

(2007) 06 CAL CK 1343
In the Calcutta High Court, Appellate Side
Case No : W. P No. 2512 Of 2002

Exide Industries Limited And Anr	Vs	APPELLANT
Union Of India		RESPONDENT

Date of Decision : 27-06-2007

Acts Referred:

Income Tax Act, 1961 — Section 28, 36, 43(B)

Citation : (2007) 06 CAL CK 1343

Hon'ble Judges : Ashim Kumar Banerjee, J

Bench : Single Bench

Advocate : Debi Prosad Pal, Manisha Seal, N. Pal, Shibdas Banerjee, Asha Ghutghutia

Final Decision : Disposed Of

Judgement

Ashim Kumar Banerjee, J

1. Section 43B(f) is called in question in this appeal. The said section is quoted below:

43B. Certain deductions to be only on actual payment.- Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of-....

(f) any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee. shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in Section 28 of that previous year in which such sum is actually paid him:...

2. Chapter IV of the IT Act, 1961 (hereinafter referred to as the said "Act of 1961") deals with computation of business income. Section 36 provides for allowable deductions while computing the income referred to in Section 28.

Under Sub-section (1)(ii) of Section 36 any sum paid to an employee as bonus or commission for services rendered is available for deduction where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission. Under Clause (f) of Section 43B any sum payable by the employer/assessee to its employees as leave encashment shall be available for deduction only in computing the income referred to in Section 28 of that previous year in which such sum is actually paid by the employer to its employees.

3. It was contended on behalf of the appellant that such sub-section was ultra vires the law of the land in view of the fact that the appellant being a body corporate was entitled to maintain its accounts by mercantile system of accounting which is permissible in law. Hence, the amount payable to its employees as leave encashment was to be shown in the balance sheet as a liability for each and every year and the employer was entitled to have deduction not only in the year in which it was actually paid but also for the years when provision was made. The grounds on which the vires of the said section were challenged by the appellant are as follows:

(i) Section 43B was introduced by the Finance Act, 1983, w.e.f. 1st April, 1984 for the purpose of preventing the attempt of the assessee to get deduction on the unpaid statutory liability instead of discharging the same. Clause (f) had no nexus with such object for which the said provision was enacted.

(ii) Assuming the legislature was entitled to bring Clause (f) by way of amendment by incorporating the same within the ambit of Section 43B such amendment is ultra vires the Act in absence of non-disclosure of the objects.

(iii) Incorporation of Clause (f) was unreasonable, arbitrary and inconsistent with the object disclosed while inserting Section 43B.

4. Challenging the said amendment, the appellant filed a writ petition before the learned single Judge. His Lordship dismissed the writ petition, inter alia, holding as follows:

(i) Legislature was not required to disclose objects and reasons for amendment of the original enactment and the object for which the original section was enacted would be applicable for the amendment too.

(ii) The amendment of the sub-section was for enlarging the scope of the original section and as such the same would not be available for challenge.

(iii) Leave encashment is not an ordinary trading liability. It was for the benefit of the employees and their welfare and the legislature was entitled to protect the interest of the employees by incorporating such provision.

(iv) By incorporating such provision the legislature did not transgress its field to nullify the effect of the decision in the case of *Bharat Earth Movers v. CIT*. His Lordship dismissed the writ petition by his Lordship's judgment and order dt.

13th April, 2005, appearing at pp. 71-77 of the paper book.

5. We have heard Dr. Pal on behalf of the appellant/assessee, and Mr. Banerjee, learned senior Counsel appearing for the Revenue.

6. According to Dr. Pal leave encashment was not the result of social welfare legislation and such liability of the employer was nothing but a trading liability and as such the appellant was entitled to make provision in the balance sheet year to year and thereby were entitled to appropriate deduction under the said Act of 1961.

7. Mr. Banerjee on the other hand contended that it was nothing but a business liability and as such the legislature was entitled to make appropriate law for restricting the deduction which was reasonable and could not be called as arbitrary and unconscionable. He further contended that because of the non obstante clause contained in Section 43B the other sections did not have any role to play on the subject issue.

