

(2006) 06 KL CK 0061
In the High Court Of Kerala
Case No : IT Appeal No. 67 of 2000

Commissioner of Income Tax

APPELLANT

Vs

Southern Cables and Engineering Works

RESPONDENT

Date of Decision : 08-06-2006

Acts Referred:

Citation : (2006) 204 CTR 269 : (2007) 289 ITR 167

Hon'ble Judges : V. Ramkumar, J;K.S. Radhakrishnan, J

Bench : Division Bench

Advocate : P.K.R. Menon and K. George, for the Appellant; C. Kochunny Nair and S. Arun Raj, for the Respondent

Final Decision : Allowed

Judgement

K.S. Radhakrishnan, J.—The CIT, Thiruvananthapuram, is the appellant herein. He is aggrieved by the order of the Tribunal deleting the disallowance made by the AO holding that the claim of Rs. 2,28,336 was not relatable to the accounting year since the assessee was following mercantile system of accounting.

2. The assessment year in question is 1991-92. Assessee is engaged in the manufacture and supply of aluminium cables for the use of Kerala State Electricity Board (KSEB). AO while framing the assessment noticed that the assessee had claimed in the P&L a/c an amount of Rs. 2,28,336 towards penal deduction from supply bills. AO also noticed that, there was no such claim for the earlier years. When the assessee was informed of the same, assessee explained that the assessee had failed to deliver the goods as per schedule and therefore, the assessee was liable to pay 1 per cent of the value of the materials supplied as liquidated damages for every month or part thereof subject to 10 per cent value of belated supplies. Since the assessee was following mercantile system of accounting, he was asked to explain as to why the claim for deduction of penalty should not be disallowed in the absence of any such claim in the previous years. Assessee replied stating that they were trying to get the penalty waived by the KSEB and therefore, the same was not claimed in the earlier years. AO did not

accept the said contention since he found that deduction of Rs. 4,24,851 was originally made by the KSEB in the year 1989-90 and that from this some adjustments have been made in the subsequent year and that since the assessee was following the mercantile system of accounting they should have accounted for such penalty deduction in the accounting year 1989-90 (asst. yr. 1990-91) itself. AO held that the claiming of such deduction in the subsequent year was not permissible. AO therefore disallowed the claim of the assessee.

3. Aggrieved by the said order assessee filed appeal before the CIT(A). Assessee contended that during the accounting year 1988-89, KSEB deducted an amount of Rs. 4,24,851 for not supplying the materials in time. Assessee tried to get the waiver of the penalty and ultimately it was reduced to Rs. 2,28,336. It was therefore contended that the liability got finally crystallized not during the previous year relevant to the assessment year but during the subsequent year under consideration and therefore it should be allowed. Alternatively it was contended that it should be treated as bad debt.

4. CIT(A) however held that the liability in fact accrued during the accounting year 1989-90 relevant to the asst. yr. 1990-91 and therefore it should have been claimed in the same year itself. The CIT(A) therefore rejected the claim. Alternative claim was also rejected on the ground that there was a specific reason for deduction of the amount from the supply bills, that the deduction was not made for short-payment but for delay and therefore it could not be treated as bad debt. Aggrieved by the said order assessee took up the matter before the Tribunal. Tribunal however deleted the disallowance made by the AO on the ground that the claim of the assessee that the amount crystallized during the year under consideration was to be accepted as the exact amount of damages was crystallized during the year under consideration. CIT is aggrieved by the said order and has filed this appeal.

5. Senior counsel, Sri P.K. Raveendranatha Menon appearing for the Revenue submitted that the Tribunal should have found that the liability for damages, if any, had accrued in the accounting year relevant to the asst. yr. 1990-91 and the assessee had accordingly deducted a larger amount of Rs. 4,24,851 for not supplying the materials in time in the previous year relevant to the asst. yr. 1990-91. Counsel submitted that the Tribunal should have found that waiver or reduction in the amount does not postpone the accrual of the liability and that the assessee should have claimed the larger amount in the asst. yr. 1990-91 and brought to tax the difference in liability on account of waiver as income in the asst. yr. 1991-92 u/s 41(1). Counsel also placed considerable reliance on the unreported decision of this Court in IT Appeal No. 113 of 2001. Reference was also made to the decision of the apex Court in Keshav Mills Ltd. Vs. Commissioner of Income Tax, Bombay, and also the Full Bench decision of this Court in Commissioner of Income Tax Vs. K.A. Karim and Sons and Others, .

6. Counsel appearing for the assessee however submitted that the Tribunal was right in holding that the claim of the assessee was crystallized during the year

under consideration and that the amount in question was damages for the delay in supply and arises out of the contract and not a penalty. Counsel submitted in any view of the matter there is no substantial question of law raised by the Revenue for consideration by this Court. Counsel made reference to the decision of this Court in Commissioner of Income Tax Vs. A.M. Zainalabdeen Musaliar, . Counsel submitted that the order of the Tribunal deleting deduction (sic-disallowance) is not a substantial question of law. Counsel therefore submitted there is no justification in disturbing the finding of the Tribunal.

7. Indisputedly, the assessee is following mercantile system of accounting. An assessee who is following mercantile system of accounting is entitled to deduct from the profits and gains its business liability which arose during the relevant previous year and that liability did not cease to be a liability because the assessee had taken proceedings before higher authorities for getting it reduced or wiped off. The apex Court in The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, has considered the liability of an assessee who had followed the mercantile system of accounting. The Court held that although the liability to pay tax could not be enforced till quantification was effected by assessment, proceedings, the liability for payment (of) tax was independent of the assessment. The Court held that the liability for payment of sales-tax had accrued during the year of assessment even though it had to be discharged on a future date. A Bench of this Court in K.A. Karim's case (supra) followed the above principle and held that where an assessee maintains his accounts on the mercantile system of accounting his liability to sales-tax arises in the year in which he undertook the transactions liable to tax. Same is the view taken by a Bench of this Court, of which one of us, K.S. Radhaknshnan, J. is a party in IT Appeal No. 113 of 2001.

8. We are of the view since the assessee was following mercantile system of accounting, the assessee should have accounted for the penalty by deducting in the accounting year 1989-90 itself to maintain a claim. The KSEB had made a deduction towards penalty from bills for delayed supplies and the penalty deduction related to the accounting year 1989-90 relevant to asst. yr. 1990-91. Facts would show that KSEB had deducted a sum of Rs. 4,24,851 from supply bills for delay in supply during the year 1989-90. Subsequently the Board refunded a sum of Rs. 2,18,529 to the assessee during the accounting period 1990-91. The liability for the penalty accrued during the accounting period 1989-90 relevant to asst. yr. 1990-91. Even if it is true that part of the amount was refunded by the Electricity Board, the actual liability relates only to asst. yr. 1990-91. The assessee was following mercantile system of accounting. Hence the assessee should have claimed the same in the year 1989-90. The contention that the assessee was trying its best to get the penalty waived by KSEB and only, after exhausting all steps assessee could claim deduction cannot be sustained. Mere protest or opposition by a subject to the levy of tax or other duties payable to the Government cannot carry with it the implication that there is no proper levy legally recoverable till such protest or opposition ceases or is silenced. So

long as assessee is following mercantile system of accounting, in our view, assessee should have claimed deduction in the year 1989-90 (i.e.) accounting year. Therefore, Tribunal was not justified in interfering with the order passed by the appellate authority. Consequently, appeal is allowed and the order of the Tribunal is set aside to that extent.