
(1997) 08 P&H CK 0036

In the Punjab And Haryana At Chandigarh

Case No : Income-tax Reference No. 37 of 1984

Commissioner of Income Tax

APPELLANT

Vs

Punjab Bone Mills

RESPONDENT

Date of Decision : 18-08-1997

Acts Referred:

Income Tax Act, 1961 — Section 35B, 35B(1)

Citation : (1998) 146 CTR 63 : (1998) 232 ITR 795

Hon'ble Judges : N.K. Agrawal, J; Ashok Bhan, J

Bench : Division Bench

Advocate : B.S. Gupta and Sanjay Bansal, for the Appellant; None, for the Respondent

Judgement

N.K. Agrawal, J.—The following two questions of law have been referred in Income Tax Reference No. 37 of 1984 relating to the assessment year 1978-79 by the Income Tax Appellate Tribunal (for short, "the Tribunal") at the instance of the Department u/s 256(1) of the Income Tax Act, 1961 (for short, "the Act") :

"1. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in upholding the order of the Commissioner of Income Tax (Appeals), in allowing weighted deduction u/s 35B of the Income Tax Act, 1961, on proportionate expenditure without specifically relating the expenditure to any of the sub-clauses of Clause (b) of Section 35B(1) of the Income Tax Act ?

2. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that cash incentive accrues to the assessee on the date when application for claim is made to the competent authority ?"

2. In the other two references (income tax References No. 36 of 1987 and No. 2 of 1991) relating to the same assessee for the subsequent two different years (1981-82 and 1982-83), one common question has been referred in each

reference and that common question is identical to question No. 2 referred in the assessment year 1978-79,

3. Question No. 1 in Income Tax Reference No. 37 of 1984 :

The assessee-firm was dealing in crushing bones and the manufacture and sale of its by-products. A return of income for the assessment year 1978-79 was filed, declaring income of Rs. 67,963. The assessee had claimed weighted deduction u/s 35B of the Act on the total expenditure of Rs. 2,22,267. The Assessing Officer allowed weighted deduction on commission and trade discount of Rs. 9,257 only. In appeal, the Commissioner of Income Tax agreed with the assessee that expenditures, other than those covered under Sub-Clause (iii) of Clause (b) of Section 35B(1), are not to be excluded on the ground that those were incurred in India. The Commissioner also agreed for allowing weighted deduction on salaries (Rs. 66,101), printing and stationery (Rs. 7,727), gratuity (Rs. 4,313), electricity (Rs. 2,599), postage and telegrams (Rs. 1,252) and travelling expenses (Rs. 4,688).

4. The assessee had shown the total exports at Rs. 51,42,000 against the total turnover of Rs. 81,55,000. The export was thus about 63 per cent, of the total turnover. The Commissioner of Income Tax, after adopting the percentage of export at 63 per cent., further reduced it by 50 per cent, on the ground that, in the absence of details, expenditure incurred for export promotion and development would qualify for weighted deduction and not the expenditure for making of the exports. He thus allowed weighted deduction on Rs. 27,304 against the expenditure totalling Rs. 86,680 on the aforesaid items.

5. Both the assessee and the Department went in appeal before the Tribunal. The order of the Commissioner was upheld and the contentions of the assessee as well as the Department were rejected by the Tribunal.

6. Shri B.S. Gupta, learned senior counsel for the Department, has argued that the Tribunal wrongly allowed weighted deduction on various expenditure without co-relating each item of expenditure with the specific sub-clause of Clause (b) of Section 35B(1). In the alternative, he has challenged the deduction allowed on gratuity amounting to Rs. 4,313.

7. The Tribunal has examined the nature of the expenditure for the purpose of allowing weighted deduction. Though it is correct that the specific sub-clauses of Clause (b) of Section 35B(1) have not been mentioned in the order while examining the admissibility of the various items of expenditures but that alone, in our opinion, would not render the order invalid or vitiated. If the expenditures are found to be allowable on merits, there was no requirement in law to make a special mention of the specific provision. So far as the second contention of Shri Gupta is concerned, it may be seen that gratuity has also been allowed as an admissible expenditure inasmuch as other establishment expenses, including salary, had been held to be eligible for weighted deduction. Gratuity is payable to such employee at the end of his employment, who was employed on wages not

exceeding Rs. 2,500 or the higher amount specified by the Central Government in that behalf. If the employee had rendered continuous service for not less than five years before his superannuation, retirement, etc., the Payment of Gratuity Act, 1972, laid down the quantum of gratuity to be 15 days' salary for every completed year of service or part thereof in excess of six months subject to the specified ceiling. Prior to the bringing into force of the Payment of Gratuity Act, the payment by an employer to his employee of gratuity on retirement, death, etc., was a matter of contract or practice. With the bringing into force of the aforesaid Act, with effect from September 16, 1972, the payment is a statutory liability in the case of employers. The said Act has subsequently been amended several times.

