THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 07.02.2014

+ **ITA 41/2000**

OSWAL AGRO MILLS LTD ..... Appellant

versus

COMMISSIONER OF INCOME TAX ..... Respondent

Advocates who appeared in this case:
For the Appellant : Mr C.S. Aggarwal, Sr. Advocate with
Mr Prakash Kumar and Mr Sheel Vardhan.
For the Respondent : Mr Sanjeev Sabharwal, Sr. Standing Counsel.

CORAM:-
HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE VIBHU BAKHRU

JUDGMENT

VIBHU BAKHRU, J

1. The present appeal has filed by the appellant under section 260A(1) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') challenging the order dated 16.09.1999 passed by the Income Tax Appellate Tribunal, Delhi (hereinafter referred to as the 'Tribunal') in I.T.A. No.2722/De1/91 relating to assessment year 1987-88. The order dated 16.09.1999 is hereinafter referred to as the 'impugned order'.

2. The impugned order is a common order whereby the Tribunal disposed of the appeals relating to the Assessment Years 1986-87 and 1987-88 being ITA Nos. 2271/91 and 2272/91 respectively.

3. By the impugned order, the Tribunal has rejected the claim of the appellant (hereinafter also referred to as the assessee) for deduction of an amount equivalent to the additional custom duty which is disputed by the sellers (importers) and, consequently, not paid to the custom authorities. The appellant claimed that the additional custom duty demanded by the customs department was a part of the landed cost of the goods that were imported and as such was an ascertained trading liability which had accrued during the course of business. And therefore, the appellant was entitled to deduct the same from its trading revenue for the relevant Previous Year. The said deduction was disallowed as the additional customs duty (which was the statutory liability of the importers- sellers) was disputed by the importers and in terms of the contract between the appellant and the importers the same would be payable only when the custom authorities prevailed in the proceedings pending before the Supreme Court and the importers were called upon to pay the said duty.

4. The Tribunal further disallowed the deduction claimed by the assessee for loss on account of fluctuation in the rate of foreign exchange in respect of an advance received by the assessee in foreign currency. The said advance was received by the assessee for export of certain goods and the same was to be adjusted from amounts receivable for supply of goods to be made over a period of five years.

5. This court by an order dated 22.05.2000 admitted the present appeal and framed the following questions of law:-

> "1. Whether the Income Tax Appellate Tribunal is correct in law and on facts in upholding the disallowance of an amount of

Rs.1,60,33,064. It being a contractual trading liability incurred in the nature of additional cost of material, holding the same to be a liability contingent on the happening of an event and thus not an allowable deduction while computing the income for the instant assessment year?

2. Whether the Income Tax Appellate Tribunal is correct in law and on facts in holding that the liability of Rs.1,60,33,064 claimed by the appellant was not allowable u/s 43B of the I.T. Act.

3. Whether the Income Tax Appellate Tribunal is correct in law and on facts in upholding the disallowance of a sum of Rs.1,19,07,989/- being the loss incurred on account of devaluation of rupee against US Dollars, holding the same to be a fictitious and notional loss?"

6. The figures as stated in the above questions framed by this court relate to the assessment year 1986-87. The present appeal relates to the assessment year 1987-88 and thus the figures referred to in the questions as framed are required to be corrected and replaced by the amounts disallowed in the previous year ended 30.06.1986 (which would be relevant to the Assessment Year 1987-88). Accordingly, the questions of law that are to be considered in the present appeals are re-stated as under:-

"1. Whether the Income Tax Appellate Tribunal is correct in law and on facts in upholding the disallowance of an amount of ₹1,64,87,375/- It being a contractual trading liability incurred in the nature of additional cost of material, holding the same to be a liability contingent on the happening of an event and thus not an allowable deduction while computing the income for the instant assessment year?

2. Whether the Income Tax Appellate Tribunal is correct in law and on facts in holding that the liability of ₹1,64,87,375/- claimed by the appellant was not allowable u/s 43B of the I.T. Act.

