
(1991) 09 KL CK 0023

In the High Court Of Kerala

Case No : Income-tax Referred Case No. 42 of 1990

Eddy Current Controls (India) Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 27-09-1991

Acts Referred:

Central Excises and Salt Act, 1944 — Section 3
Income Tax Act, 1961 — Section 145, 37

Citation : (1992) 1 ILR (Ker) 204 : (1992) 198 ITR 491

Hon'ble Judges : K.S. Paripoornan, J; K.A. Nayar, J

Bench : Division Bench

Advocate : J. Vellappaly and S. Siri Jagan, for the Appellant; P.K.R. Menon and N.R.K. Nair, for the Respondent

Judgement

K.A. Nayar, J.—At the instance of the assessee, the Income Tax Appellate Tribunal, Cochin Bench, referred the following question of law for our opinion :

"Whether, on the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in having held that the excise duty demands raised relating to this year in the subsequent year was not an admissible deduction ?"

2. We are concerned with the assessment year 1983-84, for which the accounting period ended on June 30, 1982. The assessee paid central excise duty on the goods manufactured by it in accordance with its own calculations. Subsequent to the close of the accounting year relevant to the assessment year 1983-84, the Central Excise Department had raised certain demands based on a different calculation. This additional demand was later paid by the assessee. The assessee also contested the validity of the demand, without success, before the appellate authorities. The assessee paid the additional central excise duty as demanded in respect of the goods manufactured in the accounting year only after the close of the accounting year and claimed the same as a deduction in the accounting year. The Tribunal, upholding the finding of the Assessing Officer and the Commissioner of Income Tax (Appeals), held that the additional demand for

the central excise duty of Rs. 1,46,476 was raised by the Central Excise Authorities for the period from March 1, 1982, to April 30, 1982, and Rs. 73,645 related to the period from May 1, 1982, to June 30, 1982, and that as the quantification of the two figures was made on October 6, 1982, which fell outside the accounting year which ended on June 30, 1982, the same are not allowable as a deduction in the year in question. It is thereafter that the above question of law was referred for our opinion.

3. We heard counsel. Admittedly, the method of accounting followed by the assessee is "mercantile" and the accounting period ended on June 30, 1982. u/s 3 of the Central Excises and Salt Act, 1944, the central excise duty shall be levied and collected on all excisable goods produced or manufactured in India at the rate set forth in the Schedule to the Central Excise Act. Excise duty is primarily a duty on goods produced or manufactured within India. The tax can be levied at a convenient stage, so long as the character of the impost is not lost. The method of collection will not affect the character of excise duty. The collection in point of time need not synchronise with the completion of the manufacturing process, for, the point of collection is located where the statute declares it will be. In *Union of India (UOI) and Others Vs. Bombay Tyre International Ltd. and Others*, , the Supreme Court held that (at page 471 of 59 Comp Cas) :

"A duty of excise, according to the Federal Court, in the AIR 1939 1 (Federal Court) is a duty ordinarily levied on the manufacturer or producer in respect of the manufacture or production of the commodity taxed. A distinction was drawn between the nature of the tax and the point at which it was collected, and Gwyer C. J. observed that theoretically (at page 6 of AIR 1939 FC) : "there can be no reason why an excise duty should not be imposed even on the retail sale of an article, if the taxing Act so provides. Subject always to the legislative competence of the taxing authority, a duty on home-produced goods will obviously be imposed at the stage which the authority finds to be the most convenient and the most lucrative, wherever it may be ; but that is a matter of the machinery of the collection, and does not affect the essential nature of the tax. The ultimate incidence of an excise duty, a typical indirect tax, must always be on the consumer, who pays as he consumes or expends ; and it continues to be an excise duty, that is, a duty on home-produced or home-manufactured goods, no matter at what stage it is collected".

4. Further, the Supreme Court, after examining several cases, held (at page 474 of 59 Comp. Cas) ;

"We think we have shown sufficiently that while the levy is on the manufacture or production of goods, the stage of collection need not in point of time synchronise with the completion of the manufacturing process. While the levy in our country has the status of a constitutional concept, the point of collection is located where the statute declares it will be."

