ORISSA HIGH COURT

Commissioner of Income-tax

Vs

S. Sen

S.J.C. No. 20 of 1948

(Ray, C.J. and Narasimham, J.)

09.12.1948

JUDGMENT

Ray, C.J.

1.The proceeding arises out of two applications, consolidated, because of the facts being identical, by the Commissioner of Income-tax, Excess Profits Tax, Bihar and Orissa, under Section 66 (1) of the Income-tax Act read with Section 21 of the Excess Profits Tax Act for stating a case and opinion of this Court on the following (three) questions of law :

> (1) Whether in the circumstances of the case, the Tribunal was right in asking the Income-tax Officer to assess the assessee on receipts basis with regard to contracts carried on and completed during the year of account?
> (2) Whether the reduction of the estimated profit rate from 40 per cent, adopted by the Income-tax Officer to 30 per cent. by the Tribunal on the ground that 30 per cent. was the general rate adopted by it in the cases of other assessees doing the same kind of contract works during the same assessment year was legal?
> (3) Whether the Tribunal was right in not applying R. 9 of Schedule 1 of the Excess Profits Tax Act to the facts of this case?"

2. The circumstances of the case and the findings of facts, that form the context, are, as gleaned, from the statement of the case, in short, as follows : S. Sen and J. Bhuyan constituted an unregistered firm sharing the profits and losses in the proportion of 9 as and 7as. respectively. The Business, of which the profits and gains are subjects of assessment, consisted of Aerodrome work under the Central Public Works Department, certain Katch-building constructions under the Military Engineering Service and small supply of potatoes to Garrison Engineer. The work began on 28-3-1942 and terminated on 27-7-1942; but the work of repairs and maintaining the same continued up to February 1943. The accounting year is the financial year of 1-4-1942 to 31-3-1943. During the fair year the assessee received a sum of Rs. 2,92,256/-. During the next year, that is, 1-4-1943 to 31-3-1944, they received a sum of Rs. 86,434/-; and during the following accounting year of 1-4-1944 to 31-3-1945, they received a sum of Rs. 25,703/-. Besides, it

appears, there were certain estimated outstanding bills to the credit of the assessee which had been excluded from assessment.

3. The Income-tax Officer issued notices under Sections 22 (4) and 23 (2) of the Income-tax Act. In pursuance of these notices, S. Sen informed him that the books of account were with his partner, J. Bhuyan. When the latter was examined, he, in his turn, shifted the responsibility unto S. Sen. Subsequently, the Officer was told that the books had been destroyed by fire. In these circumstances, the assessees were assessed under Section 23 (4). The relevant finding of default was upheld by the Appellate Assistant Commissioner and the Appellate Tribunal. It is not controverted before us that the assessment was rightly made under Section 23 (4). The Income-tax Officer took the sum total of the above sums, received in course of three years, as already said, that is, Rs. 4,54,948/-, as the basis of his assessment. He deduced the income at Rs. 1,18,975/- on the ratio of 40 per cent. a flat rate on the gross receipt, deducting the Excess Profits-tax of Rs. 1,13,317, the assesable income was set at Rs. 65,659/- which was reduced by the Appellate Assistant Commissioner by a sum of Rs. 28,270/- by way of rectification of an error in calculation of Rs. 24,270 and deducting the profit of Rs. 4,000/- riepresenting 40 per cent of the estimated outstanding bills. There had never been a controversy in the Courts below nor is there any before us in relation to the aforesaid reduction and deduction.

4. The Appellate Assistant Commissioner, on appeal, came to the conclusion that since it was a question of determination of that year's income, in the absence of account books and since this was the first assessment in the case, the proviso to Section 13 came into operation and no question of cash basis could arise.

5. The Tribunal, however, thought :

> "that in the circumstances of the case, the Income-tax Officer should have applied the rate of profit to the entire receipts instead of to the total receipts and thought, by amalgamating the receipts under one assessment, the Income-tax Officer raised the tax liability of the assessee which was not fair. The Tribunal, therefore, set aside the 'basis of the present assessment' and remanded the case back to the Income-tax Officer to assess the income on the basis of the receipts during each year." On the question of the flat rate :
> "In view of the general rate of profit adopted by the Tribunal in other cases of the same nature for the same assessment year of 1943-44, the Tribunal thought that the profit rate of 30 per cent. would be reasonable in the circumstances of the case. The estimate of 40 per cent. was, therefore, reduced to 30 per cent. by the Tribunal."

