

# **BOMBAY HIGH COURT**

Commissioner of Income-Tax

Vs

Babulal Narottamdas

(V Tulzapurkar, C.J. R Kantawala, J.)

09.07.1975

## **JUDGMENT**

### **Kantawala, C.J.**

1. At the instance of the revenue under section 66(1) of the Indian Income-tax Act, 1922, the following question is referred to us for our determination :

"Whether, on the facts and in the circumstances of the case, the sum of Rs. 58,125 was properly held by the Tribunal to have accrued to Shri Narottamdas Jethalal only in November, 1955, when the High Court's judgment was pronounced ?"

2. The question had reference to assessment years 1950-51 to 1953-54, the relevant accounting years being calendar years 1949 to 1952. On January 4, 1928, a limited company called Chandulal & Co. Ltd. (hereinafter referred to as "the company") was incorporated with the object of promoting another company called Bhalakai Mills Co. Ltd. (hereinafter referred to as "the mills"). The company was to act as secretaries, treasurers and agents of the mills. The mills was also incorporated on January 4, 1928. The capital of the company was Rs. 640 divided into 128 shares of Rs. 5 each. Out of these 128 shares, 72 shares were allotted to Chandulal. Chandulal and his nominees had an interest of 9 annas in a rupee in the shareholding of the company. The rest of the shares in this company were held by the other shareholders of the mills. The company was appointed as the secretaries, treasurers and agents of the mills for a period of 60 years. The management of the company was vested in Chandulal. Chandulal resigned on June 6, 1931, and was succeeded as the managing agent by Jethalal Bhalakai in the year 1932. Both Chandulal till his resignation and Jethalal subsequent to his assuming office as managing agent of the company were managing the company and also the mills. After Jethalal came on the scene, clause 15 of the memorandum of association of the company was amended so as to provide for his appointment as the managing agent of the company to manage it solely and exclusively. On February 24, 1932, an agreement was entered into between the company and Jethalal whereby

the terms of appointment of Jethalal under clause 15 of the memorandum were fixed. Jethalal continued to work as the managing agent till his death on November 12, 1937. His place was thereafter taken by Narottamdas Jethalal thereafter managed the company and the mills, as was done by his predecessors. On June 21, 1949, a notice convening the annual general meeting was to be held on July 18, 1949, and one of the items of business on the agenda was "regarding payment of special additional remuneration to company's agent Narottamdas Jethalal". Some of the shareholders of the company objected to the inclusion of this item in the agenda. The company, however, replied to such objection of the shareholders by asserting that the inclusion of the item in the agenda was proper. Later on, on July 16, 1949, the shareholders of the company filed a representative suit in the court of the Third Joint Civil Judge, Ahmedabad, for a give or pay any remuneration to Narottamdas Jethalal and for a permanent injunction restraining the company from paying or giving any remuneration to the said managing agent. After the suit was filed a temporary injunction was issued which was vacated on July 20, 1949. On the same day the annual general meeting of the company was held when, inter alia, a resolution for payment of extra remuneration to Narottamdas Jethalal was passed. Under this resolution a sum of Rs. 15,000 per year was to be paid Narottamdas Jethalal as additional special remuneration for performing the duties as the managing agent from January 1, 1949. The additional remuneration of Rs. 15,000 per year was to be curtailed if the commission income of the company was below Rs. 1,50,000 as provided in this resolution. After this resolution was passed the shareholders amended the plaint on September 26, 1949, by introducing a prayer for injunction restraining the company from paying additional remuneration to Narottamdas Jethalal. The suit was ultimately decided by the trial court on October 31, 1950. The learned judge, inter alia, held that the resolution sanctioning additional remuneration to be paid to Narottamdas was illegal and granted an injunction restraining the company from paying the said amount to Narottamdas. An appeal being first Appeal No. 134 of 1951 was preferred against the decision of the trial court, which was disposed of by the Bombay High Court by its judgment dated November 25, 1955. The Division Bench of this court set aside the decree that was passed by the trial court and dismissed the suit. In the meanwhile, while this appeal was pending Narottamdas died on November 16, 1952. In accordance with the resolution that was passed by the annual general meeting in July, 1949, a sum of Rs. 15,000 per annum was payable to Narottamdas. This amount of Rs. 15,000 was brought to tax for each of the years 1950-51, 1951-52 and 1952-53. For the assessment year 1953-54 the proportionate sum of Rs. 15,000 up to the date of death of Narottamdas was brought to tax. The company debited the sum of Rs. 15,000 in the profit and loss account prepared by it on June 22, 1950, for the year ended December 31, 1949. In view of the trial court's judgment for the subsequent years the sum of Rs. 15,000 due under the resolution to Narottamdas was shown as contingent liability in the profit and loss account.

