IN THE HIGH COURT OF HIMACHAL PRADESH, SHIMLA

ITA Nos. 37of 2007, 56 of 2008, 57 of 2008, 54 of 2009 and 20 of 2011
Reserved on: 21.12.2024
Date of decision : 31.12.2024.

H.P. State Civil Supplies Corporation Ltd. ...Appellant.

Versus

Asstt. Commissioner of Income Tax &another ...Respondents

Coram:

The Hon'ble Mr. Justice Tarlok Singh Chauhan, Judge.

The Hon'ble Mr. Justice Satyen Vaidya, Judge.

Whether approved for reporting?[1] *Yes.*

For the appellants : Mr. Vishal Mohan, Sr. Advocate with Mr. Prashant Sharma and Mr. Praveen Sharma, Advocates.

For the respondents : Mr. Neeraj Sharma & Mr. Ishan Kashyap, Advocates.

Satyen Vaidya, Judge:

Since common questions of law have arisen in these appeals *inter-se* the same parties out of assessment proceedings for different assessment years, all the appeals have been heard and are being decided together by a common judgment.

[1] **Whether reporters of Local Papers may be allowed to see the judgment?**

2. The relevant assessment years are 2002-03, 2003-04, 2004-05, 2005-06 and 2007-08.

3. For brevity the facts of the case involving assessment year 2002-03 are being considered herein.

4. By way of instant appeal under Section 260-A of Income Tax Act, 1961, (for short, 'the Act'), the assessee has assailed order dated 25.5.2007, passed by the Income Tax Appellate Tribunal (ITAT), Chandigarh in ITA No. 1044/Chandi/2005. The appeal was admitted for hearing vide order dated 11.10.2007 on the following substantial questions of law:-

"1) Whether on the facts and in the circumstances of the case, the provision for meeting the liability for encashment of saved leave by the employee is an admissible deduction?

ii) Whether leave encashment, which is a kind of earned leave, is a present liability or a future liability so as to be allowed the expenses u/s 37 of the Income Tax Act, 1961 d deductible from gross profit?

iii) Whether leave encashment is a current or present liability or a contingent liability in view of the principles laid down by the Hon'ble Supreme Court in the case of Bharat Earth Movers 245 ITR 428 (SC) and thus accordingly allowable as an expense deductible from gross profit?

iv) Whether the provision for leave encashment is a defined benefit entitled to be allowed as an expense during the

year in which such provision is made in books of accounts in view of Accounting Standard 15 issued by ICAI?

(v) Whether the expense of leave encashment deduction has been rightly claimed by the appellant in view of the judgment of the Apex Court in the case of Bharat Earth Movers 245 ITR 428 (SC)?

vi) Whether the liability towards leave encashment has been ascertained during the period of assessment under consideration for the payment of the same at a future date in view of the leave Rule 26 & 29 of the Central Civil Services Leave Rule as applicable to the employees of the appellant and has been rightly claimed as an expense deductible during the year under assessment?

vii) Whether the procedure adopted for ascertaining of liability as leave encashment by adhering to Accounting Standard-15 issued by ICAI was proper & correct and the expense so claimed is an allowable deduction under the Income Tax Act. 1961?

(viii) Whether the expenses towards contribution to have encashment trust for the discharge of the Statutory liability is an allowable expense under the provisions of Section 37(1) of the Income Tax Act, 1961?

ix) Whether the Learned Tribunal was justified going beyond the pleadings in issuing the directions for enhancing the income by adding to the income the amount to the extent of which the said deduction has been set off against the liability when such a ground was neither agitated by either party?

x) Whether the learned Tribunal was justified in holding that amount of Rs.242,35,622.00 payable to the State

Government on account of its share in Handling charges of Cement as income of the Appellate Corporation?

xi) Whether the learned Tribunal was justified in holding in para 9 that there is no change in the accounting system whereas in reply to question No. 18 it was specifically mentioned that there is a change in the accounting system and A.O. vide his letter dated 14.3.2005 categorically asked for the reasons of the change of system?"

5. At the outset it appears that question number (x) as framed above has been carved out from the material which is not the subject matter of instant appeal nor has any argument been raised on such issue by either of the parties at the hearing of the matter.

6. The assessee filed its Income Tax Return (ITR) for the assessment year 2002-03, declaring income of Rs. 1,20,64,680/-. The ITR was filed on 31.10.2002. Assessee claimed an expenses of Rs. 88,01,203/- in the profit and loss account, which included a sum of Rs. 45,00,000/- paid by the assessee to Life Insurance Corporation of India (LIC) on account of contribution to Credit Leave Encashment Trust (CLET). The assessee, thus, claimed deduction of Rs. 45,00,000/-.

