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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA 288/2010

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Ms. Prem Lata Bansal, Advocate

versus

EXXON MOBIL LUBRICANTS PVT. LTD. ..... Respondent
Through: Ms.Shashi M. Kapila, Advocate
with Mr. Siddharth Kapil,
Mr. Pranav Bhaskar and
Mr. Pranesh Sharma, Advs.

% Reserved on: 05th August, 2010
Date of Decision: 08th September, 2010

CORAM:
HON'BLE THE CHIEF JUSTICE
HON'BLE MR. JUSTICE MANMOHAN

1. Whether the Reporters of local papers may be allowed to see the judgment?Yes.

2. To be referred to the Reporter or not? Yes

3. Whether the judgment should be reported in the Digest? Yes

J U D G M E N T

MANMOHAN, J

1. The present appeal by the Income Tax Department has been filed under Section 260 A of the Income Tax Act,1961 (for brevity "Act 1961") challenging the order dated 2nd April, 2009 of Income Tax Appellate Tribunal (in short "ITAT") in ITA No. 1261/DEL/2008 for the Assessment Year 2003-2004. By the impugned order, ITAT has deleted the addition of Rs. 1,34,34,500 /- made by the Assessing

Officer (hereinafter referred to as "AO") on account of prior pe
expenses.

2. Briefly stated the relevant facts of this case are that respondent-assessee filed a return declaring a loss of Rs 3.81 Crores. The case was selected for scrutiny wherein AO observed that although the respondent assessee had entered into an agreement in August, 2002 with M/s Exxon Mobil Asia Pacific PTE. Ltd. with retrospective effect i.e. from 1st January 2002, yet the expenses had been incurred during the period January to March 2002 and, thus, the liability thereunder had crystallised during the relevant previous year.

3. An appeal was filed by the respondent assessee against the order of AO before the Commissioner of Income Tax (Appeals) (hereinafter referred to as "CIT (A)") and the same was allowed in favour of the assessee.

4. The Revenue appealed against the order of CIT (A). By the impugned order, ITAT dismissed the Revenue's appeal. ITAT held that the assessee itself could not have known about the liability in the earlier Assessment Year. According to ITAT, the liability of the assessee under the agreement had arisen and accrued in August 2002, when the Agreement was executed. It was under the said Agreement that the liability to pay for period January 2002 to March 2002 arose. Thus, the assessee could only have claimed the liability as expenditure in Assessment Year 2003-2004.

5. Ms Prem Lata Bansal, learned counsel for the Reve submitted that ITAT had erred in law in deleting the addition of Rs. 1,34, 34,500/- made by the AO on account of prior period expenses by holding that the expenditure was incurred in the Assessment Year under consideration though it had been admitted that these expenses were incurred w.e.f 01st January, 2002. Ms Bansal further submitted that ITAT had allowed expenses merely on the ground that invoices had been raised on 19th September, 2002 i.e during the Assessment Year under consideration.

6. The learned counsel for the Revenue relied on Supreme Court's decision in the case of ***Bharat Earthmovers v, CIT, 245 ITR 428*** wherein it was held that 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. According to her, what should be certain is the incurring of the liability and it should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible.

7. Ms Shashi M Kapila, learned counsel for the respondent-assessee submitted that the liability of the assessee arose by virtue of the agreement in August 2002 when the agreement was duly entered into and therefore the liability to pay crystallised only in August 2002. Prior to this, there did not exist any basis upon which the assessee could have made any provision for claim for expenses from January to

March 2002 in the relevant previous year i.e. 2002-2003. Hence, expenses were properly deductible in the computation of profits relevant to Assessment Year 2003-2004.

8. In support of her submissions, she relied upon decisions in ***Nonsuch Tea Estate Ltd. v. Commissioner of Income Tax, Madras, 98 ITR 189 (SC); Surashtra Cement and Chemical Industries Ltd. v. CIT 213 ITR 523 (HC Gujarat) and; Additional Commissioner of Income Tax v. Farasol Ltd., 163 ITR 364) (HC Rajasthan).***

9. We have considered the submissions made by both the counsel. The reliance placed by the Revenue's counsel on ***Bharat Earthmovers V CIT*** (supra) is misconceived. In the said case, the assessee-company had two sets of employees. One set of employees was covered by the Employees State Insurance Scheme and was generally known as "staff". The other set of employees not so covered was known generally as "officers". The company had floated beneficial schemes for its employees for encashment of leave. The officers were entitled to earned leave calculated at the rate of 2.5 days per month, i.e., 30 days per year. The staff (other than officers) were entitled to vacation leave calculated at the rate of 1.5 days per month, i.e., 18 days in a year. The earned leave could be accumulated up to a maximum of 240 days while the vacation leave could be accumulated up to a maximum of 126 days. The earned leave/vacation leave could be encashed subject to the ceiling on accumulation. The officers could at their option avail of the

