BOMBAY HIGH COURT

Keshav Mills Co. Ltd

Vs.

Commissioner of Income-tax

Income-tax Reference No. 2 of 1949

(Chagla, C.J. and Tendolkar, J.)

15.09.1949. 14.09.1949

JUDGMENT

Chagla, C.J.

1. The assesses company is a company registered in the Baroda State and the assessment year of this reference is 1942-43 (calendar year 1941). This company is a non-resident company. It manufactures textile goods, and after the goods are manufactured, they are sold by the company ex-mills. The company has their guaranteed brokers Messrs. Jagmohandas Ramanlal and Co., and they guarantee the payment by the merchants to the company and they receive a commission for the work which they do. The contention of the company was that the company being a non-resident company it was not liable to pay any tax on its profits or income as none of the profits made by the company had teen received in British India. In order to decide this question we have to consider separately three items which are the subject-matter of this reference, viz., (1) an item of Rs. 12,68,480, (2) an item of Rs. 4,40,878 and (3) an item of Rs. 6,71,735. Now, with regard to the first item of Rs. 12,69,480 the company debited in their boobs of account a sum of Rs. 13,41,744 to Messrs. Jagmohandas Ramanlal and Co. and credited it to the sales accounts, thereby representing that the goods covered by this amount had been sold by the company for this sum. I may mention that the company maintains its accounts on a mercantile basis and not on cash basis. Messrs. Jagmohandas Ramanlal and Co. realized from various merchants from Ahmadabad to whom goods had been sold the sum of Rs. 12,68,480 and they utilised that sum is paying off various creditors of the company at Ahmadabad. On these facts there can be no doubt that the sum of Rs. 12,68,480 was received by the assessee company in Ahmadabad. A contention was put forward by the assessee company that the company was not concerned with payments made by the merchants in Ahmadabad and that they were only concerned with Messrs. Jagmohandas Ramanlal and Co., being their guaranteed brokers. It was argued that the sum of Rs. 13,41,744 was debited to Messrs. Jagmohandas Ramanlal and Co. and the company only looked to Jagmohandas Ramanlal and Co. for the payment. It must not be forgotten that Messrs. Jagmohandas Ramanlal and Co. were merely guaranteed brokers. The primary liability to pay for the goods was upon the merchants to whom they were sold by the company. Messrs. Jagmohandas Ramanlal and Co. were mere guarantors and their guaranteeing the payment by the merchants did not in any way affect the primary liability of the merchants to pay the company.

Therefore, when the merchants paid to Messrs. Jagmohandas Ramanlal and Co. they were discharging their primary liability to the company, and Messrs. Jagmohandas Ramanlal and Co. having made use of this sum of Rs. 12,68,480 according to the instructions of the company, they in law did receive this sum on behalf of their principals, the assessee company.

2. But an important contention has been raised by Mr. Kolah on behalf of the assessee company, viz., that the receipt of Rs. 12,68,480 by Messrs. Jagmohandas Ramanlal and Co. was not a receipt of the sale proceeds of the goods sold by the company but was merely realization of the debt due by the merchants to the company. This argument is based on the fact that the company maintains its accounts on the mercantile basis and not on cash basis. It is urged that under the mercantile basis the actual receipt of money is irrelevant and has not got to be considered. Under the mercantile basis the company debits and credits various sums of money either as they become liable to pay money or become entitled to receive money and under the mercantile basis profits accrue to the company when the necessary entries are made in the books of accounts. The actual receipt of cash is irrelevant for the determination of the profits earned by a company. In contradistinction under the cash basis the amount received or expended is the basis for the determination of income and profits to the assesses who maintains accounts in that form. It is perfectly true that when the company made the entry of Rs. 13,41,714 in its books of account, as the system of accounting was mercantile basis, it must be deemed that at that date and at that time profits accrued or arose to the company and these profits accrued or arose to the company at Baroda, where the entry was made. But as the company is a non-resident company, mere accrual of income or profits or the mere fact that profits or income arose to the company in Baroda would not entitle the taxing authorities to tax any of the profits of the assessee company. It must he shown that these profits were received or deemed to be received in British India in the year of assessment in order that they can be taxed. Now, in my opinion, there is a clear distinction between the accrual or arising of an income and the actual receipt of an income and there is also a clear distinction between the notional accrual or arising of an income and a notional receipt of an income. In this case we are not concerned with whether the income or profits accrued or arose in British India, because as I stated before, we are not dealing with an assessee resident in British India. What we are concerned with is whether in this case a non-resident assessee received any income or profits in British India in the year of assessment.

