

Commissioner Of Income-Tax West ... vs M/S. Birla Gwalior (Pvt.) Ltd on 4 April, 1973

Equivalent citations: 1973 AIR 2486, 1973 SCR (3) 902, AIR 1973 SUPREME COURT 2486, 1974 3 SCC 196, 1973 TAX. L. R. 1317, 1974 (1) SCJ 504, 89 ITR 266, 1973 3 SCR 902, 1973 SCC (TAX) 519, 1974 (1) ITJ 277

Author: K.S. Hegde

Bench: K.S. Hegde, Hans Raj Khanna

PETITIONER:

COMMISSIONER OF INCOME-TAX WEST BENGAL-II, CALCUTTA

Vs.

RESPONDENT:

M/S. BIRLA GWALIOR (PVT.) LTD.

DATE OF JUDGMENT 04/04/1973

BENCH:

HEGDE, K.S.

BENCH:

HEGDE, K.S.

KHANNA, HANS RAJ

CITATION:

1973 AIR 2486 1973 SCR (3) 902

1974 SCC (3) 198

CITATOR INFO :

R 1986 SC 368 (16)

RF 1986 SC 757 (15,18,55,57,59)

ACT:

Indian Income Tax Act 1922-S. 10(2)(xv)-Whether an amount foregone by the assessee as Managing Agency Commission and an amount foregone as office allowance was allowable as Revenue Expenditure.

HEADNOTE:

These are all connected appeals. The assessee-respondent was the managing agent of two companies N & G. As Managing Agent of N Company, it was entitled to receive a commission of 12 1/2 on the net profits of the Managed Company together with a sum of Rs. 18,000/as office allowance. In the case

of G company, the assessee was entitled to get an allowance of Rs. 30,000/- in addition to its agreed commission. In all these appeals, certain questions were submitted by the Tribunal to the High Court. In Civil Appeal No. 242 of 1970 only one question was submitted and in the other two cases, i.e., Civil Appeal No. 243 and 244 of 1970, two questions were submitted.

In the first appeal, the question submitted was whether on the facts and circumstances of the case, a certain sum said to, have been foregone by the assessee as managing agency commission was allowable as revenue expenditure. Similar questions were called for, for the remaining two assessment years as well and in addition, one more question was submitted as to whether certain sum, said to have been 'foregone by the assessee as, office allowance, was allowable as revenue expenditure under the Income Tax Act. The assessment years were 1954-55, 1955-56 and 1956-57. The High Court came to the conclusion that it is not necessary to answer the common question referred to in all these appeals because it was academic; but the question relating to the office allowance was answered in favour of the assessee.

In the relevant accounting years, the assessee gave up the managing agency commission from both the managed companies. It also gave up the office allowance due from G. Company. The accounting years of both the assessee company as well as the managed companies were the financial year. The commission was given up by the assessee company after the end of the financial year, but before the accounts of the managed company were made up. The accounts of the managed companies were made up some time during the end of September of the year following the respective accounting years. But in the case of office allowance, the same was given up even before the end of the financial years,

On the basis of these facts, the I.T.O. as well as the Appellate Assistant Commissioner held that the deductions claimed were not allowable. As regards the commission, they came to the conclusion that the same having accrued at the end of each of the financial years, the agency giving up the same subsequent to these dates, does not bring the case under s. 10(1) of the Income-tax Act. So far as the office allowance was concerned, they came to the conclusion that there was no justification for giving up the same. The Income Tax Appellate

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Tribunal differed from this view and held that to the extent the commission was given up, the assessee company had no income at all. In other words, the commission that was given up cannot be considered as the real income of the assessee company. Therefore, it is an allowable expenditure under s. 10(2)(xv). As regards the office allowance the Tribunal held that the same was allowable deduction under s. 10(2) (xv). The Tribunal further held that the commission

as well as the office allowance were given up by the assessee on the ground of commercial expediency. The High Court agreed with this view taken by the Tribunal.