8. There is no dispute about the fact that payment of gratuity is an allowable deduction u/s 37(1) of the Act. Gratuity is paid to a retiring employee in lieu of his past services. The plea put forward by Shri Gupta, learned senior counsel for the Department, is that the amount paid by way of gratuity was not an expenditure for the service rendered by an employee during the current year. Since it was not paid in lieu of the service rendered during the current year, it was not admissible for the purpose of weighted deduction inasmuch as it was not relatable to the development of export market during the year.

9. As has been seen earlier, weighted deduction was allowed by the Commissioner of Income Tax as well as the Tribunal on various establishment expenditures including salary. Gratuity is paid to an employee by way of remuneration in lieu of his past services. Therefore, it would be difficult to say that it was different from salary. In these circumstances, no distinction can be drawn between the allowability of salary and gratuity as an admissible expenditure u/s 35B of the Act. Only because it reflects the payment in lieu of the past services, that alone would not render it ineligible for the purposes of weighted deduction. It was not shown that the employee, receiving gratuity, did not render any service either in the past or in the current year for the development of the export market. If salary paid to the employee could be allowed for the purposes of weighted deduction, gratuity paid to him on his retirement should also meet with the same treatment.

10. In the result, question No. 1 is answered in the affirmative, i.e., against the Revenue and in favour of the assessee.

11. Question No. 2 in Income Tax Reference No. 37 of 1984 and Questions in I T. Reference No. 36 of 1986 and I T. Reference No. 2 of 1991 :

The accounting period of the assessee in each year (1978-79, 1981-82 and 1982-83) ended on 31st March. The assessee-firm was following the mercantile system of accounting. Cash incentives for exports were to be received by the assessee from the Central Government. The assessee had accounted for the amount of cash incentive on receipt basis. The sum of Rs. 2,40,083 was not credited to the profit and loss account though it had accrued to the assessee.

The Assessing Officer, during the course of assessment for the assessment year 1978-79, treated the sum of Rs. 2,40,083 as income of the year under assessment on accrual basis. He was of the view that the assessee was bound to account for the amount of cash incentive in its books of account under the mercantile system which the assessee followed. Cash incentives accrued on the sale made by way of export. After the right to receive the cash incentive on the export had legally accrued, it was part of the assessee's income. The details regarding the amounts in question are as under :

Date of application

Date of receipt of amount

Amount received (Rs.)

(i)

18-1-1978

194-1978

1,35,779

(ii)

1-4-1978

30-9-1978

1,04,304

12. The assessee's plea before the Assessing Officer was that accrual of income would occur only when the amount was sanctioned and not when the export was made or application, claiming the cash incentive, was filed by the assessee. The basis of the plea was that the right was not settled during the year and, if there was a disputed right, it could not form part of the income of the year.

13. None of the two amounts, mentioned above, was stated to have accrued during the accounting year ending on March 31, 1978, inasmuch as those were received after the said date. Even the second amount of Rs. 1,04,304 had not accrued as the application was made after the close of the accounting year. Since the claim for cash incentive was required to be filed at the end of each quarter and it was admissible only when the exporter submitted the application, the income was said to be not assessable before its receipt, as per the assessee.

14. The Tribunal took the view that the cash incentive accrued to the assessee on the date on which the application for claim was made by the assessee to the competent authority.

15. Shri B.S. Gupta, learned senior counsel for the Department, has argued that the actual computation of the cash incentive was only a formal act and may be done at any time. Quantification was, therefore, not a condition precedent to the

accrual of a right. If the assessee had acquired the right during the year under assessment on his exports, its value should be included in that year. Determination or quantification of the amount would not postpone the accrual. An income accrues when it becomes due. Postponement of actual receipt of income would not affect its accrual. According to Shri Gupta, cash incentive accrued as and when an export was made. Accrual would thus arise in the event of export and not on the date of making application nor on the date of actual receipt of the money.

16. There is no dispute as to the fact that the assessee was maintaining his accounts on the mercantile system. All items of credit are brought into the account immediately after they become legally due and before they are actually received under the mercantile system of accounting. Similarly, all expenditures for which a legal liability has been incurred are debitable before they are actually disbursed. Such income which has become legally due or such liability for which a legal liability has arisen must be one that has been ascertained or is capable of being enforced by the person in whose favour the credit or the debit has been recorded. The mercantile system can, however, not be stretched to impress all sorts of provisional, notional or contingent receipts or payments which the assessee considered that he might ultimately receive or pay.