3. Mr. Kolah contends that once the income accrues of arises in Baroda, it can never be received in British India. I cannot accept that contention as correct. Accrual or arising of an income has nothing whatever to do with the actual receipt of a particular income. Income may accrue or arise in a particular place and it may be received in an entirely different place. Mr. Kolah was therefore forced to contend that when an assessee maintains his accounts on it mercantile basis his profits and income do not merely accrue or arise to him when he makes the necessary entries in the books of account, but they must be deemed to accrue, arise and be received when he makes the entries. Therefore his contention is that in this particular case the proceeds of Rs. 13,41,744 should be deemed to have been received in Baroda and not merely to have accrued or arisen in Baroda. That contention again is not sound, because the Legislature has in the Income-tax Act drawn a clear distinction between accrual or arising of income and the receipt of income, and I see no reason why when accounts are kept on mercantile basis it must be held that income does not merely accrue or arise when the necessary entries are made in the books of account but it must be held that the income is actually received or deemed to be received by the assessee. In support of his contention Mr. Kolah has relied on certain authorities. In my opinion these

authorities do not bear out the submissions made by Mr. Kolah. The first case on which Mr. Kolah relies is *Commissioner of Income-tax, Bombay v. Ahmadabad Advance Mills Ltd*[1]*.,* In that case what was held was that if an income which had accrued outside British India was capitalised and was brought into British India in the shape of capital and not in the shape of income, then that amount could not be taxed as income under the Income-tax Act. This case would only have application if Mr. Kolah can satisfy us that the profits which accrued in Baroda in the books of account of the assessee changed their shape and form and were received in British India when Rs. 12,68 480 were received by the guaranteed brokers not as income or profits but as something else which was not liable to tax.

4. But on the facts found in this case it is clear that what the guaranteed brokers collected from the merchants at Ahmadabad was nothing else than the sale proceeds payable to the assessee company and what they were paying were the bills for the goods received by them and which were issued by the assessee company.

5. Mr. Kolah then relied on a Full Bench decision of the Allahabad High Court, *Commissioner of Income-tax v. Shingari Bai*[2] This was really a converse case from the case which we are considering. There the assessee who had chosen the mercantile basis for keeping accounts contended that she was not liable to pay tax on certain amounts which had not in fact been received by her. In the judgment of the learned Chief Justice the distinction between receipt and accrual is clearly illustrated, This is what the Chief Justice says (p. 585) :

> ".. Where the assessee has himself chosen a mercantile basis, then the Income-tax Officer is bound to concede that basis to the assessee, provided the assessee's accounts regularly kept on that basis, afford a proper and sufficient means of deducing what the profits or gains on that basis have been. In such a case the Income-tax officer has no option but to do what he has done in the present case, that is to say, to take the assessee's own method of accounting and to compute-from it what profits or gains had 'arisen' or 'accrued' to (not merely been 'received' by) the assessee according to it."

6. The nest case on which Mr. Kolah has relied is *Kamalnam Hamir Singh v. Commissioner of Income-tax*[3]*,* There the Court was dealing with the case of a resident assessee and what they held was that the particular two sums with which they were concerned did not actually arise or accrue in British India and were not physically transferred to or received in British India but such profits however were deemed to have arisen or accrued in British India or to have been received in British India. Mr. Kolah relies on the expression used in this case where the Court has grouped together "arising or accruing of income" with "receiving of income." In this case also the assessee maintained a mercantile system of accounts and therefore Mr. Kolah argues that when that system is adopted the income does not merely arise or accrue but must be deemed to be received in British India. Now, all that the judgment states is that the income falls under a particular

