Godhra Electricity Co. Ltd., Ahmedabad

Vs

Commissioner of Income-Tax, Gujarat-Ii, Ahmedabad

Civil Appeals Nos. 5638-40 of 1983

(S. C. Agarwal, G. B. Pattanaik JJ)

03.04.1997

JUDGMENT

S.C. AGRAWAL, J. –

1. These appeals, by certificate granted under Section 261 of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), have been filed by the Godhra Electricity Co. Limited, (hereinafter referred to as "the assessee company") against the judgment of the Gujarat High Court dated 24/25-2-1982 in Income Tax References Nos. 288 of 1975, 73 of 1978 and 171 of 1978. Income Tax Reference No. 288 of 1975 related to the Assessment Year 1969-70, while Income Tax Reference No. 73 of 1978 related to the Assessment Years 1970-71 and 1971-72 and Income Tax Reference No. 171 of 1978 related to Assessment Year 1972-73.

2. On 19-11-1922, the then Government of Bombay granted a licence under the Indian Electricity Act, 1910 to Lady Sulochana Chinubhai & Company authorising it to generate and supply electricity to the consumers in Godhra area. The assessee company is the successor of the said licensee. On the recommendations of a Rating Committee constituted under Section 57(2) of the Electricity (Supply) Act, 1948 the State Government had fixed the charges for supply of electricity and motive power by the assessee company with effect from 1-2-1952. After the amendment of the Electricity (Supply) Act, 1948 in 1956 the assessee company increased the charges for motive power from 1-1-1963 to 35 np. per unit with a maximum of Rs. 7 per month for every installation and a few months thereafter on 22-6-1963 the assessee company increased the rates for electricity supplied for lights and fans to 70 np. per unit with a minimum of Rs. 5 (sic 15) of every installation with effect from 1-7-1963. This unilateral increase in the rates for supply of motive power as well as electricity for lights and fans led to the institution of two representative suits by the consumers (Civil Suits Nos. 152 of 1963 and 50 of 1964) in the Court of Civil Judge (Senior Division) at Godhra wherein the right of the assessee company to unilaterally increase the charges in respect of motive power and lights and fans was challenged. The said suits were decided by the trial court in favour of the consumers and the decree of the trial court was affirmed in appeal by the Assistant Judge, Panchmahals at Godhra. The second appeals filed by the assessee company were dismissed by the learned Single Judge of the Gujarat High Court on 11-4-1996 but the letters patent appeals (LPAs Nos. 42 and 43 of 1966) filed by the assessee company against the said judgment of the learned Single Judge were allowed by the Division Bench of the High Court by judgment dated 3-12-1968 and both the representative suits filed by the consumers were dismissed. It was held that under the Electricity (Supply) Act, 1948, as amended in 1956, the assessee company was entitled to enhance the charges unilaterally subject to the conditions prescribed in the Sixth Schedule to the said Act. The said judgment of the Division Bench of the Gujarat High Court was affirmed by this Court by judgment dated 26-2-1969 in Jindal Oil Mills v. Godhra Electricity Co. Ltd. [(1969) 1