3. Whether the Income Tax Appellate Tribunal is correct in law and on facts in upholding the disallowance of a sum of ₹9,37,669.81 being the loss incurred on account of devaluation of rupee against US Dollars, holding the same to be a fictitious and notional loss?"

7. At the outset, it was submitted by the learned counsel for the parties that the issue involved in question no. 3 was covered, in favour of the assessee and against the revenue, by the decision of Supreme Court in the case of ***CIT v. Woodward Governor India Private Limited***: **(2009) 312 ITR 254 (SC).** Accordingly, the said question is answered in the negative and in favour of the assessee.

Brief facts relevant to the disallowance of ₹1,64,87,375 - disputed additional customs duty claimed by the assessee as a part of the landed cost of goods.

8. The facts, relevant to the question of deduction on account of additional customs duty, briefly stated are as follows: The appellant is, *interalia,* engaged in manufacturing and trading of products like de-oiled meals, industrial hard oils, edible oils, marine products, emergency lighting units and soaps, etc. The appellant entered into agreements dated 18.01.1983, 14.04.1983 and 16.05.1983 with Overseas Processors Pvt. Ltd., Shahji International Pvt. Ltd. and Oswal Soap & Allied Industries Pvt. Ltd. respectively for purchase of imported Palm Stearine Fatty Acid (hereinafter referred to as the 'imported material'). All the three parties as mentioned above are collectively referred to as the 'importers'. The agreements entered into between the assessee and the importers were similarly worded. As per clauses 8 of the agreements, the imported material was to be purchased by the appellant at landed cost i.e. CIF price, custom duty,

clearing charges, etc. and 3% of the total cost. As per clause 11 of the agreements, any liability arising after the sale of the imported material, in respect of custom duty, excise duty, penalty, sales tax, etc., would be paid by the appellant and included in the landed cost of imported material. Clauses 8 & 11 of the agreements read as under:-

> "8. We will sell to you the above imported material as it is for actual use by you as per the agreement at landed cost i.e. CIF price, custom duty, clearing charges, etc. and 3% of the total cost. We will also sell to you the manufactured products in our factories as per this agreement at landed cost i.e., cost price, custom duty, clearing charges, etc. plus manufacturing expenses plus 3% of the total cost.
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> xxxx xxxx xxxx xxxx xxxx
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> 11. In case of any disputed amount like custom duty, excise duty, penalty, sales-tax, etc., which may arise during the transactions the same will be taken as part of the landed cost by you but we shall provide Bank Guarantee, etc. for which the counter guarantee in our favor for the same amounts shall be given by you. You will be required to pay the disputed amount on our behalf as and when we are called upon to make the payment and shall be taken as part of the landed cost by you. Any liability arising after the sale of the goods to you, shall be on your account only and you shall arrange payment for the same and entitled for refund of any duty, penalty, etc. paid if any, is refunded to us. This amount so refunded shall be paid to you on actual receipt of the amount."
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> (emphasis supplied)

9. At the time of actual import of material by the importers, the Custom Department demanded 100% of the applicable custom duty as additional

customs duty on the CIF value of imported material. The said additional demand was challenged by the importers before the Supreme Court in Writ Petition (Civil) No.15220-22/1984. The Supreme Court allowed the clearance of imported material on payment of 15% of the disputed additional custom duty and granted stay for balance 85% of the said duty, pending the final decision in the writ petition. The stay granted by the Supreme Court was subject to furnishing of bank guarantees by the importers in favour of the department for the unpaid amount of disputed duty. In terms of the agreement between the assessee and the importers, the assessee provided counter guarantees for the bank guarantees provided by the importers for the unpaid disputed amount of customs duty i.e. 85% of the additional customs duty.