6. Of the three questions submitted to us, it is conceded by the learned Standing Counsel for the Department that the 3rd question does not arise for detailed consideration as Rule 9 of Schedule I of the Excess Profits-tax Act is not attracted by the facts of the case, and that the Tribunal was, therefore, right in not applying the same. The answer of this question must, therefore, be in the affirmative.

7. The question No. 1 is one of deceptive simpliciy. It has hidden within its simple garb the not-very-easy question of determination of the Tribunal's right of interference with the final

assessment order of the Income-tax authorities. The question has been argued from a jurisdictional angle of vision. I should wish the question should have been more explicitly worded. We are not asked to say whether the assessment should or should not have been governed by the proviso to Section 13 of the Income-tax Act not have we been asked whether in the circumstances of this case the income should have been ascertained either on receipt basis or on accrual basis. The question may be viewed as involving one or the other of the provisions but it does not apparently say so. As it appears to us, the question is more attracted against the right or power of interference of the Tribunal with assessment orders of the Income-tax authorities from their factual aspect rather than legal. The learned Standing Counsel wants to maintain that in cases falling within the purview of Section 23 (4) or proviso to Section 13, or both, of the Income-tax Act, the method of computation of the income, profits and gains and the ascertainment thereof are within the discretion of the Income-tax authorities and the Tribunal, far less this Court, has no power of interference. He invites our attention to a series of statutory provisions and judicial authorities based thereon dealing with the limits of the power of interference of a Court of Appeal with orders passed in exercise of statutory discretionary powers of the Subordinate Courts and argues that such discretionary orders shall seldom be interfered with unless the appellate authority is of opinion that the discretion has been capriciously, injudiciously and arbitrarily exercised. He laid particular stress upon High Court's limited power of interference under Section 115, Civil Procedure Code, by which it has been authorised in its discretion" to make such orders in the case as it thinks fit." In this connexion, he draws a parallel between the words just quoted from Section 115, Civil Procedure Code, and the words defining the powers of the Appellate Tribunal in Section 33 (4) of the Income-tax Act, which provides : "The Appellate Tribunal may pass such orders thereon as it thinks fit." This contention, however, is fallacious. The limitations that have gathered round the High Court's power of interference in revision as defined in Section 115, Civil Procedure Code, do not owe their existence to the words of Section 115 already quoted, but to the enumeration of requisite circumstances in the earlier part of the section which alone go to vest the High Court with its power of interference. One, however, does not find such words of limitation in Section 33 (4). The Tribunal's power of dealing with an order passed by an Appellate Assistant Commissioner is plenary and has been expressed as widely as can be conceived. According to the section, every order of assessment passed by an Appellate Assistant Commissioner either under Section 28 or 31 is appellable to the Tribunal. The latter can substitute its own order of assessment for the one passed by the Appellate Income-tax Authority. This very widely expressed power, however, shall not be immuned from such limitation to which ordinarily an Appellate Authority or Tribunal is subject in disposal of its duty. The learned Standing Counsel wanted to argue that the Appellate Tribunal's power of interference is confined more often than not to questions of law and that in matters of questions of fact, its power is not as full and wide as is that of an Appellate Income-tax Authority in respect of any order of assessment passed by the Income-tax Officer. Neither is there any warrant for such a contention in the Section 33. The contention of the learned Standing Counsel is placed in the background that in certain cases of assessment, as is the present one, the Income-tax Officer, as good as the Appellate Commissioner, has discretionary power which is seldom liable to interference. Great assistance is prayed in aid in relation to this contention from the case of '*Rehmat-un-Nisa v. Price*[1]', where in a case involving the provisions of Sections 252 and 254 (6) of the Indian Contract Act. it was contended that the order passed by the High Court Bombay in its power of discretion as enacted in the latter section of the Act, the Judicial Committee had no power of interference. Sir Lawrence Jenkins, in replying to this contention, observed : "The appellate Bench decided adversely to it and it was urged in argument against

interference with this decision that it is opposed to 'sound practice' for an appellate Court to substitute its discretion for that of the Court from which an appeal has been preferred. The justice of this argument is undoubted, but it was at least as relevant before the appellate Bench as it is before this Board. And yet the appellate Bench did not hesitate to express its readiness to substitute its discretion for that of the Original Court, although in the view it took of the Court's jurisdiction the question could not arise. In these circumstances the real question is whether there was or is any justification for questioning or disturbing the discretion exercised by the original Court when it passed the decree for dissolution in the Nawab's favour. It cannot be said that the Court acted capriciously or in disregard of any legal principle in this exercise of its discretion. On the contrary, there are elements in the case which can fairly be regarded as ample warrant for the first Court's decision, and for this it is enough to point to the dual position of the defendants, which brought their interests as contractors into sharp conflict with their duties as partners of the Nawab, and also to the prominence given in the recital to the common purpose that the quarries should be remunerative and profitable to the partners."