3. Before the Income-tax Officer it was contended on behalf of the assessee by his legal heirs that

the remuneration at the rate of Rs. 15,000 per annum arising under the resolution of the company fell under the head "income from other sources" and that should not be treated as income liable to be taxed under section 7 as and when it becomes due. Such a contention of the assessee was rejected by the Income-tax Officer and for each of the three years 1950-51 to 1952-53 the sum of Rs. 15,000 was brought to tax and for the year 1953-54 the proportionate amount was brought to tax. An appeal Assistant Commissioner. On a second appeal to the Tribunal the Tribunal held that there was no relationship of master and servant between Narottamdas and the company and that the provisions of section 7 could not apply to any remuneration paid to him. The Tribunal also held that the amount accrued to Narottamdas only in November, 1955, when the High Court pronounced its judgment and till that date the amount could not be said to have accrued to him. It is from this decision of the Tribunal that the revenue had asked for a reference for determination of the question mentioned above.

4. Mr. Joshi, on behalf of the revenue, contended that in view of the resolution passed by the annual general meeting of the company income of Rs. 15,000 accrued to Narottamdas in each year; that such accrual of income was not postponed simply because a suit was filed by the shareholders to challenge the validity of the resolution passed by the company. He submitted that, ultimately, when the suit was dismissed by the High Court in appeal no new right was created in Narottamdas but only a pre-existing right was merely declared; that the decision of the High Court, according to his submission, does not create a new right in Narottamdas or a fresh liability in the company, but such right and liability existed in view of the resolution passed by the annual general meeting of the company and the Income-tax Officer and the Appellate Assistant Commissioner were, therefore, right in taking the view that the sum of Rs. 15,000 accrued to Narottamdas during the first three years and the proportionate amount during the fourth year till the date of his death. Further, he submitted that the fact that this amount accrued to Narottamdas as aforesaid is strengthened by the fact that after the appeal was decided by the High Court and the suit was dismissed the heirs of Narottamdas, in view of his death, in the meanwhile, have been paid not only the amount as per the resolution but also the amount of interest thereon. He submitted that such interest can never be claimed by the legal heirs unless a right had accrued to Narottamdas to receive the amount. He pointed out that if the date of accrual of income for all these years was to be postponed till November 25, 1955, when the appeal was disposed of by the High Court, then it will mean that the income accrued to Narottamdas even after his death, he having died on November 16, 1952. On the other hand, Mr. Trivedi, on behalf of the legal heirs of Narottamdas, has contended that simply because the resolution was passed by the company at its annual general meeting, it cannot be said that income accrued to Narottamdas from year to year as contended by the revenue. His submission was that in view of a representative suit instituted by the shareholders an obstacle or hurdle was created on the right of Narottamdas to claim the amount and until such hurdle or obstacle was removed by a final decision of the High

Court it cannot be said that income accrued to Narottamdas from year to year.

5. Under the Income-tax Act, income is taxable when it accrues, arises or is received, or when it is by fiction deemed to accrue, arise or is deemed to be received. Receipt is not the only test of chargeability to tax; if income accrues or arises it may become liable to tax. Income is said to be received when it reaches the assessee : when the right to receive the income becomes vested in the assessee, it is said to accrue or arise. *See Commissioner of Income-tax v. Ashokbhai Chimanbhai*, at pages 45-46. It is equally well settled that income may accrue to the assessee without the actual receipt of the same. If the assessee acquires a right to receive income the income can be said to have accrued to him, though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him. *See E. D.Sassoon & Co. Ltd. v. Commissioner of Income-tax, at page 51.*

6. It is common ground that the assessee, Narottamdas, was maintaining his accounts on mercantile system. The difference between the mercantile system of accounting and the cash system of book-keeping is clearly pointed out by the Supreme Court in *Morvi Industries Ltd. v. Commissioner of Income-tax*. The mercantile system of accounting differs substantially from the cash system of book-keeping. Under the cash system, it is only actual cash receipt and actual cash payments that are recorded as credits and debits; whereas, under the mercantile system, credit entries are made in respect of amounts due immediately they become legally due and before they are actually received. Similarly, the expenditure items for which legal liability has been incurred disbursed. Where accounts are the mercantile basis, the profits or gains are credited though they are not actually realised, and the entries thus made really show nothing more than an accrual or arising of the said profits or the material time. On July 20, 1949, the company at his annual general special remuneration to give a sum of Rs. 15,000 per year as additional special remuneration to Narottamdas for performing the duties as managing agent from January 1, 1949. This amount of Rs. 15,000 was to be reduced if the commission income of the company was below Rs. 1,50,000. In view of this resolution passed by the company at its annual general meeting, for each one of the assessment years with which we are concerned at the end of the accounting period Narottamdas became entitled to the sum of Rs. 15,000 because it is not the case of any party that the commission earned by the company in any one of these years was below Rs. 1,50,000. Thus, the income of Rs. 15,000 accrued or arose to Narottamdas at the end of each accounting year irrespective of the fact whether the amount was actually paid by the company to Narottamdas or not. It should not be overlooked that there was no controversy between the company on the one hand and Narottamdas on the other as regards the liability to pay the sum of Rs. 15,000. The company as payer accepted this liability and Narottamdas as

