REPORTABLE

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

\+ **ITA No. 1208 of 2008**

With

ITA No. 1351 of 2010
ITA No. 965 of 2007
ITA No. 958 of 2007

Reserved On: 28th October, 2010.
% *Pronounced On: 19th November, 2010.*

1) **ITA No.1208 of 2008**

COMMISSIONER OF INCOME TAX, DELHI-IV . . . Appellant

through : Mr. Sanjeev Sabharwal, Sr. Standing Counsel.

VERSUS

GOVIND NAGAR SUGAR LTD. . . .Respondent

through: Mr. Rajiv Dutta, Sr. Advocate with Mr. Uday Kumar, Mr. Sanjeev Singh and Mr. Kumar Dushyant Singh, Advocates.

2) **ITA No.1351 of 2010**

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Sr. Standing Counsel.

VERSUS

BASTI SUGAR MILLS CO. LTD. . . .Respondent

through: Mr. Rajiv Dutta, Sr. Advocate with Mr. Uday Kumar, Mr. Sanjeev Singh and Mr. Kumar Dushyant Singh, Advocates.

3) **ITA No.965 of 2007**

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Sr. Standing Counsel.

VERSUS

BASTI SUGAR MILLS CO. LTD. . . .Respondent

through: Mr. Rajiv Dutta, Sr. Advocate with Mr. Uday Kumar, Mr. Sanjeev Singh and Mr. Kumar Dushyant Singh, Advocates.

4) **ITA No.958 of 2007**

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Sr. Standing Counsel.

VERSUS

BASTI SUGAR MILLS CO. LTD. . . .Respondent

through: Mr. Rajiv Dutta, Sr. Advocate with Mr. Uday Kumar, Mr. Sanjeev Singh and Mr. Kumar Dushyant Singh, Advocates.

CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MS. JUSTICE SURESH KAIT

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. Questions of law raised in all these appeals arise in almost similar circumstances. In fact, in three appeals even the assessee is same. It is for this reason all these appeal were heard together and we now proceed to render common judgment. For the sake of convenience, we shall take note of the facts as they appear in ITA No. 1208 of 2008. Following two substantial questions of law were formulated in this appeal:

"a) Whether the interest paid on the late payment of the provident fund can partake the character or nature of the provident fund?

b) Whether the provisions of Section 43B of the Act are applicable on the interest paid by the assessee on the late payment of provident fund?"

2. We now narrate the facts under which these questions have arisen for consideration. The respondent-assessee filed its return of income for the Assessment Year 2001-02 declaring a loss of ₹6,75,38,576/-. During the assessment proceedings, the Assessing Officer (AO) found that there was delay in making payment of provident fund (in short 'PF') dues by the assessee. For this reason, the assessee had to pay interest on late payments as well. Interest in the sum of ₹18,29,287/- was paid along with the PF dues belatedly and not in the year in question. Section 43B of the Income Tax Act (hereinafter referred to as 'the Act') provides that certain payments have not actually made, would not qualify for deduction as business expenditure. Payment of PF dues is one such item. Therefore indubitably, the assessee was not entitled to seek deduction of the dues towards PF, as this amount was not actually deposited with the PF Authorities. However, on the ground that because of late payment interest thereon had also become due, the assessee had claimed as deduction though not actually paid. The AO was of the view that since this amount was not paid, no deduction was allowable under Section 43B of the Act.

Plea of the assessee was that the interest amount is not in the nature of PF and therefore, Section 43B of the Act would not apply. Though this plea was rejected by the AO, the CIT (A) accepted this plea and allowed the appeal of the assessee. The CIT (A) relied upon the judgment of the Calcutta High Court in the case of ***Commissioner of Income-tax*** Vs. ***Padmavati Raje Cotton Mills Ltd.*** **[239 ITR 355]** holding that the interest on late payment was outside the scope of Section 43B of the Act and therefore, the rigour of that provision was not attracted. The Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') has concurred with the view of the CIT (A). It is how the Department is in appeal and has raised the aforesaid two questions of law.

