



\$~Part –IIB (R-32 & 33)

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
 + **INCOME TAX APPEAL NOS. 84/2000 & 85/2000**

Date of decision: 23rd August, 2013

KRISHAK BHARATI COOPERATIVE LIMITED

..... Appellant

Through Mr. Rajat Navet, Advocate.

versus

COMMISSIONER OF INCOME TAX & ANOATHER

..... Respondents

Through Mr. N.P. Sahni, Sr. Standing
 Counsel & Mr. Ruchesh Sinha, Advocate.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJIV KHANNA, J. (ORAL):

The petitioner, a multi-State Cooperative Society, has filed two appeals under Section 260A of the Income Tax Act, 1961 (Act, for short), which relate to Assessment Years 1987-88 and 1988-89. By order dated 7th November, 2000, the following two substantial questions of law were admitted for hearing:-

“(1) Whether in the facts and circumstances of the case an amount of Rs.1,88,17,168/- was deductible from the petitioner’s income as a deduction, by virtue of Section 36(1)(iii), on account of interest accrued in respect of capital



converted into loan for the period 1st July, 1986 to 30th June, 1987?

(2) Whether in the facts and circumstances of the case an amount of Rs.62,66,667/- was deductible from the petitioner's income as a deduction, by virtue of Section 36(1)(iii), on account of interest accrued in respect of capital converted into loan for the period 1st April, 1986 to 30th June, 1986?"

2. The facts are not in dispute. The appellant had built a fertilizer plant at Hazira, West Bengal. Government of India held equity share capital in the appellant society. By their letter dated 20th April, 1988, the Government of India converted a part of their equity share capital amounting to Rs.16 crores into a loan with retrospective effect; Rs.6 crores from 26th December, 1983 and Rs.10 crores from 20th January, 1984. As a result of the said conversion, the appellant became liable to pay interest on the said amount, which was payable with effect from 26th December, 1983 on loan of Rs.6 crores and 20th January, 1984 for loan of Rs.10 crores. Interest payable on the said loan was capitalised upto 28th February, 1986, i.e., the date on which the commercial production started in the fertilizer plant at Hazira.

3. In respect of Assessment Year 1987-88, the appellant had filed return of income on 20th June, 1987 and for the Assessment Year 1988-89 the return of income was filed on 28th June, 1988. In the two returns, interest payable for the aforesaid period to the Government of



India in terms of letter dated 20th April, 1988 was not treated as accrued liability. Interest payable on or after 1st March, 1986 in view of the letter of the Government of India dated 20th April, 1988 was not shown and claimed as an expenditure in the profit and loss account filed with the two returns. However, during pendency of the assessment proceedings, the appellant filed revised returns (dates are not available) and claimed deduction of interest under Section 36(1)(iii) for the period 1st March, 1986 to 30th June, 1986 (four months) amounting to Rs.62,66,667/- and Rs.1,88,17,168/- for the period 1st July, 1986 to 30th June, 1987 (it is apparent that the accounting year of the assessee during the two years was from 1st July to 30th June of the relevant previous year).

4. The Assessing Officer did not accept the claim for interest on the ground that the liability had not accrued during the relevant previous years but had accrued subsequently only because of letter dated 4th April, 1988.

5. In first appeal, the appellant assessee did not succeed in the Assessment Year 1987-88 but succeeded in the Assessment Year 1988-89.

6. The appellant and the Revenue preferred appeals before the tribunal against the two conflicting orders passed by the first appellate authority.



7. The tribunal by their common order dated 6th December, 19 has accepted the stand of the Revenue and observed that the liability to pay interest had not accrued during the relevant previous years and, therefore, the interest which was payable in terms of letter dated 4th April, 1988 written by the Government of India cannot be claimed as an expenditure under Section 36(1)(iii) of the Act in the two assessment years. It can be claimed as an expenditure in the period relevant to the assessment year when letter dated 4th April, 1988 was written and received.