17. The word "accrue" has been defined in The Shorter Oxford English Dictionary (volume I), third edition", as under :--

"1. To fall (to any one, as a natural growth or increment ; to come as an accession or advantage.

2. To arise or spring as a natural growth or result.

3. To grow, grow up.

4. To collect."

18. It would be thus manifest that, in order that an income or profit may accrue to a person, it is necessary that he must have acquired a right to receive the same or a right to the income or profit had become vested in him though its valuation may be postponed.

19. If accounts are maintained according to the mercantile system, whenever the right to receive money in the course of trading transaction accrues or arises even though income is not realised, income embedded in the receipt is deemed to accrue or arise. Where the accounts are maintained on cash basis, receipt of money and not the accrual of the right to receive is the determining factor.

20. "Accrue" means to increase, to augment, to be added as an increase, to arise or spring as a natural growth or result. The words "accrue" and "arise" have not been defined in the Act but they appear to be synonymous and have been used for bringing in a natural result. Strictly speaking, the word "accrue" may not be synonymous with "arise" ; the former would be connoting the idea of growth or

accumulation and the latter, of the growth or accumulation with a tangible shape so as to be receivable. It is clear that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires the right to receive the income, the income can be said to have accrued to him though it may be received later, on its being ascertained. The basic conception is that he must have acquired a right to receive the income. When an Income Tax Officer includes a particular income in the assessment, two questions would arise, namely, what was the system of accountancy adopted by the assessee and when has the right to receive the amount accrued. If it is found that the mercantile system of accountancy is followed by the assessee, then the question would arise as to when the right accrued or arose in a particular accounting year. Income which accrues to an assessee is taxable in his hands. However, income which he could have but has not earned cannot be made taxable as income accrued to him.

21. Income is liable to be taxed on the basis of its accruing or arising to the assessee or its receipt by the assessee. The accrual or arising of income is generally dependent on the method of accounting employed by the assessee. In the cash system of accounting, the accrual or arising of the income will be simultaneous with its receipt. In the mercantile system of accounting, accrual of income is independent of its receipt. Mere sending of bills for goods sold, charging a rate which was never payable would not amount to "accrual of income". Sending the bills amounted merely to "making a claim" and did not create a legal enforceable right for the amount.

22. A question about the accrual of interest arose before the Rajasthan High Court in Commissioner of Income Tax Vs. Vijay Laxmi Trading Co. Ltd., . The assessee had advanced some money to a person and there was an agreement for charging interest. No interest, however, was charged after the year 1956. The assessee filed a civil suit for the recovery of the amount and a decree was passed in his favour. The decree provided for the repayment of the decretal amount. It was held that interest had accrued in view of the system of accounting adopted by the assessee and the decree of the civil court. The bad financial position of the debtor was held to be not relevant. Since interest had accrued, it was includible in the assessee's total income.

23. The Karnataka High Court in Commissioner of Income Tax Vs. A.B.V. Gowda (Deceased) (By L/R. Yeshoda Gowda), , has held that income is liable to be taxed on the basis of its accruing or arising to the assessee or on the basis of its receipt. Ordinarily, income is said to have accrued to a person when he has acquired an enforceable right to that income, though actual quantification and receipt may follow in due course.

24. The Patna High Court has also examined a question about the accrual of income and the method of accounting in Commissioner of Income Tax Vs. Bihar State Agro Industries Development Corpn., . The assessee in that case had sold tractors and other agricultural implements on cash payment basis as also on hire purchase basis. In respect of the sales effected on hire purchase basis, the

buyers were liable to pay interest on the price remaining due. The assessee credited the amount of interest in part to the "Interest suspense account". A certain portion of the interest was taken to the profit and loss account. It was held that the entire income had accrued to the assessee and the transfer of part of the interest to a suspense account was indicative of the fact that the assessee treated the income as having accrued to it. If that was so, there would be nothing to transfer part of the income to the suspense account.

25. The Allahabad High Court in *Commissioner of Income Tax Vs. Govind Prasad Prabhu Nath*, , noticed, in the case of an assessee-firm selling fertilizers and maintaining its accounts on the mercantile system, that certain money, received by way of excess price, had been deposited under the orders of the Supreme Court with the District Magistrate in a separate account. The claim of the assessee was that this amount did not represent its income. It was held that, till the claim of the assessee was decided by the Supreme Court, it could not be said that there was in existence a right in favour of the assessee to receive the amount in question. The amount had not accrued or arisen to the assessee nor was it received. It was, therefore, not assessable in the hands of the assessee.