[1]42 Bom LR 318 : AIR 1940 PC 36 [3]1938-6 ITR 675 : AIR 1939 All7
[2]ILR (1945) All 577 : AIR 1945 All 102

category and the Court was not concerned to decide whether in fact it accrued or arose in British India or it was received in British India. As the assessee was a resident and not a non-resident, the accrual or arising of income in British India would have been sufficient, and therefore the

question whether the income was actually received in British India did not arise for determination at all. I do not look upon this case as a decision that when a mercantile system of accounting is adopted the income shown in the books of the assesses must be deemed not only to accrue or arise but also deemed to be received although in fact the income is received at a different time and at a different place.

7. The next case relied on by Mr. Kolah is *Lakshmanan Chettiar v. Commissioner of Income-tax, Madras*[4], That case dealt with a particular type of loans known as tawanai loans and the learned Judges of the Madras High Court were at pains to point out the distinguishing feature of the loans advanced under that particular system, and the distinguishing feature was that if the interest on the loan was not received it was added on to the principal and a receipt was actually issued as if the interest bad been received on that date. The Court there was considering the question of a sum of Rs. 5,578 and the contention of the assessee was that the interest on sums lent to persona in Ceylon and Straits Settlement accrued and arose outside British India and could not be taxed as income unless and until it was actually received in British India. The sum of Rs. 5,578 represented the interest on the loans lent and advanced to persons in Ceylon and the Straits Settlement. Under the old law if profits or income accrued outside British India, unless they were received in or brought into British India they were not taxable, and therefore the Court had to consider whether they were received in British India, and the Court came to that conclusion on the special facts of the case having considered the unusual characteristics of tawanai loans. Therefore, I do not read this decision to lay down that when income or profits have accrued in a particular place, they should be deemed to have been received in that place. As a matter of fact this case has made a distinction between the accrual of income or profits at a particular place and the receipt of that income at a different place, because although the income had accrued in Ceylon and the Straits Settlement as the income was received in British India the Court held that the sum of Rs. 5,578 was liable to tax.

8. The nest case relied on by Mr. Kolah was *Subramaniam Chettiar v. Commissioner of Income-tax*[5], There two questions were submitted for the opinion of the Court and they were (p. 368 :

> "(1) In the circumstances of this case can the interest on the loans or advances made by the assesses to the partnership firm at Penang be said to be income accruing or arising in British India within the meaning of Section 4(1), Income-tax Act ?
> (2) If the answer to the above question is in the negative and if the income is one accruing or arising without British India to a person resident in British India is the income one received in British India an as to make it taxable under Section 4 read with Sections 6, 10 and 13 of the Act ?"

On the facts of the case the Court held that the income arose in British India and therefore

[4]3 ITC 421 : (AIR 1929 Mad 675 SB)
[5]2 ITR 365 : AIR 1927 Mad 841 FB)

the question whether each income was received in British India so as to be taxable under the Act did not arise.

9. The assesses there kept his books of account on mercantile basis and credit entries used to be made on account of interest due by debtors in foreign places and the Court expressed its opinion

that the assessee treated the interest as paid when the entries were made though the interest was not actually received and therefore the question whether payment had actually been received or not was immaterial and profits and income must be deemed to accrue or arise when the entries were made by the assessee. This decision merely supports Mr. Kolah's contention that the sale proceeds must be deemed to accrue or arise in Baroda when the entries were made by the assessee company, which maintains its books on the mercantile basis, but this case does not support his contention that the sale proceeds were received or must be deemed to have been received in Baroda merely because the entries with regard to them were made in the books of account of the assesses company. Therefore, in my opinion, it is not a correct proposition in law to lay down that when profits or income accrue or arise at a certain place it must be deemed to have been received at that place.

10. I cannot accept Mr. Kolah's contention that what was received in British India was a debt due to the assessee by the merchants. The true characteristic of the payments made was not a debt but sale proceeds which although they bad accrued and arisen had not yet been paid. Mr. Kolah has alternatively contended that the sale proceeds must be deemed to have been received in Baroda when the entries were made, and when payments were actually made they must be deemed to be a second receipt of the sale proceeds. The contention is entirely untenable and its refutation is to be found on the face of the contention. As I have held that the sale proceeds cannot be deemed to have been received at Baroda the rather curious proposition advanced that the sale proceeds should be deemed to be received a second time in British India does not arise for determination.

