R. G. S. Naidu and Co.

Vs

Commissioner of Income-Tax and Excess Profits Tax, Madras. (and connected appeals).

Civil Appeals Nos. 181 to 184 of 1960.

(J.L. Kapur, M. Hidayatullah, J.C. Shah JJ)

14.12.1960

JUDGMENT

SHAH, J. -

These appeals relate to Excess Profits Tax liability of the appellants in respect of two chargeable accounting periods April 1, 1944, to March 31, 1945, and April 1, 1945, to March 31, 1946.

The appellants were, under an agreement dated July 11, 1945, appointed managing agents for 20 years of the Coimbatore Spinning and Weaving Co. Ltd. - hereinafter referred to as the company. Prior to October 1, 1944, the appellants were the managing agents of the Coimbatore Mills Agency Ltd. - hereinafter referred to as the Agency Company who were the Managing Agents of the company. The year of account of the appellants ended on March 31, of the company on June 30, and of the Agency Company on September 30. Under the agreement by which the appellants were appointed managing agents, the following remuneration was provided :

1. Office allowance at Rs. 1,500 per mensem;

2. Commission at 1% on all purchases of cotton and stores and 2 1/2% on all capital expenditure incurred from time to time; and

3. Commissioner at 10% on the net profits of the company due and payable yearly immediately after the accounts of the company were closed.

For the assessment year 1945-46, the appellants submitted a return of their income inclusive of the following items :

#1. Remuneration from the agency Company Rs. 36,000.2. Commission at 10% on profits from theAgency Company upto 30-9-1944 Rs. 37,953.3. Remuneration from company from1-10-1944 to 31-3-1945 Rs. 9,000.4. Commission at 1% on cotton and storespurchased during this period Rs. 21,704.##

This return was accepted by the Additional Income-tax Officer, Coimbatore I & II Circles, and the appellants were assessed to income-tax. Excess Profits Tax was also worked out on the same basis for the chargeable accounting period ending March 31, 1945. For the assessment year 1946-47, the appellants submitted a return of their income which included the following items :

#1. Remuneration from the company forone year from 1-4-1945 Rs. 18,000.2. Commission at 10% on the profits of thecompany paid in December 1945 (1-10-

1944to 30-6-1945) Rs. 1,90,889.3. Commission at 1% on purchases ofcotton and stores from 1-4-1945to 30-6-1945 Rs. 16,777.4. Commission at 2 1/2% on capitalexpenditure from 1-10-1944 to 30-6-1945 Rs. 1,690.##

The Tax Officer in charge of the assessment directed that the commission on purchases and capital expenditure be taken into account for the year April 1, 1945, to March 31, 1946, and that the receipts be computed accordingly. The amount of Rs. 1,127 attributable out of item 4 was accordingly taken into the account of the pervious year after reopening the assessment under s. 34 of the Income-tax Act, and the commission on the profits of the company was apportioned between the period October 1, 1944, to March 31, 1945, and April 1, 1945, to June 30, 1945, by the application of r. 9 of Sch. 1 of the Excess Profits Tax officer also determined the proportionate commission payable under items 3 and 4, for the period ending March 31, 1946, and as a result of the apportionment, the liability of the appellants, original and revised, for income-tax and Excess Profits Tax for the assessment year 1945-46 and chargeable accounting period April 1, 1944, to March 31, 1945, stood as follows :

#Original assessment of income-tax Rs. 1,04,654.Excess Profits Tax Rs. 45,292.Revised figures ----------Income-tax (loss) Rs. 36,182.Excess Profits Tax Rs. 1,41,962-11-0.##

For the assessment year 1946-47 and chargeable accounting period April 1, 1945, to March 31, 1946, tax liability was computed at :

#Income-tax Rs. 1,66,271.Excess Profits Tax Rs. 1,13,163-5-0.##

The orders of assessment of income-tax and Excess Profits tax were confirmed by the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal. On the applications of the appellants for reference under s. 66(1) of the Income-tax Act and s. 21 of the Excess Profits Tax Act, the Tribunal drew up a statement of the case and submitted the following four question to the High Court of Judicature at Madras :

1. Whether on the facts of and in the circumstances of the case, the Income-tax Officers/Excess Profits Tax Officer was right in taking action under s. 34 and 15 of the Income-tax and the Excess Profits Tax Act ?

2. Whether on the facts and in the circumstances of this case, the provisions of r. 9, s. 1, were properly applied ?

3. Whether, on the facts and in the circumstances of the case, the Income-tax Officer/Excess Profits Tax Officer was correct in including the proportionate commission income of Rs. 1,127 for income-tax assessment 1945-46 and Rs. 1,43,163 plus Rs. 1,127 for Excess Profits Tax assessment for the chargeable accounting period ending 31st March 1945, and

4. Whether, on the facts and in the circumstances of the case, the proportionate commission of Rs. 37,129 and Rs. 2,299 were rightly assessed for the assessment years 1946-47 ?

The High Court answered all the questions against the appellants and in favour of the Department. Against the order passed by the High Court, these appeals have been preferred with certificate

granted under s. 66A(2) of the Income-tax Act read with s. 21 of the Excess Profits Tax Act.

Two questions were canvassed in these appeals :

> 1. Whether it was open to the Taxing Officer to reopen the assessment for 1945-46; and
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> 2. Whether the commission received by the appellants was liable to be apportioned under r. 9 of Sch. 1 of the Excess Profits Tax Act ?

