IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Income Tax Appeal No.356 of 2015 (O&M)
DATE OF DECISION: 21.03.2018

Principal Commissioner of Income Tax, Faridabad …..Appellant

versus

M/s NHPC Limited .....Respondent

CORAM:- HON'BLE MR.JUSTICE S.J.VAZIFDAR, CHIEF JUSTICE
HON'BLE MR. JUSTICE AVNEESH JHINGAN

Present: Mr. Tajender K. Joshi, Advocate for the appellant
Mr. Ved Jain, Advocate for the respondent

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S.J. VAZIFDAR, CHIEF JUSTICE:

This is an appeal against the order of the Income Tax Appellate Tribunal upholding the order of the Commissioner of Income Tax (Appeals). The appeal pertains to the Assessment Year 2006-07.

2. The appellant contends that the following substantial questions of law arise in the appeal:-

> "1. Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in dismissing appeal of the Revenue observing that 'in view of categorical finding of the Supreme Court we hold that the CIT(A) was correct in holding that advance against depreciation cannot be added under the computation of the normal income', whereas the Hon'ble Supreme Court in its decision dated 05.01.2010 has held that the 'advance against depreciation' is 'income received in advance', thus making the said income subject to 'Charge under Chapter-II, as business income under Chapter-IV-D read with sub-clause (i) of sub-section 24 of section 2 of the Income Tax Act?"

2. Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in deleting the addition of Rs.47,88,00,000/- made by the Assessing Officer under section 143(3) (and not under section 115JB) on account of "Advance Against Depreciation" ignoring the provisions of section 2(24) read with section 28 of the Income Tax Act, 1961, which provides that "income" includes profits and gains and the profits and gains of any business or profession carried on by the assessee at any time during the previous year is taxable?

3. Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in confirming the order of Ld. CIT(A) in deleting the addition of Rs.51,80,00,000/- made by AO in normal income as well as book profit computed u/s 115JB on a/c of tariff adjustments being unascertained liability?

4. Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in holding that 'the contention of the AO that this liability has not crystallized is also not correct and the AO has not appreciated the facts in the right perspective' disregarding the fact that later on, the CERC actually approved the tariff rates which were different from the rates proposed by the assessee and the quantification of adjustment of tariff was evidently not an ascertained liability during the year under consideration.

5. Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in deleting disallowance of Rs.27,05,83,117/- made by the AO in computing book profit u/s 115 JB on a/c of provisions provision made for gratuity, leave encashment, post retirement medical benefits, LTC, Baggage allowance and Matching Contribution on Leave Encashment even when the assessee has failed to establish these provisions to be of ascertained in nature.

6. Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in deleting disallowance of Rs.1,00,25,510/- made by the Assessing Officer in computing the book-profit u/s 115JB in respect of depreciation claimed on land after amortization of land by the assessee because there is no depreciation allowable on land under Companies Act and no rate of depreciation is provided in schedule XIV of Companies Act?

7. Whether, on the facts and in circumstances of the case and in law, the Hon'ble ITAT was right in law in applying ratio of decision in case of M/s Apollo Tyres 255 ITR 273 (SC) when the computation of book profit was not as per Companies Act and wrongly claimed depreciation on land not allowable in Companies Act."

3. It is agreed that question Nos.1, 2, 5, 6 and 7 are liable to be answered in favour of the respondent-assessee in view of our order and judgment dated 28.02.2018 in the assessee's case in ITA No.136 of 2015.

4. The appeal is admitted on the substantial questions of law raised in question Nos.3 and 4 which can be dealt with together.

Re: Question Nos.3 and 4:

5. The respondent-assessee sells electricity to the State Electricity Boards (DISCOMs). The tariff is determined and identified by the Central Electricity Regulatory Commission (CERC). The assessee filed its return declaring a loss of about Rs.225.31 crores. The case was selected for scrutiny and the proceedings pursuant thereto ensued. The assessee computed book profit under section 115JB at about Rs.58 crores in the original return. The Assessing Officer, upon examining the computation of book profit, noticed that

the provision for tariff adjustment of about Rs.51.80 crores was not considered for addition while computing the book profit under section 115JB. The assessee answered the notice issued by the Assessing Officer under section 143(2).

6. The facts are admitted. For the purpose of answering these questions, it is sufficient to note that the assessee received an amount of Rs.1713.79 crores for the relevant Assessment Year 2006-07. The assessee, however, adjusted tariff in the sum of Rs.51.80 crores. The assessee did so on account of the manner in which it is required to compute the tariff for the sale of electricity during the financial year in question viz. 2005-06. It is initially or provisionally charged at the immediately previous rate. The tariff was fixed for the period 01.04.2001 to 31.03.2004. That is not the final tariff that would be charged for the subsequent period. For the subsequent year, the assessee is required to submit its application before the CERC for revision of tariff. Thus, in the present case, the assessee was required to submit its application before the CERC for revision of tariff for the period 01.04.2004 to 31.03.2009. After the close of the previous year on 31.03.2004, the CERC approved the tariff rates by orders dated 29.05.2006 and 31.05.2006 for its two projects Chamera and Rangit for the period 01.04.2005 onwards i.e. relevant to the current Assessment Year i.e. 2006-07 onwards. The CERC fixed the tariff at rates lower than what was demanded by the respondent. In other words, whereas, the assessee claimed a tariff at a particular rate, the CERC approved the tariff at a different rate.

