amount was allowable to it, because it had incurred a liability for a corresponding amount to the employees on account of holiday wages which

would have to be paid to them sometime in the following year. That claim, it appears, was based upon Section 49B of the Factories Act XXV of

1934 which was referred to before the Appellate Tribunal and it may be also upon Rules 12, 15 and 17, framed under the same Act, which were

referred to before us. The income tax authorities refused to allow the deduction claimed and the reasons for the refusal are given by the tribunal in

its appellate order. The reasons given are that the amount was not actually expended during the relevant accounting year and that it did not even

represent a certain liability which would have to be discharged in any event at some future point of time. The Tribunal referred to the relevant

sections of the Factories Act and pointed out that holiday wages would have to be paid only if and when an employee went in for a holiday. But if,

being entitled to a holiday, he took none, he might on paper go on accumulating holidays, but the employer would not be called upon to make any

payment under the head at all. Even if the employer ever came under the liability to pay holiday wages, the same would have to be computed at the

rate of the wages current at the time when the claim was made and the amount paid. It could not, therefore, be said, before a claim was actually

made, what the amount would be that would have to be paid, or that any amount would have ever to be paid at all. Various possibilities were

pointed out by the Tribunal, such as, that an employee might die before he made any claim or the contingencies in which the holiday wages would

be payable to him might never occur. In those circumstances, the view taken by the Tribunal was that till an amount was actually paid on account

of holiday wages, the Assessee could not be allowed any deduction in its assessment and that the officers below had been right in not allowing this

item of expense ""at this stage"".

4. It appears that the Assessee asked for a Reference of a number of other questions, but was unable to persuade the Tribunal to refer them. It

then moved this Court u/s 66(2) of the income tax Act for a Rule on the Tribunal, directing it to refer the remaining questions of law, but was again

unsuccessful. Before us, Mr. Bose stated today that if only no order for costs was made against him, he would not press this Reference as well. As

he did not seem to be entitled to an order, merely refusing to answer the Reference and not making him liable for costs, we informed him

accordingly, and thereafter he said that he would then place before us the arguments he wished to advance in support of his client''s point of view.

5. We invited Mr. Bose to tell us under what section of the Indian income tax Act he was claiming the deduction, to which he replied that he was

making the claim under Clause (x) and also Clause (xv) of Section 10(5) of the income tax Act. The first of those clauses speaks of ""any sums paid

to an employee"" and the second refers to ""any expenditure laid out or expended"". Since both the clauses relied upon by Mr. Bose contemplate,

prima facie at least, actual expenditure and therefore did not cover the case of a reserve fund, Mr. Bose ultimately said that he was relying upon

general principles. What the general principles were, he did not specify.

6. Taking the question on its merits, the sheet-anchor of Mr. Bose''s case was Section 49B of the Factories Act of 1934. That section is divided

into three paragraphs, the first of which provides that every worker, who has completed a period of twelve months'' service in a factory, shall be

allowed, during the subsequent period of twelve months, holidays for a period of ten days. I am leaving aside the case of children who are entitled

to fourteen days. The second paragraph next provides that if a worker fails to avail himself of the whole of the holidays allowed to him during any

one period of twelve months, the holidays not taken by him shall be added to the holidays to be allowed to him under Sub-section (1) in the

succeeding period of twelve months, subject, however, to the limit that the number of holidays that can be carried forward to a succeeding period

shall not exceed ten days. Again, I am leaving aside the case of children. Reading the two paragraphs together, it would seem that the maximum

amount of holidays for a worker, who has been in continuous service in a factory for at least twenty-four months, is twenty days in the second year

and never more than that number of days.

7. The above, however, is only the measure of the holidays to which he is entitled. Payment of holiday wages is an entirely different matter.

Payment is provided for in the third paragraph of Section 49B and all that is there provided is that an employee shall be entitled to the amount

payable to him as holiday wages under the provisions of Section 49C if (a) he is discharged by his employer before he has been allowed the

holidays, or (6) if, having applied for and having been refused the holidays, he quits his employment before the holidays have been allowed. We

asked for information as to whether there was any other provision in the Factories Act or in the rules framed thereunder regarding actual payment

of holiday wages. Mr. Bose referred us to Rule 12, but it is perfectly clear that what that rule deals with is that the workers shall be allowed a

number of holidays with full pay in the circumstances mentioned in the rule. It has nothing to do with actual payment.

