
(1978) 12 AHC CK 0022

In the Allahabad High Court

Case No : Income-tax Reference No. 66 of 1977

Commissioner of Income Tax

APPELLANT

Vs

Brijmohan Das Laxman Das

RESPONDENT

Date of Decision : 22-12-1978

Acts Referred:

Income Tax Act, 1961 — Section 28, 37(1), 40, 5

Citation : (1979) 11 CTR 243 : (1979) 117 ITR 121 : (1979) 1 TAXMAN 223

Hon'ble Judges : Satish Chandra, C.J.; M.B. Farooqi, J

Bench : Division Bench

Advocate : Ashok Gupta, for the Appellant; S.P. Gupta, for the Respondent

Judgement

Farooqi, J.—The Income Tax Appellate Tribunal has submitted this statement of the case and has solicited our opinion on the following questions of law :

(1) Whether the Tribunal was correct in allowing the assessee's claim for interest paid on the credit balance in the individual account of Sri Rajendra Kumar ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was in law justified in holding that the assessee's claim for Rs. 26,453 representing liability to Central Sales Tax which was quantified through an assessment made on 10-7-73 was an allowable deduction in the year under consideration ?

2. The reference relates to the assessment year 1974-75. The assessee was a registered partnership firm, having three partners, one of them being Rajendra Kumar. He was a partner representing his own HUF. The firm maintained two accounts in the name of Sri Rajendra Kumar, a capital account and a deposit account. The share of the profit of Rajendra Kumar was credited to the capital account, while to the deposit account the firm paid interest to Rajendra Kumar, amounting to Rs. 7,923 in this year. The ITO added back this amount u/s 40(b) of the I. T. Act. This was upheld in appeal. The Tribunal, relying on The Commissioner of Income Tax Vs. Ram Laxman Sugar Mills, Mohiuddinpur, , deleted the add-back. The Tribunal found that Rajendra Kumar was a partner in

his capacity as karta of his HUF. The interest was paid to him in his individual capacity. Hence the payment was not to a partner. It could not be disallowed u/s 40(b). This finding is the subject matter of the first question referred to us.

3. In Commissioner of Income Tax Vs. London Machinery Co., , this Bench took the view that interest paid to a person who was a partner was disallowable u/s 40(b), no matter in which capacity the payment was made. In view of that decision, the first question has to be answered against the assessee.

4. In respect of the second question, the admitted position is that the assessee had been maintaining his account books on mercantile basis. The relevant transactions of sale were effected in the accounting period relevant to the assessment year 1969-70. The assessee did not make any provision for sales tax in his accounts for that year. The sales tax was assessed and demanded in the accounting period relevant to the assessment year 1974-75. The ITO took the view that the liability to pay sales tax accrued as and when the transactions of sale and purchases were effected. The liability had nothing to do with its quantification by the sales tax department. In this view he held that the liability could not be allowed as a deduction in the assessment year 1974-75. The AAC agreed with this view. The Tribunal, however, held that the assessee was not aware whether the Central sales tax would be payable by him and it was for this reason that he could not make provision in the relevant year and accordingly allowed the claim.

5. In The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, , the Supreme Court has observed (page 366):

"Now under all sales tax laws including the statute with which we are concerned, the moment a dealer makes either purchases or sales which are subject to taxation the obligation to pay the tax arises and taxability is attracted. Although that liability cannot be enforced till the quantification is effected by assessment proceedings, the liability for payment of tax is independent of the assessment."

and then again as under :

"An assessee who follows the mercantile system of accounting is entitled to deduct from the profits and gains of the business such liability which had accrued during the period for which the profits and gains were being computed."

6. In the present case it is not disputed that the relevant transactions were effected in the accounting period pertaining to the assessment year 1969-70. In view of observations of the Supreme Court, it is clear that the obligation to pay the sales-tax arose in that year. The liability did not cease to be there merely because the assessee thought that in law it had not arisen or because the assessment was made and demand created in a subsequent year. The assessee, who was following the mercantile system of accounting, should have deducted from his profits and gains of business such liability in the year 1969-70 u/s 37(1) of the I. T. Act, 1961. His omission to do so disentitled him to claim the

deduction in any subsequent year irrespective of the fact whether, he knew or not that the liability had arisen. For liability of one year cannot be taken into account for computing, u/s 28, the profits and gains of business in respect of a subsequent year.

7. Learned counsel for the assessee, however, argued that the assessee's omission to claim the deduction in the year 1969-70 would not disentitle him to claim it in the assessment year 1974-75, in which year the assessment was made and demand created against him. He urged that u/s 37(1) it is not obligatory that an assessee following the mercantile system of accounting should necessarily claim the deduction in the year in which the liability accrues. He can as well claim it in the year in which the liability is discharged and paid. We are unable to accept this submission.

8. Section 37(1) provides that any expenditure laid out or expended for the purpose of business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession ". When it says so, it contemplates two points of time at which a liability may be debited in the expenses account, one such time being when the liability accrues and the other when the liability is actually discharged and paid, depending on the method of accounting regularly employed by the assessee. If the accounts are maintained on the mercantile basis, then the deduction has to be made in the year in which the liability accrues. On the other hand, if the accounts are maintained on cash basis, then the deduction has to be made in the year in which the liability is discharged and paid. The expressions "laid out" and "expended" in this section have been used in contradistinction in order to bear out this meaning. On this construction, Section 37(1) must be held to provide, that expenditure would be allowed either when the liability accrues or when it is discharged and paid, according as the accounts are kept on mercantile basis or cash basis. Support is lent to this construction by Section 5. The effect of this section is that if the assessee's accounts are kept on mercantile basis, the income would be chargeable when it accrues or is earned irrespective of the fact whether it is actually received. On the other hand, if the accounts are maintained on cash basis, the income would be taxable only, when it is actually received. We see no reason why the same principle should not apply for debiting the expenditure.

9. On behalf of the assessee reliance was placed on the decisions reported in Commissioner of Income Tax Vs. R. Shantilal and Co., , CIT v. Nathmal Tolaram [1973] 88 ITR 234 and Commissioner of Income Tax Vs. Banwari Lal Madan Mohan, . In the first two cases it was held that sales tax for earlier years is an allowable deduction in the year in which the demand is created even if the assessee was maintaining his accounts on mercantile basis and had not made any claim in those years. With great respect we are unable to agree with this view. As already indicated by us, liability for payment of sales tax, which has accrued in one year, cannot be claimed as a deduction in a subsequent year

under the Act. In Commissioner of Income Tax Vs. Banwari Lal Madan Mohan, the assessee was following the mercantile system of accounting. He had made provision for sales tax in the relevant year on estimate basis, which turned out to be less when the assessment was made and the demand for sales tax was created. In the circumstances, it was held that the excess amount was an allowable deduction in the year in which the assessment was made. On the facts this case is clearly distinguishable from the present Case. There are some more cases on which reliance was placed by the learned counsel for the assessee, but we do not propose to refer to them here, as, in our opinion, they have no bearing on the controversy in the present case.

10. For these reasons we hold that the Tribunal was not justified in holding that the claim for Rs. 26,453 representing liability to Central sales tax for the year 1969-70 was an allowable deduction in the assessment year 1974-75. Accordingly, question No. 2 also has to be answered against the assessee.

11. In the result, our answer to the questions referred to us is in the negative, in favour of the department and against the assessee. The Commissioner will be entitled to costs, which are assessed at Rs. 200.