

IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

INCOME TAX APPEAL No.103 of 2016 (O&M)
DATE OF DECISION: 11.11.2016

Pr. Commissioner of Income Tax, Panchkula

....Appellant

versus

M/s Haryana Warehousing Corporation

.....Respondent

CORAM:- HON'BLE MR.JUSTICE S.J. VAZIFDAR, CHIEF JUSTICE
HON'BLE MR. JUSTICE DEEPAK SIBAL

Present: Mr. Yogesh Putney, Advocate for the appellant

Mr. Rajesh Garg, Senior Advocate with
Mr. Sandeep Kumar, Advocate for the respondent

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S.J. VAZIFDAR, CHIEF JUSTICE:

This is an appeal against the order of the Tribunal partly allowing the assessee's appeal against the order of the CIT (Appeals). The matter pertains to the Assessment Year 2009-10 (inadvertently mentioned as 1999-2000 in paragraph 1 of the Tribunal's order).

2. According to the appellant, the following substantial questions of law arise in this appeal:-

“(i) Whether on the facts and in the circumstances of the case, the Ld. Income Tax Appellate Tribunal was right in law in cancelling the order passed by the Commissioner of Income Tax under Section

263 of the Income Tax Act, 1961 by holding that there is nothing in the aforesaid order to show that assessment order passed by the Assessing Officer was erroneous in so far as prejudicial to the interests of the revenue?

(ii) Whether on the facts and in the circumstances of the case, the order passed by the Ld. Income Tax Appellate Tribunal was right in law in allowing the appeal of the Respondent-Assessee on the issue on account of revision of pay scales as prior period expenses and not allowable under Section 37 of the Income Tax Act, 1961?

(iii) Whether on the facts and in the circumstances of the case, the order passed by the Ld. Income Tax Appellate Tribunal was right in law in allowing the appeal of the Respondent-Assessee on the issue on account of Misc. expenses of Rs.50,16,675/- being capital in nature?

(iv) Whether on the facts and in the circumstances of the case, the order passed by the Ld. Income Tax Appellate Tribunal was perverse in nature and against law as it grossly overlooked the material evidence/information on record?

(v) Whether on the facts and in the circumstances of the case, the Ld. Income Tax Appellate Tribunal was right in law in partly accepting the order passed by the Commissioner of Income Tax under Section 263 of the Income Tax Act, 1961 and examining the issues on merits of matter once it is found that invocation of particular provisions of Act is valid?

3. The appeal is admitted only with respect to question (ii) and the question is answered in favour of the assessee/respondent. The other questions do not raise a substantial question of law. In the result, we have dismissed the appeal.

4. For the relevant assessment year, the respondent filed its return of income on 30.09.2009 declaring an income of about Rs.15.57 crores. A revised return was filed on 31.03.2011 declaring an income of about Rs.19.02.crores. The assessment was ultimately completed on 19.12.2011 under section 143(3) of the Income Tax Act, 1961 (for short, "the Act") assessing the income at about Rs.21.77 crores. On 18.01.2012, the assessee filed an appeal before the CIT (Appeals) which was dismissed by an order dated 02.04.2013.

Thereafter, it was noticed that the assessee had debited a sum of about Rs.12.88 crores in the profit and loss account in respect of "Revised Pay Scales". The notes on account stated that this was a provision on an ad hoc basis for the payment of revised pay scales of the staff. The CIT found this to be an omission leading to the income being under assessed to the extent of about Rs.12.88 crores and observed that the Assessing Officer had been

negligent in not making proper enquiry and in not examining the expenses claimed by the assessee. It was, therefore, held that the assessment was prejudicial to the interest of the Revenue.

The CIT further noted that the assessee had also debited a sum of about Rs.50 lacs in respect of unabsorbed overhead on capital works under "Miscellaneous Expenses" in the profit and loss account and observed that the expenditure being capital in nature was required to be capitalised and deduction as revenue expenditure was not allowable.

It was further noted that a sum of about Rs.22 lacs under the head "Procurement of Wheat Account" was debited which pertained to carry over charges of the Nagpur Mandi and that the recovery of this amount was doubtful but not bad and the same was, therefore, not allowable under section 36 as a bad debt. The CIT found that the Assessing Officer had allowed the deduction without any enquiry to verify the same. Lastly, a discrepancy was noted on account of not charging tax at maximum marginal rate as per the provisions of section 167B of the Act. The assessee was treated as an AOP.