SCC 781 : (1969) 3 SCR 836] During the pendency of this litigation in the various courts the assessee company was not able to realise the enhanced charges from the consumers. After the decision of this Court on 26-2-1969 some of the citizens of Godhra met the Minister of Industries, Mines and Power, Government of Gujarat, with a view to persuading him to intervene and restrict the assessee company from recovering the enhanced rates from the consumers. Thereafter the Under Secretary to the Government of Gujarat in the Industries, Mines and Power Department addressed a letter dated 19-3-1969 to the assessee company suggesting that the company may be advised to maintain the status quo for the rates to the consumers concerned and also to continue the existing street light agreement for at least six months. The Chief Electrical Inspector was requested to go through the accounts of the assessee company from year to year and report to the Government the actual position about the reasonable return earned by the assessee company. On 16-5-1969 some of the consumers filed another representative suit (Suit No. 118 of 1969) against the assessee company in the Court of Civil Judge (Junior Division) at Godhra challenging the right of the assessee company to recover the consumption charges at the enhanced rates. In the said suit it was claimed that the decision of this Court was only of academic interest as, in April 1965, the assessee company began to purchase in bulk electrical energy at 10 paise per unit from the Gujarat Electricity Board and it had to work merely as distributing agency and had to collect the charges and not generate electrical energy and that the assessee company would earn more profits even if it supplied electricity at 31 paise per unit to the consumer of motive power and that it would earn a reasonable return even on the basis of the existing rates. An interim injunction was granted by the trial court in that suit. A written statement was filed by the assessee company contesting the said suit but when the suit came up for hearing no evidence was led to controvert the evidence produced on behalf of the consumers since at that point of time the undertaking of the assessee company was under the management of the Collector of Godhra and he did not give any instructions to the lawyer appearing on behalf of the assessee company with the result that the said lawyer reported no instructions. The said suit was decreed in favour of the consumers by the Civil Judge by his judgment dated 20-6-1974 and a declaration was granted to the effect that the assessee company shall not recover the charges exceeding 31 np. per unit for lights and fans and 20 np. per unit for motive power. The interim injunction which had been granted against disconnection or discontinuance of the supply was made absolute on the same terms on which it was initially granted. During the course of the hearing before the High Court it was stated by the learned Advocate General appearing for the assessee company that an appeal was in fact filed against the said judgment but the plaintiffs by their application dated 27-7-1979 sought permission of the court to withdraw the suit with liberty to file a fresh suit on the same cause of action, if and when necessary and the trial Judge by order of even date permitted the plaintiffs to withdraw the suit and granted them the liberty sought. While the said suit was pending before the trial court the Gujarat State Electricity Board, in exercise of power conferred on it by Section 6(1) of the Indian Electricity Act, 1910 read with clause (2) of the terms of the licence, sought to exercise its option to purchase the electrical undertaking of the assessee company by issuing a notice dated 8-11-1971. The assessee company filed a writ petition (Special Civil Application No. 1752 of 1972) in the Gujarat High Court challenging the validity of the said notice. During the pendency of the said writ petition the Government of Gujarat issued an order under Rule 115(2) of the Defence of India Rules, 1971 taking over the management of the undertaking of the assessee company with effect from 19-11-1972 and the Collector of Godhra was authorised by the said order to take over the management of the undertaking of the assessee company. The said writ petition was ultimately dismissed by the High Court by its judgment dated 16/17-10-1973. In the appeal filed by the assessee company against the said judgment in this Court an interim order was passed directing the Collector of Godhra to hand over the undertaking to the Gujarat State Electricity Board and in accordance with the said direction the Government of Gujarat

on 20-12-1973 instructed the Collector of Godhra to hand over the management of the undertaking to the Gujarat State Electricity Board which was done on the next day and thereafter the notification issued under Rule 115(2) of the Defence of India Rules, 1971 was cancelled on 4-5-1974.

3. Up to Assessment Year 1963-64 the assessee company was assessed on the basis of the accounts maintained according to the mercantile system. For the subsequent assessment years, i.e., from 1964-65 to 1967-68, the assessee company deducted a total amount of Rs. 10,87,828 from the total earnings in respect of sale of electrical energy on the ground that the said amount was not actually recovered by it from the consumers since the consumers had filed a suit against the assessee company and had obtained interim relief in that behalf. The particulars of the deductions made for the aforesaid four assessment years were as under :

#----------Assessment Year Amount Deducted----------1964-65 Rs. 2,59,7771965-66 Rs. 3,16,9531966-67 Rs. 3,89,7611967-68 Rs. 1,21,337----------##