10. The unpaid additional custom duty pertaining to the Previous Year relevant to the Assessment Year 1987-88 was ₹1,64,87,375. The appellant, who follows the mercantile system of accounting, claimed deduction on account of the said additional custom duty, in as much as, the same was included in the landed cost of imported material. The Assessing Officer, by an order dated 28.09.1989 (relating to Assessment Year 1987-88), rejected the claim of the appellant on the ground that the assessee had failed to produce evidence by which it could be ascertained that the liability had arisen or was crystallized during the period relevant to the Assessment Year 1987-88. Accordingly, the Assessing Officer held that the claim on account of the unpaid additional custom duty could not be allowed as admissible expenditure during the period relevant to the Assessment year 1987-88.

11. Aggrieved by the assessment order passed by the Assessing Officer, the appellant challenged the same before the CIT (Appeals). The CIT (Appeals) also rejected the claim of the appellant, by an order dated 28.02.1991, on the ground that the custom duty was a statutory liability and in terms of section 43B of the Act the same was deductible only if the actual payment was made. The CIT(Appeals) also held that the liability of the appellant would arise only when the Supreme Court gave a verdict in favour of the Custom Department.

12. The appellant challenged the order passed by CIT (Appeals) before the Tribunal. The Tribunal, by the impugned order dated 16.09.1999 rejected the appeal and held as under:-

> "14. ..... The custom duty demanded by the Custom Department from the importers was disputed by the importers and the matter is still pending with the Hon'ble Supreme Court. There was no actual payment and the liability was covered only by bank guarantee. The bank guarantee has not been appropriated nor encashed and the same is still in the ownership of the assessee. In such a case the claim of deduction cannot be allowed. Law is well settled that expenditure which is deductible for income-tax purpose is towards liability actually existing in the year of account. Contingent liabilities do not constitute expenditure and cannot be subject matter of deduction even under the mercantile system of accounting as held by the Hon'ble Bombay High Court in the case of Standard Mills Co. vs. CIT (1998) 229 ITR 336 and in the case of CIT vs. Indian Smelting & Refining Co. Ltd. (1998) 230 ITR 194. The Hon'ble Supreme Court in the case of Indian Molases Co. vs. CIT (1959) 37 ITR 666 held that expenditure which is deducted from income-tax purposes is one which is towards liability actually existing at the time but the putting aside of money which may become expenditure on the happening of an

event is not expenditure. The Hon'ble Supreme Court further explained the meaning of expenditure and it was held that expenditure is what is paid out or away and is something which is gone irretrievably. If the case of the assessee is examined in the light of the above, it is seen that the liability is contingent upon the happening of an event that is decision of the Hon'ble Supreme Court where the dispute is pending. Secondly, the bank guarantee provided by the assessee cannot be said to be an expenditure as the same has not been encashed nor appropriated by the customs authorities. The ownership remains with the assessee though the operation may be suspended temporarily. Therefore, the bank guarantee cannot fulfil the requirements of expenditure so as to qualify for deduction from the total income. We hold accordingly.

15. With regard to the claim of the assessee in regard to deduction u/s 43B, we are of the view that this claim also cannot be accepted. Even assuming that it is a statutory liability as the liability is eventually fasten upon the assessee, even then the provision of bank guarantee in itself cannot be treated as payment as the same has not been adjusted towards the custom duty. On this ground also, the CIT is fully justified and no interference is called for in this regard."

Aggrieved by the impugned order, the appellant has filed the present appeal.

Submissions

13. It is contended by the senior counsel appearing for the appellant that the appellant was under a contractual obligation to make the payment for the imported material at the landed cost including the duty payable under the law. It was contended that the liability of the appellant would arise as soon as the ownership of the imported material was transferred from the importers to the appellant. On such transfer of ownership of imported

material, the appellant became obliged to make payment for the same to the importers. It was submitted that the additional custom duty is an incident of import and the said statutory liability is to be discharged by the importers only. It is submitted that the liability of the appellant is contractual and accrued by virtue of the agreement between the appellant and the importers.

14. It is further contended that the liability of the appellant is ascertained as the appellant is obliged to pay the additional custom duty in terms of the agreement and, therefore, the same cannot be considered as a contingent liability**.** The mere fact that the importers have disputed the liability and have not paid the same, would not characterize it as a contingent liability. The liability is ascertained even though the quantification is not final.

