Supreme Court of India
Commissioner Of Income Tax, ... vs M/S, T.V. Sundaram Iyengar & Sons ... on 11 September, 1996
Author: Sen
Bench: B.P. Jeevan Reddy, Suhas C. Sen

PETITIONER:
COMMISSIONER OF INCOME TAX, MADURAI

Vs.

RESPONDENT:
M/S, T.V. SUNDARAM IYENGAR & SONS LTD.

DATE OF JUDGMENT: 11/09/1996

BENCH:
B.P. JEEVAN REDDY, SUHAS C. SEN

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T SEN,J.

Leave granted.

The amounts in dispute in this case are small and the tax effect is even smaller. We would have declined to go into the dispute at this stage, but for the fact that an interesting question of law is involved.

The income tax assessment of M/s T.V. Sundaram Iyengar & Sons Ltd. for the assessment years 1982-83 and 1983-84 were completed on 1st August, 1984. The Income Tax Officer found that the assessee had transferred an amount of Rs. 17,381/- to the profit and loss account of the company during the accounting period ended on 31st March, 1982 (assessment year 1982-83), and an amount of Rs. 38,975/- (assessment year 1983-84), But these amounts were not included in the total income of the assess, The sums were stated to be credit balances standing in favour of the customers of the company, Since these balances were not claimed by the customers, the amounts were transferred by the assessee to the profit and loss account. There is no dispute that the amount was received by the assessee in course of trade transactions, The Income Tax Officer was of the view that because the surplus had arisen as a result of trade transactions, the amounts had a character of income and had

to be added as income of the assessee for the purpose of income tax assessment.

The Commissioner of Income Tax (Appeals), held in his order that since the parties were not claiming these amounts for a long time, the assessee wrote back these amounts by crediting them to profit and loss account, Such an amount cannot be treated as income either under Section 41(1) or under Section 28, since these were excess trading advances given by the clients to the assessee. In the first instance, these amounts were not revenue receipts, but were capital receipts, when the assess writes back such a credit balance, it would not constitute part of his taxable income. The additions were, therefore, deleted by the Commissioner of Income Tax.

On further appeal, the tribunal took the same view and rejected the contention of the department that these amounts were essentially trading receipts and were of a revenue nature and, therefore, were liable to be included in the computation of assessee's taxable income. The tribunal took note of the decision of Punjab High Court in the case of Punjab Steel Scrap Merchants' Association Ltd. v. Commissioner of Income Tax Punjab (43 I.T.R. 164) but held that the decision of the madras high court in the case of Commissioner of Income Tax, Tamil Nadu, I v. A.V.M. Ltd. (146 I.T.R 355) was binding upon it and, therefore, dismissed the appeal.

An application was made to the tribunal to refer the question of law arising out of the order of the tribunal to the High Court. The application was dismissed by the tribunal holding that no question of law arose in this case, On further application to the High Court under Section 256(2), the High Court held that the question now sought to be agitated was completely concluded by the decision of that Court in case of A.V.M. (supra). Hence this appeal.

It has been contended on behalf of the appellant that there is a conflict of decision among the High Courts on this question, Some of the High Courts have taken the view that if deposits taken by the company in course of its trading operations were not refunded at all or in full, the amounts retained by the assessee and taken to profit and loss account would constitute its income. The second view which has been adopted by some other High Court is that if the deposits taken were originally of a capital nature, its character will not change merely by lapse time and even when the amount is taken to the profit and loss account of the assessee. The origin of the amount may be the business activity of the assessee. But every receipt in the business carried out by the assessee is not income.

It has been urged that on review of the conflicting decisions of the Tribunals, the following question of a law raised by the Department should have been referred to the High Court for its decisions:-

> Whether on the facts and in the circumstances of the case, the appellate Tribunal is right on law in deleting the addition made by the Income Tax Officer representing unclaimed sundry credit balances written back to the Profit & Loss Account by the assessee during the previous year relevant for the assessment year under consideration?

