
(1997) 03 BOM CK 0066
In the Bombay High Court
Case No : IT Ref. No. 95 of 1990

Standard Mills Co. Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 21-03-1997

Acts Referred:

Income Tax Act, 1961 — Section 37(1), 43B

Citation : (1997) 142 CTR 16 : (1998) 229 ITR 366 : (1998) 100 TAXMAN 535

Hon'ble Judges : B.P. Saraf, J;B.H. Marlapalle, J

Bench : Division Bench

Advocate : F.B. Andhyarujina, for the Appellant; Dr. V. Balasubramaniam and P.S. Jetly, instructed by H.D. Rathod, for the Respondent

Judgement

DR. B.P. Saraf, J.—By this reference under s. 256(1) of the IT Act, 1961, at the instance of the assessee, the Tribunal has referred the following question of law to this Court for opinion.

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the show cause notice received from the Central Excise Department cannot be equated with or considered to be a demand notice and thus erred in not allowing the claim of excise duty amounting to Rs. 46,86,431 ?"

2. The assessee is a limited company engaged in the business of manufacturing textiles. This reference pertains to asst. yr. 1979-80, the relevant previous year being the financial year ending 31st March, 1979. In its return of income for the above assessment year under the IT Act, 1961 ("the Act"), the assessee claimed deduction of a sum of Rs. 46,86,431 on account of excise duty on the basis of show cause-cum-demand notices for the years 1976-77, 1977-78 and 1978-79 received by the assessee during the relevant previous year from the excise authorities. The assessee replied to the show cause and denied any liability on account of excise duty as alleged in the show cause notice. No order was passed by the concerned excise authorities rejecting the above claim of the assessee and/or demanding any amount in pursuance of the above show cause notice.

Nothing was paid by the assessee in pursuance of the above show cause notices, nor any provision was made for the same in the accounts of the previous year relevant to the assessment year under consideration. The amount of excise duty mentioned in the show cause notice was however, shown by the assessee by way of a note in the balance sheet and P&L a/c as "contingent liabilities representing the disputed amount of central excise". On the basis of the above, the assessee claimed deduction of the amount mentioned in the show cause notices in computation of its income as "excise duty liability" under s. 37 of the Act. The ITO first of all noticed, that the amount stated in the show cause notice for which deduction had been claimed, did not relate only to the previous year relevant to the assessment year under consideration, but also to two earlier assessment years. The bifurcation of the amount specified in the show cause notices yearwise is as follows :

The ITO found that the show cause notice did not create any liability against the assessee. According to him, in the instant case, neither there was a crystallised liability nor the assessee had accepted any part of it. The ITO also noticed that the assessee had neither made any payment in pursuance to the show cause notice nor made any provision for the same or any part thereof in its accounts for the relevant previous year because, according to the assessee itself, it was not liable to pay any amount as excise duty as alleged in the show cause notices. The assessee accordingly denied the same. As earlier stated, neither the cause shown by the assessee was rejected by the excise authorities nor any demand made on the assessee after the assessee showed cause. The ITO, therefore, rejected the claim of the assessee for deduction of the above amount under s. 37 of the Act as excise duty liability. The appeal of the assessee against the above disallowance was rejected both by the CIT(A) as well as the Tribunal. Hence, this reference under s. 256(1) of the Act at the instance of the assessee.

3. We have heard the learned counsel for the assessee who submits that the show cause notices having been received by the assessee in the year under consideration, the assessee was entitled to claim deduction for the amount mentioned therein as it was maintaining its account on mercantile basis. According to the learned counsel for the assessee, the fact that no order had been passed by the concerned authorities rejecting the cause shown by the assessee was not relevant in determining the allowability of deduction on account thereof. Reliance is placed in support of this contention on the decision of the Supreme Court in *The Kedarnath Jute Mfg. Co. Ltd. Vs. The Commissioner of Income Tax, (Central), Calcutta*, . Learned counsel for the Revenue on the other hand, submits that the ITO was fully justified in this case in disallowing the claim of the assessee for deduction of the above amount as a liability on account of excise duty and the CIT(A) as well as the Tribunal were justified in confirming the order of the ITO. The learned counsel for the Revenue pointed out to us that in the instant case neither the assessee incurred any liability in pursuance of the show cause notices nor any provision was made by the assessee for the same or any part thereof in its accounts in the previous year relevant to the assessment