11. It cannot be disputed that we came to the conclusion that Rs. 12,68,480 were received in British India, then this sum will include the profits and gains of the business of the assessee company. As to what is the proportion that the profits bear to the total sale proceeds is a matter of calculation which will have to be done by the Department.

12. Turning now to the second item of Rs. 4,40,878, the same contention has been put forward by Mr. Kolah with regard to this item as was put forward with regard to the item of Rs. 12,68,480. But with regard to the receipt the facts are much stronger with regard to this item because the position is that the assessee company sent goods to British India and they drew hundis on the merchants who got delivery of the railway receipts representing the goods only on their discharging these hundis. Mr. Kolah has contended that when the hundis were honoured by the merchants they were really discharging their debts on the hundis and not pacing for the goods. That contention is untenable because it is clear on the facts that the merchants would not be entitled to get possession of the goods unless and until they had honoured the hundis. The terms of the business were that the merchants can only get the railway receipts on their honouring the hundis which were drawn against the goods. Therefore there cannot be any doubt that the sum of Rs. 4 40,878 was received in British India and the assessee company is liable in respect of this amount.

13. The third item is for Rs. 6,71,735 which represents the cheques on British Indian banks and hundis on British Indian shroffs and merchants received by the assesses company in British India in respect of the goods sold by them. Now, the Tribunal has held that the cheques and hundis represented the payment for the goods sold, and as the payments were made and received in the Baroda State, the assessee company is not liable in respect of this amount. This view can only be justified on the assumption that the sending by the merchants of cheques or hundis resulted in an unconditional discharge of their liability in respect of the goods sold to them. Now, I should have

thought that ordinarily the payment of a debt by a cheque never results is the discharge of the debt. The cheque merely represents an order by the drawer of the cheque to his banker to pay the amount to the person named in the cheque, and till that payment is made, the debt is not discharged. Therefore, the sending of the cheque, as I said before, ordinarily is not an unconditional discharge of the liability. The same would be the position with regard to the hundis. But I can well imagine a case where there may been arrangement between a creditor and a debtor that the receipt of a cheque or a hundi by a creditor may result in an unconditional discharge of the debt, and in the event of the cheque or the hundi not being honoured the creditor would have no right to sue on the original cause of action but only on the cheque or the hundi. That would be a pure question of fact. The Privy Council has taken the same view of the law as is to be found in *Commissioner of Income-tax, B. and O. v. Rameshwar Singh*[6], There a debtor owed the assesses Rs. 32 lacs odd principal and Rs. 6 lacs odd as interest in respect of an unsecured loan. In discharge of that liability the assessee took over assets worth Rs. 20 lacs and baud notes for Rs. 17 lacs odd. The question then arose whether the execution of hand notes of Rs. 17 lacs had been a payment and therefore liable to tax. The Assistant Commissioner held that they were not and this is what their Lordships of the Privy Council said (p. 741) :

> "A debtor who gives his creditor a promissory note for the sum he owes can in no sense be said to pay his creditor; but merely gives him a document or voucher of debt possessing certain legal attributes. So far then as this item of Rs. 17,34,596 is concerned, the assesses did not receive payment of any taxable income from his debtor or indeed any payment at all."

14. Therefore, before we can express an opinion as to the correctness of the decision of the Tribunal we should like to have further facts found by the Tribunal, and what we direct is that the Tribunal should submit a supplement, any statement of case and state therein as to whether there was any arrangement or agreement between the assessee and the merchants that the giving of cheques or hundis by the merchants to the assessee would result in an unconditional discharge of the liability of the merchants. There is also another point on which we would like to have supplemental facts from the Tribunal. In one part of their statement of the case the Tribunal states that the cheques and hundis were collected by the bankers and shroffs while in another part of the statement of the case the Tribunal states that the cheques were negotiated in Petlad and sent bank for credit to its accounts with those banks and shroffs. Now, it is not clear to us what exactly is the finding of fact by the Tribunal. If a cheque is received by a creditor on a British Indian bank and the creditor is outside British India he gives the cheque to his bank and asks the bank to collect the cheque foe him. Then the bank acts as his collecting agent and the money is received by the creditor when the same is collected by the bank. So in this case if the facts