The appellants maintained their books of account on cash basis and commission received from the company was credited after the accounts of the company were closed. The amounts received by the appellants from the company were included in their return and assessment for the year 1945-46 was completed for the purposes of the Excess Profits Tax by the Tax Officer without apportionment appropriate to the chargeable accounting periods. In so doing, the Tax Officer committed an error. He overlooked the fact that the chargeable accounting period for the assessment of Excess Profits Tax and the year of account of the company did not tally. Under s. 15 of the Excess Profits Tax Act, if the Tax Officer discovers, in consequence of definite information which has come into his possession that profits of any chargeable accounting period chargeable to excess profits tax have escaped assessment, or have been under-assessed, he may serve on the person liable to pay such tax a notice containing all or any of the requirements which may be included in a notice under s. 13 and may proceed to asses or reassess the profits. The provision is substantially similar to s. 34(1) of the Income-tax Act before it was amended in the year 1948. It is manifest that, by the assessment of income made on the assumption that the chargeable accounting period and the accounting period of the company tallied, there resulted underassessment in the computation of tax liability for Excess Profits Tax, and it was open to the Tax Officer to take action under s. 15 of the Excess Profits Tax Act.

Determination of the second question depends upon r. 9, Sch. 1, of the Excess Profits Tax Act. By s. 2(19) of the Excess Profits Tax Act, the expression "profits" means profits as determined in accordance with Sch. 1. That schedule sets out rules for computation of profits for the purpose of the Excess Profits Tax Act; and by r. 9 it is provided in so far as it is material that :

> "Where the performance of a contract extends beyond the accounting period, there shall (unless the Excess Profits Tax Officer, doing to any special circumstances, otherwise directs) be attributed to the accounting period such proportion of the entire profits or loss which has resulted, or which it is estimated will result, from the complete performance of the contract as it properly attributable to the accounting period, having regard to the extent to which the contract was performed therein."

The performance of the contract of the managing agency extended beyond the period of account of the company which was July 1, 1945, to June 30, 1946 : it covered parts of two accounting periods. The Tax Officer was therefore obliged to apportion to the chargeable accounting periods the entire profits resulting from the complete performance of the contract in proportions properly attributable to the accounting periods and this, he proceeded to do. Counsel for the appellants contends that the contracts contemplated by r. 9 are those of the nature of engineering or works contracts and the like where execution of the contract involves a profit making operation de die in diem and not contracts where remuneration is payable at a certain time for services performed throughout the stipulated period. It is true that remuneration was paid to the appellants after the expiry of the year of account

of the company; but the contract was one the performance of which extended throughout the year of account of the company. The appellants were the managing agents of the company and they had to perform their duties as managing agents for the whole year. It is not disputed that the contract of agency for 20 years is to be regarded for assessment of excess profits tax as an annual contract. That the performance of the contract unmistakably cut across the accounting period is also manifest. The remuneration for performance of the contract is not computed at a daily rate, but is computed on a percentage of the commission not the profits of the company for the whole year, but on that account, the contract is not one in which performance does not extend throughout the year of account. Normally in a managing agency contract, the managing agent may not suffer loss, but that does not rule out the application of r. 9 to managing agency contracts. The terms in which r. 9 is enacted are general; the rule is applicable to all contracts which are intended to be operative of a fixed period. If, for the performance of the entire contract, remuneration is payable at rates stipulated, the profits earned out of that remuneration must be apportioned in the manner provided by r. 9 if the performance of the contract extends beyond the accounting period.

The judgment of this Court of E. D. Sassoon & Co., Ltd. v. Commissioner of Income-tax, Bombay City [[1955] 1 S.C.R. 313] on which strong reliance was placed by the appellants has no application to this case. In that case, M/s. E. D. Sassoon & Co., Ltd. who were managing agents of three different companies transferred the managing agencies to the three other companies on several dates during the accounting year. A question arose in the computation of income-tax payable by M/s. E. D. Sassoon & Co., Ltd. whether the managing agency commission was liable to be apportioned between M/s. E. D. Sassoon & Co., Ltd. and their respective transferees in the proportion of the services rendered as managing agents for the respective periods of the accounting year. It has held by this court (Jagannadhadas, J., dissenting) that on a true interpretation of the managing agency agreements in each case, the contract of service between the companies and the managing agents was entire and indivisible and the remuneration or commission became due by the companies to the managing agents only on completion of definite periods of service and at stated intervals; that complete performance was a condition precedent to the recovery of wages or salary in respect thereof and the remuneration payable constituted a debt only at the end of each period of service completely performed, no remuneration or commission being payable to the managing agents for broken periods; that no income was earned by or accrued to M/s. E. D. Sassoon & Co., Ltd. and as the transfer of the agencies did not include any income which E. D. Sassoon & Co., Ltd. had earned, they were not liable to be taxed under the Income-tax Act. But that was case dealing with liability of the assessees who did not receive any income and to whom no income had accrued to pay income-tax on the amounts of remuneration paid to their transferees. The court was not called upon to apply to income received by the assessee the principle of apportionment under r. 9 of Sch. 1 of the Excess Profits Tax Act, or any provision similar thereto. It is r. 9 of Sch. 1 which attracts the principle of apportionment. The rule enunciated in M/s. E. D. Sassoon & Co.'s case [[1955] 1 S.C.R. 313] has therefore no application to this case, and the High Court was right in holding that the assessment made by the Excess Profits Tax Offcer by apportionment of the commission income between the chargeable accounting periods was correct.

The appeals, therefore, fail and are dismissed with costs. One hearing fee.

Appeals dismissed.

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