4. The aforesaid disputed amounts were shown by the assessee company on the liability side in the balance-sheet under the head "Disputed increase in rates charged to customers (consumer), carried forward pending settlement of disputes in the District Court". In the Assessment Year 1968-69 there was an adjustment of the claim amounting to Rs. 3,54,152 due to settlement of dispute with the railway authorities and the disputed balance stood reduced to Rs. 7,33,676. While making the assessment for the Assessment Year 1969-70 the Income Tax Officer included the said amount of Rs. 7,33,676 on the ground that the suit filed against the assessee company by the consumers was decided in favour of the assessee company by this Court during the Accounting Year 1968-69 and the assessee company has the legal right to recover the said amount and on the basis of the accountancy followed by the assessee company the amount of Rs. 7,33,676 will have to be taxed as the income that has accrued to the assessee company on account of the decision of this Court in the Assessment Year 1969-70. The said addition made by the Income Tax Officer was, however, deleted by the Appellate Assistant Commissioner, on appeal, on the view that no legally enforceable claim had accrued to the assessee company during the previous year by which it could recover the arrears of the earlier years for enhanced charges/rates in respect of motive power and electricity for lights and fans from the consumers. The Income Tax Appellate Tribunal (hereinafter referred to as "the Tribunal"), on further appeal, held that the question of fixing a reasonable return was still an open issue since it was a subject-matter of further litigation wherein as a result of the decision of Civil Judge, Junior Division, Godhra the assessee company was restrained from recovering the charges of more than 31 paise per unit for lights and fans and 20 paise per unit for motive power from the customers and that the right to receive the increased rates had not crystallized. According to the Tribunal the claim at the increased rates as made by the assessee company and on the basis of which necessary entries were made in the books, represented only hypothetical income and the impugned amount as brought to tax by the Income Tax Officer did not represent the income which had accrued to the assessee company during the relevant previous year. On an application by the Revenue the Tribunal referred following question of law for the opinion of the Gujarat High Court :

> "Whether the Tribunal was right in law in holding that the amount of Rs. 7,33,676 which had accrued to the assessee during the previous year, and which was brought to tax by the Income Tax Officer did not represent the income and, therefore, could not be included in computation of the total income of the assessee."

5. On the basis of the said reference Income Tax Reference No. 288 of 1975 was registered in the High Court.

6. Similarly in respect of Assessment Years 1970-71 and 1971-72 the Income Tax Officer included the sums of Rs. 2,63,465 and Rs. 2,98,077 respectively as income that had accrued to the assessee company in those years and was taxable. The said addition was deleted by the Appellate Assistant Commissioner on appeal by the assessee company and the said decision was upheld by the Tribunal. On an application moved by the Revenue the following question of law was referred to the High Court for its opinion :

> "Whether, the Tribunal was right in law in holding that the amount of Rs. 2,63,465 for Assessment Year 1970-71 and Rs. 2,98,077 for Assessment Year 1971-72 which had accrued to the assessee during the previous year and which was brought to tax by the Income Tax Officer did not represent the income of the assessee and therefore not liable to be included in computation of the total income of the assessee ?"

7. On the basis of the said reference, Income Tax Reference No. 73 of 1978 was registered in the High Court.

8. For the Assessment Year 1972-73 the Income Tax Officer included a sum of Rs. 3,17,741 as income that had accrued and was taxable in the hands of the assessee company which addition was deleted by the Appellate Assistant Commissioner and the said order of the Appellate Assistant Commissioner was upheld by the Tribunal. The following questions were referred by the Tribunal to the High Court for opinion :

> "1. Whether, the Income Tax Appellate Tribunal was right in holding that the amount of Rs. 3,17,741 which had accrued to the assessee during the previous year, and which was brought to tax by the Income Tax Officer did not represent the income and therefore it could not be included in the computation of the total income of the assessee ?
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> 2. Whether, on the facts and in the circumstances of the case, the receipt of Rs. 3,17,741 could be subjected to tax in the assessment year in question as the income of the assessee ?"

