

Nonsuch Estate Ltd.

Vs

The Commissioner of Income-Tax, Madras

Civil Appeal No. 1554 (NT)/1970

(A . C. Gupta, H. R. Khanna JJ)

21.11.1974

JUDGMENT

GUPTA, J. -

1.

This is an appeal by special leave from a judgment of the Madras High Court in a reference under Section 66(1) of the Income-Tax Act, 1922. The appellant, Nonsuch Estate Limited, is a public limited company incorporated in the year 1924 under the Indian Companies Act, 1913. The appellant, referred to hereinafter as the Company derives its income from tea grown in its estate, for which it is assessed to income-tax. M/s. Harrisons and Crosfield Limited have been the managing agents of the Company from the beginning. The following question relating to the assessment year 1959-60 was referred to the High Court :

Whether on the facts and in the circumstances of the case, the sum of Rs. 97,188 representing the managing agency remuneration for the period April 1, 1956 to June 30, 1957 was deductible in the computation of the income of previous year ending on June 30, 1958, relevant for the assessment year 1959-60.

2. The relevant facts leading to the reference are these. The managing agents of the Company were entitled to commission at the rate of one and a half per cent on all sales of tea and other produces of the Company and a further sum of Rs. 12,000 per annum for secretarial work. There was, however, no written agreement embodying the terms. After the Companies Act, 1956 came into force on April 1, 1956 it was decided that there should be a fresh managing agency agreement between the Company and its managing agents in conformity with the provisions of the said Act. A fresh agreement drawn up and submitted by the managing agents was approved by the Company. The new agreement proposed the re-appointment of M/s. Harrisons & Crosfield Limited as the managing agents of the Company for a period of ten years on a remuneration of five per cent commission on the net profits of the Company computed in the manner laid down in Sections 349 and 351 of the Companies Act, 1956 subject to a minimum remuneration of Rs. 12,000 per annum. The revised terms were to take effect from April 1, 1956. As required by Section 326 of the Companies Act the new agreement was sent to the Central Government for approval by a communication dated August 3, 1957 enclosing a formal application for the purpose in Form 25. On September 2, 1957 by a letter addressed to the Company the Government conveyed its approval to

the appointment of M/s. Harrisons & Crosfields Ltd. as the Managing Agents . . . for a period of ten years with effect from April 1, 1956, on a remuneration of five per cent commission on the net

emphasis on the fact that the Company followed the mercantile system of accounting. The distinction between the two methods of accounting, one on the cash basis and the other on the mercantile basis is well-known. In Commissioner of Income-tax, Madras v. A. Gajapathy Naidu (53 ITR 114 : AIR 1964 SC 1653), this Court explained the difference between the two methods quoting with approval an extract from a judgment of the Allahabad High Court in Commissioner of Income-tax v. Singari Bai ((1945) 13 ITR 224 (All)). In Gajapathy Naidu's case this court said :

It is commonplace that there are two principal methods of accounting for the income, profits and gains of a business; one is the cash basis and the other, the mercantile basis. The latter system of accountancy "brings into credit what is due immediately it becomes legally due and before it is actually received; and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed".

However, even an assessee following the mercantile system of accounting is not entitled to claim a deduction until liability for the sum for which deduction is claimed has accrued. The reasons given by the High Court overlook the plain terms of Section 326 of the Companies Act, 1956. Section 326 so far as it is material for the question involved in this case, is in these terms :

Section 326. (1) In respect of any company

#(a) ##

(b) unless the approval of the Central Government has been obtained for such appointment or re-appointment.

(2) The Central Government shall not accord its approval under sub-section (1) in any case, unless it is satisfied -

(a) that it is not against the public interest to allow the company to have a managing agent;

(b) that the managing agent proposed is, in the opinion, a fit and proper person to be appointed or re-appointed as such, and that the conditions of the managing agency agreement proposed are fair and reasonable; and

(c) that the managing agent proposed has fulfilled any conditions which the Central Government requires him to fulfil.

5. Section 326 prohibits the appointment or re-appointment of a managing agent unless the Central Government approves such appointment or re-appointment. The Central Government would not accord its approval unless the requirements specified in clauses (a), (b) and (c) of sub-section (2) of the section have been fulfilled. Therefore, it cannot be assumed that the Central Government will approve every proposed appointment or re-appointment of a managing agent. Thus in the instant case it is only when the Central Government conveyed its approval to the appointment of M/s. Harrisons and Crosfield Limited as managing agents by its letter dated September 2, 1957 that the appointment became effective and the Company's liability to pay the remuneration of the managing agents accrued. The position here is not that the liability has arisen earlier and its quantification only depended on the approval of the Central Government. It is true that the liability became effective from April 1, 1956, a date anterior to the relevant previous year, but that is because the Central Government chose to give its approval retrospective operation. The liability in these circumstances

cannot be said to have arisen from any date prior to September 2, 1957 when the approval was given as Section 326 contains an absolute prohibition against the appointment or re-appointment of a managing agent before the approval of the Central Government was obtained. In our opinion, the position is quite clear from the terms of Section 326 and we do not consider it necessary to refer to the authorities cited by the learned Counsel for either side.

6. The appeal is accordingly allowed, the answer given by the High Court to the question referred to it is discharged and the question is answered in the affirmative and in favour of the assessee. The appellant will be entitled to its costs in this Court and in the High Court.

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