5. The production or manufacture of goods is sufficient to attract duty and the consumption or sale is not at all necessary. In *South Bihar Sugar Mills Ltd., etc. Vs. Union of India (UOI) and Others*, , the Supreme Court held that the Act charges duty on manufacture of goods. The duty being on manufacture and not on sale, the mere fact that the goods manufactured are not actually sold would not make any difference, if what they manufactured is a dutiable item. The imposition of excise duty is on the act of manufacture or production (see *In re : Sea Customs Act, 1878, Section 20(2)* AIR 1963 SC 1760 and *Union of India v. Bombay Tyre International Ltd.* [1986] 59 Comp Cas 460 : [1983] ELT 869). Thus, it is the fact of manufacture that attracts the duty even though it may be collected later. On a reading of Sections 3 and 4 read with Rule 9, it can be seen that no excisable goods shall be removed from any place where they are produced or manufactured until excise duty, leviable thereon, has been paid at such place and in such manner as is prescribed. Thus reading Sections 3 and 4 and Rule 9 read with Rules 49 and 52, it will be seen that the duty has to be paid on manufacture and at the point of clearance. Though the assessee followed the mercantile method of accounting and the accounting period ended on June 30, 1982, the Income Tax Officer found that the additional demand by way of excise duty, viz., Rs. 1,46,476.45 and Rs. 73,645.98, were quantified and communicated to the assessee only after the close of the accounting year on June 30, 1982. The demand was quantified by the Department on August 16, 1982, and October 16, 1982, respectively. The Income Tax Officer, therefore, held that the liabilities were neither paid during the relevant accounting year nor were ascertained before the close of the accounting year. It is in that view that the claim for deduction was disallowed. The assessee claimed that the demand is raised towards the liability for the accounting year. The expenditure ought to have been allowed as revenue expenditure of the year in which the dutiable event took place. The difference arose because the manufactured item, viz., variable speed motors produced and cleared by the assessee were classified under the Tariff item No. 68. But, according to the Excise Department, those goods ought to have been classified under item No. 30 and duty paid on that basis. The Appellate Assistant Commissioner took the view that, when show cause notice was issued for short levy after the end of the previous year, the two payments were not ascertained. Liabilities due from the assessee was as on June 30, 1982. There was no dispute that the demands were in respect of the goods manufactured during the accounting year. The Tribunal also agreed with the reasoning of the Appellate Assistant Commissioner holding that the amount evidenced by the additional demand accrued only with demand notice issued. In other words, the Tribunal did not agree with the contention that the liability arose as soon as the manufacturing process was completed.

6. In *Commissioner of Income Tax Vs. Poyilakkada Fisheries Pvt. Ltd.*, , a Division Bench of this court, of which one of us was a party, held that (at page 89) :

"... in a case where the assessee's method of accounting is "mercantile", the liability to purchase tax accrues or arises in the year the transactions liable to tax

took place."

7. The Division Bench followed a Full Bench decision of this court in Commissioner of Income Tax Vs. K.A. Karim and Sons and Others, and the decision of the Supreme Court in The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, . The law in this regard is seen summarised by Kanga and Palkhivala's The Law and Practice of Income Tax (Eighth Edition), Vol. I, at page 1164, as under :

"The decision of the Supreme Court in The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, establishes that under the mercantile system of accounting, a fiscal liability (e.g., sales tax or excise duty) under a statute should be allowed as a deduction in the year in which the relevant transactions take place, although (i) the precise quantification of the liability in the form of an assessment and demand may come later, (ii) the assessee may contest the liability in appeal or other proceeding's, and (iii) the assessee may have made no provision for the liability in his books."

8. In The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, , the question was whether the sales tax liability incurred on sales made during the accounting period is deductible when the assessee kept the mercantile system of accounting, even though the assessee denied the liability to pay the amount and failed to make an entry in books for claiming deduction. The Supreme Court observed (at page 366) :

"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. It can again not be disputed that the liability to payment of sales tax had accrued during the year of assessment even though it had to be discharged at a future date. In Pope The King Match Factory Vs. Commissioner of Income Tax, Madras, , a demand for excise duty was served on the assessee and though he was objecting to it and seeking to get the order of the Collector of Excise reversed, he debited that amount in his accounts on the last day of his accounting year and claimed that amount as a deductible allowance on the ground that he was keeping his accounts on the mercantile basis. The Madras High Court had no difficulty in holding that the assessee had incurred an enforceable legal liability on and from the date on which he received the Collector's demand for payment and that his endeavour to get out of that liability by preferring appeals could not in any way detract from or retard the efficacy of the liability which had been imposed upon him by the competent excise authority. In our judgment, the above decision lays down the law correctly."

9. If the assessee, under some misapprehension or mistake, fails to make an entry in his books of account, the assessee will lose the right of claiming deduction. Whether the assessee is entitled to a particular deduction or not will depend upon the provisions of the law, in this case, viz., the Central Excise Act.

It cannot be denied that the excise duty sought to be deducted is in respect of the item manufactured during the accounting year. In *Buddala China Venkata Rao and Co. Vs. Commissioner of Income Tax*, , the question was whether the sales tax collected from customers by the assessee who maintained the mercantile system of accounting, but not remitted by the assessee to the Government, because the liability to pay the same was not finally decided, constituted income in the hands of the assessee. It was held that the liability of the assessee to pay sales tax would not cease merely because he carried the matter by way of revision to the higher authority for getting it reduced or wiped out as long as the contention of the assessee does not prevail with regard to the quantum of liability. An assessee who maintains his books of account on the mercantile basis is entitled to deduct from the profits and gains of the business any liability which had accrued during the period for which the profits and gains were being computed. Where the liability to pay sales tax accrued during the year of assessment, even though it had to be discharged at a future date, it has to be deducted from the profits and cannot be held to be the income of the assessee. In *Sirsa Industries Vs. Commissioner of Income Tax and Another*, the Punjab and Haryana High Court reviewed all the cases and observed (at page 440) :

