

Commissioner of Excess Profit Tax, Kanpur

Vs

M/S. Kalyan Mal Phool Chand

Civil Appeal No. 1375 of 1974

(S. Natarajan, Sabyasachi Mukharji JJ)

13.03.1987

JUDGMENT

SABYASACHI MUKHARJI, J. -

1. This appeal is directed against the judgment and order of the High Court of Allahabad dated February 21, 1971. It relates to the assessment under the Excess Profits Tax Act, 1940 (hereinafter called the 'Act'). The assessee was an unregistered firm carrying on business of manufacture and sale of katechu. The chargeable accounting period was April 1, 1943 to March 31, 1944. There were two partners of the assessee firm, namely, L. Phoolchand and M/s. Biharilal Balkrishan each having profits in proportion of 11 annas and 5 annas respectively. The work in connection with the extraction of katechu was carried on in Nepal by L. Phoolchand and the sale of katechu was effected by M/s. Biharilal Balkrishan at their shops in Kanpur. The assessee firm did not maintain any books of account and the entire record of the business transaction was maintained in the books of M/s. Biharilal Balkrishan in the account styled "Kalyanmal Phoolchand".

2. The assessee firm had taken a jungle on lease for this purpose and has extracted katechu from October 1940 to September 1941. The sales of katechu extracted were effected from May 30, 1941 to September 29, 1941. Thereafter another jungle was taken on lease in November 1942 and katechu was extracted from November 23, 1942 to November 6, 1944. The sales in this case were effected between July 26, 1943 to April 4, 1944. The High Court divided the entire period of manufacture and sale as follows;

- (1) October 28, 1940 to March 31, 1941, falling in the financial year ending March 31, 1941. Katechu was manufactured but there was no sale.
- (2) April 1, 1941 to September 29, 1941, falling in the financial year ending March 31, 1942. Sales took place from May 30, 1941 to September 29, 1941.
- (3) November 23, 1942 to March 31, 1943, falling in the financial year ending March 31, 1943. Katechu was manufactured but there was no sale.
- (4) April 1, 1943 to March 31, 1944, falling in the financial year ending March 31, 1944. Sales took place from July 26, 1943 to March 31, 1944.
- (5) April 1, 1944 to April 4, 1944, falling in the financial year ending March 31, 1945. Sales were effected from April 1, 1944 to April 4, 1944, when the business was discontinued.

3. Therefore, while there was manufacturing activity there was no sale during the financial years ending March 31, 1941 and March 31, 1943. The dispute in this case is with regard to the set off of deficiency of profit relating to the periods October 20, 1940 to October 17, 1941 and November 23, 1942 to March 31, 1943.

4. The Excess Profit Tax Officer did not set off the said deficiency of profits that accrued in respect of the period 1940-41 out of the profits for the chargeable accounting period from April 1, 1943 to March 31, 1944. The submission of the assessee was that the business carried on during the chargeable accounting period under consideration was not separate to and distinct from the business carried on in 1940-41. The excess Profit Tax Officer held that business carried on during October 1940 to October 1941 was completely different from the business carried on during the chargeable accounting period under consideration.