8. The principle deducible from this authority can be summarized in the simplest possible way, that is, where the original Court is empowered to make an order in exercise of his discretion and if there are elements in the case which can fairly be regarded as ample warrant for the first Court's decision and where it cannot be said that the Court acted capriciously or in disregard of any, legal principle in this exercise of its discretion, there will remain no justification for questioning or disturbing the discretion so exercised by the original Court. I do unhesitatingly accept that the Appellate Tribunal's power of interference is subject to this rule of which the justice can be seldom doubted. It would be unduly narrowing down this principle to confine its application to cases where there is apparently an error of fact or an erroneous decision of law in the exercise of the original Court's discretion. The concept involved in the words used by Sir Lawrence Jenkins, namely :

> "There are elements in the case which can fairly be regarded as ample warrant for the first Court's decision."

does not eliminate the element of fairness and natural justice. The discretionary order of the original Court may apparently be based on right appraisement of facts pro tanto, but may yet, when contrasted with the conclusion derivable from another mode of appraisement result in injustice and inequity to the subject. In such cases it can be well said that such elements as are referred to by Sir Lawrence Jenkins as elements which can be regarded as ample warrant for the decision can be found wanting. I should hold that in such cases too, the Appellate Tribunal shall be attributed with the power of interference. At the same time this power shall not be exercised indifferently to the materials on record. In my view, the Appellate Tribunal is a Court of Appeal of fact as well as of law.

9. I shall now address myself to the ambits of the power of an Income-tax Authority in cases falling within the proviso of Section 13 or 23 (4) of the Income-tax Act. In this connexion I shall quote a passage from the judgment of their Lordships of the Privy Council delivered by Lord Thankerton in the case of *'Commissioner of Income-tax, Bombay Presidency and Aden v. Sarangpur Cotton Manufacturing Co. Ltd. Ahmedabad*[2]*,'*

> "Their Lordships are clearly of opinion that the section relates to a method of accounting regularly employed by the assessee for his own purposes in this case, for the purposes of the company's business - and does not relate to a method of making up the statutory return for assessment to income-tax. Secondly, the section clearly makes such a method of accounting a compulsory basis of computation, unless, in the opinion, of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom. It may well be that, though the profit brought out in the accounts is not the true figure for income-tax purposes, the true figure can be accurately deduced therefrom. The simplest case would be where it appears on the face of the accounts that a stated deduction has been made for the purpose of a reserve. But there may well be more complicated cases in which, nevertheless, it is possible to deduce the true profit from the accounts, and the judgment of the Income-tax Officer under the proviso must be properly exercised. "It is misleading to describe this duty of the Income-tax Officer as a discretionary power."

10. After making the said observations, their Lordships came to the finding :

> "Their Lordships agree with the High Court that the facts stated make clear
> that here the Income-tax Officer has never exercised his judgment under the proviso, and their Lordships are further of opinion that if he had so exercised his judgment, the Income-tax Officer would not reasonably have come to any other opinion than that the profit shown in the profit and loss account could not be the true figure for income-tax purposes."

In this view of the matter it is open to the Appellate Tribunal to examine, in a deserving case, whether the Income-tax Officer or its Appellate Authority exercised his judgment in exercise of the discretion vested in him. Even in the strongest possible case with which their Lordships of the Judicial Committee were dealing their Lordships answered the question –

> "Whether, in view of the provisions of Section 13 of the Income-tax Act or otherwise, the Income-tax Officer was right in computing for the purpose of Section 10 of that Act income, profits and gains, in accordance with the method of accounting regularly employed income, profits and gain."-

in the negative.

11. In dealing with the question involved in the width of the Income-tax Officer's discretionary power of assessment in cases of default of the assessee either under Section 23(4) or Section 13 proviso visa-vis the Appellate Tribunal's power of interfereence, it would not be out of place to refer to the decision of the Privy Council in the case of '*Commissioner of Income-tax, U.P. and C.P. v. Badridas Ramrai Shop, Akola*[3]*',* Lord Russell of Killowen, who delivered the judgment of their Lordships, after referring to what the Judicial Commissioners had laid down in that case, observed as follows :

"The Judicial Commissioners have laid down two rules which impose upon the officer the duty of (1) conducting some kind of local enquiry before making the assessment under Section 23 (4), and (2) recording a note of the details and results of such inquiry".

