J.P. Shrivastava And Sons (Bhopal) ... vs Commissioner Of Income-Tax, Madhya ... on 24 March, 1965

Equivalent citations: [1965]57ITR624(SC)

Bench: J.C. Shah, K. Subba Rao, S.M. Sikri

JUDGMENT

Sikri, J.

1. The two appeals by special leave arise out of a reference made by the Income-tax Appellate Tribunal, Bombay Bench, 'A' - hereinafter referred to as "the tribunal" - referring to the High Court of Madhya Pradesh two questions of law, the questions being :

> (1) Whether in determining the "smallness of profits" made by the applicant for the purpose of section 23A, the Tribunal correctly included the commission of Rs. 41,842 and Rs. 1,16,690 in the applicant's profits of the accounting periods ended 31st March, 1952, and 31st March, 1953, respectively ? and (2) Whether, on the facts and in the circumstance of the case, the Tribunal was justified in upholding the order under section 23A ?"

2. The appellants, J. P. Shrivastava and Sons (Bhopal) Private Ltd, hereinafter called "the assessee-company", was at the relevant time the managing agents of New Bhopal Textile Ltd., hereinafter called "the managed company." Both the assessee-company and the managed company had the financial year as their accounting period. For the accounting period ending March 31, 1952, the assessee-company was entitled to the managing agency commission accounting to Rs. 41,842 under the agreement dated May 2, 1950, which is part of the case. Sub- clause (c) of clause 2 of the agreement prescribed that "such commission shall become due and payable to the managing agency every year immediately on the passing of the audited accounts of the company by the shareholders at a general meeting at each and every year during the continuance of these presents." It appears that the managed company claimed this amounts as expenses for its assessment year 1952- 53, and the assessing authority allowed it as an expense for that year. The assessee-company however, claimed before the Income-tax officer assessing its own income that the commission did not accrue to then during the accounting year 1951-52 as the requisite resolution was not passed during the accounting year but was passed on March 28, 1953. The Income-tax Officer, however, included this amount in the assessment for the previous year ending March 31, 1952. In the books of the company the sum of Rs. 41, 842 was credited only in the financial year 1952-53.

3. In respect of the commission for the accounting year ending March 31, 1953, similar events happened. The amount of Rs. 1,16,690 was credited in the books of the assessee-company not in the

year ending March 31,1953, but in the financial year 1953-54. The Income-tax Officer similarly included this amount in the assessment of the previous year ending March 31, 1953,

4. As far as the managed company was concerned, this amount was debited in its accounts and allowed as expenses by the Income-tax Officer for the previous year ending year March 31, 1953.

5. The assessee-company appears to have accepted this position and not filed any appeal against the inclusion of the said sum in its assessments.

6. The assessee-company declared dividends of Rs. 9,516 and Rs. 18,300 in respect of the accounting period ending March 31, 1952, and March 31, 1953, respectively. The Income-tax Officer, by order dated march 11, 1953, applied section 23A to the year of assessment 1952-53. He came to the conclusion that as the assessee-company and the managed company both had the financial year as the accounting year and that as the assessee-company maintained its accounts on the mercantile basis, it could have taken into consideration the commission accrued to it as per the managing agency agreement. Having obtained concurrence of the Inspecting Assistant Commissioner he held that section 23A of the Income-tax Act applied and based an order that the remaining profits of Rs. 25,037 be deemed to have been declared as dividend among shareholders. He was not impressed with the plea that the profits were small. He arrived at the figure of Rs. 25,037 thus. He took the assessable income at Rs. 58,503 and the income-tax and super-tax payable at Rs. 23,950. Deducting Rs. 9,516 as the dividend declared by the company, he arrived at the balance of Rs. 25,037. In respect of assessment year 1953-54, he held that Rs. 60,583 should be deemed to have been declared a s dividend among the shareholders. From the assessable income of Rs. 1,33,203 he deducted Rs. 54,320 as income-tax and super-tax and the declared dividend of Rs. 18,300.

7. The assessee-company filed two appeals before the Assistant Commissioner, who allowed the appeals for the assessment year 1952-53, and for assessment year 1953-54, he allowed it in part. He held that in terms of clause 2(c) if the agreement, already set out above, the assessee-company did not have any right to receive the commissioner till the general meeting of the managed company was held and the audited accounts were placed before the general meeting. He held that in spite of the fact that the commission has been debited by the managed company in its accounts for the year ending March 31, 1952, and March 31, 1953, the assessee-company could not account for these commissioner till the accounts of the managed company y has been passed. He was of the opinion that the word "profits" in the expression "smallness of profits Made" means accounting profits. He found that for the assessment year 1952-53, the assessee had declared as dividend more than the distributable surplus left with it after payment of the taxes, but in respect of the assessment years 1953-54, whereas the distributable surplus came to Rs. 33,047 i.e., Rs. 58,426, income returned by the assessee less taxes thereon Rs. 25,379 it had declared a dividend of Rs. 18,300 only, the distribution being more that 60 percent. of the distributable surplus but less that 100 per cent. He came to the conclusion on the facts of the case that the company should have declared 100 per cent profits left in its hands after paying the taxes, i,e. Rs. 33,047, instead of Rs. 18,300. Therefore, he directed that a further sum of Rs. 14,747 be deemed to have been distributed as dividend as at the date of the general meeting, i.e., June 30,1950.