It may be mentioned that three other questions of law on some other points decided by the Tribunal were directed to be referred to the High Court under Section 256(2) of the Income Tax Act. Since the

case relates to assessments for the assessment years 1982-82 and 1983-84, we have decided to deal with and answer the question instead of directing a reference to the High Court for its opinion. The assessee had received deposits in course of its business which were originally treated as capital receipts. Some of the deposits were neither claimed by not returned to the depositor. There is no dispute that the deposits were received in course of the carrying on of the business of the assessee. The only point to be decided so that even though the deposits were of capital nature at the point of time of receipt by the assessee, could its character change by influx on time? IN the case of Morley (H.M. Inspector of Taxes) v. Messrs. Tattersall, (1939) 7 ITR 316 (CA), it was laid down by Lord Greene that the taxability of a receipt was fixed with reference to its character at the moment it was received and that merely because the recipient treated if subsequently in his income account as his own did not alter that character. This principle of law is the basis of several judgments delivered on this issue by our courts. In some cases, the principle laid down by Lord Greene had not been followed because of special facts, but the principle as such has not been doubted.

We shall refer to some of the cases decided by our courts to see how this principle was understood and applied. In the case of Punjab Steel Scrap Merchants" Association Ltd. v. Commissioner of Income Tax, Punjab, (1961) 43 ITR 164, the assessee company was a dealer in scrap iron. It received form its constituents a deposit in advance for the supply of scrap. I the price of scrap iron delivered was more that the amount deposited, the assessee recovered the excess. Where the price of scrap iron delivered was less that the amount deposited and a surplus remained with the assessee and the constituents did not claim the excess amount, the assessee retained the amounts to the credit of the constituents. Unclaimed credit balances, after a period of three years were transferred by the company to its profit and loss account. The amounts so transferred to the profit and loss account were held by the Punjab High Court to be trading receipts and liable to be included in the computation of the assesee's taxable income. It was held that the amount in question were payments towards price of the scrap iron which was to be supplied to the constituents. They were essentially trading receipts. The case of Morley v. Tattersall (supra) was distinguished on the ground that in that case the moneys received by Tattersall were never the moneys of the firm but moneys of the customers.

In the case of Punjab Distilling Industries Ltd. v. Commissioner of Income Tax, Simla, (1959) 35 I.T.R. 510, the assessee carried on business as a distiller of country liquor and sold the produce of its distillery to licensed wholesalers. Under a scheme devised by the Government, the distiller used to charge the wholesalers a price for the bottles in which the liquor was supplied at rates fixed by the Government, which the distiller was bound to repay when the bottles were returned. Additionally, the assessee tool from the wholesalers certain further amounts described as security deposits without the Government's sanction and entirely as a condition imposed by the assessee itself for the sale of its liquor. The moneys described as security deposits were also returned as and when the bottles were returned. The price of the bottles received by the assessee was entered by it in its general trading account while the additional sum was entered in the general ledger under the heading "empty bottles return security deposit account". After the bottles were returned, the assessee was left with a surplus in the security deposit account. The question was whether this amount left with the assessee even after the refunds were made could be treated as business income of the assessee. It was held by a Bench of Three Judges of this Court that the additional amounts

taken as deposits were integral parts of the commercial transactions of the sale of the liquor bottles. When they were paid, they were the moneys of the assessee and remained thereafter the moneys of the assessee. They were the assessee's trading receipts. The balance of these additional sums left after the refunds, were held to be assessable to tax. The case of Morley v. Tattersall (supra) was distinguished, by observing "it was never contented that the amounts when received as price of the constituent's horses were Tattersall's income and the only contention was that they became income upon being transferred to the credit of the partners." It was observed that the case turned on the fact that the moneys received by the Tattersall were never it's moneys; they had been received on behalf of others and that receipt only created a liability towards Tattersall. It was held, " Now it seems to us quite impossible to say that amounts with which we are concerned were not the appellant's moneys in the sense that the constituent's moneys in the hands of Tattersall were not it's own ." Later on, in the judgment, it was pointed out that the moneys were part of the transactions of sale of liquor which produced the profit and, therefore, they had a profit-making quality.

In the case of Commissioner of Income Tax, West Bengal- I, v. Sandersons and Morgans, (1970) 75 ITR 433, principle of Morley v. Tattersall (supra) was applied. In that case, the question was whether interest received by a solicitor on the amounts belonging to his clients was taxable as his income. This court held that amounts received from his clients by a solicitor were not trading receipts, but were in fiduciary capacity. Therefore, the principles laid down in Tattersall's case will apply.

