
(1999) 05 CAL CK 0005
In the Calcutta High Court

Case No : Income-tax Reference No. 15 of 1993

Commissioner of Income Tax

APPELLANT

Vs

Todi Tea Co. Ltd.

RESPONDENT

Date of Decision : 18-05-1999

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1999) 156 CTR 23 : (1999) 239 ITR 28 : (1999) 105 TAXMAN 697

Hon'ble Judges : Y.R. Meena, J;Debi Prasad Sircar-I, J

Bench : Division Bench

Advocate : Mallik, for the Appellant;

Judgement

Y.R. Meena, J.—By this reference application, the Tribunal has referred the following questions for our opinion :

"1. Whether, on the facts and in the circumstances of the case, the finding of the Tribunal that Rs. 10 lakhs was agreed to by both the parties as full and final settlement of the dispute between them in March, 1984, is based on any material or perverse ?

2. Whether, on the facts and in the circumstances of the case, the finding of the Tribunal that the assessee moved the Calcutta High Court in the Matter No. 338 of 1986 for setting aside the arbitrator's award dated March 14, 1984, so far as it relates to the payment of the balance amount of Rs. 7,00,000 only is based on any material or perverse ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in allowing Rs. 10 lakhs as an allowable deduction in the assessment year 1984-85 ?"

2. The assessee, Todi Tea Co. Ltd., has entered into a contract with Taurus Foundry Private Ltd. During the course of assessment, the Income Tax Officer found that the assessee has created a liability of Rs. 10 lakhs in the previous

year, relevant to the assessment year 1984-85. The assessee-company claimed that the assessee has a liability to pay, by way of damages to Taurus Foundry Pvt. Ltd., of 33A, J. L. Nehru Road, Calcutta. It was submitted before the Income Tax Officer that the assessee-company had entered into an agreement with Taurus Foundry Pvt. Ltd., by a letter dated December 15, 1982. As per that letter, the assessee agreed to supply three lakhs Ps. of made tea from its garden during the period July to December, 1983, to Taurus Foundry Pvt. Ltd. By a letter dated December 20, 1982, signed by the director, Sri B. M. Beriwal, Taurus Foundry Pvt. Ltd., agreed upon the stipulation laid down in the said letter dated December 15, 1982. Subsequently, Taurus Foundry Pvt. Ltd., reminded the assessee by various letters of its commitment, but the assessee-company in spite of various reminders by Taurus Foundry Pvt. Ltd., did not respond and could not keep its commitment. Meanwhile the price of the tea increased by Rs. 3 to Rs. 4. per kilogram, more than the price settled in the contract between the parties.

3. While Taurus Foundry Pvt. Ltd., found that the assessee will not supply the tea as agreed upon, the Taurus Foundry Pvt. Ltd., claimed compensation on account of breach of contract to the tune of Rs. 30,00,000.

4. The matter was referred to the arbitrator. The arbitrator in his award settled the compensation at Rs. 17,00,000 payable by the assessee to Taurus Foundry Pvt. Ltd. That award was also challenged before this court. Meanwhile even before the arbitrator the assessee prepared to pay Rs. 10,00,000 as compensation on account of breach of contract. Even after the award the assessee prepared to pay Rs. 10,00,000 as against Rs. 17,00,000 referred to in the award as payable by the assessee to Taurus Foundry Pvt. Ltd. Finally, when the matter was pending before the High Court, the assessee settled the matter on payment of Rs. 10,00,000 and as per the settlement the amount has been paid.

5. There is a controversy whether that amount should be allowed or not. If so in which year it should be allowed-whether in the year when the assessee has created the liability of its dues or in the year of settlement.

6. Mr. Mallik, learned counsel for the Revenue, further submits that as there was a winding-up proceeding initiated against Taurus Foundry Pvt. Ltd., in the year 1982 and finally the company was wound up in 1985 any payment made to the director of the company is illegal and the same should have been paid to the administrator of the company. Shri Mallik doubted the genuineness of the transaction saying that when the matter was pending before the arbitrator and even before the High Court, how the matter could be settled out of court for Rs. 10,00,000. There could not be a genuine contract as Taurus Foundry Pvt. Ltd., was on the verge of winding up.

