

THE HON'BLE SRI JUSTICE DILIP B. BHOSALE
AND
THE HON'BLE SRI JUSTICE A.RAMALINGESWARA RAO

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I.T.T.A No.70 of 2003

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JUDGMENT: (Per Hon'ble Sri Justice Dilip B. Bhosale)

This appeal by the assessee is directed against the order dated 17.01.2003 of the Income Tax Appellate Tribunal, Hyderabad Bench A, Hyderabad, passed in I.T.A.No.331/Hyd/02 for the assessment year 1998-99. By this order, the assessee's appeal was partly allowed against the order of the Commissioner of Income Tax (Appeals)-III, Hyderabad (for short, CIT (A)), dated 04.02.2002.

The substantial questions of law, formulated by the assessee, for our consideration in the instant appeal read thus:

- "1. Whether on the facts and in the circumstances of the case, when the accounts of the Appellant were maintained under the Mercantile System, the Tribunal was justified in law in holding that the liability to compensate stockists/dealers had not accrued, on the basis of credit notes issued by the Appellant – assessee?
2. Whether on the facts and in the circumstances of the case, the Appellant having clearly admitted its liability to its stockists/dealers, the liability could be allowed?
3. Whether the Tribunal was right in holding that the liability could be allowed only on actual payment basis, contrary to the method of accounting regularly maintained by the Appellant?"

The facts leading to this appeal, to the extent they are relevant, are as follows: The appellant – assessee – company, hereinafter called as assessee, is a marketing organization engaged in marketing electric goods such as bulbs and tubes. One of the suppliers of the goods to the assessee, at the relevant time, was M/s.Mysore Lamps Works, Bangalore (for short, Mysore Lamps). The assessee had entered into a contract dated 01.04.1987 with Mysore Lamps under which they had undertaken to supply specified goods as per the requirement of the

assessee. The assessee claims, in turn, they had entered into agreements with its stockists and dealers for supply of bulbs and tubes as per their requirement and demand. It is the case of the assessee that there was total failure on the part of Mysore Lamps in supplying the stock in terms of the contract and as a result thereof, they could not supply stock to their stockists. The assessee, therefore, had invoked the arbitration clause under the contract with Mysore Lamps. The sole Arbitrator awarded a sum of Rs.4,98,15,376/- as damages to the assessee, to be paid by Mysore Lamps, vide award dated 27.10.1991. The award was challenged by Mysore Lamps before the Civil Court and, thereafter, in appeal before this Court. Then it was carried to the Supreme Court, where the Supreme Court, vide its order dated 18.09.1997, awarded a sum of Rs.4.00 crores towards compensation to the assessee along with interest. Accordingly, Mysore Lamps paid the entire amount as award in 3-4 installments. It is against this backdrop, the assessee claims that they were liable to reimburse the loss suffered by the stockists to whom it had fixed targets, in anticipation of the agreement between them and Mysore Lamps. According to the assessee, the targets were fixed on 25.03.1987 i.e., just before the agreement was entered into with Mysore Lamps dated 01.04.1987. The assessee claims that they had already recognized their liability to the stockists by showing contingent liability in their books of accounts throughout the period during which the matter was in litigation. According to the assessee, they had a liability to the stockists and they had issued credit notes aggregating to Rs.3,11,18,213/-. The assessee also filed a list of stockists from different States, such as Andhra Pradesh, Kerala, Tamilnadu etc., and also copies of the credit notes issued to various stockists.

The assessing officer disallowed the claim for expenditure of Rs.3,11,18,213/- towards damages payable by the appellant to the stockists holding it to be the contingent liability. The assessing officer did not accept the correspondence exchanged between the stockists and

the assessee for accepting the liability as claimed towards the stockists. It was held that the targets were fixed unilaterally and there was no formal contractual agreement and that the letters written by the stockists/dealers claiming losses were general and vague. It is in this backdrop, the CIT (A) also confirmed the order of the assessing officer vide its order dated 04.02.2002. The appellate Tribunal allowed the appeal partly against the order of the CIT(A) and allowed the deduction holding that the assessee is entitled for deduction under Section 37 of the Income Tax Act, of only the payments made by them aggregating to an amount of Rs.31,48,048/- as expenditure incurred out of commercial expediency. This amount, according to the assessee, was actually paid to the stockists in the assessment year 1998-99.

We have heard learned Counsel for the appellant and for the revenue, and perused the entire materials placed before the Court.

Sri Pushyam Kiran, learned Counsel for the appellant, at the outset, submitted that the appellant was following the Mercantile System of accounting, and that being so, the deduction ought to have been allowed when the liability was accrued to the assessee. He submitted that the liability to pay either by way of damages or reimbursement towards the losses suffered by them was accrued in 1998-99, when the credit notes were issued and, therefore, the entire amount, irrespective of the fact whether it is actually paid or not, ought to have been allowed for the assessment year 1998-99.