15. It is contended that the non-quantification of the sum, does not convert an ascertained liability into a contingent liability. The appellant has to discharge its contractual obligation as per the terms of the contract irrespective of the fact that the importer/supplier has challenged the levy of additional custom duty and the amount is not quantified. In support of this contention, the appellant has relied on decisions in ***Kedarnath Jute Manufacturing Co. Ltd. v. CIT***: **(1971)82 ITR 363 (SC),** ***Calcutta Co. ltd. v. CIT*****: (1959) 37 ITR 1 (SC),** ***ACIT v. Rattan Chand Kapoor*****: (1984) 149 ITR 1 (Del.),** ***CIT v. Kwality Ice Cream***: **(2008) 304 ITR 384 (Del.)** and ***Bharat Earth Movers v. CIT*****: (2000) 245 ITR 428 (SC)**.

16. It was submitted that since the subject liability was in the nature of a trading liability which had accrued, the same could not be treated as a contingent liability. It was contended by the appellant that the subject

obligation was an actual liability in *praesenti* and not a liability *de futuro*. It was submitted that the total amount of consideration for the purchase of any goods would include not only the price charged but also other amounts which were payable by the purchaser and were required for completing the purchase.

17. It was further contended that the appellant had paid the requisite funds as margin money to the bank for arranging the bank guarantee. The said money could, thus, be utilised towards the payment of custom duty if the writ petition was decided against the importers. It was emphasized that the funds had gone out from the coffers of the assessee and, therefore, providing bank guarantee would have to be treated as making actual payment. Thus, even if the provisions of section 43B of the Act were held to be applicable, the deduction on account of the disputed additional customs duty would be allowable. For this proposition, reliance was placed by the learned counsel for the appellant on the decision of the Tribunal in the case of ***Nuchem Plastics v. Dy. CIT*** :**ITA No. 1040/Del/89 and ITA No. 5914/De1/91**.

18. It is contended by the respondent that the liability on account of additional customs duty was contingent in nature and was dependent on the outcome of the matter pending with the Supreme Court. In terms of the contract, the assessee would be required to pay the disputed amount of additional customs duty only when the importers were called upon to pay the same. Since that event had not happened, the contractual liability to pay the additional customs duty by the assessee had not arisen in the relevant period. It was submitted that a liability actually existing in the relevant

accounting year could be deductible as expenditure for the purposes of Income Tax, however, contingent liabilities did not constitute expenditure and could not be the subject matter of deduction even under the mercantile system of accounting.

19. The respondent also contended that there was no actual payment and the liability was covered only by bank guarantees. The bank guarantees provided by the assessee could not be construed as expenditure as the same had not been encashed nor appropriated by the customs authorities. It was contended that the ownership of the bank guarantees remained with the assessee, therefore, the amount covered by the bank guarantees would not qualify for deduction from the total income.

20. The learned counsel for the revenue contended that, in terms of clause 11 of the agreement, the assessee would be required to pay the disputed amount on behalf of the importers as and when they were called upon to make the payment and the same could not be taken as part of the landed cost of imported material by the assessee. It was argued by the learned counsel for the revenue that the claim of the assessee that the subject liability was a trading liability which had accrued and crystalised during the year was liable to be rejected in view of the settled law that an assessee would incur a liability only when a claim, if made, is settled amicably or through adjudication. The learned counsel relied upon the decision of the Supreme Court in ***CIT v. Swadeshi Cotton & Flour Mills Pvt. Ltd.:*** **(1964) 53 ITR 134 (SC)** in support of this contention.