8. At the very outset, we note that the appellant is following mercantile system of accounting. Under the said system, both accrued credits and liabilities have to be taken into consideration. Accrual normally takes place before the amount is actually received or paid. Expenditure as a debt or a legal liability once incurred is treated as expenditure, even before it is actually disbursed.

9. There is difference between contractual liabilities and statutory liabilities. Statutory liabilities are incurred under the statute and become payable in terms of the charging Section of the applicable statute. Contractual liabilities, on the other hand, become due and payable as per the terms of the contract and when quantification is settled by an agreement or otherwise. In the present case, the transaction in question was contractual in nature and not statutory,



though Government of India was a party to the said transactions with the appellant-assessee as it had invested substantial amounts, including Rs.16 crores, which was subsequently vide letters dated 4th April, 1988 and 24th April, 1988 converted into a loan. These two letters state that in view of the official cost estimates, the Government of India had decided, in partial modification of their earlier letter dated 25th March, 1986, to convert an amount of Rs.16 crores already drawn by the appellant as equity into loan with retrospective effect. Interest on the said amount, which was now converted into loan, should be disbursed and paid to the Government of India. Letter dated 20th April, 1988 further clarified and stated that conversion of equity into loan would be in two stages; Rs.10 crores would be treated as converted into a loan with effect from 20th January, 1984 and Rs.6 crores would be treated as converted into a loan as on 26th December, 1983. The said letter further records that dividend of 3% for the cooperative year 1986-87 might be worked out and paid on Rs.328 crores in place of Rs.344 crores. It is apparent that dividend had already been paid and the letter further records that interest may be paid to the Government of India immediately after making adjustment of dividend on Rs.16 crores with effective date of conversion of Rs.16 crores mentioned in the letters.

10. It is clear from the said correspondence that Government of India was earlier a shareholder and was entitled to dividend on share



capital to the extent of Rs.16 crores, which had been issued or were allotted by the appellant-assessee. Pursuant to the letters dated 4th April, 1988 and 20th April, 1988 there was a change in the character of the relationship between the parties to the extent of Rs.16 crores, which became a loan for the first time. The relationship of a shareholder came to an end. The said conversion took place after the end of the respective previous years, subject matter of the present appeals. We do not think, in these circumstances, it can be held that the liability had accrued or crystallised during the relevant assessment years. It is clear that the liability had accrued and had crystallised subsequently after the end of the previous years on 30th June, 1986 and 30th June, 1987. During the previous years, the appellant assessee had no clue or even an indication that this liability might accrue or the shareholding to the extent of Rs.16 crores would be converted into a loan. Before the said letters, neither the appellant was liable to pay any amount as interest nor Government of India had any right to claim any interest from the appellant. Government of India was entitled to dividend and in fact it appears that dividend had been paid. Till the two letters were written, there was not even a possibility or whisper that any liability would accrue or arise. Government of India did not have any right to claim interest before these two letters were written and or were accepted by the appellant, whether under pressure or otherwise.



11. Profits and gain of business are computed on ordinary commercial principles. However, when there is a statutory interdict or stipulation, regardless of the ordinary commercial principles, the statute has to be followed. Section 36(1)(iii) of the Act does not help the appellant -assessee in form of any statutory interdict. There is no statutory provision that this amount should be allowed as interest accrued pursuant to the two letters dated 4th April, 1988 and 20th April, 1988. No such contention has been raised or even argued. We do not think that under the ordinary principles of accountancy the two amounts were liabilities. It was only after letters dated 4th April, 1988 and 20th April, 1988, interest became payable and accrued liabilities were incurred. Interest became due and payable for the first time. Period for which interest became payable, is different and should not be confused with time/date when liability accrued. As per the ordinary principles of commercial accountancy, the said liabilities cannot be allowed as an expenditure in the earlier years.