7. The Assessing Officer (AO) passed an assessment order dated 29.3.2005. The claim of the assessee for deduction of an amount of Rs. 45,00,000/- was disallowed and resultantly an amount of Rs. 45,00,000/- was added to the income of the assessee.

8. The assessee preferred an appeal to the Appellate Authority i.e. Commissioner Income Tax (Appeals). The objection of assessee against the order of AO, disallowing the deduction of Rs. 45,00,000/- was rejected by the CIT(A) *vide* order dated 14.5.2005.

9. The assessee further approached the Income Tax Appellate Tribunal (ITAT), Chandigarh, who *vide* impugned order again remained unsuccessful in its challenge against disallowance of the deduction of Rs. 45,00,000/-., hence this appeal.

10. The AO *vide* assessment order dated 29.3.2005 had held the deduction of Rs. 45,00,000/- claimed by the assessee as inadmissible on following grounds: -

a) The financial year 2001-02 relevant to the assessment year 2002-03 had already been over

on 31.3.2002 and the accounts of the assessee for the said financial year also stood closed on the said date. Therefore, the Credit Leave Encashment Scheme (for short, 'the scheme') set up by the assessee for providing leave encashment benefits to its employees on 29.10.2002 by remitting an amount of Rs. 45,00,000/- to LIC on the same day i.e. 29.10.2002, could not be said to be the payment made in the relevant accounting year 2001-02.

b) The liability to pay leave encashment as per the details provided by the assessee was due only in the year 2004 and onwards, as such, neither any liability had accrued nor discharged during the financial year 2001-02.

c) There was no mention of the profit on the interest accruable on the amount paid to LIC being subjected to the income tax or being adjusted against the liability of the assessing amount.

d) The process for establishment and registration of CLET was initiated and completed during the assessment year 2002-03 and was registered in the said year only.

e) No liability was ascertained in the financial year 2001-02.

11. While rejecting the appeal of the assessee against the assessment year, disallowing the deduction of Rs. 45,00,000/-, the CIT(A)recorded the following reasons:-

a) As; there was no specific provision under Section 36 of the Act relating to contribution to leave encashment fund, the amount of Rs. 45,00,000/- paid into the said fund by the assessee had no statutory recognition.

b) There was no ascertained liability and rather the same was only contingent. In this behalf, reliance was placed on the judgment of CIT vs. Sileman Khan passed by the Hon'ble High Court of Andhra Pradesh, reported in 174 ITR 200 and judgment passed by the Hon'ble Karnatka High

Court in CIT vs. Hindustan Aeronautics Ltd., reported in 174 ITR 340.

c) Since the liability did not pertain to the relevant financial year, the deduction was not admissible.

d) The sum of Rs. 45,00,000/- did not meet annual contribution payable by the assessee on the basis of actuarial valuation to reach a part of initial contribution payable on account of liability for the past service.

e) Since the initial contribution was not admissible as deduction under Section 36 of the Act, the provision of Section 43-B of the Act was not applicable.

f) The applicability of Accounting Standard-15was also doubted on the ground that where the liability for determining the benefit was found through a scheme administered by an insurer, the actuarial certificate or a confirmation from the insurer obtained for the contribution payable

to the insurer is the appropriate accrual of the liability for the year.

12. The ITAT also held as under:-

a) Neither any liability had accrued to the assessee on account of leave encashment of employees in the year under appeal nor any payment was made to the employees during the said year.

b) Section 43-B of the Act regulates the deductions, which are otherwise allowable under the Act and since no other provision of act allowed the deduction of amount paid towards the fund created for discharge of leave encashment liability of employees by the employer, hence the applicability of section 43-B of the act was ruled out.

c). Even otherwise sub-clause (f) to section 43-B of the Act inserted by the Finance Act, 2001 w.e.f. 1.4.2002 provided for deduction for the year of payment of the liability in respect of any sums

payable by the assessee as an employer in lieu of any leave at the credit of his employees.

d) In the earlier year, the assessee was following the cash system of accounting in respect of the liability on account of encashment of leave salary. Therefore, the deduction was being claimed on the basis of actual payment for encashment salary. There has been no change in the system of accounting in the year under appeal as the steps for formulation of the scheme had not taken after the end of financial year 2001-02.

e) Since the scheme has no recognition under Section 36 (1) (iv) and (v), the assessee was not entitled to the deduction.