"Their Lordships find it impossible to extract these requirements from the language of the Act, which after all is, in such matters, the primary and the safest guide. The officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate for the proper figure of assessment, and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate : and though there must necessarily be guess-work in the matter, it must be honest guess-work. In that sense too, the assessment must be to some extent arbitrary. Their Lordships think that the section places the officer in the position of a person whose decision as to amount is final and subject to no appeal, but whose decision of it can be shown to have been arrived at without an honest exercise of judgment, may be revised and reviewed by the Commissioner under the powers conferred upon that official by Section 33. Their Lordships can find no justification in the language of the Act for holding that an assessment made by an officer under Section 23(4) without conducting a local enquiry and without recording the details and results of that inquiry cannot have been made to the best of the judgment within the meaning of the section."

12. As the authorities already dealt at length by me do furnish sufficient guide for disposal of the present case, I need not specifically refer to the other authorities cited at the bar, which I have considered with care as they do not lay down any principle of law at variance with what has been set out above. In the circumstances of this case, it is clear that on account of default committed by the assessee, the Income-tax Officer was called upon to exercise his statutory power of discretionary assessment conferred upon him under proviso to Section 13 as also under Section 23(4). As laid down' in the case of *'Ganga Ram-Balmokanda v. Commissioner of Income-tax*[4]*',* both the
aforesaid provisions of law may be combined in their operation and application to the facts of the present case. This assessment however must not be arbitrary but should be one to the best of the Income-tax Officer's judgment. True that in coming to his finding he should make what he honestly believes to be the fair estimate of the proper figure of assessment and he can pray in aid his local knowledge of such matters as he thinks would assist him in arriving at such an estimate. Though there must necessarily be guess-work in the matter, it must be honest guess-work. It may be arbitrary to some extent and his order may appear to be final so far as it goes, but wherever it can be shown that the figures arrived at by him are either not based on facts or are erroneous inferences from facts or even as a guess-work it has not been arrived at by an honest exercise of judgment it may be disturbed by the Appellate Authority or Tribunal. In the present case, the Income-tax Officer arrived at the figure on the basis of the receipts extending over three

accounting years. He took the sum total of these receipts to be the base for the net income that had accrued to the assessee during the accounting year 1943-44 as the entire contract work had been completed during that year. It is well-settled in law that the words "accrue and arise" used in Section 4 of the Income-tax Act - the section that defines income in the previous year (accounting year) - are of the same import except that the use of one or the other may be more appropriate in the facts of any particular case. 'Accrued income' is always different from' earned income'. One might conceivably claim to have earned a gain but it may not have reached the stage when he can make a just demand of it against the person legally liable. I should quote a passage from the judgment of Mukherji, J., in *'Roger Pyatt Shellac Co. v. Secy, of State'*[5],

> "These definitions (accruing or arising) do not support the view that income accrues or arises in a particular country by reason of the fact that it is earned in that country and on the contrary go to show that income accrues or arises in the country where there is a demand payment of it or where in fact it is said :

13. Mere execution of the contract work will not necessarily entitle the contractor to make a demand for payment until it is ascertained that the works are upto the standard agreed upon between the parties. Some parts of such work may be wholly rejected and like bad debts in every earning may be ignored in computing the gains or profits. It might have been open to the Income-tax Officer, in exercise of his discretion, to make an enquiry into whether and when the bills for payment became due to the assessee. Much depends upon the terms in the contract, and the manner of its performance. Even as a basis of guesswork which the Income-tax Officer is entitled to do, the basis cannot be said to be in consonance with honest guess-work. The Income-tax Officer does not seem to have taken into consideration why the payments, which, according to him, were due to the assessee in the accounting year were not fully paid till three years after. Sometimes the payments to the contractors are withheld on account of unsatisfactory execution and they are held entitled to payments only if and when, they replace the rejected work by acceptable and accepted ones. The bare possibility of such contingency cannot be wholly eliminated in the present case. If the Income-tax Officer, in arriving at the figure for assessment, leaves out these considerations, he certainly cannot be said to have exercised his judgment which he is none-the-less called upon to do in making the assessment in cases of assessee's default under Sections 23(4) and 13 proviso of the Income-tax Act. As laid down by their Lordships of the Privy Council, any method of accounting adopted by the Income-tax Officer acting under the proviso of Section 13 can be rejected if the method in fact does not show the true income, profits and gains. In this view of the matter, the Appellate Tribunal was right in asking the Income-tax Officer to assess the assessee on receipt basis with regard to contracts carried out and completed during the year of accounting, there being every presumption that the incomes were paid as soon as they became due. At any rate, the Tribunal's decision may be upheld on the ground that when two methods of guess-work are available for the purpose of assessment, the one which is more just to the assessee and which involves a much less margin of chance of uncertainty should be taken as the basis. In the result, I would answer the first question in the affirmative. With regard to the second question it is not disputed that adoption of flat rate for deducing the net income was wrong in principle. The Tribunal substituted their own rate in the place of that of the Income-tax Authorities. It has been contended, in this behalf, by the learned Standing Counsel that "the principle of assessment at flat rate not being contested, its amount must be for the Income-tax Officer to determine" (per Lord Blanesburgh in the case of