12. In ***Commissioner of Income Tax, Madhya Pradesh etc. versus Swadeshi Cotton and Flour Mills Private Limited***, 1964 (53) ITR 134 bonus was paid in the year 1949, after an award under the Industrial Disputes Act. However, as the books for the year 1948 was not closed, this amount added and shown as expenditure in the year relating to the years 1948 and 1947. Referring to the nature and character of bonus in



the said case, i.e., profit bonus, it was observed that it was not wage and at least not a liability for computing income tax as it was not an expense in ordinary course of term. It was also observed that reopening of accounts does not fit in with the scheme of the Indian Income Tax as was observed in ***Commissioner of Income Tax versus A. Ganpathy Naidu***, 1964 (53) ITR 114, which relates to case of receipts but the proposition of law could be equally applied to expenses. [see also ***Laxmi Devi Sugar Mills Vs. CIT***, (1993) 200 ITR 603 (SC)].

13. ***In Metal Box Company of India Limited versus Their Workmen***, 1969 (73) ITR 53, the Supreme court was concerned with liability towards gratuity under the statutory provisions and whether the amount calculated on actuarial valuation of the estimated liability could be treated as expenditure in the profit and loss account. It was observed that estimated liability under the gratuity schemes when properly ascertained, it was possible to arrive at proper discounted present value. Liability, though contingent provided it is discounted i.e. its present value, if ascertainable, could be taken as trading expenses once they were sufficiently certain, capable of valuation and if profits cannot be properly estimated without taking them into account. It was a case of an accrued liability in praesenti but payable in future.



14. Learned counsel for the appellant has relied up ***Kedarnath Jute Manufacturing Company Limited versus Commissioner of Income Tax***, 1971 (82) ITR 363 (SC) and submits that in this case the assessee was following mercantile system of accounting and the claim of expenditure was allowed though no entry had been made in the books of accounts. The facts of the said case are distinguishable as the liability under the said case was under the sales tax laws, i.e., statutory liability, which was created and had accrued when a dealer either made the sales or purchases and the obligation to pay tax had arisen and was attracted. In ***Laxmi Devi Sugar Mills versus Commissioner of Income-Tax*** (*supra*), the government had issued a notification on December 23, 1960 declaring that the workers were entitled to bonus after the concerned accounting year for the assessee had ended on September 19, 1960. The Supreme Court observed that the accounting year concerned therein was one prior to the coming into force of the Bonus Act. Therefore, there was no existing liability upon the assessee to pay bonus during the said accounting year. In other words, during the relevant accounting year, the liability to pay bonus had not fastened on to the assessee. The liability itself was created subsequent to the closing of the accounting year. In the said situation, merely because the assessee has made a provision would not entitle a deduction under section 10(2)(x) read



with section 10(5) of the Indian Income-tax Act, 1922.

15. In ***Commissioner of Income-tax versus Shri Goverdhan Ltd.***

(1968) 069 ITR 0675, the court observed that it is well established that the income may accrue to an assessee without actual receipt of the same and if the assessee acquires a right to receive income, the income can be said to have accrued to him though it may be received later on, on it being ascertained. The legal position is that a debt is a liability payable in praesenti or in future but it should have arisen and obligation must have come into existence. The fact, that the amount has to be ascertained, does not make it any less a debt, if the liability is certain and what remains is only a quantification of the amount: debitum in praesenti, solvendum in futuro.

16. Payment of a liability is distinct from creation or accrual of the liability and under the mercantile system profits and gains of persons are computed on the basis of principle of accrual during the period for which profits and gains have to be computed. It is not material that the liability is to be discharged at a future date or by mistake or failure, no entry of the accrued liability was made in the books of accounts. An assessee will be entitled to a particular expenditure or deduction depending upon provisions of law and not on the basis of existence or absence of entries in the books, which are not conclusive. The same principle applies to accrual of income.



