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IN THE HIGH COURT OF ORISSA AT CUTTACK

ITA No. 29 of 2006

Tata Refractories Limited

....

Petitioner

Mr.B.K.Sharma, Advocate

-versus-

***Commissioner of Income Tax,
Sambalpur & another***

....

Opp. Parties

Mr. S.S.Mohapatra,SC, Income Tax

**CORAM:
THE CHIEF JUSTICE
JUSTICE R.K.PATTNAIK**

ORDER

02.02.2022

Order No.

4. 1. This matter is taken up by video conferencing mode.
2. This appeal arises from an order dated 28th November, 2005 passed by the Income Tax Appellate Tribunal, Cuttack (ITAT) in ITA No. 791/CTK/2004 for the Assessment Year (AY) 2001-02.
3. While admitting this appeal, on 12th September, 2007 the following question law was framed for consideration by this Court:

“Whether on the facts and in the circumstances of the case and on a true and proper interpretation of Section 35DDA of the Income Tax Act, 1961, the allowance for deduction under the Voluntary Retirement Scheme is to be made on the basis of 1/5th of the liability for the payment of Voluntary Retirement Scheme incurred under the mercantile system of accounting or is to be allowed on the basis of 1/5th of the actual payment made during the relevant year?”

4. The background facts are that, the Appellant Assessee is stated to be engaged in the business of manufacture and sale of refractory products. The Appellant follows the mercantile system of accounting and its accounts are maintained on accrual basis.

5. During the AY 2001-02 (accounting year 2000-01), the Appellant / Assessee implemented a Voluntary Retirement Scheme (VRS) for its employees, which was otherwise known as Friendly Departure Scheme (FDS). 291 employees were covered thereunder during the accounting year 2000-01. The liability towards compensation under the FDS for the said 291 employees worked out to Rs.12,83,51,995/-. This ascertained liability was accrued during the accounting year 2000-01, and had been accounted for in Appellant's books of accounts. The aforesaid amount of Rs.12,83,51,995/- was amortized over a period of 60 months started from the accounting year 2000-01 and this was reflected in the Balance Sheet as at 31st March, 2001.

6. Section 35DDA (1) of the Income Tax Act, 1961 ('Act') reads as under:

“Section 35 DDA Amortisation of expenditure incurred under voluntary retirement scheme

(1) Where an assessee incurs any expenditure in any previous year by way of payment of any sum to an employee at the time of his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement, one-fifth of the amount so paid shall be deducted in computing the profits and gain of the business for that previous year, and the balance shall

be deducted in equal installments for each of the four immediately succeeding previous years.”

7. Section 43 (2) of the Act reads as under:

“Section 43 (2) Definitions of certain terms relevant to income from profits and gains of business or profession.

“(2) In Sections 28 to 41 and in this section, unless the context otherwise requires....

‘paid’ means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the head Profits and gains of business or profession”

8. Under Section 43(2) of the Act, the word ‘paid’ means “actually paid” or “incurred” according to the method of accounting upon the basis of which the profits or gain are computed under the head ‘profits and gain of business or profession’. In other words, the above definition does not require actual payment of a sum for it to be treated as expenditure. Even if the liability is ‘incurred’ and the Assessee is following the accrual system of accounting, the liability would stand attracted in the first year in which it was incurred. It would be up to the Assessee to amortise the liability by spreading it over the remaining years.

9. However, the Assessing Officer (AO), i.e., the Assistant Commissioner of Income Tax, Circle 1(1), Sambalpur disallowed the claim of deduction of Rs. 2,56,70,399/- and only allowed 1/5th of the amount, i.e. Rs.17,22,059/-. The balance amount was treated as ‘contingent liability’ on the ground that what cannot be ascertained or quantified could not be treated as

expenditure. The above order was affirmed by the Commissioner of Income Tax (Appeals) [(CIT (A))] holding the amortization of the accrued liability as 'capital expenditure.' When the Appellant Assessee further went in appeal before the ITAT, it concurred with the view of the CIT (A) that only the amount paid during the year had to be taken into consideration and not the entire amount payable under the VRS.

10. Having heard learned counsel for the parties, this Court is of the view that the ITAT erred in treating the liability under the VRS scheme not as an accrued one but in proceeding on the basis that only the amount actually paid during the AY in question can be allowed. The definition of 'paid' under Section 43(2) of the Act contemplates an 'accrued liability'. There is no dispute that the Appellant follows the accrual method of accounting. There is also no dispute regarding the actual amount that was incurred as liability by the assessee under the VRS scheme.

11. In the circumstances, it was equally erroneous on the part of the CIT (A) to treat the expenditure towards the aforementioned liability as 'capital expenditure'. There is no warrant for such a conclusion. It was not even the Department's case that liability incurred for settling VRS dues would be 'capital' in nature. It needs to be borne in mind that the Assessee follows the mercantile accounting system and not the cash system and that its income is assessed under the head 'profits and gains and business of profession.'

12. For the aforesaid reasons the question framed by this Court is answered in favour of the Assessee and against the Department by holding that allowance and deduction under the VRS scheme are to be based on the entire accrued liability incurred and not just of the amount actually paid during the relevant AY.

13. The impugned orders of the CIT (A) and the ITAT and the corresponding order of the AO to the above extent are hereby set aside. The appeal is allowed in the above terms but with no order as to costs.

14. As the restrictions due to resurgence of COVID-19 situation are continuing, learned counsel for the parties may utilize a printout of the order available in the High Court's website, as par with certified copy, subject to attestation by the concerned advocate, in the manner prescribed vide Court's Notice No.4587, dated 25th March, 2020, modified by Notice No.4798, dated 15th April, 2021 and Court's Office Order circulated vide Memo Nos.514 and 515 dated 7th January, 2022.

(Dr. S. Muralidhar)
Chief Justice

(R.K.Pattnaik)
Judge