'Feroz Shah v. Commissioner of Income-tax, Punjab and N.W.F. Province[6]',). The submission is that in case of flate rate, the rate adopted by the Income-tax Officer is invariably to be accepted and is incapable of disturbance by any Appellate Authority. The decision, however, does not go so far as that, because the passage quoted is immediately followed by :

> "Their Lordships would only add that the Commissioner, acting under Section 33 of the Act, caused further enquiry to be made into this matter, and as a result he found no reason for interfering with the Income-tax Officer's finding".

14. The last quoted makes it plain that flat rates are liable to alteration under Section 33 by Income-tax Commissioner or the Appellate Tribunal, as the case may be. The Tribunal, however, must not arrive at its conclusion unsupported by any facts which are justly receivable as evidence. As laid down in the case of *'Bomford v. Osborne (Inspector of Taxes[7]),* per Viscount Simon;

> "A mere statement in the case that a conclusion of the Commissioners is a finding of fact does not preclude the High Court from reviewing that conclusion, if it is in truth 'a determination in point of law that the facts proved or admitted provide evidence to support the Commissioners' conclusions'."

15. It is laid down in this case that it is open to the High Court to enquire whether there was any evidence upon which it was possible to come to the findings and that is a question of law. It has to be regretted that in the case stated it is nowhere stated by the learned Tribunal what in reality is the evidence - provable and proved - supporting their finding as to alteration of the rate. We are, however, entitled to examine their judgment in order to find out if there was any such evidence in support of their finding. We can even construe the said judgment as a written document just as a Court of law in order to find out if there is any error of law (Vide *'Usher's Wiltshire Brewery v. Bruce[8]',* In the same case, Lord Sumner, while laying down that an inference from a wide area of facts is itself a fact, observed that the question is different where there is a suggestion "that the Commissioners found the facts under any mistake in law including in that term the view, conscious or unconscious, that a fact may be found which there is no relevant evidence to support.....". This is exactly the case here as the Appellate Tribunal had arrived at the lesser flat rate on the basis of their decisions in similar cases in the district. Their opinions are not receivable evidence in the present case. The decisions in different cases must have been based upon different facts and different inferences deducible from such facts. On the contrary, the Income-tax Officer in his order of assessment says :

> "when others working on similar works and in the same year have 'actually' made 40 per cent. on gross value of bills, there is no reason why the assessee should not make 40 per cent. on net value of the bills".

In this connexion, it may be observed that the Income-tax Officer has been very fair to the assessee bearing in mind the difference between the gross value and net value of the bills. The Appellate Tribunal, therefore, did commit a mistake of law in arriving at a finding which there was no relevant evidence to support. In the circumstances, the question No. 2 must be answered

in the negative.

16. The Appellate Tribunal without having caused any further enquiry to be made and without having had any relevant evidence before them should have accepted the Income-tax Officer's profit rate to be the last words on the subject. They could, if they like, have called upon the Income-tax Officer to make further enquiries under stated directions. Their decisions in other cases, however similar, adopted as relevant evidence, must be held to have been so done on mistake of law.

17. In the result, the application of Income-tax Commissioner succeeds in part. The question No. 1 is answered in the affirmative, No. 2 in the negative and No. 3 in the affirmative.

18. In the peculiar circumstances of the case the parties should bear their costs in this Court.

Narasimham, J.

19. I agree with my Lord the Chief Justice.
Questions answered.

Cases Referred.

[1]45 Ind App 61 at p. 66
[2]65 Ind App 1 at pp. 6 and 7
[3] AIR (24) 1937 PC 133 at p. 138
[4] AIR (24) 1937 Lah 721
[5]52 Cal 1
[6]60 Ind App 325 at p 334
[7] (1942) AC 14 at p. 22
[8]1915 AC 433 at pp. 449, 450