Dismissing the appeal,

HELD : (i) As regards office allowance, following C.I.T. Bombay North v. Chandulal Keshavlal & Co., 38 I.T.R. 601 the Tribunal was fully justified in coming to the conclusion that the expenditure incurred came within the scope of s. 10(2)(xv). The only contention advanced by the appellant was that the allowance was paid to meet certain expenses incurred by the assessee, company. Therefore, the assessee could not have given up the same. This contention makes no difference in law. The ratio of the decision of this Court in Chandulal's case completely covers the point under consideration. [906B]

(ii) The question regarding giving up of the commission, no due date was fixed for the payment of the commission under the managing agency agreements. The commission receivable could have been ascertained only after the managed company made up its accounts. The assessee had given up the commission even before the managed company made up its accounts. Hence, the fact that the assessee company was maintaining its accounts on the basis of mercantile system cannot lead to the conclusion that the commission accrued to 'it by the end of the relevant accounting year. It was the real income of the assessee company that was liable to tax and the real income could not be arrived at without taking into account the amount given up by the assessee. Therefore, in the present case, the contention of the revenue that a surrender of the commission under the provisions mentioned in the agreement were not deductible for the purposes of Income Tax, cannot be sustained. [906 F] Poona Electric Supply Co. Ltd. v. Commissioner of Income-tax, Bombay City 1, 57 I.T.R. 521 H. M. Kashiparekh & Co. Ltd. v. Commissioner of Income-tax, Bombay North, Kutch & Saurashtra, 39 I.T.R. 706, referred to.

The question whether the given up commission comes under s. 10(2)(xv) depended on 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. In the present case, since there was no real accrual of Income, the assessee was not liable to tax for this amount.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 242 to 244 (NT) of 1970.

Appeals by certificate from the judgment and order dated April 22, and 23, 1969 of the Calcutta High Court in Income- tax Reference Nos. 187, 188 & 189 of 1963.

S. T. Desai, B. B. Ahuja, S. P. Nayar and R. N. Sachthey, for the appellant (in C.A. No. 242).

B B. Ahuja, S. P. Nayar and R. N. Sachthey, for the appellant (in C.A. Nos. 243-244).

B. Sen, Leila Seth, U. K. Khaitan and B. P. Maheshwari, for the respondent.

The Judgment of the Court was delivered by HEGDE, J.-These are connected appeals by certificate. They relate to respondent's assessment for the assessment years 1954-55, 1955-56 and 1956-57. The previous financial years are the relevant accounting years.

In all these appeals, as directed by the High Court of Calcutta under S.66(2) of the Indian Income Tax Act, 1922, certain questions were submitted by the Tribunal. In the first case i.e. Civil Appeal No. 242 of 1970 only one question was submitted and in the other two cases i.e., Civil Appeals Nos. 243 and 244 of 1970, two questions were submitted. The question submitted in the first case is as follows :

"Whether on the facts in the circumstances of the case the sum of Rs. 1, 1 1,779 said to have been foregone by the assessee as Managing Agency commission was allowable as a revenue expenditure under S. 10(2) (xv) of the Indian Income-tax Act, 1922 for the assessment year 1954-55" ?

Similar questions were called for the remaining two assessment years as well. But, in addition, one more question, namely "Whether on the facts and in the circumstances of the case the sum of Rs. 30,000 said to have been foregone by the assessee as office allowance receivable from Gwalior Rayon and Silk Manufacturing Co. Ltd. was allowable as a revenue expenditure under Section 10(2) (xv) of the Indian Income Tax. Act, 1922 for the assessment years, 1955-56 and 1956-57, was called for."