5. The Appellate Assistant Commissioner on appeal found that the constitution of the firm during the chargeable accounting period was the same as in 1940-41 and the accounts were maintained in the same fashion; and that the same business of manufacturing katechu in Nepal and selling the finished products at Kanpur was carried on. The Appellate Assistant Commissioner, therefore, held that the assessee was entitled to set in respect of the deficiency of profits accruing in the year 1940-41. The Appellate Assistant Commissioner further found that the assessee had effected sales only during May 30, 1941 to September 29, 1941. As such there were no sales either during or until May 30, 1941 and subsequent to September 29, 1941. As such he held that there was no profit arising during the accounting period ending on March 31, 1941. He, therefore, confirmed that there were no profits and losses during the chargeable accounting period ending on March 31, 1941 and as such there could be no deficiency of profits. In the premises, according to the Appellate Assistant Commissioner, the assessee was entitled to a set off of the deficiency only for the chargeable accounting period ending on March 31, 1942 which consisted of the period April 1, 1941 to September 29, 1941. He allowed such deficiency of Rs. 5600 only ? So far as the deficiency pertaining to the period November 1942 to March 31, 1943 was concerned, the facts were that the manufacturing operation started in Nepal on or about November 23, 1942 and the sales of katechu started at Kanpur on July 26, 1943. Katechu produced in Nepal from November 23, 1942 to March 31, 1943 remained in stock till the last date of the chargeable accounting period namely March 31, 1943 and no part of it was sold. As the assessee did not maintain any books of account, the provisions of Section 13 of the Indian Income Tax Act, 1922 as applied to the Act vide Section 21 of the Act were applicable. The revenue, therefore, valued the stock-in-trade at cost and held that there could be no profit or loss during the chargeable accounting period. In appeal, the assessee had urged that deficiency in profits pertaining to the chargeable accounting periods from October 1940 to March 31, 1941 and November 23, 1942 to March 31, 1943 should be allowed a set off in computing the excess profits for the year under consideration. It was submitted that there were no profits pertaining to the said chargeable accounting period, and therefore, the standard profits as provided in the Act became the deficiency of the said two chargeable accounting period, and therefore, the standard profits as provided in the Act became the deficiency of the said two chargeable accounting periods which should have been allowed set off. It was further urged on behalf of the assessee that the manufacturing operations were carried on during the said periods and as such it could not be said that the assessee did not on any business.

6. The Tribunal, however, held that no profits accrued unless sale was effected and, therefore, there was no merit in the submission made on behalf of the assessee that during the said two chargeable accounting periods, although there were no sales effected, yet profits accrued to the assessee. It was urged on behalf of the revenue that as provided in the Act, the provisions of the Act would apply to

every business of which any part of profits was made during the chargeable accounting period, is chargeable to Income-tax. It was further urged that no part of profits, if any, which accrued during the said two chargeable accounting periods could be charged and were in fact not so charged, to Income-tax, as no sales were effected and, therefore, the Act itself did not apply to the said two chargeable accounting periods. The Tribunal accepted this contention on behalf of the revenue and as such confirmed the order of the Appellate Assistant Commissioner.

7. On the said facts, the following question of law was referred to the High Court at the instance of the assessee :

Whether, on the facts and in the circumstances of the case, the assessee was entitled to a set off of deficiency of profits relating to the period October 28, 1940 to March 31, 1941 and November 23, 1942 to March 31, 1943 from the profits of the chargeable accounting period April 1, 1943 to March 31, 1944 in accordance with the provisions of the EPT Act, 1940 ?

8. The High Court held that it was not disputed before them that the assessee was carrying on the same business from October 28, 1940 to April 4, 1944 for the purpose of the Act. The only question was whether the assessee could be said to have suffered any deficiency of profits during the period October 28, 1940 to March 31, 1941 and November 23, 1942 to March 31, 1943 and was therefore entitled to be given the benefit of such deficiency of profit.

9. The High Court referred to certain definitions and recognised and in our opinion rightly that there were several stages in business activities before profits could be realised. The High Court observed that profits realised were not of the sale alone. The profits were attributable to the manufacturing operations as well. The High Court referred to certain decisions to which out attention was also drawn where under the Act as the place where the profits arose, the courts had enquired into the place where the manufacturing took place and where the sales took place. This contention is no longer relevant for the controversy before us. It was accepted before us that a manufacturing process may begin in one year and result in sale in another year and also that manufacturing process may take place at one place and sale at another place. For the purpose of computing the profit of certain operation, it is true as the High Court noted, that manufacture and sale might take place in two different years.