In view thereof, the Assessing Officer held that the liability is not ascertained and is contingent upon the order of the CERC. The Assessing Officer held:-

> "The CERC may have kept the tariff at the same level or have reduced by a factor which is not certain on the date of provisioning and therefore, the liability cannot be ascertained."

Accordingly, the Assessing Officer added back Rs.51.80 crores to the book profit for the purpose of computing the minimum alternate tax under section 115JB.

7. The CIT (Appeals) upheld the assessee's contention that as per the Companies Act, 1956, Schedule IV and Accounting Standard-1 all known liabilities have to be accounted for as the assessee follows the mercantile system of accounting. It was also held that the assessee properly explained various factors leading to tariff adjustment of Rs.51.80 crores made in the books; that the orders of the CERC are binding; that the adjustment made by the assessee adhered to the rules/guidelines/orders of the CERC and that this was not a contingent liability as calculated as per the CERC guidelines and is, therefore, an accrued liability.

The Tribunal upheld the order of the CIT (Appeals) but only on the ground that a similar issue was raised before the Tribunal by the Revenue/appellant in its appeal for the Assessment Year 2005-06 and that the Tribunal had, by an order dated 30.09.2014, confirmed the deletion of an amount similar in nature.

8. The question of law that arises is whether the tariff charged by the assessee from 01.04.2005 and till the

final order of the CERC is contingent and cannot be said to have crystallized or attained certainty and is, therefore, liable to be added back to the assessee's income.

9. As we noted earlier, the assessee is not entitled to fix the tariff. It is the CERC which fixes the tariff, albeit upon the assessee's application. Upon completion of the period for which tariff is fixed, the assessee is bound to make an application to the CERC for fixing the future tariff. This application is made after the completion of the earlier period for which the tariff is fixed. There is, therefore, a time-lag between the expiry of the period for which the tariff is fixed and the date on which the CERC fixes the tariff for the subsequent period. In the present case, the earlier period came to an end on 31.03.2004 and the tariff was fixed for the subsequent period i.e. 01.04.2004 to 31.03.2009 on 29.05.2006 and 31.05.2006. On account thereof, there was a difference in the tariff collected to the extent of Rs.51.80 crores for the assessment year. During this period, namely, 01.04.2004 onward, the assessee made an adjustment towards tariff charged as per its application filed with the CERC.

The assessee has been following this accounting practice consistently in accordance with the principle of conservatism as laid down in Accounting Standard-1 as per which all known ascertained liabilities have to be accounted for. The assessee is following the mercantile system of accounting.

10. The reliance placed by Mr. Ved Jain, the learned counsel appearing on behalf of the respondent/assessee upon

the judgment of the Supreme Court in Bharat Earth Movers vs. Commissioner of Income-Tax, [2000] 245 ITR 428 (SC) is well-founded. In that case the assessee had created a fund by making a provision for meeting its liability arising on account of accumulated earned/vacation leave that the employees were entitled to for the relevant assessment year. An amount of about Rs.62 lakhs was set apart in a separate account as provision for encashment of accrued leave which was claimed as a deduction. The Tribunal held that the assessee was entitled to do so whereas the High Court held that the provision for accrued leave salary was a contingent liability and, therefore, was not a permissible deduction. The High Court based its judgment on the ground that the liability will arise only if an employee does not go on leave and applies for encashment. 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.
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> 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 fulfilment 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."

11. Although the judgment was not under section 115JB, the ratio applies equally to the case before us as the question is the same. The liability in the present case also has definitely arisen, although it would have to be quantified and discharged to adjust it at a future date, i.e., the date on which the CERC determined the tariff. It is not even suggested by the revenue that the liability was not likely to be incurred. Considering the nature of the assessee's enterprise and the mode of fixation of tariff, it is reasonably certain that the liability would arise. Nor is it suggested that the liability was not capable of being estimated with reasonable certainty. The assessee estimated the liability after taking all the relevant factors into consideration. Indeed, the liability was enhanced on account of the CERC fixing the tariff at a rate lower than that sought by the assessee. The difficulty in estimating does not convert the accrued liability into a conditional one as held by the Supreme Court. Further, as held by the Supreme Court, it is upon the tax authorities to arrive at a proper estimate of the liability having regard to all the circumstances of the case. However, it is not suggested that the liability was not properly estimated.

12. The Delhi High Court dealt with a similar question in NTPC Ltd. Vs. Commissioner of Income Tax-V, 2014(4) TMI 683 – Delhi High Court. We were informed that the nature of the NTPC activities in business and the manner in which it fixes

the tariff are the same. The Division Bench of the Delhi High Court held:-

> "21. There is authority, in the form of Supreme Court judgments in Shree Sajjan Mills Ltd v. CIT, (1985) 156 ITR 585, Bharat Earth Movers Ltd v. CIT, (2000) 245 ITR 428 and Metal Box Company of India Ltd v. Their Workmen, (1969) 73 ITR 53, that a provision made on a reasonable basis, it would be in the nature of an ascertained liability and that in a mercantile system of accounting, provision for liability ascertained during the course of the relevant accounting period, which is payable at a future is permissible."

We are in respectful agreement with this conclusion based on the judgments cited therein.

13. Question Nos.3 and 4 are, therefore, answered in favour of the assessee and against the revenue.

14. The appeal is accordingly dismissed.

(S.J. VAZIFDAR)
CHIEF JUSTICE

(AVNEESH JHINGAN)
JUDGE

21.03.2018
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NOTE:
Whether speaking/non-speaking: Speaking
Whether reportable: YES/NO