8. The Income-tax Officer filed two appeals before the Income-tax Tribunal. The Appellate Tribunal held that in spite of the provision in the agency agreement, it was not correct to say that the managing agency had not earned the commission at the close of the accounting year. It observed that "an ascertained debt had been created in their favour. It was an assets. The payment was only deferred after the shareholders had passed it in the general meeting. The managed company had claimed the amount as a revenue deduction in its own assessment. The managed company's books show the amount to the assessee's credit as the close of the accounting year. As businessman, in order to ascertain the commercial profits, we must add the commission accrued to the profits as disclosed by the books of the managed company. The assessee is trying to be clever. In the accounts of the managed company it has claimed deduction in the year of account as a definite and ascertained liability. In the hands of the assessee it is claimed that it did not earn the incomes . This could certainly not be a businessmans approach to the question.

9. The High Court answered both the question in the affirmative, It held that the assessee-company not having appealed against the assessment order including the sums of its assessable income for the respective years could not contend in the proceeding under section 23A that for calculating the commercial profits these sums should be excluded, and this notwithstanding that under the managing agency agreement of the commission did not accrue till the passing of the audited accounts by the shareholders at a general meeting. It observed that "the time of the accrual and payment of the managing agency commission has no bearing at all on the question whether the managing agency commission income represented real profits or notional profits."

10. The first question that arises is whether it as open to the Income-tax Officer disregard the assessment order and ascertain the true commercial profits. The learned counsel for the respondent urges that the Income-tax Officer cannot disregard the items that went to make up the receipts, but he can reconsider the items on the expenditure side; for example, he can consider the reasonableness of a particular expenditure. In other words he does not contend that the assessment order is final for all purpose. We are unable to agree with this contention. Proceedings under section 23A are separate proceedings, and recently Subba Rao J., speaking for the court, in analysing 23A, observed thus in Commissioner of Income-tax v. Gangadhar Banerjee and Co. :

> "These two concepts, `accounting profits' and `assessable profits', are distinct. In arriving at the assessable profits the Income-tax officer may disallow many expenses actually incurred by the assessee; and in computing his income, he may include many items on notional basis, But the commercial or accounting profits are the actual profits earned by the assessee calculated on commercial principles. Therefore, the words smallness of the assessable profits of the year."

11. It follows that the Income-tax officer, in proceeding under section 23A, must determine commercial profits. In proceeding under section 23 he is not concerned with this. There he is concerned with assessable income or profits. Therefore, it is difficult to appreciate why a finding in the assessment order that a particular income is assessable income or profits necessarily means that that assessable income must form part of the accounting profits.

12. It seems to us that the Appellate Assistant Commissioner was right in going into the question and holding that under the managing agency agreement the assessee-company did not have any right to receipt the commissioner till the general meeting of the managed company was held and, therefore, it could not form part of its accounting profits.

13. Mr. Rajagopala Sastri further urges that in proceedings under section 23A the Income-tax Officer could not exclude "notional income" which has been included in the assessable income and there was nothing "notional" about managing agency commission. But the question which we have to consider is whether managing agency commission due in the accounting period becomes "accounting profits" because an Income-tax Officer erroneously treats it in the assessment order to be due in that period. It seems to us that the answer is plainly in the negative.

14. Mr. Rajagopala Sastri further urged that if we hold that the assessment order was not conclusive on the question, on the facts of this case there was an implied agreement superseding the managing agency agreement by which the managing agency commission became due in the accounting periods. He points out that it is stated in the assessment order dated January 9, 1954, that the amount of Rs. 1,16,690 has been credited to the accounts of the assessee-company in the books of the managed company and that the Appellate-Assistant Commissioner considered the effect of this Act, but the Appellate Assistant did not advert to this fact in its order dated October 8, 1959. He says this fact is also mentioned in the statement of the case. He says that all these facts show that there was implied agreement, superseding the managing agency agreement, that the managing agency commission would be payable to the assessee-company when the amount is credited in the books of the managed company.

15. We are not inclined to deal with this argument as the High Court has not considered this question. We accordingly accept the appeals, set aside the order of the High Court and remand the cases back to the High Court to dispose of the reference in accordance with law and the light of this judgment. In the circumstances, it is not necessary to deal with the second question referred to the High Court. The costs here and in the High Court will be the costs in the case.

16. Appeals allowed.