13. We have heard learned counsel for the parties and have also gone through the record carefully.

14. Mr. Vishal Mohan, learned Senior Counsel for the assessee/appellant has contended that the liability incurred by the assessee in the shape of payment of Rs.

45,00,000/- to LIC under the scheme was the part of the entire past liability of Rs. 1.80 crores assessed by the insurer. The liability was ascertained and calculated on actuarial basis. It was not a contingent liability. As the fund was created on 29.10.2002 and the payment of Rs. 45,00,000/- was made to LIC on the same day, the process was completed within the admissible time limit for submission of income tax return and hence, the same was liable to be construed as an exercise having been undertaken during the relevant financial year in terms of proviso to section 42B(f) of the Act which includes cases where the payment is actually made by the assessee before the due date for furnishing of return under Section 139 (1) of the Act.

15. Per contra, Mr. Neeraj Sharma, Advocate, representing the revenue has supported the impugned order passed by the ITAT by contending that the proviso of Section 43-B (f) of the Act makes allowance for only those deductions, which were ascertained liability during the relevant financial year and had been paid up during the

said year itself. He further asserted that the liability undertaken by the assessee, even if, assumed to be deductible, was not during the relevant financial year i.e. 2001-02. Learned counsel for the revenue further submitted that Section 43-B was applicable only to those deductions, which otherwise were allowable under the Act and since the sum payable by the assessee as an employer in lieu of any leave at the credit of his employees was not deductible under the proviso of the Act, the claim of the assessee was rightly rejected.

16. Since the assessment year relevant in the instant case is 2002-03, the proviso of Section 43-B(f) of the Act having become applicable w.e.f. 1.4.2002, shall be seen in its application to the facts of instant case.

17. The findings of facts recorded concurrently by the AO, CIT(A) and ITAT can be summoned up as under:-

a) The fund was established on 29.10.2002 and the contribution of Rs. 45,00,000/- towards the fund was also made by the assessee to LIC on the same date.

b) No provision for contribution towards the fund was made by the assessee after closure of accounting year 2001-02, on 31.3.2002.

c) The assessee has not resorted to the option of mercantile accounting during the accounting year 2001-02.

d) The liability of payment of amount towards leave encashment was neither accrued nor paid during the relevant accounting year 2001-02.

18. Further, both the appellate authorities have also held that contribution towards fund for payment of leave encashment due to the employees was not deductible under any provision of the Act. In alternative, it has been held that Section 43-B (f) of the Act attracts the deductibility of the amount only if it was incurred and paid in the relevant accounting year.

19. The first question that arises for determination is whether the contribution made by a corporate employer towards fund for payment of leave encashment to its

employees is entitled for deduction from profit and loss account under the Act?

20. The above question has arisen because the ITAT and CIT(A) have held such contribution to be not deductible under any of the provisions of the Act. The appellate authorities have rendered the view that such a fund had no statutory recognition as only those funds were recognized as were declared under Section 36(1)(iv)&(v) of the Act.

21. We have our reservations in endorsing the view so taken by the appellate authorities. The inclusion of Clause (f) in Section 43-B of the Act will be rendered otiose by such a pedantic interpretation. The three Judges Bench of the Hon'ble Supreme Court while adjudging the constitutional validity of sub-Section (f) of Section 43-B of the Act in the matter titled as ***Union of India vs. Excide Industries Ltd, reported in (2020) 425 ITA-1 (SC)*** has observed as under

> ".....it holds no merit to urge that the section only provides for deduction concerning statutory liabilities. Section 43-B is a mix bag and new and dissimilar interpretation have been inserted

therein from time to time to cater to different fiscal scenarios which are to be determined by the Government of the day……."

22. Further underlining the object and purpose of the leave encashment scheme, it has been observed in Excide Industries (*supra*) as under: -

> *"19. The leave encashment scheme envisages the payment of a certain amount to the employees in lieu of their unused paid leaves in a year. The nature of this payment is beneficial and pro employee. However, it is not in the form of a bounty and forms a part of the conditions of service of the employee. An employer seeking deduction from tax liability in advance, in the name of discharging the liability of leave encashment, without actually extending such payment to the employee as and when the time for payment arises may lead to abhorrent consequences. When time for such payment arises upon retirement (or otherwise) of the employee, an employer may simply refuse to pay. Consequently, the innocent employee will be entangled in litigation in the evening of his/her life for claiming a hardearned right without any fault on his part. Concomitantly, it would entail in double benefit to the employer – advance deduction from tax liability without any burden of actual payment and refusal to pay as and when occasion arises. It is this mischief clause (f) seeks to subjugate."*