Reasons and conclusion

21. It is now well settled that it is only an extant liability, which has arisen in the relevant accounting period, that is permissible as a deduction for the purposes of determining the taxable income of an assessee. It is, thus, necessary for a liability to have accrued for the same to be taken into account for the purposes of determining the taxable income of an assessee. A liability which is contingent and which may arise in future on happening of an event cannot be deducted as expenditure. The substratal controversy that needs to be addressed is whether in the facts of the present case, a liability in *praesenti* can be stated to have accrued in the relevant previous year or whether the subject liability is a contingent one. While the former is allowed as a deduction, the latter is not.

22. The expression 'contingent liability' has been defined under Accounting Standard 29 as issued by the Institute of Chartered Accountants of India as under:-

> "A contingent liability is:
>
> (a) A possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
>
> (b) A present obligation that arises from past events but is not recognized because:
>
> (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
>
> (ii) A reliable estimate of the amount of the obligation cannot be made."

23. This definition would also be relevant for the purposes of the Income Tax Act as it clearly indicates the liabilities which cannot be considered as deductible for the purposes of determining the taxable income of an assessee. The Supreme Court in the case of ***Rotork Controls India P. Ltd. v. CIT*: (2009) 314 ITR 62** while considering whether a provision made for future claims against warrantees was allowable as a deduction, held that;

> "a provision is recognised when : (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognised."

24. A plain reading of the above three conditions as articulated by the Supreme Court indicate that the same are an antithesis of the definition of 'contingent liability' as provided under the Accounting Standard 29. A contingent liability cannot be allowed as a deduction for the purpose of calculating the taxable income of an assessee. And, a provision can only be recognised when the obligation has already fructified and is not contingent upon an occurrence of any uncertain event in the future. It is not necessary that the obligation must result in a minimum outflow of resources. It is sufficient, if the liability has arisen although the outflow in respect of the same may result later. It is also not essential that an accurate quantum of the outflow of resources required for settling the liability is ascertained. Even in cases where the entire quantum of outflow of resources to settle a liability has not been ascertained, a deduction on the basis of a reliable estimate of the outflow of resources would be allowed in the year in which the liability so arises.

25. In the present case, the language of clause 11 of the agreement between the assessee and the importers is the key to determine whether a present obligation has fructified or whether the subject liability is a contingent one. In our view, a plain reading of clause 11 of the agreement indicates that the assessee would be required to pay the disputed amount of duty on behalf of the importers as and when they are called upon to make such payment. In other words, the assessee has agreed that as and when the importers would be called upon to pay the amount of additional customs duty, the assessee would pay the same on their behalf. Therefore, the liability of the assessee to pay the disputed amount would arise only when the importers are called upon to pay the same. In the event, the importers were to succeed in the writ petition filed before the Supreme Court then the demand of additional customs duty against them would be quashed and they would be not called upon to pay the amount of duty disputed by them. And in this scenario, the appellant would have no obligation to pay any amount as the condition precedent for the assessee to pay disputed amount would not be satisfied. In other words, the liability of the assessee to pay the additional customs duty is contingent upon the importers being called upon to pay the same. Unless and until, the importers are called upon to pay the disputed amount of tax, the assessee has no obligation to pay the same either to the importers or on their behalf to the customs authorities. There is no certainty whether the importers would succeed or fail in the writ petition filed by them before the Supreme Court. Undoubtedly, there is a possibility that the importers may fail before the Supreme Court and the writ petition may be rejected. In the event of such an occurrence, the importers may be called upon to pay the disputed amount of tax as a

consequence of which the assessee may become liable to pay the same on behalf of the importers. Thus, in our view, the subject liability is clearly a contingent liability and squarely falls within the definition of the expression contingent liability as defined under the Accounting Standard 29 issued by the Institute of Chartered Accountant of India and as is generally understood.