10. The High Court held that though chargeable levy was an annual charge and generally for the purpose of the levy of the annual charge the profits of the year preceding the year of charge are taken into consideration if the manufacturing activity leading to the production of finished article which was subsequently sold contributed to the profits realised, according to the High Court, it mattered little whether or not the manufacturing activity of the sale related to the same period of twelve months. Some part of the profits realised would be attributable to the manufacturing activities and, therefore, could be said to arise during the period when manufacturing was carried on even though sales were effected in the next year. The High Court, therefore, was of the view that it was necessary to determine what part of the profits realised upon the sales from May 30, 1941 to September 29, 1941 could be attributed to the manufacturing activity between October 28, 1940 to March 1941 and then to compute the deficiency of profits for the chargeable accounting period ending March 31, 1941. That might require, according to the High Court, a fresh determination of the profits earned during the period April 1, 1941 to September 29, 1941 and consequently, of the deficiency of profits during the chargeable accounting period ending March 31, 1942. The High Court was of the view that the deficiency of profits for the chargeable accounting periods ending

March 31, 1941 and March 31, 1941 and 1942 would have to be set off when computing the excess profits for the relevant chargeable accounting period ending March 31, 1944. The High Court expressed the view that under Section 2(5) of the Act, the job of the assessee in the extraction and sale of katechu under the two jungle leases must be considered as a single business for the purpose of the Act. The High Court, therefore, came to the conclusion that upon the principle of apportionment of profits to which it had adverted, the profits earned upon sales effected during the chargeable accounting period ending March 31, 1944 must similarly be apportioned between the manufacturing activity during the chargeable accounting period ending March 31, 1943 and the sales during the chargeable accounting period ending March 31, 1944 and the deficiency of profits worked out on the basis in respect of the chargeable accounting period ending March 31, 1943 must be set off in computing the excess profits for the chargeable accounting period ending March 31, 1944. The High Court, therefore, did not accept the opinion of the Tribunal that because the chargeable accounting periods during March 31, 1941 and March 31, 1943 were occupied with manufacturing activity alone and there were no sales, therefore, no part of the profits realised upon the sales could be apportioned to those chargeable accounting periods and consequently that it could not be said that there was any deficiency of profits during those periods. The question referred to the High Court was answered in affirmative.

11. In order to appreciate the real controversy in this matter, it is appropriate to refer to the observations of Kania, J., as the Chief Justice then was, in the decision in the case of CIT v. Raipur Manufacturing Co. Ltd. ((1946) 14 ITR 725, 733 (Bom)) It was observed as follows :

The Excess Profit Tax as shown by the preamble itself is a legislation to impose tax on excess profits arising out of certain businesses. The Income Tax Act is the principal legislation which imposes a tax on the income of a person. Section 6 divides the income under five heads which are chargeable to tax. The fourth head is profits and gains of business, profession or vocation. Out of that a certain portion is carved out by the legislature for the purpose of imposing the excess profits tax. I am unable to accept the contention of the Commissioner that the Excess Profits Tax Act is an entirely independent legislation, which is connected with the Income Tax Act only to the extent it is expressly so stated in the Excess Profits Tax Act. The scheme of the two acts clearly shows that the Excess Profits Tax Act is a legislation intended to tax the profits of certain businesses in excess of a certain limit as provided in that Act. It is therefore complementary to the Income Tax Act by its very nature.

12. As the Statement of Objects of the Act stated that the out break of war, while it has necessitated greatly increased expenditure by the government on defence and other services, has simultaneously created opportunities for the earning by companies and persons engaged in business of abnormally large profits. The object of the Bill (which later became the Act) was to secure for the government a considerable portion of the additional business profits which accrued as a result of the conditions prevailing during the war. To begin with, the right to impose a tax of 50 per cent of the excess of the profit made in any accounting period after April 1, 1939 was given. It had subsequently been increased to 66 $\frac{2}{3}$ per cent.