23. In the same context their Lordships in Excide Industries, then further observed as under:

> "In line with other clauses under Section 43B, clause *(f)* was enacted to remedy a particular mischief and the concerns of public good, employee's welfare and prevention of fraud upon revenue is writ large in the said clause. In our view, such statutes are to be viewed through the prism of the mischief they seek to suppress, that is, the Haydon's case [1584] 3 Co rep 7 *principle. IN* CRAWFORD, Statutory Construction (CRAWFORD Statutory Construction p.508), *it has been gainfully delineated that "*an enactment designed to prevent the fraud upon the revenue is more properly a statute against fraud rather than a taxing statute, and hence should receive a liberal construction in the government's favour."

24. In an adjudication by Hon'ble High Court of Kerala in its judgment dated 27.6.2012 passed in ITA No. 64 of 2012, titled as CIT vs. M/s Hindustan Latex Ltd. It has been observed as under: -

> *"However, it cannot be doubted for a moment for the premium paid towards the renewal and continued validity*

of the insurance policy necessarily becomes business expenditure wholly and exclusively incurred for the business purpose and allowable as a deduction under Section 37 of the Act."

25. In view of what has been held above, we have no hesitation to hold that the amount of contribution made by the assessee towards the fund for payment of leave encashment to its employees qualifies to be deductible as expenses, subject, however, to the conditions imposed under Section 43-B of the Act.

26. Taking the benefit of proviso to section 43B of the Act it has been contended on behalf of the assessee that the last date for filing of income tax return by the assessee for accounting year 2001-02 was 31.10.2002 and since sum of Rs. 45,00,000/- had been paid to the LIC on 29.10.2002, the assessee was covered under the aforesaid proviso.

26.1 The proviso to Section 43-B of the Act deals with any sum which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income under sub-Section (1) of Section 139

of the Act, in respect of the previous year in which, the liability to pay such sum was incurred and instance of such payment is furnished by the assessee along with such return.

27. The argument raised on behalf of the assessee deserves to be rejected for the reason that the proviso to Section 43-B relates only to that liability as was incurred by actual payment of the sum in the previous accounting year, which in the instant case is 2001-02. Thus, in our considered view, the exception carved out by the aforesaid proviso only derives the limitation from end of accounting year to the date of submission of return as per Section 139 (1) of the Act. It nowhere takes away the mandatory requirement for assessee to comply with the provisions of main section, which reads as under: -

> *"Section43-B : notwithstanding anything contained in any other provision of this act, a deduction otherwise allowable under this Act;*
>
> *(f) in respect of any sum payable by the assessee as an employer in lieu of any leave at the credit of his employees shall be allowed (irrespective of the previous year for which the liability to pay such sum was incurred by the assessee according to method of*

accounting regularly employed by him) only in computing the income referred to in Section 28 of that previous year in such sum is actually paid by him:

28. Thus, as per the aforesaid proviso only that sum payable by the assessee as an employer in *lieu* of any leave at the credit of his employees shall be allowed as deduction where ***firstly*** the liability to pay such sum was incurred by the assessee according to method of accounting regularly employed by him and ***secondly*** the sum was actually paid by the employer in the previous accounting year.

29. The question next arises whether the assessee in the instant case had incurred the liability to pay a sum of Rs. 45,00,000/- to its employees for the previous year in which such sum is actually paid.

30. Admittedly, the sum of Rs. 45,00,000/- was paid by the assessee to LIC in the year 2001-02 by application of the proviso to Section 43-B. We are, however, not inclined to hold that the liability had already been incurred as a past liability. Though, the assessee has tried to impress upon us by referring to a communication *inter-se* the assessee and the insurer that the amount of past

liability was assessed at Rs. 1.80 crores, but the same has not been substantiated before AO or the appellate authorities by the assessee. Both the appellate authorities have concurrently held that it was not on account of any past liability, rather, the payments of leave encashment were actually made during the years 2004 to 2016. We are not convinced with the contention of assessee that the finding of fact to that effect is perverse.

31. Learned Senior Counsel for the appellant has contended that the liability in similar circumstance has been held to be ascertained and permissible for deduction by the Hon'ble Supreme Court in the judgment ***Bharat Earth Movers vs. CIT (2000) 245 ITR 428***. He has also placed reliance on the judgment passed by the Hon'ble Supreme Court in the matter of ***CIT vs. Textools Co. Ltd.*** rendered on 9.9.2009 in Civil Appeal No. 447 of 2003, whereby the view favouring the assessee/appellant herein taken by Hon'ble Madras High Court was affirmed.