[6]35 Bom LR 731 : (AIR 1933 PC 103)

are that the assessee handed over the cheques and hundis for collection to the banks and shroffs and the banks and the shroffs acted merely as collecting agents and realised the cheques and hundis from the banks or shroffs in British India, then the payment is in British India and not in the Baroda State. On the other hand, if the creditor treated the cheques and hundis as negotiable instruments and cashed them as such with the banks or shroffs, then the payment was received by the assessee is the Baroda State, they having negotiated the cheques and hundis. This again is question of fact, and in order to determine whether the sum of Rs. 6,71,735 was received in the Baroda State or in British India we should like to know from the Tribunal as to the circumstances

under which the cheques and hundis came to be cashed. Therefore when they submit to us the further statement of the case they should also find as to the procedure followed by the banks and shroffs and the assessee so that we should be in a position to know whether these cheques and hundis were given to the shroffs and the banks merely for collection or whether they were cashed with them. Mr. Kolah also stated to us that in some cases the assessee endorsed the cheques and hundis in favour of someone in Baroda. If that be so, the Tribunal will also find whether the endorsee was a holder for value of these cheques or hundis or whether he was merely an agent for collection of the assessee.

15. With regard to the question submitted to us with regard to the items of Rs. 12,68,480 and Rs. 4,40,878 the questions framed by the Tribunal with respect to them are cot properly framed. The real and only questions that we have to consider are whether these two items represent sale proceeds of debts, and further if they were sale proceeds they were received in British India. We therefore frame the questions in the following terms :

> (1) Whether the sums of Rs. 12,68,480 and Rs. 4,40,878 were sale proceeds of the goods sold by the assessees to merchants in British India or were debts due by the said merchants ? and we answer that they were sale proceeds.
> (2) Whether if they were sale proceeds, they were received in British India ? and we answer that they were received in British India.

16. As the third question has also been submitted to us by the Tribunal although we feel that the answer is consequential upon our answers to the first two questions, we may formally answer the question which we frame as follows : Whether the profits of the assesses's business are included in the sums of Rs. 12,68,480 and Rs. 4,40,878 ? and we answer that they are included in these two sums.

17. As the assesses has failed in respect of two out of three items, the order of costs that we make is that the assessee should pay two-thirds of the respondent's costs. With regard to the coats of the third item we reserve the costs pending the receipt of the supplemental statement of the case.

18. There is a notice of motion taken out by the assessee asking us to call upon the Tribunal to raise certain further questions. The only question that Mr. Kolah has pressed for is that assuming that by receipt of the said sums any income was received in British India, whether the method of computation of the income adopted for the assessment is a correct method to ascertain the extent thereof. Now this point was never urged or argued before the Tribunal and the Tribunal has not dealt with it in as order. It is true that the Assistant Appellate Commissioner finds in favour of the assessee with regard to the item of Rs. 12,68,480 and the sum of Rs. 6,71,735 but he has found against the assessee with regard to the item of Rs. 4,40,878. Therefore it was open to the assessee to have raised this point at least with regard to the item of Rs. 4,40,878. They did not do so and did not challenge the mode of computation. In our opinion the Tribunal was right in refusing to refer the questions to us. Mr. Kolah contends that the question of law is apparent on the order itself and that it also arises from the facts stated by the Tribunal, but in our opinion there is no suggestion as to this point of law either in the order of the Tribunal or in the statement of the case submitted by the Tribunal to us. We therefore decline to direct the Tribunal to raise this question. The result is that the notice of motion fails. As some of the questions suggested really elucidated

the matter and as we have ourselves taken a view that the questions were not properly framed by the Tribunal and had to frame the questions our-selves, we think that a fair order for costs will be that there should be no order as to the costs of the motion.
Answers accordingly.