In the case of Pioneer Consolidated Company of India ltd. v. commissioner of Income Tax, U. P. (1976) 104 ITR 686, the assessee transferred an amount of Rs 18,295,00 to it's profit and loss account in the previous year relevant to the assessment year 1957-58. This amount was mainly composed of refunds of customs and other duties paid on behalf of it's customers. The unclaimed surplus was treated as income of the assessee by the department. It was held that though the amount was not income when it was realised, but when it was not claimed by the customers and the assessee chose to treat the unclaimed balance as its income and showed it in its account as such, it could not be said that the income tax authorities committed an error in accepting the statement of the assessee.

In the case of commissioner of Income Tax, Tamil Nadu- I, v. A. V. M. Ltd., (1984) 146 ITR 55, the assessee was a distributor of films. It took security deposits from the exhibitors before handing over films for exhibition. sometimes the exhibitors did not send the collections but instructed the assessee to set off or adjust its security deposits against overdue collections. Some times, the deposits were kept for the purpose of adjustment either wholly or in part against dues of the exhibitor towards payment of collections. It happened that even after adjustment some balance was still left in deposits with the assessee. No one came forward to claim these deposits and the assessee after waiting for five years decided to appropriate the amounts for its own use by making suitable book entries. It was held the amount could be treated as chargeable receipts of the assessee from trade.

In the case of Commissioner of Income Tax, Bombay city- IV v. Batliboi and co. pvt Ltd., (1984) ITR 604, the Bombay High Court dealt with a case where the assesses was a dealer in machinery. The

practice of the assessee company was to take deposits from intending purchasers. The deposits were later adjusted towards purchase price of the machinery that were sold. The surplus deposits, if any, were not generally refunded to the customers. Occasionally, the assessee was unable to refund some of the excess deposits for various reasons. Such excess deposits were written of in the books of the assessee by transferring them to the profit and loss account. It was held by the Division Bench of the Bombay High Court that having regard to the nature of the transaction, the receipts in question could not be considered as amounts held by the assessee for the benefit of anybody else. The deposits were in respect of specific transaction of sale and were adjusted towards the purchase price of the machinery that were sold. It was more in the nature of a trade receipt, especially when the assessee brought such surplus deposits remaining the hands to its profit and loss account. Therefore, the amount was taxable as trade receipt in the hands of the assessee.

There is no dispute that the deposits in the case before us were received from trade parties who had not made any claim for repayment of the balance. The income tax officer has pointed out that the amount had arisen as a result of trading transaction and had a character of income. The Tribunal has, however, held that the amount received in course of trade was of capital nature. The Tribunal, thereafter, straightway applied the principle of Morley v. Tattersall (supra) and held since it was of a capital nature at the time of the receipt, it could not become assessee`s income later on.

We are unable to uphold the decision of the Tribunal. The amounts were not in the nature of security deposits held by the assessee for performance of contract by its constituents. As it appears from the facts of the case, the amounts were depleted by adjustments made from time to time. The commissioner of income tax (Appeal) found that the assessee wrote back the amounts to its profit and loss account because the various trading parties did not claim these amounts for a long time. The amounts represented credit balances in the name of the trading parties and was taken to its profit and loss account. The Commissioner of Income Tax (Appeal) hold that these amounts were not revenue receipts but were of capital nature. Provisions of Section 41(1) were not attracted in the facts of this case because the assessee`s liability to pay back the amounts to its customers had not ceased. The Tribunal agreed with this view.

We fail to see how these deposits were in any way different from the deposits which came for consideration in the case of Punjab Distilling Industries Ltd. v. Commissioner of Income Tax, Simla, (1959) 35 ITR 519. The amounts were not given and retained as security to be retained till the fulfillment of the contract. there is no finding to that effect. The deposit were taken in course of the trade and adjustments were made against these deposits in course of trade. The unclaimed surplus retained by the assessee will be its trade receipt. The assessee itself treated the amount as its trade receipt by bringing it to its profit and loss account.

The basic fact in Morley v. Tattersall (supra) was that Tattersall was an auctioneer. He sold horses on behalf of his clients. The sale proceeds were not his money but were his client's money. Tattersall was entitled to receive only commission out of the sale proceeds. The agreement between Tattersall and his customers was that the sale proceeds would be returned to the customers as and when demanded and not earlier. Sometimes the customers did not demand the payment of the sale proceeds immediately. Such amount remained with Tattersall. But important point was that the

amount was not returnable unless and until demanded by the customers. There was no question of the claim of the customers being barred by limitation in that case. When the amount was taken to the character of the receipts did not change and the amount did not become a trading receipt in the hand of Tattersall.