payee acquired a right to receive the amount from the company. It was, however, urged by Mr. Trivedi that a hurdle or obstacle was created upon the right of Narottamdas to receive this amount and upon the liability of the company to pay this amount by a suit filed by the shareholders in their representative capacity. Mr. Trivedi is right that the trial court declared the resolution passed by the company at its annual general meeting on July 20, 1949, as illegal and void and issued a permanent injunction against the company restraining it from paying the amount to Narottamdas. However, the decision of the trial court in the suit was neither accepted by the company nor by Narottamdas. An appeal was filed before the High Court which was decided on November 25, 1955. The High Court by its final decision declared that the resolution passed by the company at its annual general meeting was valid and actually set aside the decree that the was passed by the trial court. The argument of Mr. Trivedi is that as this decision of the appellate court was given in November, 1955, the amount payable to Narottamdas for all these years should be regarded as having accrued due to Narottamdas only in November, 1955, because that was the time when the decision of the High Court was given. It is not possible for us accept this contention. As already pointed out, between the company and Narottamdas there was no controversy. Further, a judgment and decree of a court does not create a right or liability in a party. The normal function of a court while adjudicating a dispute between two parties is to declare a right where there is a pre-existing right or to determine a liability where there is a pre-existing liability. The right or liability as the case may be exists by itself but it is not created by judgment or decree of a court. Thus, it will not be proper for us to accept the contention of Mr. Trivedi that till the High Court decided the appeal and reversed the decision of the trial court it cannot be said that a sum of Rs. 15,000 per year had not accrued to Narottamdas.

7. That this was a clear position is quite apparent from the subsequent conduct of the parties. Narottamdas died on November 16, 1952, much before the appeal was disposed of by the High Court. Actually, apart from the amounts payable for the four assessment years aggregating to Rs. 58,125 the legal heirs of Narottamdas have been paid a further sum of Rs. 11,896 as and by way of interest on the said amounts payable from time to time. The very payment of interest clearly shows that in each year a sum of Rs. 15,000 had become due and payable to Narottamdas and for the last year the proportionate amount had become due and payable before the close of the accounting year. Such payment of interest really clinches the matter because it can only be paid when the right to receive the amount was acquired by Narottamdas at the end of the accounting year with which we are concerned. No rational reason was given by Mr. Trivedi to explain such payment of interest by the company to the legal heirs of Narottamdas except by saying that it may be treated as *ex gratia*. The shareholders who opposed the resolution to pay additional special remuneration to Narottamdas will not permit the company to make payments *ex gratia* to the legal heirs. In fact, such payments had to be made if regard be had to the legal rights of the parties, because at the end of each accounting period a sum of Rs. 15,000 becomes due and

payable by the company to the assessee, Narottamdas.

8. Further it should not be overlooked that the assessee himself died on November 16, 1952. If the amount had not become due and payable during his lifetime it is difficult to see how it became the judgment and decision was given by the High Court in that month. In the hands of the legal heirs of deceased, Narottamdas, only tax was leviable in respect of the income that had accrued to deceased Narottamdas and not in respect of the income which accrued for the first time after his death. Thus it will not be possible for us to take the view that the sum of Rs. 58,125 accrued to Narottamdas only in November, 1955.

9. It will be necessary to refer to the three decisions referred to by Mr. Trivedi with a view to contend that if there is a pending litigation it cannot be said that the amount claimed by the assessee has become due and payable simply because the claim is made. His submission is that until the claim is finally adjudicated the amount cannot be regarded as merely due and payable. On this aspect of the matter it should be clearly pointed out that this is not a case where there was a bona fide dispute between the company on the one hand and the assessee on the other. On the contrary, a third party like the shareholders wanted to challenge the validity of the resolution on the ground that it was either ultra vires the powers of the company or contrary to the provisions of the law. As there was no question of any controversy between the company on the one hand and the assessee on the other, merely because the third party raised a dispute as regards the liability of the company to pay the amount, it cannot be said that the date of accrual of such income was postponed to a future date when the rights are finally adjudicated upon by a court of law. None of the cases cited by Mr. Trivedi refers to a case where there is no controversy whatsoever about the payment between the payer and the payee by a dispute is sought to be raised by a third party. All the cases cited by him refer to cases where between the payer and the payee there is a bona fide dispute. Such cases are not of much assistance in determining the matters in controversy in the present reference.

