

Supreme Court of India

J.B. Mangharam And Co. vs Commissioner Of Income-Tax, ... on 11 August, 1970

Equivalent citations: 1970 78 ITR 85 SC, (1971) 3 SCC 954 a

Author: J Shah

Bench: A G Shah, K Hedge

JUDGMENT J.C. Shah, J.

1. The appellants, hereinafter called " the assessees", are engaged in the business of manufacturing biscuits and confectionery. They have factories at Gwalior and Hyderabad and have their selling organisation spread all over India. The assessees also carry on a money-lending business at Gwalior in the name and style of Khanchand Lachmandas, hereinafter called " K. L.". In the books of account of K. L. were posted entries for advances made to the Gwalior factory. Under a notification issued by the Central Board of Direct Taxes the income arising to the assessees from the Gwalior factory during the account year ending March 31, 1955, was exempt from payment of income-tax and super-tax.

2. In proceedings for assessment for the year 1954-55 of the assessees the Income-tax Officer disallowed, out of the amounts claimed for " shortage ", Rs. 3,64,000 in the Gwalior factory, and Rs. 35,000 in the Hyderabad factory. Again the Income-tax Officer held that K. L. in its transactions had incurred a loss of Rs. 1,35,566, and since it had invested Rs. 20,88,077 in the Gwalior factory, income from which was exempt from payment of tax, loss amounting to Rs. 59,000 being the amount proportionately attributable to the investments of K. L. in the Gwalior factory of the assessees was liable to be allocated in computing the income of the Gwalior factory, and the balance only in computing the loss of profit of K.L.

3. The Appellate Assistant Commissioner in appeal corrected an arithmetical error and disallowed under the head "shortage" in the Gwalior factory Rs. 1,60,000 only, and maintained the amount of Rs. 35,000 disallowed in respect of the Hyderabad factory. In the view of the Appellate Assistant Commissioner, K. L. had advanced Rs. 16,85,534 and not Rs. 20,88,077 as determined by the Income-tax Officer and the proportionate amount debitible out of the loss suffered by K. L. to the Gwalior factory was Rs. 47,550.

4. In second appeals by the assessees and the Commissioner of Income-tax, the Income-tax Appellate Tribunal considered the evidence and held that the modifications made by the Appellate Assistant Commissioner in the amounts disallowed under the head " shortage " were " fair and reasonable ". The Tribunal also upheld the allocation of loss to the Gwalior factory out of the loss suffered by K.L. The Tribunal observed :

The partners' capital was mixed up by the branch with its borrowings and in the absence of evidence as to which fund went into the investment of the Gwalior factory, it is not possible for us to give a finding on the question as to whether the entire capital or which portion of it was invested in the Gwalior branch out of the partners' capital contribution. The best and the reasonable course under these circumstances was to allocate the loss in the proportion of the capital invested in the Gwalior branch to the total capital invested in the money-lending business by the branch. The allocation

which has been made on that basis appears to us to be quite fair and reasonable.

5. The Tribunal rejected an application of the assessee under Section 66(1) of the Income-tax Act, requesting that certain questions be referred for opinion to the High Court. The assessee then applied to the High Court of Madhya Pradesh for an order directing the Tribunal to draw up a statement of case and to refer the following questions of law which arose out of the order of the Tribunal:

(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in upholding the addition of Rs. 1,60,000 on account of excessive shortage ?

(2) Whether, on the facts and circumstances of the case, the Tribunal Was right in upholding the addition of Rs. 1,60,000 even though the applicant had led evidence to show that the shortage would not be regarded as unreasonable or excessive in the line of business carried on by the applicant ?

(3) Whether there was any evidence on which the Tribunal could sustain the addition of Rs. 1,60,000 in Gwalior factory and Rs. 35,000 in Hyderabad factory on account of excessive shortage ?

(4) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in upholding the allocation of loss suffered by one of the branches, viz., Khanchand Lachmandas ?