At the hearing, the High Court came to the conclusion that it is not necessary to answer the common question referred to in all these three appeals as the same was academic but the question relating to the office allowance was answered in favour of the assessee following the decision of this Court in Commissioner of Income tax Bombay North v. Chandulal Keshavlal & Co.(1) The material facts of the case may now be stated. The assessee --respondent is the managing agent of the National Bearing Co. Ltd. and Gwalior Rayon and Silk Manufacturing Co. As managing agent of the former company it was entitled to receive a commission of 12 1/2 per cent on the net profits of the managed company together with a sum of Rs. 18,000 as office allowance. In the (1) 38 I.T.R. 601.

case of Gwalior Rayon and Milk Manufacturing Co. the, assessee was entitled to get an office allowance of Rs. 30,000 per year, in addition to the agreed managing agency commission. In the relevant accounting years the assessee gave up the managing agency commission due from both the managed companies. It also gave up the office allowance due from Gwalior Rayon and Silk Manufacturing company. The accounting years of both the assessee company as well as the managed companies were the financial years. In the agreement entered into between the assessee company

and the managed companies, no, date for payment of the managing agency commission appears to have been stipulated. The commission was given up by the assessee company after the end of the financial year but before the accounts of the managed Co. were made up. The accounts of the managed companies appear to have been made up somewhere during the end of September of the year following the respective accounting years. But, in the case of office allowance the same was given up even before the end of the financial year. On the basis of these facts the Incometax Officer as well as the Appellate Assistant Commissioner came to the conclusion that the deductions claimed were not allowable. As regards the commission, they came to the conclusion that the same having accrued at the end of each of the financial years, the assessee giving up the same subsequent to those, dates does not bring the case under S.10(1) of the Act and no case was made out under S.10(2) (xv). So far as the office allowance is concerned they came to the conclusion that there was no justification for living up the same. The Income-tax Appellate Tribunal differed from the view taken by the Income-tax Officer and the Appellate Assistant Commissioner. Dealing with the question of commission it came to the conclusion that to the extent the commission was given up the assessee company. earned no income at all. In other words the commission that was given up cannot be considered as the; real income of the assessee company. It further came to the conclusion that under any circumstance it is an allowable expenditure under S. 10(2) (xv). As regards the office allowance, the Tribunal was of the opinion that the same was an allowable deduction under S. 10(2)(xv). The Tribunal held that the commission as well as the office allowance were given up by the assessee on the ground of commercial expediency. The High Court agreed with the view taken by the Tribunal.

We will first take up the question relating to the office allowance. According to the finding of the Tribunal the assessee company gave up the office allowance on the ground of commercial expediency. It opined that the managed company's financial position was not sound during the relevant accounting years and it 10-L797SL.P. C.I./73 9 0 6 was necessary for the assessee company to give up the office allowance in order to stabilise the finances of the managed company. The Tribunal further came to the conclusion that because of the sacrifices made by the assessee company, the finances of the managed company improved subsequently, as a result. of which the assessee company was able to earn more profits in the later years. This is a finding of fact. That finding was binding on the High Court. On the basis of that finding the Tribunal was fully justified in coming to the conclusion that the expenditure incurred came within the scope of S. 10(2) (xv). That conclusion is supported by the decision of this Court in Chandulal's case (supra). The only contention advanced in this Court in respect of the office allowance was that it was paid to meet certain expenses incurred by the assessee company-; consequently the assessee could not have given up the same. We do not know whether the office allowance was paid solely for that purpose or whether it was partly as, remuneration and partly to meet the expenditure incurred. In either case it makes no difference in law. The ratio of the decision of this Court in Chandulal's case completely covers the point under consideration.