9. On the basis of the said reference, Income Tax Reference No. 171 of 1978 was registered in the High Court.

10. All the three references were disposed of by the High Court by a common judgment dated 24/25-2-1982. The High Court has held that the assessee company was following the mercantile system of accounting and that even under this system in order to visit the assessee company with the obligation to pay tax the profit must become actually due no matter when it is received and that income cannot be said to have accrued to an assessee company if it is based on a mere claim not backed by any legal or contractual right to receive the amount at a subsequent date. The High Court has held that in the mercantile system of accounting it is the real income, as distinguished from a hypothetical income, which can be brought to tax. In view of the decision of the Division Bench of the High Court allowing the letters patent appeals of the assessee company, which judgment was affirmed by this Court on 26-2-1969 [(1969) 1 SCC 781 : (1969) 3 SCR 836], the High Court has held that the assessee company had a legal right to recover the consumption charge at the enhanced rate from the consumers. As regards the letter from the Under Secretary to the Government of

Gujarat, Industries, Mines and Power Department, dated 19-3-1969, the High Court has observed :

> "We do not know if this letter was a directive to the assessee under any provision of law but in any case it was in the form of a suggestion which, if accepted, enured for a period of six months only. Therefore, the contention of the learned Advocate General that income could not be said to have accrued to the assessee in view of this letter, received by the assessee within a few days after the Supreme Court dismissed the appeals filed by the consumers, does not appeal to us. In any case, the request made by the State Government was to maintain the status quo for a period of six months only. That letter did not take away the right of the assessee to recover consumption charges at the enhanced rates from its consumers."

11. As regards the representative suit (Suit No. 118 of 1969) which was filed by the consumers in the Court of Civil Judge (Junior Division) at Godhra, the High Court has observed that "the said suit concerned the recovery of enhanced charges for the period subsequent to 31-3-1969 and not prior thereto". The High Court rejected the contention urged on behalf of the assessee company that no real income had accrued to the assessee company in the facts and circumstances of this case since the assessee company was legally entitled to recover the consumption charges from the consumers at the enhanced rates and at no point of time had the assessee company forgone or given up its right to recover the enhanced rates from its consumers. On that view of the matter, the High Court answered the questions mentioned above against the assessee company and in favour of the Revenue. By order dated 15-1-1983 the High Court granted a certificate of fitness to appeal to this Court against the said judgment. Hence these appeals.

12. Shri S. Ganesh, the learned counsel appearing for the assessee company, has submitted that in the facts and circumstances of this case it must be held that no real income had accrued to the assessee company on account of enhanced charges for electricity since the assessee company was not able to recover the said enhanced charges from the consumers in view of the protracted litigation during the period from 1963 to 1969 and thereafter on account of the letter from the Under Secretary to the Government of Gujarat dated 19-3-1969 asking the assessee company not to charge the enhanced rates for at least six months and the subsequent suit (Suit No. 118 of 1969) filed by the consumers in 1969 and the taking over of the management of the assessee company by the Collector, Godhra in pursuance of the order passed under Rule 115(2) of the Defence of India Rules, 1971. It has been urged that though the assessee company was following the mercantile system of accounting but in the mercantile system also tax can be imposed only if there is real income and income tax cannot be imposed on hypothetical income. The learned counsel has placed reliance on the decisions of this Court in CIT v. Shoorji Vallabhdas and Co. [(1962) 46 ITR 144 (SC)]; CIT v. Birla Gwalior (P) Ltd. [(1974) 3 SCC 196 : 1973 SCC (Tax) 519 : (1973) 89 ITR 266]; Poona Electric Supply Co. Ltd. v. CIT [(1965) 57 ITR 521 : AIR 1966 SC 30]; R.B. Jodha Mal Kuthiala v. CIT [(1971) 3 SCC 369 : (1971) 82 ITR 570] and State Bank of Travancore v. CIT [(1986) 2 SCC 11 : 1986 SCC (Tax) 289 : (1986) 158 ITR 102].

13. Under the Act income charged to tax is the income that is received or is deemed to be received in India in the previous year relevant to the year for which assessment is made or on the income that accrues or arises or is deemed to accrue or arise in India during such year. The computation of such income is to be made in accordance with the method of accounting regularly employed by the assessee. It may be either the cash system where entries are made on the basis of actual receipts and actual outgoings or disbursements or it may be the mercantile system where entries are made on accrual basis, i.e., accrual of the right to receive payment and the accrual of the liability to disburse

or pay. In CIT v. Shoorji Vallabhdas and Co. [(1962) 46 ITR 144 (SC)] it has been laid down : (ITR p. 148)

> "... Income tax is a levy on income. No doubt, 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 or its receipt; but 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."