10. The first case to which our attention was invited by Mr. Trivedi is *Commissioner of Income-tax v. Chunilal V. Mehta & Sons P. Ltd.* This was a case where the assessee, Chunilal V. Mehta & Sons Private Ltd., instituted a suit claiming Rs. 28 lakhs as compensation for unlawful termination of the managing agency. The managed company was prepared to pay even before the controversy arose Rs. 2,34,000, but however the assessee felt that it was entitled to the sum of Rs. 25 lakhs. When the suit was finally decided a decree was passed in favour of the assessee in the sum of Rs. 2,34,000 on the ground that under clause 14 of the agreement the respondent, i.e., the assessee, was only entitled to liquidated damages at the rate of Rs. 6,000. This case is in no way of any assistance to Mr. Trivedi. So far as the sum of Rs. 2,34,000 was concerned it was treated as having accrued to the assessee on April 23, 1951, as the assessee was maintaining

accounts on mercantile system. Thus, even though the decision came much later still it was regarded as having accrued to the assessee much earlier when the company was willing to pay the same.

11. The other case of which reference was made by Mr. Trivedi is the decision of this court in *Commissioner of Income-tax v. Nadiad Electric Supply Co. Ltd.* This was a case where between Nadiad municipality and the assessee-company there was a contract to supply electricity at the rate specified. The contract was for a specified duration. Under the contract the municipality was liable to pay for the electricity consumed by it at the rate of 19 paise per unit. Even after the expiry of the contract by efflux of time stipulated therein, the municipality continued to receive electricity from the assessee-company. For such supply the assessee-company made a claim at the rate of 30 paise per unit, but in its books of account it merely made a credit of 19 paise per unit, and so far as the balance of the amount was concerned, it was shown under the head "sundry creditors considered doubtful" in the balance-sheet. The amount under this head "sundry creditors considered doubtful" came to Rs. 35,251.02. A question arose whether the assessee-company was under an obligation to credit this sum of Rs. 35,251.01 in its books of account, even though they were maintained on mercantile system. The contention of the revenue that it should be included as income of the assessee was rejected by the High Court on the ground that sending of the bills amounted merely to making a claim for the amounts mention in the bill. Such mere sending of bills did not create a legal enforceable right in the assessee-company. Nor a corresponding legal enforceable obligation on the municipality. It should not be overlooked that this was also a case where a bona fide controversy existed between the payer and the payee and even in the case of mercantile system of accounting when such a dispute exists the assessee who makes a claim is not bound to treat it as income until the claim is finally adjudicated upon by a competent authority. Such is not the position in the present case as there was no controversy whatsoever between the company and Narottamdas.

12. To the same effect is the decision of the Bombay High Court in *Commissioner of Income-tax v. Associated Commercial Corporation*. This was a case where in a dispute between the partners of a firm a claim was made by the partners on behalf of the firm in respect of profit made by one of the partners by reason of sale of one of its assets. The liability was disputed by the partner who had effected the sale. The Division Bench of this court took the view that the scheme of the Income-tax Act shows that only those sums were taxable which accrued as income, i.e., they must have actually accrued or arisen. No amount can be said to accrue unless it was dully due. A claim to an amount is not tantamount to the claim being due or having accrued. A profit can be said to have accrued or a liability or loss can be said to have been incurred only when the profit is either actually due or the liability becomes enforceable. A mere claim to a profit or to a liability for the purposes of the Income-tax accrue or the liability to be a liability is not sufficient to make

the profit to accrue or the liability to be incurred for the purposes of the Income-tax Act. This was also a case where a controversy existed between the person making a claim and the person who was liable to make the payment. We are not concerned with any such question in the present case as no controversy really existed between the company and the assessee. In fact, right from the inception the company had accepted its liability to pay and notwithstanding the litigation by the shareholders it ultimately paid not only the amount due but interest as and from when each respective amount had become payable in respect of each accounting period. These cases, therefore, in our opinion, are not of much assistance to Mr. Trivedi to support his contentions.

13. Thus our answer to the question referred to us is in the negative and against the assessee. The assessee shall pay the costs of the revenue.