8. It is clear from what I have stated above that if a worker goes on serving continuously in a factory for years and years, the maximum number of

holidays which he can earn for any particular year for wages purposes is twenty days, but he can be paid wages for those twenty days only in three

circumstances, namely, (1) if he takes the holidays, (2) if he is discharged and (3) if, on being refused a holiday or holidays, he quits his

employment before the holidays are allowed to him. If none of these contingencies occur, nothing will ever be payable to any employee on account

of holiday wages. Indeed, if, as Mr. Bose contended, the liability for holiday wages is a certain liability and occasion for making payment arises

every year, it is surprising to a degree that during the accounting year in question not a price was paid on account of holiday wages and the whole

claim relates to only an amount set apart by way of a reserve fund.

9. It should be clear from what I have stated above that such statutory liability for holiday wages as the Factories Act creates is only a contingent

liability which may or may not have to be discharged; and, secondly, the measure of that liability can never be known in advance. It cannot be so

known, because it cannot be known in advance how many employees will avail themselves of how many holidays and when and, necessarily, at

what rate, holiday wages would be payable. In those circumstances it is perfectly clear that not only is the amount claimed not allowable as an item

of expenditure, because, in fact, no expenditure had been incurred and not a price had gone out of the funds of the company, but also that the

amount does not even represent a certain liability which will have to be discharged in any event. It may be that although a particular amount is not

actually expended during the currency of a particular accounting year, the Assessee will still be entitled to a deduction if a certain liability for its

payment has arisen so that it may be said that the expenditure is as good as made. The amount claimed in the present case is certainly not even of

that character and, as I have already pointed out, it is not an amount which was actually spent.

10. Mr. Bose contended that his client kept its accounts in the mercantile method and therefore the fact that it had debited the amount in its books

would be sufficient to establish expenditure. I entirely disagree. It is true that under the mercantile system of accounting a debit can often be

equated with actual expenditure provided a liability has been incurred, but on the facts I have stated, the debit in the present case is no better than

a fictitious debit and is liable to be disregarded on that account.

11. On behalf of the Commissioner of income tax Mr. Meyer drew our attention to the case of Peter Merchant, Ltd. v. Stedeford, (1948) 30 T.C.

496, which went up to the Court of Appeal. There the Assessee-company was in the business of managing factory canteens and was bound under

a contract with a factory-owner, who provided the crockery, cutlery and utensils used in the canteen, to maintain the same ""in their original quantity

and quality"". Each year, the company went on charging in its accounts as expenses not only the sums actually spent in effecting replacements, but

also sums representing at current prices the company''s liability to effect further replacement as soon as the required equipment became available.

The latter provision had to be made, because the goods were scarce and prices were high. The assessing authorities allowed the company

deductions to the extent of the amounts actually spent, but so far as the amounts which were set apart, as it were, against the liability to make

replacements in the future were concerned, those were not allowed. Both the High Court and the Court of Appeal held that the second set of

amounts were not permissible deductions and the reason given was that the liability of the company under the contract with the factory-owner was

a contingent liability, because the contract did not require the company to replace items of crockery or cutlery or utensils whenever a breakage or

loss occurred, but only required it to produce the whole quantity before the factory-owner at the termination of the contract. The replacements

could, therefore, be effected as and when convenient and when prices were favourable and, to that extent, the entries made in the accounts at the

high prices, currently prevailing, did not represent the actual liability of the company. Secondly, even if any replacement remained to be made at the

time the period of the contract came to an end, it might be possible at that time to procure the goods required at a cheaper price and therefore the

amounts set apart in the accounts could not be claimed as an allowable deduction on the basis that it represented a certain liability of the company.

That case, to my mind, is a much stronger case from the Assessee''s point of view than the case before us, because although, as the Court of

Appeal held, the company might be free to effect the replacements as and when convenient and at times when the prices were the lowest, still, the

liability to make the replacements was a certain liability. The only uncertainty that there was, was attached to the quantum of the cost and that itself

was considered sufficient to make the liability uncertain and to disentitle the Assessee from claiming the deduction. In my opinion that case

completely covers the point before us and the answer here must be the answer which the English Courts returned in the case cited.

12. In my opinion, the Tribunal was entirely right in holding that the Assessee was not entitled to the deduction claimed, both for the reason that no

expenditure had been actually incurred and also for the reason that the amount could not be claimed even as an amount representing a certain

liability. The answer to the question referred must therefore be ""No"".

13. The Commissioner of income tax will have the costs of this Reference.

Lahiri, J.

14. I agree.