8. In support of the respective contentions the following decisions were cited:

(i) Calcutta Co. Ltd. v. CIT ;

(ii) Bharat Earth Movers v. CIT (supra);

(iii) G.C. Kanungo v. State of Orissa ; and

(iv) Federation of Railway Officers Association v. Union of India .

(i) Calcutta Co. Ltd. v. CIT (supra): In the case of Calcutta Co. the appellant dealt in land and property. They were to develop land and make infrastructure for the plot-holders to whom they were selling plots. When a particular plot was sold by the appellant the purchaser paid 25 per cent of the purchase price and the balance was to be paid with interest in 10 instalments. The appellant in its turn was to carry out development work within six months from the date of sale of the plot of land. The appellant maintained their accounts in mercantile method by showing future instalments as receivable after showing the entire price of the plot of land which they did not actually receive in a particular financial year. Provision was also made with regard to the expenses required for development work to be done in future. The ITO disallowed their claim for deduction on the ground that the expenses had not been actually incurred in that particular year as also on the ground that the estimate had not been proved to be based on a consideration of the real expenses which the company would have to incur for the purpose. The Appellate CIT confirmed the order of the ITO on the ground that there was no accrued liability as on that date. Moreover, the development work would be carried out in the future and as such the estimated cost could not be taken into account for the purpose of deduction. The Supreme Court ultimately held that it was not open for the Revenue to disallow the expenses as such estimated expenditure should have been taken into account to arrive at the actual profit which would be liable for tax.

(ii) *Bhamt Earth Movers v. CIT (supra)*: In the case of *Bharat Earth Movers* the apex Court observed that if a business liability has arisen in a particular accounting year the deduction should be allowed although the liability may have to be quantified and discharged at a future date. In the said case the appellant had two sets of employees, one set was covered under the Employees State Insurance Scheme and the other set of employees were called as "officers" not covered under the Employees State Insurance Scheme. The company floated beneficial scheme for the officers for encashment of leave. The appellant made provision for leave encashment payment in a particular financial year and claimed deduction therefor. The apex Court held that the assessee was entitled to deduction out of the gross profits of the accounting year during which the provision was made for the liability. The apex Court held such liability was not a contingent liability. The apex Court while deciding this issue relied upon the earlier decision in the case of *Calcutta Co. Ltd. v. CIT (supra)*.

(iii) *G.C. Kanungo v. State of Orissa (supra)*: In this case a particular amendment in arbitration law was called in question. The apex Court held that such enactment was to nullify an award passed by the Arbitral Tribunal. Thus such amendment amounted to encroaching upon the judicial power of the appropriate judicial authority and as such was held to be unconstitutional.

(iv) *Federation of Railway Officers Association and Ors. v. Union of India (supra)*: In this case the apex Court held that in examining a question involving the policy of the Government scope of judicial review is limited. The apex Court was of the view that in matters affecting policy and requiring technical expertise the Court would leave the matter for decision to those who are qualified to address those issues. Unless the policy or action is inconsistent with the Constitution and the laws or arbitrary or irrational or an abuse of power, the Court will not interfere with such matters.

9. The objects and reasons as disclosed by the Finance Act, 1983, for enacting Section 43B are quoted below:

59. Under the IT Act, profits and gains of business and profession are computed in accordance with the method of accounting regularly employed by the assessee. Broadly stated, under the mercantile system of accounting, income and outgo are accounted for on the basis of accrual and not on the basis of actual disbursements or receipts. For the purposes of computation of profits and gains of business and profession, the IT Act defines the word 'paid' to mean 'actually paid or incurred' according to the method of accounting on the basis of which the profits or gains are computed.