We have perused the judgment of the appellate Tribunal and also the correspondence exchanged between the parties as quoted in the order. It is relevant to reproduce the observations made by the Tribunal, after perusing the letters and the other material on record, in paragraphs 15 and 16, which read thus:

“15. We are of the view that the claim for deduction of liability towards stockists can be allowed only on payment basis. We are in agreement with the contentions made out by the learned

Departmental Representative. Simply because the assessee could claim damages from M/s.Mysore Lamp Works, it does not follow that there is a corresponding liability on the part of the assessee to share the said amount of damages with the stockists. The liability of the assessee to meet the losses of the stockists and dealers for failure to make supplies, if any, stands on altogether a different footing. As stated by the learned Departmental Representative, the so-called agreement contained in the circular letter of the assessee to its stockists, cannot be regarded as an agreement between the assessee and the stockists, saddling the assessee with any liability in case of failure to make the supplies as per the targets fixed. The circular letter does not spell out any such liability on the part of the assessee. It does not even provide for arbitration, nor has arbitration been undertaken to settle the dispute between the assessee and the stockists. The letters received from the stockists, which we have reproduced hereinabove, do not quantify the losses, and they do not even hold the assessee liable to meet those losses. At any rate, the letters do not contain the figures of losses incurred by the concerned parties. No legal proceedings have been undertaken by these parties against the assessee and so, there is no ascertained liability on the part of the assessee towards its stockists. With regard to the credit notes allegedly sent by the assessee, we have specifically enquired of the learned counsel for the assessee whether the postal acknowledgements in support of the action of sending the credit notes are available. He has mentioned that no such acknowledgements are available. In the circumstances, the claim of having sent the credit notes is also not established. In the year of account relevant for the assessment year 1998-99, what was paid was only an amount of Rs.31,48,048. There is a huge gap of almost a decade between the receipt of letters from the stockists, which took place in 1988, and the so-called sending of credit notes in 1997. There is an yawning gap of almost a decade between the unquantified claims of stockists and alleged entertainment of those claims by way of sending credit notes, which, as already mentioned, is not established.

16. The evidence tendered by the assessee, in the form of letters received by it from stockists/dealers complaining against short supply of goods by the assessee to them, which resulted in losses in their business, or in the form of internal memos received by the assessee from its salesmen, or the proceedings before the Arbitrator, only indicates the damage in reputation that the assessee has suffered in the eyes of its stockists and dealers and in market, and none of them establish any liability on the part of the assessee towards its stockists/dealers. Consideration of the claims of the stockists on the assessee by the arbitrator does not take the case of the assessee any far. What was under the consideration of the arbitrator was the claim of the assessee for damages against M/s.Mysore Lamp Works. In that context, to buttress its own claim, the assessee must have martialled evidence before the Arbitrator to

show that it incurred damages towards its stockists. Mere fact of consideration of such claim by the arbitrator does not prove that there is a crystallized liability on the part of the assessee towards its stockists and dealers. The award of the arbitrator is binding on M/s.Mysore Lamp Works vis-à-vis the assessee, but it has no binding effect on the assessee vis-à-vis the stockists/dealers of the assessee.”

(emphasis supplied)

The Tribunal, after having considered the materials/evidence on record as also the factual matrix that is reflected in paragraphs 15 and 16 of the order, in the concluding paragraph observed thus:

“...We are of the view that in the present case, the liability has not definitely arisen in the accounting year relevant to the assessment year 1998-99. It is not a case where merely the quantification has been postponed. There are no parameters obtaining in the accounting year relevant for assessment year 1998-99, for effecting quantification of the claim of the stockists. The claims must have been settled through mutual negotiations, and it must be held that the claims were settled in the year of payment. In the year of account relevant for assessment year 1998-99, only an amount of Rs.31,48,048 has been paid. The learned Departmental Representative conceded in principle, the claim for deduction of Rs.31,48,048 being the payments made in the year of account relevant for the assessment year 1998-99, out (sic) at the same time, wanted the matter to be remanded to the assessing officer for verification of the genuineness of the claim of payment of Rs.31,48,048. We do not see any reason for acceding to this part of the request. Assessee's accounts are audited, and the assessing officer has not doubted the payments at all, and so, there is no justification for further verification of the payments at this stage. There cannot be piece-meal assessments. So, for this year, we hold that the assessee is entitled for deduction under S.37 of the Act, of only payments aggregating to an amount of Rs.31,48,048, as expenditure incurred out of commercial expediency. The rest of the payments in other subsequent years may be considered for deduction in respective years.”

From a perusal of the record, it is clear that the assessee could not and did not place any materials, whatsoever, on record in support of their contention that there was liability towards the stockists, who allegedly suffered losses, in view of non-supply of the stocks on time. None of the stockists has ever claimed any damages or reimbursement of the losses suffered by them against the assessee. Admittedly, none of the stockists ever initiated any legal proceedings against the assessee.

Insofar as the arbitral award is concerned, though the Arbitrator made reference to the losses suffered by the stockists and the alleged claim of damages made by the stockists against the assessee, no materials in support of such claim was placed before the authorities below. That apart, none of the stockists, admittedly, was party to the arbitral proceedings. In this backdrop, it is apparent that the Tribunal held that the assessee would be entitled to claim deduction on actual payment/reimbursement to the stockists.

We do not find any illegality in the order passed by the Tribunal, which according to us, essentially based on the factual matrix. However, without entering into a controversy, as raised, whether the questions formulated in the memorandum of appeal could be termed as substantial questions of law, we answer all the questions, for the reasons recorded in the foregoing paragraphs, in favour of the Revenue and against the assessee.

The appeal is accordingly dismissed. There shall be no order as to costs. The miscellaneous petitions, if any, also stand disposed of.

(DILIP B. BHOSALE, J)

(A.RAMALINGESWARA RAO, J)

03.03.2015

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