Now turning to the question regarding giving up of the commission, as mentioned earlier, the assessee was maintaining its accounts on the basis of mercantile system. Its accounting year was the financial year. It gave up the commission after the end of the financial year. On the basis of these facts it was contended on behalf of the Revenue that the commission had accrued before it was given up. Hence it cannot be said that the assessee had not earned the commission in question. Therefore,

the assessee's case cannot be considered under S.10(1). We are unable to accept this contention as correct. As mentioned earlier no due date was fixed for the payment of the commission under the managing agency agreements. The commission receivable could have been ascertained only after the managed company made up its accounts. The assessee had given up the commission even before the managed company made up its accounts. Hence the mere fact that the assessee company was maintaining its accounts on the basis of mercantile system cannot lead to the conclusion that the commission had accrued to it by the end of the relevant accounting year. This is also the view taken by the Bombay High Court in *H. M. Kashiparekh & Co. Ltd. v. Commissioner of Income-tax, Bombay North, Kutch & Saurashtra*. (1) The facts of that case are somewhat similar to the, facts of the present case. Therein the assessee which maintained its accounts on mercantile system was the, managing agent of a paper mill company. Under the managing agency (1)391. R 706.

90 7 agreement it was under a duty to forego upto one-thirds of its commission where the profits of the managed company were not sufficient to pay a dividend of 6 per cent. For the accounting year ending March 31, 1950, the assessee earned a commission of Rs.- 1,17,644, that as a result of the resolutions passed by the managed company and the assessee company the assessee gave up a sum of Rs. 97,000 in December, 1950. The Appellate Assistant Commissioner held that the maximum amount the assessee was 'bound to forego was only Rs. 39,215 and included the balance of the amount foregone, viz., Rs. 57,785/- in the taxable income. The Appellate Tribunal, however, found that the sum of Rs. 57,785 was also given up for reasons, of commercial expediency. Affirming the decision of the Tribunal the High Court held that it was the real income of the assessee company for the accounting year that was liable to tax and that the real income could not be arrived at without taking into account the amount foregone by the assessee. In ascertaining the real income the fact that the assessed followed the mercantile system of accounting did not have any bearing. The accrual of the commission, the making of the accounts, the legal obligation to give up part of the commission, and the foregoing of the commission at the time of the making of the accounts were not disjointed facts :

there was a dovetailing about them which could not be ignored. The real income of the assessee was Rs. 27,644 and the amount of Rs. 97,000 foregone by the assessee could not be included in the real income of the assessee for the accounting year. Rejecting the contention that merely because the assessee maintained its accounts on the basis of mercantile system, the income must be held to have accrued at the end of ,the accounting year, the High Court observed "even so, (the failure to produce account books) we shall proceed on the footing that, the assessee company having following the mercantile system of account, there must have been entries made in its books in the accounting year in respect of the amount of the commission. In our judgment, we would not be justified in attaching any particular importance in this case to the fact that the company followed ,the mercantile system of account. That would not have any particular bearing in applying the principle of real income to the facts of this case. This decision was cited with approval by this Court in *Poona Electric Supply Co. Ltd. v. Commissioner of Income-tax, Bombay city*

1.(1)Dealing with that decision this is what this Court observed : "The concept of 'real income' is also expounded in the decision of the Bombay High Court in H. M. Kashiparekh & Co. Ltd. v. Commissioner of Income-tax (supra). There, under the managing agency agreement the managing agent was under a duty to forego up to one-third of (1) 57 I.T.R 521 its commission where the profits of the managed company were not sufficient to pay a dividend of 6 per cent. The contention of the revenue that such surrender of the commission under the provisions mentioned in the agreement was not deductible for the purpose of income-tax was negatived. The principle has been succinctly stated in the head-note thus "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".

