Commissioner of Income-Tax, West Bengal II

Vs

Birla Gwalior (P.) Ltd.

Civil Appeals Nos. 242 to 244 of 1970

(K. S. Hegde, H. R. Khanna JJ)

04.04.1973

JUDGMENT

HEGDE J. –

These are connected appeals by certificate. They relate to the respondent's assessment for the assessment years 1954-55, 1955-56 and 1956-57. The previous financial years are the relevant accounting years.

In all these appeals, as directed by the High Court of Calcutta under section 66(2) of the Indian Income Act, 1922, certain question were submitted by the Tribunal. In the first case, i.e., Civil Appeal No. 242 of 1970, only one question was submitted and in the other two cases, i,e., Civil Appeal Nos. 243 and 244 of 1970, two questions were submitted. The question submitted in the first case is as follows :

> "Whether, on the facts and in the circumstances of the case, the sum of Rs. 1,11,779 said to have been forgone by the assessee as managing agency commission was allowable as a revenue expenditure under section 10(2)(xv) of the Indian Income-tax Act, 1922, for the assessment year 1954-55 ?"

Similar questions were called for for the remaining two assessment years, as well. But, in addition, one more question, namely :

> "Whether, on the facts and in the circumstances of the case, the sum of Rs. 30,000 said to have been forgone by the assessee as office allowance receivable from Gwalior Rayon and Silk Manufacturing Co. Ltd. was allowable as a revenue expenditure under section 10(2)(xv) of the Indian Income-tax Act, 1922, for the assessment years 1955-56 and 1956-57 ?" was called for.

At the hearing, the High Court came to the conclusion that it is not necessary to answer the common question referred in all the three appeals as the same was academic but the question relating to the office allowance was answered in favour of the assessee following the decision of a this court in Commissioner of Income-tax v. Chandula Keshavlal & Co.

The material facts of the case may now be stated. The assessee- espondent is the managing agent of the National Bearing Co. Ltd. and Gwalior Rayon & Silk Manufacturing Co. As managing agent of the former company it was entitled to receive a commission of 12 1/2 per cent. on the net profits of the managed company together with a sum of Rs. 18,000 as office allowance. In the case of Gwalior

Rayon & Silk Manufacturing Co. the assessee was entitled to get an office allowance of Rs. 30.000 per year in addition to the agreed managing agency commission. In the relevant accounting years the assessee gave up the managing agency commission due from both the assessee-company as well as the managed companies were the financial years. In the agreement entered into between the assessee-company and the managed companies no date for payment of the managing agency commission appears to have been stipulated. The commission was given up by the assessee-company after the end of the financial year but before the accounts of the managed companies were made up. The accounts of the managed companies appear to have been made up somewhere during the end of September of the year following the respective accounting years. But, in the case of office allowance, the same was given up even before the end of the financial years. On the basis of these facts the Income-tax Officer as well as the Appellate Assistant Commissioner came to the conclusion that the deduction claimed were not allowable. As regards the commission, they came to the conclusion that the same having accrued at the end of each of the financial years, the assessee's giving up the same subsequent to those dates does not bring the case under section 10(1) of the Act and no case was made out under section 10(2)(xv). So far as the office allowance is concerned they fame to the conclusion that there was no justification for giving up the same.

The Income-tax Appellate Tribunal differed from the view taken by the Income-tax Officer and the Appellate Assistant Commissioner. Dealing with the question of commission it came to the conclusion that to the extent the commission was given up the assessee-company earned no income at all. In other words the commission that was given up cannot be considered as the real income of the assessee-company. It further came to the conclusion that under any circumstance it is an allowable expenditure under section 10(2)(xv). As regards the office allowance, the Tribunal was of the opinion that the same was an allowable deduction under section 10(2)(xv). The Tribunal held that the commission as well as the office allowance were given up by the assessee on the ground of commercial expediency. The High Court agreed with the view taken by the Tribunal.

We will first take up the question relating to the office allowance. According to the finding of the Tribunal, the assessee-company gave up the office allowance on the ground of commercial expediency. It opined that the managed company's financial position was not sound during the relevant accounting years and it was necessary for the assessee- company to give up the office allowance in order to stabilise the finances of the managed company. The Tribunal further came to the conclusion that because of the sacrifices made by the assessee- company, the finances of the managed company improved subsequently, as a result of which the assessee-company was able to earn more profits in the later years. This is a finding of fact. That finding was binding on the High Court. On the basis of that finding the Tribunal was fully justified in coming to the conclusion that the expenditure incurred came within the scope of section 10(2)(xv). That conclusion is supported by the decision of this court in Chandulal's case. The only contention advanced in this court in respect of the office allowance was that it was paid to meet certain expenses incurred by the assessee-company; consequently, the assessee could not have given up the same. We do not know whether the office allowance was paid solely for that purpose of whether it was partly as remuneration and partly to meet the expenditure incurred. In either case it makes no difference in law. The ratio of the decision of this court in chandulal's case, completely covers the point under consideration.

