Cotton Agents Ltd.

Vs

Commissioner of Income-Tax, (Central), Bombay

Civil Appeal No. 100 of 1959

(S. K. Das, M. Hidayatullah JJ)

03.05.1960

JUDGMENT

S. K. DAS, J. –

This is an appeal on a certificate granted by the High Court of Bombay under section 66A(2) of the Indian Income-tax Act, 1922. The short facts are these. The Cotton Agents Ltd., Bombay, are a limited liability company registered under the Indian Companies Act and will be called the assessee company in this judgment. It held a substantial number of shares of the new Swadeshi Mills of Ahmedabad Ltd. (hereinafter called the mills company). Messrs. Shivnarayan Surajmal Nemani (called the Nemani group) also held a block of shares of the mills company along with its managing agency. The assessment year was 1946-1947, and the year ending with Diwali, 1945 (October 18, 1944, to November 4, 1945) was the accounting year. Sometime in 1944 some differences arose between the assessee company and the Nemani group; these differences were referred to one Govindram Seksaria, who decided that the Nemani group should sell its block of shares to the assessee company at an agreed price. it was further decided t

> "Whether on the facts and circumstances of the case the managing agency commission @ 3 1/2% on sales made by the New Swadeshi Mills of Ahmedabad Ltd., between April 1, 1944, and December 31, 1944, accrued to Shivnarayan Surajmal Nemani, or to the assessee ?"

The High Court held that the matter was concluded by the decision of this court in E. D. Sassoon and Co. Ltd. v. Commissioner of Income-tax ([1954] 26 I.T.R. 27.) With reference to the argument of learned counsel for the assessee company that the commission was payable on the sale proceeds and not on the profits as in Sassoon's case, it said :

> "We would have given serious thought to this aspect of the matter but for the view we take that the decision on the Supreme Court with regard to the question of creation of the debt and with regard to the serving by the managing agents for a term of one year being a condition precedent for their being entitled to receive payment, is indistinguishable on the facts of this case. We may point out that here as in Sasoon's case the commission of 3 1/2 per cent. is to be earned in any year, and also by clause 3 of the agreement the commission is to become due to the managing agents at the end of each financial year. Therefore, till the end of the financial year there is no debt whatsoever created in favour of the managing agents and also their right to receive payment depends upon their having served for a whole year. Under the circumstances we must hold, following the decision of the Supreme Court, that the assessees are

liable to pay tax on the whole of the commission as the commission accrued due on the 31st Ma

The answer to the question really depends on a construction of the relevant terms of the managing agency agreement dated March 15, 1925, entered into between the mills company and the Nemani group. Before we proceed to a consideration of those terms it is necessary to state that the Department has assessed the Nemani group also to tax in respect of the commission for the period April 1, 1944, to December 31, 1944. That circumstance has, however, no bearing on the question of construction and learned counsel for the Department has stated before us that there is no intention to tax two parties for the same income and if the tax has been realised from both for the same income, it will have to be refunded to one of the we parties after the decision of this court. We are not considering in this case the validity or otherwise of what are known as protective or precautionary assessments, and nothing said in this judgments has any bearing on that question.

We go at once to the managing agency agreement dated March 15, 1925. Under that agreement the managing agents were appointed for a period of fifty-one years, but with liberty to them to resign the appointment and retire from the agency at any time by twelve calendar months' notice in writing, such notice to expire at the end of any financial year of the mills company. Then came clauses (2) and (3) of the agreement, which are material and must be quoted so far as they are necessary for our purpose :

"(2) The remuneration of the agents as such agents of the company as aforesaid shall be as follows :

A commission at the rate of three and a half per cent. On the gross proceeds of all sales of the yarn, cloth, waste and other articles manufactured by the company earned in any year or other period for which the accounts of the company are made up and laid before the general meeting."

Provided etc.... [It is unnecessary to quote the proviso.]

"(3) The said commission shall become due to the managing agents at the end of each financial year or other period for which the accounts of the company are to be laid before the general meeting and shall be payable and paid immediately after such accounts have been passed by the general meeting."