32. In ***Excide Industry Ltd***. (supra), the Hon'ble Supreme Court had the occasion to adjudicate the

constitutional validity of Section 43-B (f) of the Act and one of the grounds of such challenge was that the proviso had been incorporated to undo the effect of judgment passed by the Hon'ble Supreme Court in ***Bhart Earth Movers***. While rejecting the challenge on said ground it has been held that the judgment in ***Bharat Earth Movers*** was rendered keeping in view the then applicable statutory regime. Adhering to the constitutional validity of Section 43-B(f), the Hon'ble Supreme Court held that the said provision will apply prospectively meaning thereby that the period prior to period of enactment of Section 43-B(f), would be governed by the law laid down in ***Bharat Earth Movers***. In view of such exposition, the assessee cannot derive any benefit from the verdict in Bhart Earth Movers, as he has to independently tackle the obstacles raised by incorporation of Section 43-B(f) w.e.f. 1.4.2002.

33. As regards the judgment in Textools (supra), the same will also not help the cause of the assessee as the issues with respect to implication of the proviso of Section 43-B(f) were not involved in the facts of said case rather it

was a case relating to gratuity fund covered under Section 36 (1) (iv) of the Act.

34. It will also be gainful to reproduce paragraphs 39 and 40 of the ***Excide Industries Ltd*** to support our view that the liability incurred by the assessee did not qualify the requirement of Section 43-B(f) of the Act and hence were rightly disallowed by the revenue.

> *"39. Reverting to the true effect of the reported judgment under consideration, it was rendered in light of general dispensation of autonomy of the assessee to follow cash or mercantile system of accounting prevailing at the relevant time, in absence of an express statutory provision to do so differently. It is an authority on the nature of the liability of leave encashment in terms of the earlier dispensation. In absence of any such provision, the sole operative provision was Section 145(1) of the 1961 Act that allowed complete autonomy to the assessee to follow the mercantile system. Now a limited change has been brought about by the insertion of clause (f) in Section 43B and nothing more. It applies prospectively. Merely because a liability has been held to be a present liability qualifying for instant deduction in terms of the applicable provisions at the relevant time does not ipso facto signify that deduction against such liability cannot be regulated by a law made by Parliament prospectively. In matter of statutory deductions, it is open to the legislature to withdraw the same prospectively. In other words, once*

the Finance Act, 2001 was duly passed by the Parliament inserting clause (f) in Section 43B with prospective effect, the deduction against the liability of leave encashment stood regulated in the manner so prescribed. Be it noted that the amendment does not reverse the nature of the liability nor has it taken away the deduction as such. The liability of leave encashment continues to be a present liability as per the mercantile system of accounting. Further, the insertion of clause (f) has not extinguished the autonomy of the assessee to follow the mercantile system. It merely defers the benefit of deduction to be availed by the assessee for the purpose of computing his taxable income and links it to the date of actual payment thereof to the employee concerned. Thus, the only effect of the insertion of clause (f) is to regulate the stated deduction by putting it in a special provision.

40. Notably, this regulatory measure is in sync with other deductions specified in Section 43B, which are also present and accrued liabilities. To wit, the liability in lieu of tax, duty, cess, bonus, commission etc. also arise in the present as per the mercantile system, but assessees used to defer payment thereof despite claiming deductions thereagainst under the guise of mercantile system of accounting. Resultantly, irrespective of the category of liability, such deductions were regulated by law under the aegis of Section 43B, keeping in mind the peculiar exigencies of fiscal affairs and underlying concerns of public revenue. A priori, merely because a certain liability has been declared to be a present liability by the Court as per the prevailing enactment, it does not follow that legislature is denuded of its power to correct the mischief

with prospective effect, including to create a new liability, exempt an existing liability, create a deduction or subject an existing deduction to new regulatory measures. Strictly speaking, the Court cannot venture into hypothetical spheres while adjudging constitutionality of a duly enacted provision and unfounded limitations cannot be read into the process of judicial review. A priori, the plea that clause (f) has been enacted with the sole purpose to defeat the judgment of this Court is misconceived".

35. In light of above discussions, the substantial questions of law (*i) to (ix) and (xi)*are answered accordingly.

36. Accordingly, we find no merit in the appeals and the same are accordingly dismissed. Pending applications, if any, also stand disposed of.

(Tarlok Singh Chauhan)
Judge

(Satyen Vaidya)
Judge

31st December, 2024
(kck)