(5) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in allocating the loss of Khanchand Lachmandas in proportion of capital invested in the Gwalior branch to the total capital invested in the money-lending business by the branch ?

6. In the view of the High Court the first three questions raised by the assessee contemplated an enquiry whether the disallowance of Rs. 1,60,000 out of the amount disclosed by the assessee under the head " shortage of raw materials " was justified on the facts and in the circumstances of the case. In their view there was material before the Tribunal to sustain the amount of Rs. 1,60,000 disallowed, the disallowance not being based on any irrelevant material, and accordingly no question of law in that behalf arose out of the order on which the Tribunal could be directed to state a case.

7. Referring to the remaining two questions, the High Court observed :

In regard to the other two questions (Nos. (4) and (5)) sought to be referred, learned Counsel for the assessee urged that no loss sustained in the money-lending business could at all be allocated to the assessee-firm. This was never the stand taken by the assessee before the taxing authorities or the Tribunal There can, therefore, be no question of the Tribunal being required to state the case of the assessee on a point which was never urged before the Tribunal and which does not arise out of the Tribunal's decision in the appeal preferred by the assessee.

8. In our judgment, the High Court was right in declining to direct the Tribunal to state a case on questions Nos. (1), (2) & (3). The conclusions of the Tribunal relating to the "shortages" admissible in determining the profits of the assesseees are conclusions on questions of fact based on appreciation of evidence, and the question of correctness of the quantum of allowance for "shortages" claimed by the assesseees cannot be referred to the High Court for opinion in exercise of its advisory jurisdiction.

9. But we are unable to agree with the High Court that no question of law arose out of the allocation of loss suffered by K.L. The claim of the assesseees for exemption from payment of tax on the income earned by them from the Gwalior factory was upheld, but in computing the income the Income-tax Officer, the Appellate Assistant Commissioner and the Tribunal sought to take into account a part of the loss suffered by K.L. Whether a share in the loss by K.L. was liable to be taken into account and allocated in the account of the Gwalior factory in our judgment raised a question of law. Before the Tribunal it was contended on behalf of the assesseees that since the partners' capital exceeded the investments by K.L. in the Gwalior factory, it must be presumed that the entire investment had gone out of the account of K.L., out of the partners' capital and not out of the borrowings that K.L. had made, and on that score no part of the loss could be allocated to the Gwalior factory and the entire loss must be taken into account in the working of K.L. The Tribunal rejected that contention because in their view the "partners' capital and the borrowings made by K.L. went into the investment of the Gwalior factory and it was not possible to give a finding whether the entire capital which was invested in the Gwalior factory was out of the partners' contribution", and that "the best and reasonable course was to allocate the loss in the proportion of the capital invested in the Gwalior factory to the total capital invested in the money-lending business by" K.L.

10. K.L. was the name of the financial organizations of the assesseees : it had no separate existence as a taxable entity. Separate accounts of the dealings of that organization were maintained and the loss suffered in its transactions was determined as if it were a distinct taxable entity. The income of the assesseees earned out of the working of the Gwalior factory was exempt from tax. In computing the income of that factory for giving effect to the notification it was necessary to decide whether any part of the loss suffered in the transaction of K.L. was liable to be taken into account. The assesseees were entitled to and did contend that no part of the loss suffered by the financial organization of the assesseees was liable to be taken into account in determining the income exempt from liability to pay tax. In our judgment, the High Court was in error in holding that no question of law arose on which a statement of case could be directed.

11. We set aside the order of the High Court and direct that the Tribunal do submit a statement of case on the following question to the High Court of Madhya Pradesh :

Whether, on the facts and in the circumstances of the case, any part of the loss suffered by Khanchand Lachmandas was liable to be allocated between the Gwalior factory and the other ventures of the assesseees in determining their taxable income for the assessment year 1954-55 ?

12. There will be no order as to costs in this appeal.