7. On the other hand, learned counsel for the assessee submits that there is a concurrent finding of fact of the Commissioner of Income Tax (Appeals) and the

Tribunal that the transaction was genuine and the assessee paid Rs. 10,00,000 as compensation against breach of contract. That finding should not be disturbed in reference before this court.

8. He placed reliance on a decision of this court in the matter of COMMISSIONER OF Income Tax, WEST BENGAL Vs. SHEWBUX JAHURILAL., , wherein the issue has been considered that if the assessee has not debited the anticipated loss then the loss will be allowed on the basis of the mercantile system of accounting. He also drew our attention to the observations of this court where it is observed that in case the assessee admits part of the loss or liability and entries made in the books of account to that effect, to that extent the liability can be allowed if the assessee is following the mercantile system of accounting. Whether the transaction for sale of tea was genuine or not the Commissioner of Income Tax (Appeals) has considered the matter in his order.

9. Though for the purpose of resisting Taurus's claim of damages of Rs. 30 lakhs, the appellant as per its letter dated November 7, 1983, had claimed that the agreement dated December 15, 1982, was not a final or concluded contract, I find that the relevant agreement in fact amounted to a valid enforceable contract. As per its letter dated December 15, 1982, the appellant had offered to supply three lakhs kilograms of CTC tea during the period from July to December 1983, as requested for by Taurus, subject to various conditions mentioned in clauses 1 to 15 of that letter. A concluded contract had come into force when Taurus had returned this agreement on December 20, 1982, after counter signing the duplicate copy of this agreement as a token of its acceptance of the terms and conditions mentioned therein. Thus, the agreement dated December 15, 1982, represented a valid contract u/s 2(h) read with Clauses (a) to (c) and (e) of Section (2) of the Indian Contract Act, 1972, and was supported by valid consideration as per Section 2(d) of that Act, in that the appellant had agreed to supply the tea as desired by Taurus. As per Clause 12 of this agreement, the timely lifting of the goods and the timely payments for the supplies were the essential stipulations in the contract. Clause 3 of the agreement specifies the quantity of different types of CTC tea to be delivered every month between July to December, 1983, and also the price at which they were to be delivered. As per Section 47 of the Indian Contract Act, the appellant in the capacity of the promisor, was bound to supply the tea of the prescribed quantity in monthly intervals at its Manabarrie Tea Estate at Godalabari, (?) Jalpaiguri District. The non-compliance with the terms of the contract, when Taurus had required the performance of the contract as per its letters dated July 7, 1983, July 15, 1983, August 11, 1983, August 22, 1983, September 2, 1983, September 24, 1983 and October 12, 1983, amounted to a breach of contract by the applicant, inviting the scope of Section 73 of the Indian Contract Act. Though the applicant as per its letters dated August 26, 1983, September 22, 1983, October 22, 1983 and November 7, 1983, was pleading for the increase in the selling price of tea by at least rupees two per kilograms, considering the unexpected short-fall in production of tea, the rise in the wages and other cost of production and the stiff

rise in the market price of tea, Taurus appeared to have taken the correct stand that the contract did not provide for any escalation in the agreed price or for a change in the terms regarding the supply of tea. In fact Clause 3 of the agreement dated December 15, 1982, specifically provides that the prices fixed in this agreement "are firm and no revision of any extent shall be made therein.

10. For the above reasons, the accrued liability of Rs. 10 lakhs claimed in the account cannot be disallowed. The impugned addition of Rs. 10 lakhs is accordingly deleted."