Mr. S. T. Desai, learned counsel appearing for the Revenue contended that the facts of this case are governed by the rule laid down by this Court in Morvi Industries Ltd. v. Commissioner of Income-tax (Central), Calcutta(1). We do not think that submission is correct. Facts of that case are :-The assessee, which was the managing agent of its subsidiary company, maintained its accounts on the mercantile system. It was entitled to receive an office allowance of Rs. 1,000 per month, a commission of 12'2 per cent, of the net profits of the managed company and an additional commission of 12' per cent on all purchases of cotton and sales of cloth and yarn. In the accounting years ended on December 31, 1954 and December 31, 1955, the managed Company suffered losses and the assessee earned only commission on the sale of cloth and yarn for the two years. The total amounts, including the office allowance which the assessee was entitled to receive were Rs. 50,719 and Rs. 13,963 for the two years. Under clause 2(e) of the managing agency agreement the commission was due to the assessee on December 31, 1954 and December 31, 1955, respectively, and it was payable immediately after the annual accounts of the managed company was passed in general meetings, which were held on November 24, 1955, and July 21, 1956, respectively. By resolutions of its board of directors dated respectively, April 4, 1955, and June 19, 1956 [i.e., after the commission had become due but before it had become payable in terms of clause 2(2)], the assessee relinquished its commission on sales and office allowance because the managed company had been suffering heavy losses in the past years. The Tribunal held (1) 82 I. T. R. 835.

9 0 9 that the relinquishment by the assessee of its remuneration after it had become due was of no effect; and also rejected its claim that the amounts relinquished were allowable under section 10 (2) (xv) of the Income-tax Act, 1922, because, as a result of the relinquishment, the financial position of the managed company did not become stronger while that of the assessee-company became weaker and, therefore, the relinquishment was not for the benefit of the assessee. On a reference the High Court agreed with the view taken by the Tribunal. On appeal this Court affirmed the decision of the High Court.

As seen from the facts of that case the commission given up had accrued on the 31st December, 1954 and 31st December, 1955, respectively, and the assessee purported to give up that commission several months thereafter. Further, the Tribunal in that case had come to the conclusion that the assessee did not give up the amounts in question for commercial expediency. This Court came to the conclusion that the amounts in question were due at the 31st December, 1955 and 1956, though payable at a later date. Consequently, those amounts had accrued long before they were given up and the giving up of the same did not co.-lie within the scope of section 10(1). It is true that in the course of the judgment emphasis was also placed on the, fact that the assessee was maintaining its accounts on the basis of mercantile system, but it was not on that basis alone that this Court came to the conclusion that the income in question accrued on 31st December, 1955 and 31st December, 1956. In arriving at- the conclusion that the income in question accrued on the 31st December, 1955 and 31st December, 1956, this Court primarily took into consideration the terms of the agreement. In the course of the judgment delivered by one of us, Khanna, J., passage from the judgment of this Court in Commissioner of Income Tax Bombay City I v. Messrs. Shoorji Valiabhadras and Co. (1) was quoted in support of the conclusion reached by this Court. That passage reads thus :

"Income-tax is a levy on income. Though 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, yet 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. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain (1) 46 I. T. R. 144.

circumstances, have been made in the books of account"

(emphasis supplied). Hence it is clear that this Court in Morvi Industries' case 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.

In addition to the contentions taken earlier, Mr. Desai also took objection to the way in which the High Court disposed of these cases. It may be noted that the High Court came to the conclusion that the findings reached by the Tribunal were findings of fact and, therefore, it would not be proper for the High Court to interfere with the same but strangely enough, at an earlier stage the High Court called for the questions referred to earlier, under S.66(2). If the questions raised are concluded by the facts found by the Tribunal the High Court was not justified in calling for those questions. Further when the High Court issued the rule on the applications made by the Revenue, the assessee not only objected to the prayer made by the Revenue, but also submitted that in case the Court was pleased to direct the Tribunal to State a case, it

may also be pleased to direct the Tribunal to submit the question "whether the commission given up can be considered as real income coming within the scope of S.10(1)?" But, the High Court rejected that prayer but merely called upon the Tribunal to submit the questions set out earlier. The High Court has now come to the conclusion that the commission given up by the assessee cannot be considered as it real income. It is un- doubtedly true that there are certain incongruities in the procedure adopted by the High Court but the final conclusion reached by the High Court is, in our opinion, correct in law. Therefore, the High Court was justified in refusing to answer the first question in all the three cases. In the result these appeals fail and they are dismissed with costs; one set of hearing fee.

S.C.

Appeals dismissed.