Tattersall's case was explained and distinguished in the case of Jay's-The Jewellers Ltd. V. Commissioners of Inland Revenue, 29 Tax Cases 274. In that case, the assessee company carried on business of jewellers and pawnbrokers. In course of its business of pawnbroking, it received various articles as pledges on the strength of which it lent money. The pledges were of three types - (a) pledges pawned for a sum of ten shillings or under; (b) pledges pawned for a sum exceeding ten shillings as not exceeding ten pounds; and (c) pledges pawned for a sum exceeding ten pounds. The business of pawnbroking was controlled by the Pawnbrokers Act, 1872. It was pointed out in that Act that if a pledge pawned for ten shillings or under was not redeemed and days of grace, the pledged article would become pawnbrokers' absolute property. There was no dispute that profit arising out of sale of such article would be the pawnbrokers' income. Under the second type of pledges which were pawned for a sum exceeding ten shillings and not exceeding ten pounds, the pledges article did not become the property of the pawnbrokers. If the pledges were sold for more than the amount of the loan and interest due at the time of sale, the excess had to be paid to the pawner on demand provided the demand was made within three years after the sale. In the third type of case where pledges were pawned for a sum exceeding ten pounds, there was no time limit for return of the excess amount of the pawners after the sale. But limit set in after six years. It was held in that case that the surplus receipts in the pawnbrokers' trade became assessable profits. In the court agreed with the assessee's contention that these surpluses were debts owed to the customers and that for three years or six years as the case may be, the company could be called upon to pay the amount to the customers. The whole amount was a legal liability. The Court also agreed with the assessee's contention that the surpluses were not trading receipts in the year in which they were received. However, the Court went on to hold:-

> "The true accountancy view would, I think, demand that these sums should be treated as paid into a suspense account, and should so appear in the balance sheet. The surpluses should not be brought into the annual trading account as a receipt at the time they are received. Only time will show what their ultimate fate and character will be. After three years that fate is such, as to one class of surplus, that in so far as the suspense account had not been reduced by payments to clients, that part of it remaining becomes by operation of law a receipt of the Company, and ought to be transferred from the suspense account and appear in the profit and loss account for that years as a receipt and profit. That is what it in fact is. In that year Jays become the richer by the amount which automatically becomes theirs, and that asset arises out of an ordinary trade transaction. It seems to me to be the common sense way of dealing with these matters."

The principle laid down by Atkinson, J. applies in full force to the facts if this case. If a common sense view if the matter is taken, the assessee; because of the trading operation, had become richer by the amount which if transferred to its profit and loss account. The moneys had arisen out if

ordinary trading transactions. Although the amounts received originally was not of income nature, the amounts remained with the assessee for a long period unclaimed by the trade parties. By lapse of long time, the claim of the deposit became time barred and the amount attained a totally different quality. It became a definite trade surplus. Atkinson, J. pointed out that in Tattersall's case no trading asset was created. Mere change of method of book-keeping had taken place. But, where a new asset came into being automatically by operation of law, common sense demanded that the amount should be entered in the profit and loss account for the year and be treated income. In other words, the principle appears to be that of an amount is received in course of trading transaction, even though it is not taxable in the year of receipt as being of revenue character, the amount changes its character when the amount becomes the assessee's won money because of limitation or by any other statutory or contractual right. When such a thing happens, common sense demands that the amount should be treated as income of the assessee.

In the present case, the money was received by the assessee in course of carrying on his business. Although it was treated as deposit and was of capital nature at the point of time it was received, by influx of time the money had become the assessee's own money. What remains after adjustment of the deposits had not been claimed by the customers. The claims of the customers have become barred by limitation. The assessee itself has treated the money as its own money and taken the amount in its profit and loss account. There is no explanation from the assessee why the surplus money was taken to its profit and loss account even if it was somebody else's money. In fact, as Atkinson, J. pointed out that what the assessee did was the common sense way of dealing with the amounts.

Under these circumstances we dispose of the appeals as under:-

The question proposed to be raised is treated as referred under Section 256(2). The question is answered in the negative and in favor of the Revenue. There will be no order as to costs.