3. Section 43B of the Act is reproduced below:

> **"Section 43B**
>
> **CERTAIN DEDUCTIONS TO BE ONLY ON ACTUAL PAYMENT.**
>
> Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of –
>
> (a) Any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force,
>
> (b) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees,
>
> (c) Any sum referred to in clause (ii) of sub-section (1) of section 36,
>
> (d) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or

a state financial corporation or a state industrial investment corporation, in accordance with the terms and conditions of the agreement [692c governing such loan or borrowing.

(e) Any sum payable by the assessee as interest on any term loan from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan, shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which sum is actually paid by him.

Provided that nothing contained in this section shall apply in relation to any sum referred to in clause (a) or clause (c) or clause (d) or clause (e) 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 in respect of the previous year in which the liability to pay such sum was incurred as aforesaid and the evidence of such payment is furnished by the assessee along with such return 694a :

Provided further that no deduction shall, in respect of any sum referred to in clause (b), be allowed unless such sum has actually been paid in cash or by issue of a cheque or draft or by any other mode on or before the due date as defined in the Explanation below clause (va) of sub-section (1) of section 36 and where such payment has been made otherwise than in cash, the sum has been realised within fifteen days from the due date.

Explanation [1] : For the removal of doubts, it is hereby declared that where a deduction in respect of any sum referred to in clause (a) or clause (b) of this section is allowed in computing the income referred to in section 28 of the previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1983 or any earlier assessment year) in which the liability to pay such sum was incurred by the assessee, the assessee shall not be entitled to any deduction under this section in respect of such sum in computing the income of the previous year in which the sum is actually paid by him.

Explanation 2 : For the purposes of clause (a), as in force at all material times, "any sum payable" means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law.

Explanation 3 : For the removal of doubts, it is hereby declared that where a deduction in respect of any sum referred to in clause (c) or clause (d) of this section is allowed in computing the income referred to in section 28

of the previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year) in which the liability to pay such sum was incurred by the assessee, the assessee shall not be entitled to any deduction under this section in respect of such sum in computing the income of the previous year in which the sum is actually paid by him.

Explanation 3A : For the removal of doubts, it is hereby declared that where a deduction in respect of any sum referred to in clause (e) of this section is allowed in computing the income referred to in section 28 of the previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1996, or any earlier assessment year) in which the liability to pay such sum was incurred by the assessee, the assessee shall not be entitled to any deduction under this section in respect of such sum in computing the income of the previous year in which the sum is actually paid by him.

Explanation 4 : For the purposes of this section, - (a) "Public financial institution" shall have the meaning assigned to it in section 4A of the Companies Act, 1956 (1 of 1956);

(aa) "Scheduled bank" shall have the meaning assigned to it in clause (ii) of the Explanation to clause (viia) of sub-section (1) of section 36;

(b) "State financial corporation" means a financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951 (63 of 1951);

(c) "State industrial investment corporation" means a Government company within the meaning of section 617 of the Companies Act, 1956 (1 of 1956), engaged in the business of providing long-term finance for industrial projects and approved by the Central Government under clause (viii) of sub-section (1) of section 36."

4. In a mercantile system of accounting, the income which arises or is due becomes taxable even when actually received or not. Conversely, if some liability becomes due, the assessee would be entitled to get the same deducted in his income tax return even if nor actually incurred, provided it is permissible deduction under various provisions of the Act. Certain exceptions would qualify for deduction under various other provisions of the Act whether

actually incurred or not, if the liability in respect thereof has accrued. The Act so provides, keeping in view the 'matching concept', so as to arrive at realistic figure of net profits/income on which tax is to be paid. The concept of 'matching concept' is defined by the Supreme Court in the case of ***Commissioner of Income Tax*** Vs. ***Woodward Governor India (P) Ltd.*** **[312 ITR 214]**. The principle laid down would be relevant even for our purpose and therefore, we extract the same:

