

# **BOMBAY HIGH COURT**

Mohsin Rehman Penkar

Vs

Commissioner of Income-Tax

(Chagla, C.J.)

17.03.1948

## **JUDGMENT**

### **Chagla, C.J.**

1. The assessee is a business man having many activities. He used to borrow moneys from one Dharkar and in 1932 he mortgaged certain properties to Dharkar to secure payment of Rs. 17,500 found to be due and owing to Dharkar. The assessee keeps his accounts on accrual basis and in the returns submitted by him from 1932 onwards he claimed, as a permissible deduction, interest which was payable by him on this sum of Rs. 17,500 and those deductions were allowed to him by the department. Up to the year of account with which we are concerned, viz., S. Y. 1999 (30th of October, 1943, to 17th of October, 1944), about fifteen thousand rupees had been claimed by the assessee as deductions for interest and allowed to him. The total amount due to Dharkar on the foot of the mortgage was found to be Rs. 29,059-6-6 in the accounting year. On the 24th of June, 1944, the assessee paid a sum of Rs. 15,000 to Dharkar and Dharkar accepted that amount in full settlement of his claim against the assessee. In other words Dharkar remitted the balance of Rs. 14,059-6-6 and gave up his claim for that amount. The Income-tax authorities have taken a view that this sum of Rs. 14,059-6-6 is income for which the assessee is liable to pay tax. The argument advanced before us by the Advocate-General is that inasmuch as the assessee had adopted the mercantile basis and he has been given deductions on the basis of what he was liable to pay and not on the basis of what he has actually paid, if in fact it is found that in respect of a certain amount, for which there was a liability on the assessee, that liability is discharged and the amount is not claimed from the assessee, then to that extent the discharge of the liability must be looked upon as a revenue receipt and income on which the assessee must be taxed. In our opinion that is a wholly fallacious argument. Once the Income-tax department accepts the mercantile system of accounts keeping and taxes an assessee on the accrual and not on the payment basis the department is not concerned as to how the liability incurred by the assessee is in fact discharged. He may discharge that liability by actual payment or he may discharge it by

getting a remission from his creditor. But that is a question entirely for the debtor to determine. It is impossible to see how a mere remission which leads to the discharge of the liability of the debtor can ever become income for the purposes of taxation. The House of Lords had to consider a case which is almost similar to the one which we have before us. That case is *In Re British Mexican Petroleum Co.* There the appellant company entered into a contract with an oil producing company for the purchase of petroleum for a minimum period of twenty years. The appellant company came into difficulties and the accounts of the company's business were made up for the year ended the 30th of June, 1921, and for eighteen months ended the 31st of December 1922. On the 30th of June, 1921, the amount which the appellant company owed to the oil producing company was Pound 1,073,281 and on the 31st of December, 1922, Pound 1,270,232. The appellant company paid to the oil producing company Pound 325,000 and was released by the oil producing company from its liability to pay the balance, viz., Pound 945,232. The amount so released was carried direct to the appellant company's balance-sheet and was shown as a separate item under the head "Reserve" on the 31st of December, 1922. The contention of the Crown was that the amount released should be brought into account in computing the appellant company's profits for the purposes of income-tax either in the account for eighteen months up to the 31st of December 1922, or alternatively for the year ending 30th of June, 1921, that account being reopened for that purpose. Both those contentions were rejected by the Court. The House of Lords took the view that the account having been once settled as on the 30th of June, 1921, and the liability of the appellant company fixed, that could not be re-opened merely because a creditor had remitted a part of the debt. With regard to the other contention that the remission should be looked upon as a trading receipt Lord Thankerton at p. 592 stated as follows :-

"The appellants alternative contention which was not seriously pressed by the Attorney-General, is equally unsound, in my opinion. I am unable to see how a release from a liability, which liability has been finally dealt with in the preceding account, can form a trading receipt in the account for the year in which it is granted." Lord Macmillan at p. 593 is equally emphatic as to what he thought about it. This is what the learned Law Lord says :-"I say so for the short and simple reason that the appellant company did not, in those eighteen months, either receive payment of that sum or acquire any right to receive payment of it. I cannot see how the extent to which a debt is forgiven can become a credit item in the trading account, for the period within which the concession is made."

These remarks of the learned Law Lords apply in their entirety to the facts of this case. Here too the real attempt on the part of the department is to re-open assessment of the assessee for the earlier years. What they are really challenging is that the deductions allowed to the assessee in the previous years in respect of interest which he to the assessee in the previous years in respect of interest which he was liable to pay was not a proper deduction allowed to him. That attempt on the part of the department cannot be allowed to succeed. We therefore answer the question

submitted to us in the negative. The Commissioner must pay the costs of this reference.

Reference answered in the negative.

