

(1994) 11 KAR CK 0043

In the Karnataka High Court

Case No : Income-tax Reference Case No. 57 of 1985

Commissioner of Income Tax

APPELLANT

Vs

Bharat Earth Movers Ltd.

RESPONDENT

Date of Decision : 07-11-1994

Acts Referred:

Income Tax Act, 1961 — Section 256 (1)

Citation : (1995) 123 CTR 276 : (1994) ILR (Kar) 3238 : (1995) 217 ITR 515 : (1995) 211 ITR 515 : (1996) 41 KarLJ 508

Hon'ble Judges : S. Rajendra Babu, J;R.V. Vasanthakumar, J

Bench : Division Bench

Advocate : H.L. Dattu, for the Appellant; M/s King, for the Respondent

Judgement

R.V. Vasanthakumar, J.—At the instance of the Revenue, the following question of law has been referred to this court u/s 256(1) of the Income Tax Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the provision for making the liability for encashment of earned leave by the employee is an admissible deduction?"

2. The assessee company introduced a scheme by virtue of which employees of the assessee company were entitled to encash leave at their credit. The assessee, in its books of account, maintained an entry as accrued leave reserve to which it credited every year liability in respect of leave based on leave entitlement of every employee and having made such provision of meet the liability in regard to payment of leave with wages claimed deduction in respect of that provision. The original assessing authority disallowed the claim. On appeal, the first appellate authority, placing reliance on an order passed in Income Tax Appeal No. 3222340/(Bang.) of 1980, pertaining to Motor Industries Co. Ltd. v. I.T.O., upheld the contention of the assessee. Aggrieved by the order of the first appellate authority, the Revenue brought the matter before the Income Tax Appellate Tribunal which also confirmed the order of the first appellate authority. Later on, the Revenue u/s 256(1) of the act sought reference to this court.

3. The main contention advanced by the assesses is that it is entitled for deduction of the amount of Rs. 62,25,483 in respect of provision for accrued leave on the ground that the amount standing to the credit of the reserve account as at the end of the accounting year March 31, 1978, represented an ascertained liability only to be discharged in the foreseeable future depending on the actual utilisation of the employee, such utilisation being a certainty. It is contended that the employee is entitled under the rules to encash the leave and he can accumulate it for a certain period and as such encashed leave is earned by the employee and it get credited to his account. It is also contended that though the payment is deferred, the liability of the assesses to pay for accumulated leave stands accrued. The said liability is a liability in praesenti and not a contingent liability. It is further contended by the assesses that leave salary payable to the employee can be ascertained at the end of the accounting year depending on the accumulated leave to the credit of an employee and that the same is not a contingent liability but a liability in praesenti since out of the provision made, leave salary would be paid to the employees and that the leave encashment benefit is ascertainable.

4. As against the above contention, the Revenue contends that provision for leave salary is not an allowable deduction and the said liability is a contingent liability and not a liability in praesenti. It is contended that question of leave salary arises when a person goes on leave and for the particular period leave salary is payable, the person is entitled to avail of leave encashment benefit under the scheme and the same is optional. This will depend on whether he actually avails of the leave or not. If leave is due to a person he has the option either to accumulate the leave or he may avail of the leave. If he avails of the leave, he would be entitled to the leave salary. If he does not, he will be entitled to the benefit of encashment of the leave; these events are uncertain events and are contingent.

5. The test is whether a provision provides for a known liability of which the amount can be determined with substantial accuracy. The decisive factor is not the methodology of accountancy or the practice followed by the company and the intention of the employee in getting the benefit of encashment of leave but the principle is whether such a liability is contingent or a liability in praesenti. When once the element of option is there, encashment of leave may or may not arise, the liability would only be contingent and uncertain which may or may not have to be discharged. Counsel for the assesses relies on the ratios of the decisions reported in :

Commissioner of Wealth-tax Vs. Prema Laxman and Another, C. Commissioner of Income Tax Vs. C. Tharian and Sons, ; Metal Box Company of India Ltd. Vs. Their Workmen,

6. In Metal Box Company of India Ltd. Vs. Their Workmen, the supreme Court laid down certain guiding principles in respect of liabilities arising under a scheme of gratuity which is to be stated is not of such assistance of the contentions

advanced by the assesses. The Supreme court in that case was concerned, inter alias, with the question whether it is legitimate in a scheme of gratuity to estimate the liability on an actuarial valuation and deduct such estimated liability in the profit and loss account while working out the net profit. The Supreme court held that if liability is properly ascertainable and if it is possible to arrive at its discounted present value, even if the liability is a contingent liability, it can be taken into account. That question does not arise here.

7. Counsel for the Revenue invites the attention of the court to the ratio decided in Commissioner of Income Tax Vs. Hindustan Aeronautics Ltd., wherein one of us, namely, Rajendra Babu J., was a member, who delivered the judgment wherein it is observed that the provision for accrued leave salary being a contingent liability, the same is not a permissible deduction.

8. Leave salary is payable only when a person goes on leave and during the period of leave, the salary paid to him is known as leave salary. It cannot be ascertained with any certainty whether in a particular year, the employee would go on leave. It will depend upon the option of the employee. Unless the employee goes on leave, the assesses is not required to pay leave salary. The liability will only arise when a person goes on leave and it is only for that particular period he is on leave the leave salary is payable. We are unable to accept the contention of the assesses that at the end of the accounting year, it is known what is the quantum of leave due to a particular employee and on that basis a calculation could be made with accuracy. No one makes a provision for salary because salary is only payable after the employee renders service and then only it will accrue to him. similarly, in the case of salary which are paid during the leave period the employee becomes entitled to such leave salary only when he goes on leave. Accumulated leave to the extent permissible under various schemes in question can only be encashed at the time of happening of events as envisaged under the conditions of service either under the rules or schemes applicable to the employees in question. As such, this is nothing but a contingent liability and not a certain liability. We respectfully disagree with the ratio laid down in Commissioner of Wealth-tax Vs. Prema Laxman and Another, which decided the same while dealing with the provisions of the wealth-tax Act. We are of the view that neither the leave salary nor the leave encashment benefit payable to the employees can be said to be a present liability, but it is only a contingent liability and the assesses is not entitled to deduction. Hence our answer to the question is in favour of the Revenue.