> "14. In the case of **M.P. Financial Corporation v. CIT** reported in 165 ITR 765 the Madhya Pradesh High Court has held that the expression "expenditure" as used in Section 37 may, in the circumstances of a particular case, cover an amount which is a "loss" even though the said amount has not gone out from the pocket of the assessee. This view of the Madhya Pradesh High Court has been approved by this Court in the case of **Madras Industrial Investment Corporation Ltd. v. CIT** reported in [1997]225ITR802(SC) . According to the *Law and Practice of Income Tax by Kanga and Palkhivala,* Section 37(1) is a residuary section extending the allowance to items of business expenditure not covered by Sections 30 to 36. This Section, according to the learned Author, covers cases of business expenditure only, and not of business losses which are, however, deductible on ordinary principles of commercial accounting. (see page 617 of the eighth edition). It is this principle which attracts the provisions of Section 145. That section recognizes the rights of a trader to adopt either the cash system or the mercantile system of accounting. The quantum of allowances permitted to be deducted under diverse heads under Sections 30 to 43C from the income, profits and gains of a business would differ according to the system adopted. This is made clear by defining the word "paid" in Section 43(2), which is used in several Sections 30 to 43C, as meaning actually paid or incurred according to the method of accounting upon the basis on which profits or gains are computed under Section 28/29. That is why in deciding the question as to whether the word "expenditure" in Section 37(1) includes the word "loss" one has to read Section 37(1) with Section 28, Section 29 and Section 145(1). One more principle needs to be kept in mind. Accounts regularly maintained in the course of business are to be taken as correct unless there are strong and sufficient reasons to indicate that they are unreliable. One more aspect needs to be highlighted. Under Section 28(i), one needs to decide the profits and gains of any business which

is carried on by the assessee during the previous year. Therefore, one has to take into account stock-in-trade for determination of profits. The 1961 Act makes no provision with regard to valuation of stock. But the ordinary principle of commercial accounting requires that in the P&L account the value of the stock-in- trade at the beginning and at the end of the year should be entered at cost or market price, whichever is the lower. This is how business profits arising during the year needs to be computed. This is one more reason for reading Section 37(1) with Section 145. For valuing the closing stock at the end of a particular year, the value prevailing on the last date is relevant. This is because profits/loss is embedded in the closing stock. While anticipated loss is taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into account, as no prudent trader would care to show increase profits before actual realization. This is the theory underlying the Rule that closing stock is to be valued at cost or market price, whichever is the lower. As profits for income-tax purposes are to be computed in accordance with ordinary principles of commercial accounting, unless, such principles stand superseded or modified by legislative enactments, unrealized profits in the shape of appreciated value of goods remaining unsold at the end of the accounting year and carried over to the following years account in a continuing business are not brought to the charge as a matter of practice, though, as stated above, loss due to fall in the price below cost is allowed even though such loss has not been realized actually. At this stage, we need to emphasise once again that the above system of commercial accounting can be superseded or modified by legislative enactment. This is where Section 145(2) comes into play. Under that section, the Central Government is empowered to notify from time to time the Accounting Standards to be followed by any class of assessees or in respect of any class of income. Accordingly, under Section 209 of the Companies Act, mercantile system of accounting is made mandatory for companies. In other words, accounting standard which is continuously adopted by an assessee can be superseded or modified by Legislative intervention. However, but for such intervention or in cases falling under Section 145(3), the method of accounting undertaken by the assessee continuously is supreme. In the present batch of cases, there is no finding given by the AO on the correctness or completeness of the accounts of the assessee. Equally, there is no finding given by the AO stating that the assessee has not complied with the accounting standards."

5. Section 43B of the Act is an exception to the aforesaid Rule where legislature has intended that unless the expenditure is actually

defrayed, the payment made deduction is not allowed. Such a provision, which is exception to the general rule, is to be construed strictly. Certain expenditure under certain heads mentioned therein is not allowable as deduction even if it has become due in the relevant assessment year, unless the amount is actually expended. PF dues are one such amount, which qualifies for deduction only on actual payment. However at the same time, Clause (b) of Section 43B of the Act limits it to *inter alia* "provident fund" and the head "interest" does not mention therein specifically. If one has regard to the aforesaid provision of the Act, the exception contained in Section 43B would relate only to those items, which are specifically mentioned in these provisions.