26. The Madras High Court in *Commissioner of Income Tax Vs. Ashoka Lungi Company*, , examined a case of cash incentive. The assessee had maintained his accounts on the mercantile basis and had applied for and obtained cash incentives. Applications for four quarters had been made during the accounting years ending on April 13, 1966, and April 13, 1967. The assessee, however, received the cash incentives in respect of all the four applications during its accounting year ending April 13, 1967. The assessee's claim was that the right to receive the cash incentives arose on the date of the application itself and, therefore, the amount received on one application made during the accounting year ending on April 13, 1967, could be included for assessment in the assessment year 1967-68 and the balance amount relating to the other three applications made during the earlier year ending on April 13, 1966, could not be included for assessment in 1967-68. It was held that, since the assessee was maintaining his accounts on the mercantile basis, he would be liable to be assessed in case the amounts were due to the assessee during the accounting period. The incentive scheme showed that import entitlements were allowed to the exporters on production of proof of goods sent outside India and hence cash incentives would accrue to the assessee as soon as the necessary proof was tendered. It was held that the amount received on the basis of one application made during the relevant accounting year was liable to be included for assessment.

27. The distinction between the words "accruing", "arising" and "received", was examined by the Privy Council in *CIT v. Diwan Bahadur S.L. Mathias* [1939] 7 ITR 48. It was observed as under (page 56) :

"If on a question as to the exact meaning of "accruing", it were to be suggested that this only means "received", it would be reasonable to object that this can

hardly be correct even though the difficulty of distinguishing between "accruing" and "arising" may be great. In this sense, perhaps not a very important sense, the expressions are antithetical. But it is very plain that there is here no question of a complete disjunction or of the presentation of three mutually exclusive qualifications. No one would go about to prove that income was not received in British India by establishing that it arose or accrued there."

28. The Supreme Court in *Commissioner of Income Tax, Gujarat Vs. Ashokbhai Chimanbhai*, , has held that the words "accrue" and "arise" are used to contradistinguish the word "receive". Income is said to be received when it reaches the assessee ; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

29. In *Morvi Industries Ltd. Vs. Commissioner of Income Tax (Central) Calcutta*, , the Supreme Court had again an occasion to examine a case of accrual of income to an assessee maintaining the mercantile system of accounting. It was held that, under the mercantile system, credit entries are made in respect of amounts due immediately they become legally due and before they are actually received.

30. In *Commissioner of Income Tax, West Bengal-II, Calcutta Vs. Hindustan Housing and Land Development Trust Ltd.*, , the Supreme Court was examining a case of compulsory acquisition of land. Additional compensation was fixed by the arbitrator. But an appeal was filed by the Government against the award and, therefore, the amount was deposited in court. The assessee was permitted to withdraw the money only on furnishing security. It was held that additional compensation did not accrue to the assessee because the entire amount was in dispute in the appeal filed by the State Government. It was held as under (headnote) :

"There is a clear distinction between cases such as the present one, where the right to receive payment is in dispute and it is not a question of merely quantifying the amount to be received, and cases where the right to receive payment is admitted and the quantification only of the amount payable is left to be determined in accordance with settled or accepted principles."

31. It would appear from the facts of the case in hand before us that the right to receive cash incentive accrued to the assessee on filing the claim. The plea put forward by Shri Gupta that the date of the export would give rise to a right in favour of the assessee, does not appear to be appropriate because the assessee did not lay a claim asserting his right. Unless the claim is filed, no right to receive the income can be said to have arisen. Though cash incentive was connected with exports and was in the nature of a trading receipt or a revenue receipt, it cannot be said to accrue or arise unless the exporter made his claim. Cash assistance was given to an exporter to encourage exports. The making of the application was, therefore, an important event so far as the accrual of income was concerned. The date of the export would not by itself give rise to an income unless the assessee laid a claim to receive the income from the Government. The

date of the receipt of cash incentive would also be not relevant once it is found that the assessee was maintaining his accounts on the mercantile system. Therefore, the accrual of income would either depend on the date of the making of the export or on the date of the making of application by the assessee claiming cash incentive from the Government. The date of export would not create a right unless the assessee made a claim therefor. If the assessee did not file his claim, there was no accrual in his favour.

32. Keeping in view the principles laid down by the Supreme Court with reference to the accrual of income in the case of an assessee maintaining his accounts on the mercantile system, it is held that income accrued on the date of application filed by the assessee claiming cash incentive from the Government. Neither the date of making of export nor the date of receipt of cash incentive from the Government would be relevant.

33. In the result, question No. 2 in Income Tax Reference No. 37 of 1984 and the questions referred in Income Tax References No. 36 of 1987 and No. 2 of 1991, are answered in the affirmative, i.e., against the Revenue and in favour of the assessee.