26. A Division Bench of the Calcutta High Court has also taken a similar view in ***Peico Electronics and Chemicals Ltd. v. Commissioner of Income Tax***: **(1993) 201 ITR 477.** In that case, the assessee had purchased certain goods from its manufacturers and had agreed to pay the excise duty that was levied on the said manufacturers. The excise authorities levied excise on the said manufactures on the basis of the assessee's selling price. This was disputed by the manufactures who claimed that excise duty was leviable with reference to their selling price and not the selling price of the assessee. The dispute as to the differential duty that was raised by the said manufactures was pending consideration before a High Court at the material time. The assessee made a provision in its accounts with respect to the said differential duty. The Court held that the liability in the hands of the assessee was not a statutory liability but a contractual one as the levy of excise was on the manufacturers from whom the assessee had purchased the goods. The Court further held that the liability being a contingent liability in the hands of the assessee, was not allowable as an expense. The relevant extract from the said decision reads as under:-

> "28. …..Having regard to the facts and circumstances of this case, we are of the view that no statutory liability existed as far

as the assessee-company is concerned, and if there is any liability that was between the manufacturer and the Excise Department. The assessee had no legal liability in so far as the levy of excise duty was concerned at the material time. Even if it is assumed that there is an agreement on the part of the assessee to share the liability, it was only when it will be levied upon the manufacturer that the excise duty can be recovered from the assessee-company. There was no liability or obligation of the assessee-company to the Excise Department for the excise duty. It is not a statutory liability of the assessee. Unless the liability for differential excise duty was co-existent with that of the manufacturer, it cannot be treated as accrued liability of the assessee. Even if it is a contractual liability of the assessee arising out of the transactions which the assessee had with the aforesaid two manufacturers, such contractual obligation will be dischargeable by the assessee only if the manufacturers are liable to bear the liability and demand it from the assessee-company. The manufacturers are responsible to the Excise Department for payment of differential excise duty, if any, levied. That is precisely the reason why the High Court directed the manufacturers to furnish bonds to the satisfaction of the Excise Department till the matter was decided. However, in the case of Electric Lamp Manufacturing Co. (India) Ltd., it did not claim such disputed liability as an accrued liability in its balance-sheet and had shown it as a contingent liability. In the event the liability actually materialises, depending upon the outcome of the writ proceeding, the amount would be paid by the manufacturers and thereafter it may be recovered from the customers. It is, therefore, clear that the statutory liability was of the manufacturers and it is recoverable only from the assessee-company. Liability of such nature can be the liability of the assessee-company only when the manufacturers serve notices upon the assessee to pay the additional duty consequent upon the payment of such additional duty by the manufacturers to the credit of the Excise Department. The matter is still pending before the High Court and, accordingly, no liability has

accrued so far as the assessee is concerned in respect of the additional excise duty."

27. The learned counsel for the appellant had contended that the appellant has a present obligation to pay the disputed amount of duty and the only uncertainty is regarding the final quantum of the duty. And, the same would be ascertained based on the outcome of the writ petition. It is contended that in the event the importers were to succeeded in the writ petition, the quantum of duty payable by the assessee would be nil and in the event the writ petition filed by the importers was rejected then the additional customs duty demanded by the authorities would be the amount payable by the assessee. We are not in agreement with this contention of the assessee as the quantification of how much is to be paid by the assessee is not the subject matter of the controversy in the present case. The contention advanced by the appellant is premised on an erroneous assumption that the only contingency is with regard to the quantum of additional customs duty while the obligation to pay the same is a present obligation. This is clearly not the case as the assessee has no obligation to pay the disputed amount at present. The obligation of the assessee would arise only in the event the importer is called upon to pay the same.

28. The reliance placed by the counsel for the appellant on the decision of the Supreme Court in the case of ***Calcutta Company Ltd.*** (*supra*) is also misplaced. The controversy in that case was whether the estimated amount of expenditure required to develop the plots sold by the assessee should be deducted for the purposes of determining the taxable income of the assessee. In that case, the assessee was in the business of developing and

selling plots of land. The assessee had sold some plots and even though had received only part of the sale proceeds, the assessee had accounted for the total sale consideration as its income. Since the assessee was following the mercantile system of accountancy, the assessee estimated the amount of expenditure required to carry out certain development work on the plots sold, which the assessee was obliged to do, and this expenditure was claimed as a deduction. This was justified since the assessee had accounted for the total consideration of the plots as income and this expenditure was necessary for earning the said income. This was not a case where there was any dispute as to the assessee's liability or obligation to develop the plots that had been sold. The only controversy was whether the expenditure necessary for developing the plots could be allowed on the basis of a reliable estimate made by the assessee. The Supreme Court explained that under the mercantile system of accounting, not only the accrued income but also accrued expenditure was liable to be accounted for in order to determine the real income of an assessee. The *ratio decidendi* of this case has no application to the facts of the present case.