11. The facts are not in dispute that the Commissioner of Income Tax (Appeals) as well as the Tribunal found that there was a contract between the assessee and Taurus Foundry Pvt. Ltd. Under that contract, the assessee agreed to supply 3,00,000 kgs. of made tea from its garden during the period from July to December, 1983. The assessee has failed to supply that tea and sold its tea in the open market. On account of breach of contract, Taurus Foundry Pvt. Ltd., claimed compensation of Rs. 30,00,000. In arbitration the arbitrator allowed Rs. 17,00,000 as and by way of damages and/ or compensation to Taurus Foundry Pvt. Ltd. During the course of hearing before the arbitrator in arbitration proceedings, the assessee offered Rs. 10,00,000 as compensation but the compensation awarded was Rs. 17,00,000. That award was challenged before this High Court. Meanwhile the matter was settled out of court on payment of Rs. 10,00,000 to Taurus Foundry Pvt. Ltd. That settlement was also reduced into writing after payment was made, though it is not in the normal course that payment was made and thereafter the settlement is reduced into writing after 6/7 months. But when there is no dispute between the parties, that is, the assessee and Taurus Foundry Pvt. Ltd., that they have arrived at a settlement on the question of quantum of compensation and compensation of Rs. 10,00,000 has been paid to Taurus Foundry Pvt. Ltd., in full and final settlement of its claim, now at this stage there is no justification to doubt that transaction specially when there is a concurrent finding of the authorities below, viz., the Commissioner of Income Tax (Appeals) as well as Tribunal that there was a transaction and there was a breach of contract on the part of the assessee, Taurus Foundry Pvt. Ltd., suffered loss on account of breach of contract and from the very beginning that is even before the arbitrator the assessee offered Rs. 10,00,000 as compensation and recorded finally that the dispute was settled at Rs. 10,00,000. We find no justification to interfere to that extent that there was a transaction and there was an admitted liability for payment of Rs. 10,00,000 to Taurus Foundry Pvt. Ltd.

12. Learned counsel for the Revenue further argued that the payment to directors, Taurus Foundry Pvt. Ltd., is illegal, as winding up proceeding was initiated in 1982 and finally it was wound up on November 18, 1985. The winding up relates back to 1982 as per provisions of the Companies Act". Therefore any payment made to the director of the company is illegal. In fact, if any compensation is to be paid to the company, it should be paid to the liquidator.

13. We do not find any force in this submission of learned counsel for the

Revenue. Firstly, when the agreement was entered into in 1982, there was no existence of liquidator nor on the date of payment nor on the date of settlement. Therefore, there is no question of payment to liquidator till the liquidator is appointed. Secondly, whether the payment is legal or illegal, whether the income is legal or illegal it is immaterial for the purpose of tax. The income is defined in the Act, 1961, so long the income received is not exempted under the Act of 1961, it will be an income for the purpose of the Income Tax Act, 1961. At the same time, if any expenditure is incurred for the purpose of business, whether it is legal or illegal that has to be allowed. Therefore, it is immaterial from which date the winding up of the company should be taken.

14. When the facts are not in dispute that the assessee entered into a contract with Taurus Foundry Pvt. Ltd., and on breach of contract the assessee has created liability of Rs. 10 lakhs and ultimately paid that amount, the amount of compensation which is payable by the assessee to Taurus Foundry Pvt. Ltd., should be allowed as deduction when the amount has been paid for the purpose of business or in due course of business.

15. Lastly, learned counsel for the Revenue, Sri Mallik, argued that the amount of Rs. 10 lakhs liability cannot be allowed in this year as the amount has not been settled finally for the year under consideration nor the payment has been made in the previous year relevant to the assessment year in question.

16. The facts are not in dispute that the year ending in this case is March 31, 1984, and payment has been made thereafter. But we cannot ignore the fact brought to our notice, by learned counsel for the assessee, that the assessee is following the mercantile system of accounting. Therefore, on the basis of admission of liability the assessee can claim the deduction of the liability created in its books. The liability is not only created but finally the amount has been paid by the assessee under the settlement, out of court.

