

(1987) 05 OHC CK 0011
In the Orissa High Court
Case No : S.J.C. No. 52 of 1980

Kalinga Tubes Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 13-05-1987

Acts Referred:

Citation : (1987) 63 CTR 117 : (1988) 169 ITR 374 : (1988) 69 STC 271

Hon'ble Judges : S.C. Mohapatra, J; R.C. Patnaik, J

Bench : Division Bench

Advocate : B.K. Mohanty, K.K. Patnaik and A. Patnaik, for the Appellant;
Standing Counsel, for the Respondent

Judgement

S.C. Mohapatra, J.—This is a reference at the instance of the assessee u/s 256(1) of the Income Tax Act, 1961 (in short "the Act"). The following question of law has been referred to this court by the Income Tax Appellate Tribunal, Cuttack Bench, for the opinion of this court:

"Whether, on the facts and in the circumstances of the case, the assessee is entitled to deduction of Rs. 2,22,161 towards the sales tax liability for the assessment year 1971-72 ?"

2. The assessee is a limited company incorporated under the Companies Act, 1956. It carries on the business of manufacture and sale of steel tubes. In respect of tubes, for the year 1962-63, it was liable to pay sales tax under the Central Sales Tax Act, 1947. Under the scheme of the sales tax law, a dealer is liable to pay the tax on the turnover of the sale. The rate of tax depends on the nature of sale. A dealer is liable to file the return and along with the return pay the tax admitted to be the liability. If the returned figure is accepted by the assessing authority, the assessment is completed. Where the assessing officer requires examination of the accounts for examining the correctness of the return, he calls upon the dealer to produce the accounts and on examination of such accounts, either accepts the returned figure or computes the turnover on the

material available. Under certain circumstances, the assessing officer makes the assessment to the best of his judgment which becomes final subject to appeals and reference. Along with the order of assessment, a notice of demand is issued and in the case of non-payment of the tax demanded, realisation is made. In respect of the year 1962-63, the Sales Tax Officer completed the assessment on March 31, 1966, to the best of his judgment and made an additional demand of Rs. 11,02,698 on the assessee. The assessee paid a small amount under protest but did not make any provision for payment of the balance since he contested the levy. Being a company, its creditors reflected the amount as contingent liability in the printed accounts. The objection of the assessee to the additional demand could be appreciated ultimately by the Sales Tax Tribunal and the additional demand was reduced to Rs. 2,22,161 by order dated May 28, 1970. This amount being a business expenditure was claimed as deduction by the assessee in respect of the assessment for the previous year 1970-71 in the assessment year 1971-72. The Income Tax Officer did not allow the deduction in the year 1971-72 but in appeal the assessee became successful. In the second appeal by the Revenue, the Tribunal reversed the decision of the first appellate authority and affirmed the order of the Income Tax Officer in this respect.

3. There is no dispute that the mercantile method of accounting is employed by the assessee. In this method, entries are posted in the books of account on the date of transaction, i.e., on the date on which rights accrue or liabilities are incurred, irrespective of the date of payment. (See *The Commissioner of Income Tax, Madras Vs. A. Krishnaswami Mudaliar and Others*, and *State Bank of Travancore Vs. Commissioner of Income Tax, Kerala*, . Even when the assessee failed to post the entry in its books of account, it would be entitled to the benefits since the same would depend on the provision of law relating thereto and not on the view which the assessee might take of his rights since the existence or absence of entries in the books of account cannot be decisive or conclusive in the matter. (See *The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta*,). Relying on this decision, the Appellate Tribunal held that the assessee is not entitled to the deduction in the assessment year 1971-72 in which it claimed the same.

4. Mr. B. K. Mohanty, learned counsel for the assessee, submitted that from the stage of the sale transaction in the year 1962-63, the obligation to pay tax under the relevant Sales Tax Act arose, whether quantified or not. On the first quantification in the assessment order made by the Sales Tax Officer, the right of the Revenue to realise the tax by coercive process arose which continued till realisation. Where the assessee disputed the quantification but not the liability, the same becomes final in the second appellate order of the Sales Tax Tribunal. Mr. Mohanty relied upon the decision in *The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta*, and submitted that the decision of the Calcutta High Court in *Commissioner of Income Tax Vs. Royal Boot House*, was approved by the Supreme Court where the claim of deduction was allowed even when the liability was not quantified. In the decision of the

Supreme Court itself, the deduction was shifted to the stage of first assessment by the Sales Tax Officer even though the same was challenged in higher forums. In that context, it was observed (p. 366 of 82 ITR) :

"...the moment a dealer makes either purchases or sales which are subject to taxation, the obligation to pay the tax arises and taxability is attracted. Although that liability cannot be enforced till the quantification is effected by assessment proceedings, the liability for payment of tax is independent of the assessment. It is significant that in the present case, the liability had even been quantified and a demand had been created... It is not possible to comprehend how the liability would cease to be one because the assessee had taken proceedings before higher authorities for getting it reduced or wiped out so long as the contention of the assessee did not prevail with regard to the quantum of liability, etc. 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..."

4. The decision makes it clear that an assessee who regularly follows the method of mercantile system of accounting can claim the deduction in respect of the liability for payment of sales tax from the stage of the transaction which attracted the liability till the same does not cease. "Accrued" in this context cannot be read as "initially accrued". Till the liability is ceased, it shall be "accrued" and the Income Tax Officer is to examine if the assessee is liable to expend the amount claimed towards his business.

6. The matter can be examined from another angle. If the notice of demand is taken to be the basis for accrual, on the liability being reduced, a fresh demand notice is to be issued. Analysing the decision of the Supreme Court in *Income Tax Officer, Kolar and Another Vs. Seghu Buchiah Setty*, a Division Bench of this court in the decision in *L. K. Joshi & Co. v. CST* [1971] 27 STC 481 held (p, 485 of 27 STC):

"An analysis of the majority view in the Supreme Court case would indicate that their Lordships came to the conclusion that when the assessment order is set aside or the amount of demand is reduced or enhanced, a further demand notice would issue in accordance with the appellate or revisional order."

7. Thus, on the decision in the second appeal by the Sales Tax Tribunal reducing the demand by the Sales Tax Officer, a fresh demand notice is to be given. This attracts the liability of the assessee and in view of the fact that it regularly keeps its books of account adopting the mercantile system, it can claim the deduction u/s 37 during the assessment year 1971-72 since the liability was of the year 1970-71.

8. Reliance has been placed by Mr. B. K. Mohanty, on a decision of the Gauhati High Court in *CIT v. Nathmal Tolaram* [1973] 88 ITR 234. Mr. S. C. Roy, learned standing counsel for the Revenue, relied upon the decisions of the Kerala High Court in *L.J. Patel and Company Vs. Commissioner of Income Tax*, and of the

Bombay High Court in Commissioner of Income Tax Vs. Tata Chemicals Ltd., . Each of the decisions is correct on its own facts. Accordingly, they are not required to be discussed.

9. Thus, on analysis, it can safely be concluded that an assessee who maintains regularly the mercantile system of accounts can claim deduction in the year when the liability to the sales tax was finally determined by the Sales Tax Tribunal in second appeal.

10. In the result, the question is answered in favour of the assessee. There shall be no order as to costs.

R.C. Patnaik, J.

11. I agree.