29. The decision of the Supreme Court in the case of ***Kedarnath Jute Manufacturing Co. Ltd.*** (*supra*) also does not support the contentions advanced by the appellant. The controversy in that case related to allowing a deduction on account of sales tax on the sales made during the previous year. There was no dispute that the assessee was obliged to pay sales tax on the sales effected by the assessee and demands in this respect had been made by the sales tax authorities. These demands were challenged by the assessee by filing appeals which ultimately did not succeed. The Supreme

Court held that the assessee was entitled to deduct the amount of sales tax which the assessee was liable to pay in respect of the sales during the relevant accounting year. The Court further held that the liability to pay sales tax did not cease because the assessee had initiated proceedings for having the same reduced or wiped out. Indisputably, the taxable event for the purposes of levy of sales tax is a transaction of sale and purchase. This having occurred in the relevant accounting year, admittedly, the liability to pay the sales tax had also arisen in the same period. The Supreme Court held that merely because the quantification of the sales tax was subject matter of further proceedings the same would not imply that the liability had not accrued or arisen in the relevant year. There can be no quarrel with this proposition of law. However, in the present case, the appellant has contracted to make payment of the disputed customs duty only in the event the importers are called upon to pay the same. As discussed earlier, the present case is not a case of quantification of liability but a case where the liability would arise only on happening of an uncertain event.

30. The Supreme Court in the case of ***Bharat Earth Movers*** (*supra*) following its earlier decision in ***Calcutta Co. Ltd.*** (*supra*) reiterated the view that merely because an accrued liability was to be discharged at a future date, the same would not convert the liability into a conditional one. In cases where the liability had accrued, the same would not be considered as contingent only because the actual quantification may not be possible. In that case the controversy was with regard to the provision made by the assessee company for meeting its liability arising on account of accumulated earned/vacation leave. While the officers of the assessee were

entitled to earned leave, the other staff of the assessee were entitled to vacation leave. The earned leave and vacation leave could be accumulated to a maximum period of 240 days and 126 days respectively. The said leaves could also be encashed subject to the specified ceiling. The assessee company had made a provision for the same. The High Court held that the liability on account of encashment of the accrued leave was a contingent liability. The Supreme Court set aside the decision of the High Court and held that merely because the quantification of the liability was uncertain, the same did not render the liability as a contingent one. Indisputably, the employees acquired a right to encash their earned leave. Correspondingly, the assessee company incurred a liability to pay for the same. A reliable estimate of the liability could be made, however, the exact quantification would not be possible unless the accumulated leave was encashed. The relevant passage from the said decision is quoted below:-

> "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."

It is apparent that this decision is wholly inapplicable to the facts of the present case. In the case of ***Bharat Earth Movers*** (*supra*), there was no doubt or uncertainty with respect to the liability of the assessee to pay its

employees their earned leave. Although, reliable estimates could be made, the actual quantification was uncertain. Indisputably, in cases where a liability has arisen and a reliable estimate of the same can be made, the assessee would be entitled to a deduction in respect of the subject liability, if otherwise permissible. An accrued liability would not be considered as a contingent liability only because the exact quantification of the same was not possible at the material time. And, this is precisely what the Supreme Court has held in ***Bharat Earth Movers*** (*supra*).