6. Reading in the aforesaid manner, when the interest paid/payable on delayed consideration of PF is not specifically mentioned in Section 43B of the Act, normally that would not come within the mischief of exception provided in this provision. Thus, generally speaking, therefore, when PF dues are not paid and interest thereon becomes due for the period which falls within the assessment year, that would qualify for deduction even if it is not actually incurred. Realizing the aforesaid, the endeavour on the part of the Revenue is to bring the element of 'interest' payable on late payment of PF as part of the PF itself i.e. it would partake the character of the PF itself to attract the mischief of Section 43B of the Act.

7. It is, therefore, clear that the answer to the questions posed would depend on this aspect, viz., whether the interest, which is payable on late payment of PF dues would assume the character of the PF.

8. Before answering this, we may, however, clarify one aspect. It was sought to be argued by the learned counsel for the Revenue that the interest is in the nature of punitive and therefore, not allowable as deduction. Though this issue never cropped up in this perspective, still we are of the opinion that this contention of the Revenue is not legally sustainable. As per the provisions of Employees Provident Fund and Miscellaneous Provisions Act, 1952 (hereinafter referred to as 'the PF Act'), the employer is supposed to deduct certain percentage of amount from the salary of the employee, which is to be deposited in the PF account of the said employee maintained with the reasonable Provident Fund Commissioner or the Trust, in case the employee's PF trust is created by the employer. The employer is further supposed to make his own matching contribution as mandated by the said PF Act. This contribution is to be deposited in the PF account by specified date. In case of default, two consequences follow; one is the payment of interest on the late deposit as per the provisions of Section 7Q of the PF Act. Other consequence which the defaulting employer may face is the payment of damages, which can be levied by the RPFC under Section 14B of the PF Act. These two provisions are reproduced below:

"**7Q. Interest payable by the employer**

The employer shall be liable to pay simple interest at the rate of twelve per cent per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act from the date on which the amount has become so due till the date of its actual payment :

Provided that higher rate of interest specified in the Scheme shall not exceed the lending rate of interest charged by any scheduled bank.

14B. Power to recover damages

Where an employer makes default in the payment of any contribution to the Fund the Pension Fund or the Insurance Fund or in the transfer of accumulations required to be transferred by him under sub-section (2) of section 15 or sub-section (5) of section 17 or in the payment of any charges payable under any other provision of this Act or of any Scheme or Insurance Scheme or under any of the conditions specified under section 17 the Central Provident Fund Commissioner or such other officer as may authorised by the Central Government by notification in the Official Gazette in this behalf may recover from the employer by way of penalty such damages not exceeding the amount or arrears as may be specified in the Scheme;

Provided that before levying and recovering such damages the employer shall be given a reasonable opportunity of being heard :

Provided further that the Central Board may reduce or waive the damages levied under this section in relation to an establishment which is a sick industrial company and in respect of which Scheme for rehabilitation has been sanctioned by the Board for industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act 1985 (1 of 1986) subject to such terms and conditions as may be specified in the Scheme."

9. The Supreme Court in the case of ***Organo Chemicals Industries and Anr.*** Vs. ***Union of India (UOI) and Ors.*** **[(1979) 4 SCC 573]** held that the damages payable under Section 14B of the PF Act are penal in nature. However, this principle cannot be extended to the payment of interest payable under Section 7Q of the PF Act. Obviously, the payment of this interest is automatic if

the PF contribution by the employer is delayed. It is, therefore, clearly compensatory and cannot be treated as penal in nature.