year under consideration. According to the learned counsel, it is a case where merely a notice had been issued to the assessee to show cause as to why the amount mentioned therein should not be held to be due from the assessee. It was not a demand notice which could have the effect of accrual of liability. In such a situation, it is contended, that no liability accrued at all for which deduction could be claimed. It was further submitted that the show cause notices pertain not only to the year under consideration, but also to two earlier previous years. It was, therefore, contended that the assessee is not entitled to claim deduction on account of liability which did not even arise or accrue.

4. We have carefully considered the rival submissions. Law is well settled that expenditure which is deductible for Income Tax purposes is towards a liability actually existing in the year of account. Contingent liabilities do not constitute expenditure and cannot be the subject-matter of deduction even under the mercantile system of accounting. The Income Tax law makes a distinction between the actual liability in praesenti and a liability in future which, for the time being, is only contingent. The former is deductible but not the latter. (See *Indian Molasses Co. (Private) Ltd. Vs. Commissioner of Income Tax, West Bengal*, . The question to be decided in each case, therefore, is whether any present liability has accrued against the assessee which has to be decided by taking into account all the circumstances of the case. There may also be cases where the liability clearly exists under a statute. In such a case, as held by the Supreme Court in *Kedarnath Jute Mfg. Co. Ltd. vs. CIT* (supra) deduction cannot be denied on the ground that the assessee is disputing the liability. Similarly, where demand of tax or duty is served on the assessee maintaining mercantile system of accounting in the accounting year, the amount so demanded would be deductible as an accrued liability even though the assessee objects to it and seeks to get the order of the concerned authority reversed, subject, however, to any statutory provision to the contrary (viz. s. 43B of the IT Act, 1961 as inserted by Finance Act, 1983 w.e.f. 1st April, 1984, which provides that certain liabilities can be deducted only on actual payment).

5. In the instant case, there was no actual liability in praesenti. No demand was raised against the assessee of any amount. What was served on the assessee by the Collector was merely a show cause notice. The assessee did not admit any liability and showed cause refuting the allegations made in the show cause notice. Even according to the assessee there was no accrued liability. The assessee itself regarded it as a "contingent liability", which is evident from the fact that the amount of excise duty mentioned in the show cause notice was shown by the assessee in its P&L a/c and balance sheet by way of a note as "contingent liability representing the disputed amount of central excise". Obviously, there was no liability actually existing against the assessee in the year of account. It was merely a contingent liability, which might or might not arise. That being so, the amount in question cannot constitute expenditure for the purposes of Income Tax.

6. In so far as the decision of the Supreme Court in *Kedarnath Jute Mfg. Co. Ltd. vs. CIT* (supra) is concerned, the ratio of the above decision has no application to the facts of the present case. That was a case where a liability clearly existed under the statute. The claim of the assessee for deduction of the amount of sales-tax was rejected on the ground that the assessee had taken proceedings before the higher authorities for getting it reduced or wiped out. It was in this context that the Supreme Court observed :

"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. As 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."

7. We have also perused the decision of the Madras High Court in *Pope The King Match Factory Vs. Commissioner of Income Tax, Madras*, which was referred with approval by the Supreme Court in the above case. In that case also, a demand for excise duty was served on the assessee and though he was objecting to it and seeking to get the order of Collector of Excise reserved, he debited the amount in his account on the last day of accounting year and claimed that amount as deductible amount on the ground that he was keeping his accounts on mercantile basis. The Madras High Court held 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. The Supreme Court held that the above decision laid down the law correctly. Obviously, the ratio of the above decision is not applicable to the present case. The facts of the present case are completely different. In this case, neither there was a statutory liability nor any enforceable legal liability. In fact, there was no liability at all. Even if there was a liability it was a purely contingent liability, which is not deductible for Income Tax purposes.

8. In view of the above, we answer the question referred to us in the affirmative and in favour of the Revenue.

9. The reference is disposed of accordingly with no order as to costs.