31. In the present case, the controversy is not with regard to the quantification but whether the liability itself has accrued/arisen or is contingent upon the importers been called upon to pay the disputed amount. As explained earlier, the liability in the present case is itself contingent upon happening of an uncertain event. Accordingly, in our view, the first question must be answered in the affirmative and against the assessee. In our view, the Tribunal was correct in holding that the amount of ₹1,64,87,375/- represented a contingent liability and was thus, not allowable as expenditure in the relevant assessment year.

32. The question whether providing a bank guarantee would amount to payment of a liability for the purposes of Section 43B of the Act is premised on an assumption that the subject liability of the assessee to pay the unpaid additional customs duty is a statutory liability of the assessee. It is thus necessary to consider the controversy whether the obligation of the assessee to pay the additional custom duty, in terms of clause 11 of the Agreement with the importers, can be considered as a statutory liability. Although, the assessee is obliged to pay the additional customs duty as and

when the importers are called upon to pay the same, nonetheless, it cannot be considered as a statutory liability because the same is not imposed on the assessee by virtue of any statute. Customs duty is an incident of import of goods and an importer is obliged to pay the same under the Customs Act. Therefore, the liability to pay the additional customs duty is a statutory liability of the importers. However, in the hands of the assessee, the liability to pay the quantum of custom duty imposed on the importers, either directly to them or on their behalf, cannot be considered as a statutory liability as this obligation is not imposed by any statute but from the contracts entered into between the assessee and the importers. The liability in question is thus, clearly a contractual liability insofar as the assessee is concerned.

33. Section 43B applies only in cases of statutory liability. By virtue of the said section, a statutory liability is not deductable in the year in which it accrues if the same remains unpaid. A deduction with respect to a statutory liability is allowed only on payment of the same. This provision would have no application insofar as the assessee is concerned, as the liability to pay the amount of additional customs duty on behalf of the importers as and when they are called upon to discharge the same is, clearly, a contractual liability and not a statutory liability as discussed earlier. Therefore, in our view, the question whether the said liability should be considered as deductible under Section 43B of the Income Tax Act does not arise.

34. The Tribunal held that even assuming that Section 43B was applicable, the arranging a bank guarantee would not amount to actual

payment of the said liability. The decision of the Supreme Court in ***CIT v. Mcdowell and Co. Ltd.*: (2009) 10 SCC 755**, squarely answers the point in issue against the assessee. In that case the Supreme Court held as under:-

> "**15.** We shall first deal with the question whether furnishing of bank guarantee amounts to actual payment and fulfils the conditions stipulated in Section 43-B of the Act.
>
> **16.** The requirement of Section 43-B of the Act is the actual payment and not deemed payment as condition precedent for making the claim for deduction in respect of any of the expenditure incurred by the assessee during the relevant previous year specified in Section 43-B. The furnishing of bank guarantee cannot be equated with actual payment which requires that money must flow from the assessee to the public exchequer as required under Section 43-B. By no stretch of imagination it can be said that furnishing of bank guarantee is actual payment of tax or duty in cash. The bank guarantee is nothing but a guarantee for payment on some happening and that cannot be actual payment as required under Section 43-B of the Act for allowance as deduction in the computation of profits.
>
> **17.** Section 43-B after amendment w.e.f. 1-4-1989 refers to any sum payable by the assessee by way of tax, duty or fee by whatever name called under any law for the time being in force. The basic requirement, therefore, is that the amount payable must be by way of tax, duty and cess under any law for the time being in force. The bottling fees for acquiring a right of bottling of IMFL which is determined under the Excise Act and Rule 69 of the Rules is payable by the assessee as consideration for acquiring the exclusive privilege. It is neither fee nor tax but the consideration for grant of approval by the Government as terms of contract in exercise of its rights to enter a contract in respect of the exclusive right to deal in bottling liquor in all its manifestations."

35. We are also unable to accept the contention that arranging a bank guarantee would amount to actual payment.

36. Accordingly, the question no. 2 is also answered in the affirmative and against the assessee. The appeal stands disposed of with no order as to costs.

VIBHU BAKHRU, J

BADAR DURREZ AHMED, J

FEBRUARY 07, 2014
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