We are concerned in this appeal only with regard to the first two items, namely, the provision of revision of pay scales and the unabsorbed overhead on capital work under miscellaneous expense as the department had succeeded on a demurer in respect of the other two claims.

5. Accordingly, a notice dated 12.01.2014 was served upon the assessee calling upon it to show cause why the assessment order be not set aside/cancelled under section 263 and the Assessing Officer be not directed to make a fresh assessment. In view of the

above observations, an order dated 06.03.2014 was passed by the CIT under section 263(1).

6. The Assessing Officer thereafter passed a fresh assessment order dated 23.03.2015 under section 143(3) read with section 263. As regards the provision for revision of pay scales, the Assessing Officer allowed only 40% in the year in question. The expenditure of about Rs.50 lacs on construction, repair and maintenance of ware-houses claimed at 14% of the project cost was held to be capital expenditure in nature and was, therefore, added back to the returned income.

As we mentioned earlier, by the impugned order dated 21.10.2015, the Tribunal set aside the order passed by the CIT under section 263. It may only be noted at this stage that the CIT (Appeals), by an order dated 20.12.2015, set aside the fresh assessment order dated 23.05.2015 in view of the impugned order of the Tribunal dated 21.10.2105. We are, however, concerned in this appeal only with the order of the Tribunal dated 21.10.2105.

Re: Question Nos.(i) & (v):

7. Questions (i) and (v) are inter-related and are dealt with together especially as we have, for the purpose of this appeal, proceeded on the basis that section 263 was validly invoked. Section 263, in so far as it is relevant, reads as under:-

“Revision of orders prejudicial to revenue.

263. (1) The Principal Commissioner or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he may after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems

necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment."

8. The CIT (Appeals) did not merely direct the Assessing Officer to reconsider the issues and to pass an assessment order thereafter, but returned a finding on merits directing the Assessing Officer to re-compute the income in accordance therewith. In that event, the assessee was entitled to file an appeal against the order of the CIT (Appeals) before the Tribunal and the Tribunal was bound to consider the issues on merits as well.

9. The CIT in the order dated 06.03.2014, passed under section 263(1) of the Act, dealt with each of the issues separately. In paragraph-2, the CIT noted that the assessee had debited a sum of about Rs.12.88 crores in the profit and loss account in respect of the revised pay scales; that the notes on account mentioned that it was a provision made on an ad hoc basis for the payment of revised pay scales of the staff; that the same was not added back in the taxable income by the assessee or by the Assessing Officer and that, as per the provisions of section 37, any expenditure not specifically covered under sections 30 to 36 is deductible provided it is incurred during the previous year and is not in the nature of personal or capital expenses and is incurred wholly and exclusively for business purposes. Thus far the order only records the facts. What follows is important. The CIT expressly held that in view of this omission, the income was under assessed to the extent of about Rs.12.88 crores and that the Assessing Officer had been negligent in not making proper enquiries and in not examining the expenses claimed by the assessee. The

doubt, if any, that the CIT had decided the matter on merits is set at rest by the following observations:-

"The claim of the assessee has been considered and noted that as per the copy of minutes of meeting dated 25.03.2009 of the Board Directors furnished by the assessee, the revision of pay scale of Haryana Warehousing Corporation has been approved vide agenda item No.26 in which it has been proposed to adopt Finance Department Letter No.1/83/2008/1PR (FD) dated 7/1/2009 for revision of pay scales of the employees of Haryana Warehousing Corporation w.e.f. 1.1.2006. As per the Govt. Policy 40% arrear will be given in the current financial year and 60% in the next financial year. The financial implication for implementing the revised payment scales was estimated at Rs.8.50 Cr. Approx. for the year 2005-06, 2006-07 and 2007-08. Therefore, the assessee should have made provision for expenditure of 40% only in the current financial year. However, the assessee has provided Rs.12,88,15,000/-. The A.O. has failed to verify the same. Therefore, the A.O. is directed to verify the same and allow the permissible amount only."

There is, therefore, a clear direction to the Assessing Officer to allow the expenditure of only 40% in the current financial year. The CIT, therefore, exercised his discretion under section 263 to decide the issue on merits. Faced with this order, the Assessing Officer had no option but to allow the expenditure as directed by the CIT. The Assessing Officer could not possibly pass an assessment order contrary to these directions. This is precisely what the Assessing Officer did while passing the fresh assessment order dated 23.03.2015. Although the Assessing Officer does not state that he had followed the order of the CIT, it is obvious that he did. In any event, considering the nature of the observations of the CIT, he was bound to follow the same.