Clauses (6) to (11) recited the rights and duties of the managing agents, one of such rights being to retain, reimburse and pay themselves "all sums due to the agents for commission". Clauses (13) and (14) dealt with the right to assign the remuneration and the managing agency, and said inter alia that "it shall be lawful for the agents to assign this agreement and the benefit thereof and their rights and privileges etc., to any person or firm or company having authority by its constitution to become bound by the obligations undertaken by the agents.... and the company shall be bound to recognise the person, firm or company aforesaid as the agents of the company". It is unnecessary to read the other clauses of the managing agency agreement.

The controversy before us hinges really on the scope and effect of clauses (2) and (3), read in the context of the agreement as a whole. On behalf of the assessee company the argument is that under

clause (2) the managing agency remuneration accrued at the rate of 3 1/2 per cent. on the gross proceeds of all sales; the word "all" is emphasised, and it is argued that the remuneration accrued as each sale took place, the totality of sales giving the gross sale proceeds. It is argued that embedded in each sale was the managing agency commission of the assessee company. It is further suggested on behalf of the assessee company that though clause (3) uses the word "due", it merely indicated the time of payment and not that of accrual.

We do not think that this reading of the two clauses is correct. In our view, clause (3) is the accrual clause; it shows that the commission became due at the end of each financial year or other period for which the accounts of the mills company were to be laid before the general meeting. Significantly enough, the clause consists of two parts : one part says when the commission becomes due and the other says when it is to be payable and paid. In very clear terms, the clause says that the commission becomes due normally at the end of the financial year, but is payable after the accounts have been passed by the general meeting. Let us contrast clause (3) with clause (2). Clause (2) states how the remuneration has to be calculated. It says in effect that the remuneration has to be calculated at the rate of 3 1/2 per cent. On the gross proceeds of all sales etc. earned in any year or other period for which the accounts of the mills company are made up. Putting the two clauses side by side, the conclusion at whic

This view of the managing agency agreement of March 15, 1925, concludes the appeal. If the remuneration accrued at the end of the financial year, then undoubtedly it accrued in the hands of the assessee company. It remains now to refer briefly to some of the decisions cited at the Bar.

As to the decision in Sassoon's case, it is pointed out that the commission there payable by way of remuneration was a percentage on the net profits and this, it is argued for the assessee company, distinguishes that decision from the present case. Indeed, it is true that in Sassoon's case, the remuneration was fixed at a percentage on the net profits, but the real point of the decision was as to when the remuneration accrued. On this point the majority of the learned judges said :

> "It is clear therefore that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. There must be as is otherwise expressed debitum in praesenti, solvendum in futuro; see W. S. try Ltd. v. Johnson ([1946] 1 ALL E.R. 532 at P. 539.) and Webb v. Stenton and Others, Garnishees ([1883] 11 Q. B. D. 518 at PP. 522, 527.). Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him."

It has been argued before us that the decision requires reconsideration because it failed to make a further distinction; a distinction which it is stated arises in law, between the right to receive payment and the creation of a debt. We consider it unnecessary to consider such a distinction, if any such exists, in the present case. On our view of the managing agency agreement, the commission of the managing agents became due at the end of the financial year and that is when it accrued; and there were neither any debt created nor any right to receive payment when each transaction of sale took place. We were also addressed at some length on the further question whether managing agency is service and if so, whether it must be for one full year or whether apportionment is permissible. These questions do not fall for decision in the present case and we express no opinion thereon. We

have proceeded in this case on the footing that the managing agency work of the assessee company constituted business within the rul

Learned counsel for the respondent has pointed out to us that the observations of Lord Justice Fry in Colquhoun v. Brooks, were not very accurately reproduced in Rogers Pyatt Shellac and Co. v. Secretary of State for India. He submitted that Lord Justice Fry did not say that the words "accrual" or "arising" represented a stage anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate. He has argued that there is nothing inchoate about the income when it arises or accrues. We consider it unnecessary to embark on a discussion as to how far the aforesaid observations require consideration by us.

It is enough to say that on the view which we have taken of the relevant clauses of the managing agency agreement, no income arose or accrued on the sale proceeds at the time of each transaction of sale; the income accrued at the end of the financial year at the rate of 3 1/2 per cent. On the gross proceeds of all sales of yarn, cloth, waste etc. earned in any one year. In that view of the matter, the High Court correctly answered the question. The appeal fails and is dismissed with costs.

Appeal dismissed.

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