"Whenever the assessee wanted deduction of sales tax amount in the year in which the liability accrued, the stand of the Revenue was that since the amount was not paid, deduction should not be granted. Whenever the assessee did not claim deduction in the year in which the liability accrued and claimed deduction after the sales tax was determined or paid in another assessment year, the Revenue pleaded that deduction was claimable only in the year in which liability accrued and not when the liability was finally determined. Taking all these stands of the parties, the courts have taken an unanimous decision that wherever an assessee follows the mercantile system of accounting, deduction is claimable only in the year in which the tax liability accrues and not in the accounting year in which the liability is finalised or the amount is actually paid. Reference may be made to (1) *CIT v. United India Woollen Mills* [1981] 132 ITR 457 , (2) *Commissioner of Income Tax Vs. Guranditta Mal Shanti Parkash Zira*, (3) *Commissioner of Income Tax (Central) Vs. Kumardhubi Engineering Works Ltd.*, , (4) *Commissioner of Income Tax Vs. K.A. Karim and Sons and Others*, , (5) *N.K. Textile Mills Vs. Commissioner of Income Tax, Delhi*, , (6) *COMMISSIONER OF Income Tax Vs. DEORA PU CABNCON MFG. CO. PVT. LTD.*, and (7) *Commissioner of Income Tax Vs. Tata Chemicals Ltd.*, ."

10. All these cases have been mentioned in the latest decision of this court in *Commissioner of Income Tax Vs. Poyilakkada Fisheries Pvt. Ltd.*, , which has already been referred to by us. The liability in this case can be fairly estimated under the statute as, once it is classified under item No. 30 instead of 68, the duty payable is only a mere matter of arithmetic. The precise quantification of the liability in the form of an assessment and demand is not a condition precedent for allowing the deduction.

11. In Commissioner of Income Tax Vs. Shree Krishna Gyanoday Sugar Ltd., , the Calcutta High Court held that the interest payable on arrears of cess was in reality part and parcel of the liability to pay cess and it is an accretion to the cess and the liability to pay interest is as certain as the liability to pay cess. As soon as the prescribed date is crossed without payment of cess, interest begins to accrue and it is not a penalty but is in the nature of compensation paid to the Government for delay in the payment of cess. After referring to The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta, , the Calcutta High Court held that, as the assessee follows the mercantile system of accounting, he is entitled to claim a deduction even though the expenditure is not actually incurred. It is enough if the liability for such expenditure accrues. In Commissioner of Income Tax Vs. Poonam Chand Trilok Chand, , the Allahabad High Court held that the assessee, who followed the mercantile system of accounting, is entitled to claim a deduction even though the expenditure is "not actually incurred". It is enough if the liability for such expenditure "accrues". The decision by the Income Tax authorities about the liability being contingent would not be fatal, if the estimate of the liability is arrived at fairly. When the assessee follows the mercantile system of accounting, it has to be deemed that the liability which has accrued, as already paid and the income which has accrued, as already received for accounting purposes. Admittedly, the assessee maintained accounts on the "mercantile basis". Therefore, to claim deduction, it is enough that there is an accrued liability. Whether the liability accrued or not will depend upon the statute. The assessment, demand or payment is not the condition precedent. It is well-known that, in all taxing statutes, the liability is declared by the charging section. The assessment is only for quantification of the liability and the proceedings for recovery will follow after the quantification. In the case of Income Tax, it is the accrual of the income that is the taxable event and, in the case of sales tax, it is the sale of goods that attracts the tax. But, in the Central Excises and Salt Act, the duty is attracted on the production or manufacture of goods. Section 3 of the Central Excises and Salt Act, referred to above, imposes the levy at the rate set forth in the First Schedule to the Act in respect of all goods manufactured or produced. An elaborate procedure is made for levy and collection of the duty. There are also provisions in the rules to adopt self-removal procedure, viz., provision for payment of duty before removal. But the taxable event under the Central Excises and Salt Act is on the manufacture or production of goods. If the taxable event takes place, the liability accrues on the manufacturer or producer.

12. The fact that the assessee contested the liability in appeal or in other proceedings will be immaterial in allowing the deduction. As there is no dispute, the excise duty demands in question related to the accounting year which ended on June 30, 1982, and, in view of the fact that the assessee followed the mercantile system of accounting, we hold that the Appellate Tribunal went wrong in holding that the additional demand is not an admissible deduction during the assessment year in question.

13. We, therefore, answer the question referred to us in the negative, in favour of the assessee and against the Department.

14. A copy of this judgment under the seal of this court and the signature of the Registrar will be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.