10. This is also the case in respect of the unabsorbed overhead on capital works under "Miscellaneous Expenses" of about Rs.50 lacs. The CIT expressly observed that this expense

constituted capital expenditure and “was required to be capitalised and deduction as Revenue expenditure was not allowable”. This is clearly a finding on merits. The CIT did not leave any scope for reconsideration by the Assessing Officer. The Assessing Officer, on this issue, decided the matter in accordance with the directions of the CIT (Appeals) as he was indeed bound to.

11. The CIT, therefore, decided these two claims on merits. Even the other issues were decided by the CIT on merits. However, they are not relevant for the reasons already stated. The Tribunal was, therefore, bound to consider the case on merits as well. We have come to the conclusion that the decision of the Tribunal on merits must be upheld. In view thereof, it was open to the Tribunal and it certainly is open to us to proceed on the basis that the proceedings under section 263 were valid. Once we proceed even on a demurer that the proceedings under section 263 are valid, we are entitled, indeed bound to consider the issues on merits.

Re: Question (ii):

12. The Haryana State had notified the revision of pay scales of its employees with effect from 01.01.2006. This was probably in view of the sixth pay commission. The Financial Commissioner & Principal Secretary to Government Haryana, Finance Department, addressed a letter dated 07.01.2009 to this Court, all heads of departments in Haryana, all Divisional Commissioners in Haryana, all Deputy Commissioners in Haryana and all Sub Divisional Officers (Civil) in Haryana. The letter, though not specifically addressed to the assessee, appears to have been forwarded to the assessee as well. The subject of the letter was “Revised pay package formulation and implementation thereof-Documents

regarding". The letter forwarded certain documents for information and action. The letter required action to be taken in the light of the rules and notifications referred to therein immediately to ensure payment of salary to government servants who had elected to be governed by the said rules. Paragraph 4 of the letter reads as under:-

"4. The undersigned is further directed to impress upon you that the arrears should be drawn in two installments, the first installment being restricted to 40% of the aggregate arrear during the current financial year 2008-09 and the second installment of 60% of aggregate arrear will be drawn after the receipt of instruction which will be issued separately in due course."

It is important to note the word "arrears". The word, absent anything else at least, indicates that the amounts were payable even on that date, namely, 07.01.2009 - the date of the letter. A notification for the implementation thereof was also issued.

13. At a meeting of the Board of Directors of the assessee on 25.03.2009, the subject of agenda Item No.26 was "Revision of pay scales of Haryana Warehousing Corporation w.e.f. 1.1.2006." The Minutes of the meeting referred to the said letter dated 07.01.2009. The Minutes further read under:-

"The Haryana Warehousing Corporation is following the State Govt. for revision of pay scales of its employees. The last General Revision of pay was made w.e.f. 1/1/1996 for Corporation's employees on the State Govt. pattern. As per Regulation 13 of Haryana Warehousing Corporation (Officers & Staff) Regulations, 1994 the power to fix or revise the scale of pay in the Corporation shall vest in the Board of Directors subject to final approval of the Government.

It is, therefore, proposed to adopt Finance Department letter No.1/83/2008/1PR(FD) dated 7/1/2009 and aforesaid notification in to-to for revision of pay scales of the employees of Haryana

Warehousing Corporation w.e.f. 1/1/2006. As per Govt. policy 40% arrear will be given in the current financial year and 60% in the next financial year. The financial implication for implementing the revised pay scales would be Rs.8.50 crore approximately for the year 2005-06, 2006-07 & 2007-08. The funds will be arranged from Corporation's own sources. Category-wise existing functional pay scales and proposed revised functional pay structure in respect of Corporation employees have been mentioned in the statement enclosed at Annexure-II."

14. The parties proceeded on the basis that the decision taken at the meeting of 25.03.2009 was to be implemented. The question before us is as to when the liability to pay the arrears arose. In other words, the question is whether the liability to pay the entire arrears arose in the assessment year in question, namely, 2009-10 or whether the liability arose to the extent of 40% in the assessment year 2009-10 and to the extent of 60% in the following assessment year 2010-11. This required an interpretation of the decision of the assessee's Board of Directors dated 25.03.2009. The CIT, in the order under section 263, held that the assessee should have made provision to the extent of only 40% in the current financial year i.e. 2008-09 corresponding to assessment year 2009-10.