14. This principle is applicable whether the accounts are maintained on cash system or under the mercantile system. If the accounts are maintained under the mercantile system what has to be seen is whether income can be said to have really accrued to the assessee company. In H.M. Kashiparekh & Co. Ltd. v. CIT [(1960) 39 ITR 706 (Bom)] the Bombay High Court had said :

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

15. The said view was approved by this Court in CIT v. Birla Gwalior (P) Ltd. [(1974) 3 SCC 196 : 1973 SCC (Tax) 519 : (1973) 89 ITR 266] where the assessee maintained its accounts on the mercantile system. In that case this Court, after referring to the decision in Morvi Industries Ltd. v. CIT [(1972) 4 SCC 451 : 1974 SCC (Tax) 140 : (1971) 82 ITR 835], which was also a case where the accounts were maintained on mercantile system, has said : (ITR p. 273 : SCC p. 201, part 12)

> "Hence it is clear that this Court in Morvi Industries case [(1972) 4 SCC 451 : 1974 SCC (Tax) 140 : (1971) 82 ITR 835] 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 got to be taken into consideration but the real accrual of the income."

16. In Poona Electric Supply Co. Ltd. v. CIT [(1965) 57 ITR 521 : AIR 1966 SC 30] this Court has said :

> "... Income tax is a tax on the real income, i.e., the profits arrived at on commercial principles subject to the provisions of the Income Tax Act."

17. In that case the Court has approved the following principle laid down by the Bombay High Court in H.M. Kashiparekh & Co. Ltd. v. CIT [(1960) 39 ITR 706 (Bom)] :

> "The principle of real income is not to be so subordinated as to amount virtually to a 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 than the purely theoretical or doctrinaire aspect of it. 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."

18. In State Bank of Travancore v. CIT [(1986) 2 SCC 11 : 1986 SCC (Tax) 289 : (1986) 158 ITR 102] after considering the various decisions of this Court, Sabyasachi Mukharji, J. (as the learned Chief Justice then was) has said : (ITR p. 154 : SCC pp. 65-66, para 67)

> "An acceptable formula of correlating the notion of real income in conjunction with the method of accounting for the purpose of the computation of income for the purpose of taxation is difficult to evolve. Besides, any strait-jacket formula is bound to create problems in its application to every situation. It must depend upon the facts and circumstances of each case. When and how does an income accrue and what are the consequences that follow from accrual of income are well-settled. The accrual must be real taking into account the actuality of the situation. Whether an accrual has taken place or not must, in appropriate cases, be judged on the principles of real income theory. After accrual, non-charging of tax on the same because of certain conduct on the ipse dixit of a particular assessee cannot be accepted. In determining the question whether it is hypothetical income or whether real income has materialised or not, various factors will have to be taken into account. It would be difficult and improper to extend the concept of real income to all cases depending upon the ipse dixit of the assessee which would then become a value judgment only. What has really accrued to the assessee has to be found out and what has accrued must be considered from the point of view of real income taking the probability or improbability of realisation in a realistic manner and dovetailing of these factors together but once the accrual takes place, on the conduct of the parties subsequent to the year of closing an income which has accrued cannot be made 'no income'."