17. In COMMISSIONER OF Income Tax, WEST BENGAL Vs. SHEWBUX JAHURILAL., , the issue before this court was that when there was a dispute regarding anticipated loss whether the assessee is bound to show loss in his books. This court held that a mercantile system of book-keeping does not cast a duty on an assessee to take note of all claims that may be raised against him, whether good or bad but in spite of that this court has observed at page 695 that for the purpose of computing the assessable profit, such computation is only possible if the debit expenditure for which the legal liability has been incurred is brought in, even though there has been no actual disbursement. In that case as there was no liability created, the loss was not allowed, but from the observation it appears that the moment the assessee admits the liability or part of the liability and created the liability in his book or its books, the liability is to be allowed in that year if the assessee is following the mercantile system of accounting. At page 703 it is further observed by this court that when the assessee admits loss or when the loss is ascertained, then certainly it is his duty to bring the same into debit as soon as the admission is made or the

ascertainment takes place.

18. In this case, the admitted facts are that the assessee has admitted his liability before the arbitrator that he is liable to pay Rs. 10 lakhs as compensation to Taurus Foundry Pvt. Ltd. Taurus Foundry Pvt. Ltd., was claiming the compensation at Rs. 30 lakhs and the arbitrator has awarded Rs. 17 lakhs but to the extent of Rs. 10 lakhs liability there is no dispute. The assessee is prepared to pay Rs. 10 lakhs as compensation in the previous year relevant to the assessment year in question and created that liability in his books and the fact is also not in dispute that the assessee is following the mercantile system of the accounting.

19. Considering these facts, we are of the view that the assessee can claim deduction of Rs. 10 lakhs in the year under consideration. Thus, the Tribunal as well as the Commissioner of Income Tax (Appeals) have rightly allowed the claim of the assessee regarding deduction of Rs. 10 lakhs as the liability of the assessee in the year under consideration payable to Taurus Foundry Pvt. Ltd. against the compensation claimed. In this case, there is no further dispute regarding the balance amount as the matter has finally been settled at Rs. 10 lakhs but in cases where the part of the liability is admitted that can be allowed in that year itself and the balance can be allowed when the dispute is finally settled.

20. In the light of the above discussions, question No. 1 pertains to the finding of the Tribunal whether there was a full and final settlement regarding payment of Rs. 10,00,000 between the parties in March, 1984. We perused the order of the Tribunal. There is no such finding of the Tribunal. On March 14, 1984, is the date of the award. The Tribunal found that after executing the memorandum of settlement on March 26, 1984, it was agreed that the assessee-company would apply to the High Court for setting aside the arbitrator's award in so far as it related to payment of the balance amount of Rs. 7,00,500. Therefore, this question is misconceived.

21. Question No. 2 relates to the fact whether the finding of the Tribunal regarding the fact that the assessee moved the Calcutta High Court in Matter No. 338 of 1986 for setting aside the arbitrator's award dated March 14, 1984, in so far as it relates to payment of the balance amount of Rs. 7,00,000 only.

22. Counsel for the assessee brought to our notice the memorandum of settlement dated March 26, 1984, placed before the Tribunal and formed part of the paper book which was before the Tribunal. In Clause (d) of the settlement, it is stated that both the parties are agreed that Taurus Foundry Pvt. Ltd., shall not insist for the payment of the balance sum of Rs. 7,00,500 and Clause (g) of the settlement further provides that Todi Tea Pvt. Ltd., that is, the assessee, shall be entitled to apply to this court for setting aside the said award in so far as it relates to the payment of the said balance amount of Rs. 7,00,500.

23. Considering this fact, it cannot be said that the finding referred in question

No. 2 is perverse.

24. Question No. 3 pertains to whether the Tribunal was justified in law in allowing Rs. 10,00,000 as an allowable deduction in the assessment year 1984-85. Considering the matter discussed above, we answer this question in the affirmative, that is, in favour of the assessee and against the Revenue.