Now turning to the question regarding giving up of the commission, as mentioned earlier, the assessee was maintaining its accounts on the basis of the mercantile system. Its accounting years was the financial year. It gave up the commission after the end of the financial year. On the basis of the these facts it was contended on behalf of the revenue that the commission had accrued before it

was given up. Hence, it cannot be said that the assessee had not earned the commission in question. Therefore, the assessee's case cannot be considered under section 10(1). We are unable to accept this contention as correct. As mentioned earlier, no due date was fixed for the payment of the commission under the managing agency agreements. The commission receivable could have been ascertained only after the managed company made up its accounts. The assessee had given up the commission even before the managed company made up its accounts. Hence, the mere fact that assessee-company was maintaining its accounts on the basis of the mercantile system cannot lead to the conclusion that the commission had accrued to its by the end of the relevant accounting year. This is also the view taken by the Bombay High Court in H. M. Kashiparekh & Co. Ltd. v. Commissioner of Income-tax. The facts of that case are somewhat similar to the fact of the present case. Therein, the assessee which maintained its accounts on the mercantile system was the managing agent of a paper mill company were not sufficient to pay a dividend of 6 per cent. For the accounting year ending March 31,1950, the assessee earned a commission of Rs. 1,17,644, but as a result of the resolutions passed by the managed company and the assessee-company the assessee gave up a sum of Rs. 97,000 in December, 1950. The Appellate Assistant Commissioner held that the maximum amount the assessee was bound to forgo was only Rs. 39,215 and included the balance of the amount forgone, viz., Rs. 57,785, in the taxable income. The Appellate Tribunal however, found that the sum of Rs. 57,785 was also given up for reasons of commercial expediency. Affirming the decision of the Tribunal the High Court held that it was the real income of the assessee-company for the accounting year that was liable to tax and that the real income could not be arrived at without taking into account the account the amount forgone by the assessee. In ascertaining the real income the fact that the assessee followed the mercantilesystem of accounting did not have any bearing. The accrual of the commission, the making up of the accounts, the legal obligation to give up part of the commission, and the forgoing of the commission at the time of making up of the accounts were not disjointed facts : there was a dovtailing about them which could not be ignored. The real income of the assessee was Rs. 27,644 and the amount of Rs. 97,000 forgone by the assessee could not be included in the real income of the assessee for the accounting year. Rejecting the contention that merely because the assessee maintained its accounts on the basis of the mercantil system, the income must be held to have accrued at the end of the accounting year, the High Court observed :

> "Even so, (the failure to produce account books) we shall proceed on the footing that the assessee-company having following the mercantile system of account, there must have been entires made in its books in the accounting year in respect of the amount of the commission. In our judgment, we would not be justified in attaching any particular importance in this case to the fact that the company followed the mercantile system of account. That would not have particular bearing in applying the principal of real income to the fact of this case."

This decision was cited with approval by this court in Poona Electric Supply Co. Ltd. v Commissioner of Income-tax. Dealing with that decision this is what this court observed :

> "The concept of 'real income' is also expounded in the decision of the Bombay High Court in H. M. Kashiparekh & Co. Ltd. v. Commissioner of Income-tax. There, under the managing agency agreement the managing agent was under a duty to forgo up to one-third of its commission where the profits of the managed company were not sufficient to pay a dividend of 6 per cent. The contention of the revenue that such a surrender of the commission undre the provisions mentioned in the agreement was not deductible for the purpose of income-tax was negatived. The principle has been

succinctly stated in the headnote thus :

'The principle of real income is not to be so subordinated as to amount virtually to negation of it when a surrender or concession or rebate in respect of managing agency commission is made, agreed to or given on grounds of commercial expediency, simply because it takes place some time after the close of an accounting year. In examining any transaction and situation of this nature the court would have more regard to the reality and speciality of the situation rather then the purely theoretical or doctrinaire aspect of its. It will lay greater emphasis on the business aspect of the matter viewed as a whole when that can be done without disregarding statutory language."