accumulated leave or in lieu of availing of the leave, apply encashment whereupon they would be paid salary for the period of leave earned but not availed of. The question raised in the case was whether, on the facts and in the circumstances of the case, the provision for meeting the liability for encashment of earned leave by the employee is an admissible deduction? The assessee-company had created a fund by making a provision for meeting its liability arising on account of the accumulated earned/vacation leave. In the assessment year 1978-79, an amount of Rs. 62, 25,483 was set apart in a separate account as provision for encashment of accrued leave. It was claimed as a deduction. In the opinion of the Tribunal, the assessee was entitled to such deduction. The High Court reversed the same and held that the provision for accrued leave salary was a contingent liability and, therefore, was not a permissible deduction. On appeal to the Supreme Court the decision of the High Court was overturned and it was held that "the provision made by the assessee-company for meeting the liability incurred by it under the leave encashment scheme proportionate with the entitlement earned by the employees of the company, inclusive of the officers and the staff, subject to the ceiling on accumulation as applicable on the relevant date, was entitled to deduction out of the gross receipts of the accounting year during which the provision is made for the liability. The liability was not a contingent liability". In our opinion, the Supreme Court in the said case decided about the issue of contingent liability which is not the issue in the

present case. Consequently, the judgment relied upon by the Revenu counsel has no application to the present case.

10. On the other hand, in our opinion, the present case is covered by the decisions in ***Nonsuch Tea Estate Ltd. v. Commissioner of Income Tax,*** (supra)*;* ***Surashtra Cement and Chemical Industries Ltd. v. CIT*** (supra) and; ***Additional Commissioner of Income Tax v Farasol Ltd.*** (supra)**.**

11. In the case of ***Nonsuch Tea Estate Ltd. v. Commissioner of Income Tax,*** (supra) it was held that the liability to pay crystallized in the year of approval. In the said case, under an unwritten agreement, M/s. Harrisons and Crosfield Ltd. (hereinafter referred to as "H.&C. Ltd.") were the managing agent of the assessee-company and were entitled to a commission of 1½ % on all sales. After the coming into force of the Companies Act, 1956, a new agreement was entered into for the reappointment of H.& C. Ltd for a period of 10 years with effect from 1st April, 1956, on a remuneration of 5 % commission on the net profits of the company. Approval of the Central Government was applied for in August 1957 and by a letter dated 2nd September, 1957, the Central Government conveyed its approval to the appointment of H.& C. Ltd for a period of 10 years with effect from 1st April, 1956. For the period ending 30th June, 1958, relevant to the Assessment Year 1959-60, the assessee-company claimed deduction of a sum of Rs. 97,188/- towards remuneration of the managing agents for the

period from 1st April, 1956 to 30th June, 1957, on the ground that sum became payable only after Government's approval. On appeal to the Supreme Court, it was held that in view of Section 326 of the Companies Act, 1956, which contained an absolute prohibition against the appointment or reappointment of a managing agent before approval of the Central Government was obtained, the assessee-company's liability to pay the remuneration of the managing agents arose only when the Government conveyed it's approval by its letter dated 2nd September, 1957, and not prior to that date. The sum of Rs. 97,188/- was therefore deductible in computing the profits for the period ending on 30th June, 1958.

12. In the case of ***Saurashtra Cement and Chemical Industries Ltd.*** (supra) it was held that merely because an expense related to a transaction of an earlier year does not become a liability payable in the earlier year unless it can be said that the liability was determined and crystallized in the year in question.

13. In ***Additional Commissioner of Income Tax v. Farasol Ltd.*** (supra), the assessee entered into a contract with Oil and Natural Gas Commission in February, 1964. The operation started in December 1964. The assessee claimed deduction of expenses for the period 10th September 1964 to 31st December, 1965 after the communication of approval in the assessment year 1966-67. The High Court held that the expenditure incurred in earlier years can be allowed as a deduction in

the Assessment Year 1966-67 as it crystallized only when approval was received.

14. Hence, we are of the view that liability of the assessee under the agreement had arisen and accrued in August 2002, when the Agreement was executed and, therefore, the liability of the assessee to pay for period January 2002 to March 2002 arose and crystallized in August 2002. It is pertinent to mention that CIT (A) had observed that the assessee had shown prior period expense of Rs. 1,34,34,500/- against which the prior period income was shown as Rs 83,21,000/- and the net amount of Rs. 51,13,000/- had been shown as expenditure in the P & L Account. CIT (A) held that if the assessee has shown prior period income and the AO has not excluded it while working out the current year's taxable income then there was no reason on the part of AO to disallow only one part of the prior period adjustments i.e the prior period expenditure.

15. Consequently, the addition made by the AO cannot be sustained. In any event, in view of the settled legal position, no substantial question of law arises in the present proceedings. Hence, the present appeal, being bereft of merit, is dismissed but with no order as to costs.

MANMOHAN, J

CHIEF JUSTICE

SEPTEMBER 08, 2010
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