IN THE HIGH COURT OF DELHI AT NEW DELHI

Reserved on : November 12, 2007
Date of Decision : November 21, 2007

ITR No.201/1986

THE COMMISSIONER OF INCOME-TAX DELHI -VII... Appellant

Through Mr.J.R.Goel, Advocate.

Versus

M/S. KWALITY RESTAURANT & ICE CREAM CO….Respondent

Through Mr.Ajay Vohra and
Ms. Kavita Jha, Advocates.

CORAM:
HON'BLE MR. JUSTICE MADAN B. LOKUR
HON'BLE DR. JUSTICE S. MURALIDHAR

1. Whether Reporters of local papers may be allowed to see the order? Yes
2. To be referred to the reporter or not? Yes
3. Whether the order should be reported in the Digest? Yes

DR. S. MURALIDHAR,J.

1. At the instance of the Revenue, the following question of law has been referred for our opinion under Section 256(1) of the Income Tax Act, 1961 ('Act') by the Income Tax Appellate Tribunal ('Tribunal'), Delhi Bench "E", New Delhi for the Assessment Year 1980-81:

> "Whether on the facts and in the circumstances of the case, the Tribunal is correct in law in holding that the purchase-tax of Rs.89,180/- is a trading liability of the assessee, deductible in computing its income?"

2. The Assessee is a partnership firm which manufactures ice cream. A firm of the same name that was earlier constituted under a partnership deed dated

assets and liabilities of the erstwhile firm were taken over by the assessee under the same name. The assessee firm was constituted by a deed of partnership dated 27th April 1980.

3. Relevant to the Assessment Year 1974-75 the Sales Tax Department levied purchase tax on the raw material and packing material used by the Assessee in the manufacture of ice cream. The demand raised by the Sales Tax Department for the said Assessment Year 1974-75 was received by the Assessee on 26th March 1979. The accounting period of the Assessee ended on 30th June 1979. The Assessee firm discharged the liability and claimed deduction while computing its income for the Assessment Year 1980-81.

4. The Inspecting Assistant Commissioner ('IAC') in a detailed assessment order dated 31st March, 1983 disallowed the deduction on the ground that Clause 11 of the partnership deed dated 27th April, 1980 indicated that the liability to pay the purchase tax was not that of the Assessee. In other words, he was of the view that the partnership deed did not stipulate that a demand raised by the Sales Tax Department against the erstwhile firm should be discharged by the Assessee firm. Further the IAC held that the Assessee had been contesting its liability to pay purchase tax and therefore the demand of purchase tax could not be treated as a liability of the Assessee firm. The Commissioner of Income Tax (Appeals) ['CIT(A)'] concurred with the IAC and held that the liability to pay purchase tax was not that of the Assessee firm in terms of clause 11 of the partnership deed dated 27th April, 1980.

September, 1985 reversed the view taken by the IAC and the CIT (A). Interpreting Clause 11 of the partnership deed, the Tribunal held that the entire fund of the erstwhile firm belonged to the Assessee firm and it was only the surplus that remained after satisfaction of the liabilities as stipulated in sub-clauses (i) and (ii) of Clause 11 that was to be distributed among the individual partners named therein. The Tribunal noted that the demand by the Sales Tax Department was served on the Assessee firm and given the fact that under the Sales Tax law the Assessee firm could be proceeded against for recovery upon its failure to meet the demand, it could not be said that the liability was not that of the Assessee. It was further held that the deduction could not be denied only on the ground that the liability related to a previous year during which no provision had been made by the Assessee.

6. It is submitted by Mr. J.R.Goel, learned senior standing counsel for the Revenue, that in terms of Clause 11 of the partnership deed the provision made for payment of sales tax and the refunds received in reference to the sales tax paid in earlier years and lying with the erstwhile firm shall be dealt with only by the named individuals. According to him since these named individuals alone were required to handle the funds available with the erstwhile firm and discharge its liabilities, it cannot be said that the Assessee firm was required to undertake such liability. Further the purchase tax liability which was discharged by the Assessee firm did not pertain to the Assessment Year 1980-81 and therefore could not be allowed as a deduction.

The purchase tax liability of the earlier years could be claimed as a deducti computing the profits particularly since the demand was outstanding and in fact served on the Assessee firm. He relied upon the judgment of the Supreme Court in ***Kedarnath Jute Manufacturing Company Ltd. v. Commissioner of Income-tax (Central), Calcutta (1971) 82 ITR 363*** in which it was held that whether the Assessee would be entitled to a particular deduction or not will depend upon the provision of the law in relation thereto and that a deduction is to be allowed even if no provision has been made therefor by the Assessee in its accounts. He also relied upon the judgment of this Court in ***Additional Commissioner of Income-tax, Delhi-II v. Rattan Chand Kapoor (1984) 149 ITR 1*** in support of his submission.

8. The answer to the question framed will depend on the interpretation of Clause 11 of the partnership deed dated 27th April 1980, which reads as under:

> "11. That certain provisions for payment of sales-tax and certain refunds received from sales-tax paid in earlier years are lying with Unit Kwality Ice Cream Co., shall be dealt within the following manner by Shri P.L. Lamba, Shri Sunil Lamba, Smt. Meena Mehta, Smt. Sita Rani and Smt. Nirmal Kapoor and/or their successors and assigns:
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> (i) for the payment of sales-tax or purchase-tax in respect of the period upto 31st December, 1977 and legal expenses connected therewith;
>
> (ii) for the payment of Income-tax which may be found payable by the firm and/or partners as a result of cessation of sales-tax liability for the

9. A plain reading of the above clause indicates that there is an acknowledgment that there were surplus funds lying with the erstwhile firm. This clause indicates the manner in which those funds will have to be dealt with. It is clear that sub clauses (i) and (ii) give priority to the discharge of the statutory purchase tax and sales tax liabilities in respect of the period up to 31st December 1977. Since this is mandated in Clause 11 itself, it cannot be said that the individuals who are named in the said clause could have controlled these funds to the extent of discharge of such liabilities. Clause (iii) only indicates that the surplus, if any, will be shared amongst the named individuals, all of whom are partners of the Assessee firm, according to their shares. Therefore it is not possible to read Clause 11 in the manner suggested by the learned counsel for the Revenue. There is nothing in the said clause which states that the Assessee firm cannot and should not discharge the sales or purchase tax liability of the erstwhile firm. In fact, as already noticed, the demand in the instant case was in fact served by the sales tax department on the Assessee firm and discharged by it.

10. We are also unable to concur with the views expressed by the IAC and the CIT (A) that the purchase tax liability did not accrue to the Assessee since it was being contested by the Assessee. It has been explained in very clear terms by the Supreme Court in ***Kedarnath Jute Manufacturing Co. Ltd.*** that the mere fact that a statutory liability is contested by an Assessee will not take away its essential character of a trading liability, the discharge of which can be claimed

Assessee of the said sum when it has actually discharged the demand during relevant Assessment Year.

11. For the above reasons, we answer the question framed for our consideration in the affirmative, that is, against the Revenue and in favour of the Assessee.

12. The reference is disposed of accordingly.

S. MURALIDHAR, J

MADAN B. LOKUR, J

November 21, 2007
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