Mr. S. T. Desai, learned counsel appearing for the revenue, contended that the facts of this case are governed by the rule laid down by this court in Morvi Industries Ltd. Commissioner of Income-tax. We do not think that that submission is correct. The facts of that case are : the assessee, which was the managing agent of its subsidiary company, maintained its accounts on the mercantile system. It was entitled to receive an office allowance of Rs. 1,000 per month, a commission of 12 1/2 per cent. of the net profits of the managed company and an additional commission of 1 1/2 per cent, on all purchases of cotton and sales of cloth and yarn. In the accounting years ended on December 31, 1954, and December, 31, 1955, the managed company suffered losses and the assessee earned only commission on the sale of cloth and yarn for the two years. The total amounts, including the office allowance which the assessee was entitled to receive were Rs. 50,719 and Rs. 13,963 for the two years. Under clauses 2(e) of the managing agency agreement the commission was due to the assessee on December 31, 1954 and December 31,1955, respectively, and it was payable immediately after the annual accounts of the managed company was passed in general meetings, which were held on November 24, 1955, and July 21, 1956, respectively, April 4, 1955, and June 19,1956 (i.e., after the commission had become due but before it had become payable in terms of clause 2(2), the assessee relinquished its commision on sales and office allowance because the managed company had been suffering heavy losses in the past years. The Tribunal held that the relinquishment by the assessee of its remuneration after it had become due was of no effect; and also rejected its claim that the amounts reliquishedwere allowable under section 10(2)(xv) of the Indian Income-tax Act, 1922, because, as a result of the relinquishment, the financial position of the manged company did not become stronger while that of the assessee- company became weaker and, therefore, the relinquishment was not for the benefit of the assessee. On a reference the High Court agreed with the view taken by the Tribunal. On appeal this court affirmed the decision of the High Court.

As seen from the facts of that case the commission given up had accrued on the 31st December, 1954, and 31st December, 1955, respectively, and the assessee purported to give up that commission several moths thereafter. Further, the Tribunal in that case had come to the conclusion that the assessee did not give up the amounts in question for commercial expediency. This court came to the conclusion that the amounts in question were due on the 31st December, 1955, and 1956, though payable at a later date; consequently those amounts had accrued long before they were given up and the giving up of the same did not come within the scope of section 10(1). It is true that in the course of the judgement emphasis was also placed on the fact that the assessee was maintaining its accounts on the basis of mercantile system, but it was not on that basis along that this court came to the conclusion that the income in question accrued on 31st December, 1955, and 31st December, 1956. In arriving at the conclusion that the income in question accrued on the 31st December, 1955, and 31st December, 1956, this court primarily took into consideration the terms of the agreement. In the

course of the judgement delivered by one of us, Khanna J. a passage from the judgement of this court in Commissioner of Income-tax v. Shoorji Vallabhdas and Co. was quoted in support of the conclusion reached by this court. That passage reads thus :

> "Income-tax is a levy on income. Though the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income of its receipt, yet the substance of the matter is the income. If income does not result at all there cannot be a tax even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, these is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account"

Hence it is clear that this court in Morvi Industries case did emphasise the fact that the real question for decision was whether the income had really accrued or not. It is not a hypothetical accrual of income that has not to be taken into consideration but the real accrual of the income.

In addition to the contentions taken earlier, Mr. Desai also took objection to the way in which the High Court disposed of these cases. It may be noted that the High Court came to the conclusion that the findings reached by the Tribunal were findings of fact and, therefore, it would not be proper for the High Court to interfere with the same but strangely enought, at an earlier stage, the High Court called for the questions referred to earlier, under section 66(2). If the questions raised are concluded by the facts found by the Tribunal the High Court was not justified in calling for those question. High Court issued the rule on the applications made by the Revenue, the assessee not only objected to the prayer made by the Revenue, but also submitted that in case the court was pleased to direct the Tribunal to state a case, it may also be pleased to direct the Tribunal to state a case, it may also be pleased to direct the Tribunal to submit the question "whether the commission given up can be considered as real income coming within the scope of section 10(1) ?" But, the High Court rejected that prayer and merely called upon the Tribunal to submit the questions set out earlier. The High Court has now come to the conclusion that the commission given up by the assessee cannot be considered as its real income. It is undoubtedly true that there are certain incongruities in the procedure adopted by the High Court but the final conclusion reached by the High Court is, in our opinion, correct in law. Therefore, the High Court was justified in refusing to answer the first question in all the three cases.

In the reslut these appeals fail and they are dismissed with costs; one set of hearing fee.

Appeal dismissed.

</html