15. In our view, however, the Tribunal rightly held that the entire liability was incurred in the assessment year in question; had been estimated with reasonable certainty and that it was not a contingent liability. The assessee was, however, liable to discharge a part of that liability at a future date. What is relevant is when the assessee's decision that the amount was payable was taken. The provision for the payment of the salary including arrears was not a contingent liability. It arose on account of the sixth pay commission which was approved by the

Haryana Government and adopted by the assessee. We are in agreement with this finding of the Tribunal.

16. The concluding part of the Minutes adopted the letter dated 07.01.2009. The Minutes also referred to the arrears. As we mentioned earlier, the word "arrears", absent anything else, indicates that the liability had been incurred and had also been agreed to be discharged. The liability, thus, arose in praesenti and not in futuro. A part of the liability was to be discharged in future. The accrual of a liability and the time for the discharge thereof are different matters. In the mercantile system, the mere postponement of the date of payment of a liability already incurred, acknowledged and agreed to be met arises in the year it is stated to be so incurred and met.

17. Mr. Garg, the learned senior counsel appearing on behalf of the assessee, relied upon the judgment of the Supreme Court in Bharat Earth Movers vs. Commissioner of Income Tax, Karnataka, (2000) 6 Supreme Court Cases 645, which is also referred to by the Tribunal. The Supreme Court held:-

"4. 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.

5. In Metal Box Co. of India Ltd. V. Workmen [(1969) 73 ITR 53 : AIR 1969 SC 612] the appellant Company estimated its liability under two gratuity

schemes framed by the Company and the amount of liability was deducted from the gross receipts in the P&L account. The Company had worked out on an actuarial valuation its estimated liability and made provision for such liability not all at once but spread over a number of years. The practice followed by the Company was that every year the Company worked out the additional liability incurred by it on the employees putting in every additional year of service. The gratuity was payable on the termination of an employee's service either due to retirement, death or termination of service – the exact time of occurrence of the latter two events being not determinable with exactitude beforehand. A few principles were laid down by this Court, the relevant of which for our purpose are extracted and reproduced as under:

(i) for an assessee maintaining his accounts on mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid;

(ii) just as receipts, though not actual receipts but accrued due are brought in for income tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business;

(iii) a condition subsequent, the fulfillment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability; and

(iv) a trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated.

6. So is the view taken in Calcutta Co. Ltd. V. CIT [(1959) 37 ITR 1 : AIR 1959 SC 1165] wherein this Court has held that the liability on the assessee having been imported, the liability would be an accrued liability and would not convert into a conditional one merely because the liability was to be discharged at a future date. There may be

some difficulty in the estimation thereof but that would not convert the accrued liability into a conditional one; it was always open to the tax authorities concerned to arrive at a proper estimate of the liability having regard to all the circumstances of the case."

18. The liability, in the case before us, arose in the assessment year 2009-10. Sixty percent of it was liable to be discharged in the next assessment year. It is, undoubtedly, estimated with more than just reasonable certainty. The liability was, therefore, not a contingent one but one in praesenti. A part of it was to be discharged at a future date. The judgment supports the assessee's case.

19. Question (ii) is, therefore, answered against the appellant and in favour of the assessee.

Re: Question (iii):

20. This is not a substantial question of law. The assessee submitted its accounting policy since inception. It charged the administrative expenses incurred on construction staff at 14% to capital work and repair and maintenance. The system was adopted from the PWD. The remaining expenses were charged to revenue expenditure as unabsorbed overhead on capital works under miscellaneous expenses in the profit and loss account. This was the first time that the Department had not accepted the assessee's case. The Tribunal found on facts that the CIT (Appeals) had not pointed out any defect in the assessee's accounting policy. This was disclosed in the return. It was not contended that the assessee had not disclosed the true and proper income. Thus, a substantial question of law in this regard does not arise. This question is,

therefore, also answered against the Department/Revenue and in favour of the assessee.

Re: Question (iv):

21. From what we have observed earlier, it is apparent that the order of the Tribunal does not suffer from any perversity. Even on issue No.3, the Tribunal has taken a possible view. This question is, therefore, also answered in favour of the assessee and against the Department/Revenue.

22. In the circumstances, the appeal is dismissed.

11.11.2016
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(S.J. VAZIFDAR)
CHIEF JUSTICE

(DEEPAK SIBAL)
JUDGE

NOTE:

Whether speaking/non-speaking: Speaking
Whether reportable: YES