60. Several cases have come to notice where taxpayers do not discharge their statutory liability such as in respect of excise duty, employer's contribution to provident fund, Employees State Insurance Scheme, etc., for long periods of time, extending sometimes to several years. For the purpose of their income-tax assessments, they claim the liability as deduction on the ground that they

maintain accounts on mercantile or accrual basis. On the other hand, they dispute the liability and do not discharge the same. For some reason or the other undisputed liabilities also are not paid. To curb this practice, it is proposed to provide that deduction for any sum payable by the assessee by way of tax or duty under any law for the time being in force (irrespective of whether such tax or duty is disputed or not) or any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees shall be allowed only in computing the income of that previous year in which such sum is actually paid by him. On perusal of the said object it would appear that the legislature expressed concern about the unreasonable deduction claim on the basis of mercantile accounting method without discharging statutory liabilities. It was observed by the legislature that there had been a trend to evade statutory liabilities on the one hand and claim appropriate benefit under the said Act of 1961 on the other hand. Hence, such enactment was necessary.

10. The said section had undergone several changes from time to time and on each and every occasion the legislature came out with the objects and reasons disclosed therefor. In 1990 deduction on account of unpaid loan to any public financial institution or a State financial institution was roped in. By a further amendment in 1996 unpaid loan of scheduled bank was also incorporated. On each such occasion objects and reasons were disclosed. While inserting Clause (f) no special reasons were disclosed. His Lordship held that such disclosure was not mandatory. We do not have any reason for disagreement on such issue provided the subject amendment could be termed as in furtherance to widen the scope of the original section on the identical objects and reasons as disclosed at the time of enacting the original provision. As we find, the original section was incorporated to plug in deductions claimed by not discharging statutory liabilities. We also find that provision was subsequently made to restrict deductions on account of unpaid loan to the financial institutions. Leave encashment is neither statutory liability nor a contingent liability. It was a provision to be made for the entitlement of an employee achieved in a particular financial year. An employee earns certain amount by not taking leave which he or she is otherwise entitled to in that particular year. Hence, the employer is obliged to make appropriate provision for the said amount. Once the employee retires he or she has to be paid such sum on cumulative basis which the employee earns throughout his or her service career unless he or she avails the leave earned by him or her. That, in our view, could not have any nexus with the original enactment. An employer is entitled to deduction for the expenditure he incurs for running his business which includes payment of salary and other perquisites to his employees. Hence, it is a trading liability. As such he is otherwise entitled to have deduction of such amount by showing the same as a provisional expenditure in his accounts. The legislature by way of amendment restricts such deduction in case of leave encashment unless it is actually paid in that particular financial year. The legislature is free to do so after they disclose reasons for that and such reasons

are not inconsistent with the main object of the enactment. We are deprived of such reasons for our perusal. Mr. Banerjee, appearing for the Revenue, could not enlighten us on that score. We also do not find such enactment consistent with the original provision being Section 43B which was originally inserted to plug in evasion of statutory liability. The apex Court considered the situation in the case of Bharat Earth Movers (supra), when Clause (f) was not there. The apex Court, considering all aspects as disclosed by us hereinbefore, rejected the contention of the Revenue and granted appropriate deduction to the concerned assessee. The legislature to get rid of the decision of the apex Court brought out the amendment which would otherwise nullify the Judge made law. The apex Court decisions are Judge-made law and are applicable to all under the Constitution. We, not for a single moment, observe that legislature was not entitled to bring such amendment. They were within their power to bring such amendment. However, they must disclose reason which would be consistent with the provisions of the Constitution and the laws of the land and not for the sole object of nullifying the apex Court decision.

11. In this regard the observation of the apex Court in the case of Bharat Earth Movers (supra) is quoted below:

The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain....

Applying the abovesaid settled principles to the facts of the case at hand we are satisfied that the provision made by the appellant company for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by employees of the company, inclusive of the officers and the staff, subject to the ceiling on accumulation as applicable on the relevant date, is entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The liability is not a contingent liability. The High Court was not right in taking the view to the contrary.

12. With deepest regard we have for his Lordship, we are unable to agree with his Lordship on this issue.

13. The appeal succeeds and is allowed. Section 43B(f) is struck down being arbitrary, unconscionable and de hors the apex Court decision in the case of Bharat Earth Movers (supra).

14. The appeal is disposed of accordingly without any order as to costs.

15. There would be stay of operation of this judgment and order for four weeks from date.

16. I agree.