13. Section 2(1) of the Act defines the 'accounting period'. Section 2(6) defines 'chargeable accounting period' as (a) any accounting period falling wholly within the term beginning on the 1st day of September, 1939, and ending on the 31st day of March, 1946 and (b) where any accounting period falls partly within and partly without the said term, such part of that accounting period as falls within the said term. The 'standard profits' is defined under Section 2(3) which was required to be computed in accordance with the provision of Section 6 of the Act. It is not necessary in view of

the controversy before us to refer to other definitions except that Section 2(3) deals with 'average amount of capital' which is relevant for computation of the excess profits. Section 6 defines the 'standard profits' and how it is to be computed. As there was no controversy on the aspect before us, it is not necessary to deal with it. Section 2(9) defines 'deficiency of profits' as follows :

(9) "deficiency of profits" means -

(i) where profits have been made in any chargeable accounting period, the amount by which such profits fall short of the standard profits;

(ii) where a loss has been made in any chargeable accounting period, the amount of the loss added to the amount of the standard profits;

14. Section 4 defines 'charge of tax' as follows :

Charge of tax - (1) Subject to the provisions of this Act, there shall, in respect of any business to which this Act applies, be charged, levied and paid on the amount by which the profits during any chargeable accounting period exceed the standard profits a tax (in this Act referred to as "excess profits tax") which shall, in respect of any chargeable accounting period ending on or before the 31st day of March 1941, be equal to fifty per cent of that excess and shall, in respect of any chargeable accounting period beginning after that date, be equal to such percentage of that excess as may be fixed by the annual Finance Act :

Provided that any profits which are, under the provisions of sub-section (3) of Section 4 of the Indian Income Tax Act, 1922, exempt from Income-tax, and all profits from any business of life insurance shall be totally exempt from excess profits tax this Act :

Provided further that in the case of any business which includes the mining of any mineral, any bonus paid by or through the Ventral Government in respect of increased output of the mineral shall be totally exempt from excess profits tax under this Act.

(2) Where a chargeable accounting period falls partly before and partly after the end of March 1941, the foregoing provisions of this section shall apply as if so much of that chargeable accounting periods as falls before, and so much of that chargeable accounting period as falls after, the said end of March were each a separate chargeable accounting period, and as if the excess of profits of that separate chargeable accounting period were an apportioned part of the excess of profits arising in the whole period determined in accordance with the provision of Section 7-A.

15. Section 7 deals with the relief on occurrence of deficiency of profits and provides in substance that where a deficiency of profits occurs in any chargeable accounting period in any business the profits of the business chargeable with excess profits tax shall be deemed to be reduced and relief shall be granted according to the provisions laid down therein.

16. The main question in this case is to keep the distinction between 'accounting period' and 'chargeable accounting period'. The accounting period, it has to be borne in mind, is the twelve months' proceeding just on the basis of the Income-tax year and the assessment must be made on the same basis. The 'chargeable accounting period' is the period beginning from September 1, 1939

ending after amendment on March 31, 1946. So if there is any deficiency of profits in any of the accounting period which has not been absolved in the assessment for that year it may be carried forward but the assessment must be made on the basis of the accounting period. This has to be emphasised and it must be borne in mind that though it is wholly immaterial whether the manufacture and sale took place in the same year or in two different years, the division of time into periods for its assessment must be made in a real sense as in the Income-tax one, and then make appropriate adjustments. Therefore the profits and losses of each year must be computed on yearly basis in terms of the definition of 'accounting period' under Section 2(1) of the Act. But if any deficiency of profits remains unabsolved, it may be carried forward against any excess profits made and set off during the next accounting period. The chargeable accounting period is the period from September 1, 1939 to March 31, 1946. But each year's excess profit and loss must be computed in the manner contemplated in Section 2(1) of the Act. So if there was any deficiency of profits in any particular period, it must be determined on that basis. In order to work out the scheme of the Act, there must be proper dovetailing of the concept of "accounting period", "chargeable accounting period" and basic scheme of the Income Tax Act bearing in mind that excess profits are excess of profits which were intended to be mopped up during the war period intended to be taxed separately and differently. This view finds support in the decision of Allahabad High Court. In the case of Haji Rahmat Ullah and Co. v. CIT ((1966) 59 ITR 109 (All)), the High Court of Allahabad held that a payment received in any year subsequent to a chargeable accounting period is not liable to be treated as the profits of that period, merely because the work which occasioned that payment was done during the period. The "profits during the chargeable accounting period" are those profits respecting which a right to receive had accrued or arisen during that period. If the right to receive those profits had accrued or arisen subsequently, then even though they had accrued or arisen by reason of work done during the chargeable accounting period, these were not liable to be treated as the profits of that chargeable accounting period. The High Court observed that it would seem *ex facie* that if the profits earned during a certain period are taxable under the Income Tax Act, it is a part of those very profits which is liable to excess profits tax. Whether the profits in the one case could be identified with the profits in the other would be determined by reference to the period in which those accrued or arose. It was emphasised that the profits during the chargeable accounting period must be computed under the Excess Profits Tax Act on the same basis as are profits for an income tax assessment. It is clear that excess profits tax is attracted in respect of a business to which the Act applied when the profits during the chargeable accounting period exceed the standard profit. It has to be clearly borne in mind that the Act is not an entirely different Act in the sense that it proceeds upon the concept completely different from the notions of Income-tax and has its source in an entirely different tax concept. More profits which were likely to have been earned due to profits, these were made subject to excess profits.