19. If the matter is examined in the light of the aforementioned principles laid down by this Court, it must be held that even though the assessee company was following the mercantile system of accounting and had made entries in the books regarding enhanced charges for the supply made to the consumers, no real income had accrued to the assessee company in respect of those enhanced charges in view of the fact that soon after the assessee company decided to enhance the rates in 1963 representative suits (Civil Suits Nos. 152 of 1963 and 50 of 1964) were filed by the consumers which were decreed by the trial court and which decree was affirmed by the appellate court and the learned Single Judge of the High Court and it is only on 3-12-1968 that the letters patent appeals filed by the assessee company were allowed by the Division Bench of the High Court and the said suits were dismissed. But appeals were filed against the said judgment by the consumers in this Court and the same were dismissed by the judgment of this Court dated 26-2-1969 [(1969) 1 SCC 781 : (1969) SCR 836]. Shortly thereafter, on 19-3-1969, the Under Secretary to the Government of Gujarat wrote a letter advising the assessee company to maintain status quo for the rates to the consumers for at least six months and the Chief Electrical Inspector was directed to go through the accounts of the assessee company from year to year and to report to the Government about the actual position about the reasonable returns earned by the assessee company. On 16-5-1969 another representative suit (Suit No. 118 of 1969) was filed by the consumers wherein interim injunction was granted by the Court and which was finally decreed in favour of the consumers on 23-6-1974. It would thus appear that after the decision was taken by the assessee company to enhance the charges it was not able to realise the enhanced charges on account of pendency of the earlier representative suits of the consumers followed by the letter of the Under Secretary to the Government of Gujarat and the subsequent suit of the consumers and during the pendency of the subsequent suit the

management of the undertaking of the assessee company was taken over by the Government of Gujarat under the Defence of India Rules, 1971 and the undertaking was subsequently transferred to the Gujarat State Electricity Board.

20. It is no doubt true that the letter addressed by the Under Secretary to the Government of Gujarat to the assessee company had no legally binding effect but one has to look at things from the practical point of view. (See : R.B. Jodha Mal Kuthiala v. CIT [(1971) 3 SCC 369 : (1971) 82 ITR 570].) The assessee company, being a licensee, could not ignore the direction of the State Government which was couched in the form of an advice, whereby the assessee company was asked to maintain status quo for at least six months and not to take steps to recover the dues towards enhanced charges from the consumers during this period. Before the expiry of the period of six months the subsequent suit had been filed by the consumers and during the pendency of the said suit the undertaking of the assessee company was taken over by the Government of Gujarat under the Defence of India Rules, 1971 and subsequently it was transferred to the Gujarat State Electricity Board and, as a result, the assessee company was not in a position to take steps to recover the enhanced charges.

21. The High Court has observed that the subsequent suit that was filed on 16-5-1969 related to recovery of enhanced charges for the period subsequent to 31-3-1969 and not prior thereto. We have, however, perused the judgment of the Joint Judge (Junior Division), Godhra dated 20-6-1974 in the said suit which was annexed as Annexure 'D' to the statement of the case. The said judgment does not show that the suit was confined to the period subsequent to 31-3-1969. On the other hand, it shows that the plaintiffs in that suit were challenging the enhancement in charges made in 1963 and had sought a declaration that the assessee company was not entitled to recover more than 31 paise per unit for light and fans and 20 paise per unit for motive power and the trial court, while decreeing the said suit had : given a declaration in these terms. The said declaration is not confined to the period subsequent to 31-3-1969.

22. The question whether there was real accrual of income to the assessee company in respect of the enhanced charges for supply of electricity has to be considered by taking the probability or improbability of realisation in a realistic manner. If the matter is considered in this light, it is not possible to hold that there was real accrual of income to the assessee company in respect of the enhanced charges for supply of electricity which were added by the Income Tax Officer while passing the assessment orders in respect of the assessment years under consideration. The Appellate Assistant Commissioner was right in deleting the said addition made by the Income Tax Officer and the Tribunal had rightly held that the claim at the increased rates as made by the assessee company on the basis of which necessary entries were made represented only hypothetical income and the impugned amounts as brought to tax by the Income Tax Officer did not represent the income which had really accrued to the assessee company during the relevant previous years. The High Court, in our opinion, was in error in upsetting the said view of the Tribunal.

23. In the result, the appeals are allowed, the impugned judgment of the High Court is set aside and the questions referred by the Tribunal for opinion are answered in favour of the assessee company and against the Revenue. But in the circumstances, there will be no order as to costs.