10. In the case of ***Mahalakshmi Sugar Mills Co.*** Vs. ***Commissioner of Income Tax, Delhi*** **[(1980) 123 ITR 429 (SC)]** where the question of interest payable on arrears of cess which was to be paid on entry of sugarcane into the premises of a factory for use, consumption or sale therein would be in the nature of penalty. The Court answered the question in the negative holding that it would be compensatory in nature. In the case of ***Prakash Cotton Mills Pvt. Ltd.*** Vs. ***Commissioner of Income Tax*** **[(1993) 201 ITR 684]**, the Court took note of the judgment in ***Mahalakshmi Sugar Mills Co. (supra)*** and some other judgments and on that basis laid down the principle that in each case it was for the AO to find out whether the payment of damages or penalty or interest, which is claimed as allowable expenditure under Section 37(1) of the Act is compensatory in nature. The deduction was to be allowable if the concerned impost was found to be pure compensatory in nature. On the other hand, if some interest would be found to be composite nature, the same is required to be apportioned and that component which is compensatory in nature is to be allowed as deduction and component to be penal in nature.

11. We now revert back to the moot question, i.e., whether interest on delayed payment partakes the character of PF dues. Learned

counsel for the Revenue laid great emphasis on the judgment in the case of ***Mahalakshmi Sugar Mills Co. (supra)*** itself and according to them, the Supreme Court clearly stated in that judgment that the interest payable on arrears of cess under Section 3(3) is in reality part and parcel of the liability to pay cess. It was an accretion to the cess. The arrears of cess "carries" interest; if the cess is not paid within the prescribed period a larger sum will become payable as cess. The exact language used by the Court and the context in which it was said is reproduced below:

> "10. **Now the interest payable on an arrear of cess Under Section 3(3) is in reality part and parcel of the liability to pay cess. It is an accretion to the cess. The arrear of cess "carries" interest; if the cess is not paid within the prescribed period a larger sum will become payable as cess.** The enlargement of the cess liability is automatic Under Section 3(3). No specific order is necessary in order that the obligation to pay interest should accrue. The liability to pay interest is as certain as the liability to pay cess. As soon as the prescribed date is crossed without payment of the cess, interest begins to accrue. It is not a penalty, for which provisions has been separately made by Section 3(5). Nor is it a penalty within the meaning of Section 4, which provides for a criminal liability and a criminal prosecution. The penalty payable Under Section 3(5) lies in the discretion of the collecting officer or authority……. (emphasis supplied)"

12. It is clear from the reading of the aforesaid judgment that when the dues are paid belatedly and it attracts interest, which is statutorily payable, such an interest becomes part and parcel of the cess dues. On the same analogy, when the provident dues are not deposited by the employer in time, interest payable thereupon

under the PF Act (which is also a statutory liability), the said interest would become part of the provident fund dues. Thus, even if the interest is not penal in nature but only compensatory, having regard to the fact that it partakes the character of the provident dues itself, Section 43B of the Act would be attracted and unless this interest is actually paid the assessee would not be entitled to claim deduction in respect thereof.

13. Matter can be looked into from another angle. In fact, the employer and employees' share of PF, which the employer is under obligation to deposit, belongs to the concerned employee and has to be credited in the account of the said employees. This amount is kept by the RPFC or the Trust, as trust money on behalf of the concerned employees which is to be remitted to the said employees on their retirement or cessation of employment. The amount does not belong to the Government. Whenever this amount is credited to the account of the employees, it earns interest as well. However, when the amount is deposited late, the employee may lose interest for the intervening period i.e. from the date it became due till the said deposit was actually made. In this scenario, when the assessee is not entitled to deduction unless provident fund is actually paid and deposited with the provident authorities, the assessee would not be entitled to claim the deduction in respect of interest component thereupon in the absence of actual payment having been made by the assessee.

14. The upshot of the aforesaid discussion would be to answer the questions of law in the affirmative, i.e., in favour of the Revenue and against the assessee. As a consequence, these appeals are allowed and orders passed by the Tribunal are set aside and the disallowance made by the AO is affirmed.

(A.K. SIKRI)
JUDGE

(SURESH KAIT)
JUDGE

NOVEMBER 19, 2010
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