17. It appears to us that the period of assessment in the Act is an "accounting period" in the same way as the 'previous year' is the period of assessment for the purpose of Income-tax. Though profit in a composite transaction could be apportioned as between manufacture and sale in the same accounting year, such an apportionment is not permissible when one part of the transaction, i.e. manufacture, falls in one chargeable accounting period and falls in (sic) another part of the accounting period (sic transaction) i.e. the trading operations, i.e. (sic) falls in another accounting period; then set off of deficiency in profits under Section 7 of the Act is permitted but a necessary precondition was that profit must be made in the accounting period to which the deficiency relates. The profits attributed on apportionment were outside the scope of Section 7 of the Act. It must be remembered that the 'excess profits' under the Act is profit determined under the Income Tax Act subject to prescribed adjustments. If the Income-tax assessment disclose nil profits, no separate

profit can be determined independently under the Act.

18. The position of the Excess Profits Tax Act was explained by Lord President Clyde in *Edward Collins & Sons Ltd. v. IRC* ((1924) 12 TC 773, 780) where the Lord President emphasised that subject to certain modifications those profits had to be determined in the same way and on the same principle as a trader's profits and gains have to be computed for the purpose of the Income Tax Act. It is a general principle, in the computation of the annual profits of a trade or business under the Income Tax Acts, that those elements of profit or gain, and those only, enter into the computation which are earned or ascertained in the year to which the enquiry refers; and in like manner, only those element of loss or expense enter into the computation which are suffered or incurred during the year. The same principle, in our opinion, would be applicable to the facts of this case.

19. The decision of this Court in *CIT v. Ahmedbhai Umarbhai & Co.* ((1950) 18 ITR 472 (SC)) related entirely to a different context where certain part of the activities occurred at Raichur and the sales took place in Bombay, the question was whether the activity which the assessee carried or at Raichur was part of their business within the meaning of the third proviso to Section 5 of the Act, that the profits of a part of the business, the manufacturing of oil in their mills at Raichur, accrued or arose at Raichur and that such profits were not assessable to Excess Profits Tax under the third proviso to Section 5 of the Act. That is not the controversy here. The controversy is not so much where the profits arose nor is the controversy whether the profits arose during the chargeable accounting period but where the profits arose during the 'accounting period' and as such whether the deficiency of the profits not arising during 'accounting period' but during the 'chargeable accounting period' could be set off without computation. The method of computation under Section 7 of the basis of 'accounting period' and after that the deficiency in profits for that period should be computed on that basis and after set off carried forward to be set off during the chargeable accounting period. It is thus an harmonious construction of the different provisions of the Act is possible and the true excess profits. If any, as contemplated by the Act be determined. The concept of 'accounting period' in the background of the 'chargeable accounting period' can thus be harmonised. The accounting period was April 1, 1943 to March 31, 1944. In the facts of the case we are of the opinion that the question must be answered in the negative and in favour of the revenue. The appeal is allowed and the judgment and order of the High Court are set aside.

20. In the facts and circumstances of the case, parties will pay and bear their own costs.

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