17. The supreme Court in ***Bharat Earth Movers vers Commissioner of Income Tax***, 2000 (245) ITR 428 has observed that quantification or discharge of a liability of future date is not relevant but what is to be determined for allowing a business liability is to ascertain whether the liability had accrued and that the assessee was certain about incurring the liability. In other words, the liability should be capable of being estimated with reasonable certainty though actual quantification may not be possible. If these requirements are satisfied, the liability is not contingent. The liability is in praesenti though to be discharged at a future date, even if the future date on which the liability is discharged is not certain. The same principle applies to receipts, which have to be added and brought to tax in mercantile system of accounting. Again in ***Chief Commissioner of Income Tax versus Kesaria Tea Company Limited***, 2002 (254) ITR 434 it has been observed that unilateral action on the part of the assessee by way of writing off liabilities in their accounts does not necessarily mean that the liability has ceased in law. In the said case, the profit tax liability had not ceased finally. In the present case, the liability had not accrued and was not even in contemplation of the appellant till letter dated 4th April, 1988 was issued, which is after the end of the two previous years. Till then, Rs.16 crores was part of the equity share capital and was not regarded and treated as a loan. The two previous years had



come to an end on 30th June, 1986 and 30th June, 1987, long before the letter dated 4th April, 1988 was issued.

18. We will be failing, if we do not mention reference made by the appellant to a decision of this Court in ***Additional Commissioner of Income Tax, Delhi-II versus Rattan Chand Kapoor***, 1984 (149) ITR 1, which relies upon ***Kedarnath Jute Manufacturing Company Limited*** (supra). The said case again relates to a statutory liability, i.e., sales tax liability. The assessee had received demand notices for earlier years in the period relevant to the Assessment Year 1964-65. Revenue insisted and submitted that the assessee was following mercantile system of accounting and, therefore, the sales tax liability relating to earlier period cannot be allowed in the Assessment Year 1964-65. The contention was rejected observing that the decision in ***Kedarnath Jute Manufacturing Company Limited*** (supra) was distinguishable and was not an authority for the proposition that the assessee could not have claimed deduction or expenditure in the year in question. It was in the context of the factual matrix of the said case that it was observed that if statutory liability was determined after the end of the relevant assessment year, the assessee could still claim the said liability in the year in which the demand was raised or the order was passed. A Division Bench of the Delhi High Court took pragmatic view of the situation as sometimes statutory liabilities are determined



or demand is raised after contest, much later and by that time, return for the earlier assessment year stands filed or assessment proceedings have come to an end. This is not the factual position in the present case. In the present case, the liability itself had arisen much later with the letter dated 4th April, 1988. This is the date on which liability towards loan got created for the first time and the shares issued to the Government of India were treated as either cancelled or null and void and a loan and interest liability came into existence. It is on this date that the appellant became liable to pay interest, though for earlier period also. The letter dated 4th April, 1988 changed the nature of the transaction and relationship completely from that of a shareholder to a creditor and a debtor. Before the said date, the said liability did not exist as there was no relationship of a creditor and debtor between the Government of India and the appellant. The contention of the appellant that letter dated 4th April, 1988 was a unilateral letter, does not appear to be correct and in any case does not affect the outcome or legal position. The appellant accepted the said letter and has acted upon it. Therefore, the contention that it was a unilateral act is ill-founded and would not in any case negate the effect of the said letter.

19. Similarly, reliance on the decision of the Bombay High Court in ***Additional Commissioner of Income Tax versus Buckau Wolf New India Engineering Works Limited***, 1986 (157) ITR 751 is equally



futile. In the said case, the assessee had made payment of Rs.20,000 but the liability to pay entire amount of Rs.1 lac had accrued. Once accrual has taken place, there is no difficulty, when an assessee is following mercantile system of accounting. The present case is one where accrual has not taken place in the years in question.

20. In view of the aforesaid legal position and discussion, the questions of law mentioned above are answered in favour of the respondent-Revenue and against the appellant-assessee. The appeals are dismissed. No order as to costs.

SANJIV KHANNA, J.

SANJEEV SACHDEVA, J.

**AUGUST 23, 2013
VKR/NA**