

Supreme Court of India

Commissioner Of Income-Tax, West ... vs Calcutta Discount Co., Ltd on 10 April, 1973

Equivalent citations: 1974 AIR 1358, 1973 SCR (3) 952

Author: K Hegde

Bench: Hegde, K.S.

PETITIONER:

COMMISSIONER OF INCOME-TAX, WEST BENGAL CALCUTTA

Vs.

RESPONDENT:

CALCUTTA DISCOUNT CO., LTD.

DATE OF JUDGMENT 10/04/1973

BENCH:

HEGDE, K.S.

BENCH:

HEGDE, K.S.

KHANNA, HANS RAJ

CITATION:

1974 AIR 1358

1973 SCR (3) 952

1974 SCC (3) 260

ACT:

Income-tax-Right of assessee to avoid tax.

Appellate Tribunal--disposal of appeal on technicalities--Duty to consider substance of the matter.

HEADNOTE:

The assessee company floated a subsidiary company during the relevant previous year and transferred to that subsidiary company various shares held by it at a certain rate.. The authorities under the Income-tax Act, 1922, held that the assessee and its subsidiary were two different legal entities, that the transaction was a bona fide transaction and that the assessee had not made any secret profits out of that transaction. The Income-tax officer, however, valued the shares transferred at the market rate and held that the assessee company must be deemed to have made a profit. In appeal, the Appellate Assistant Commissioner set aside the order of the Income-tax Officer and remitted the case to him for finding out whether the assessee had really made any profits from the transaction. The Tribunal dismissed the appeal of the Income-tax Officer against that order, summarily, on the ground that the Income-tax Officer had not taken the necessary pleas that the decision of the Appellate Assistant Commissioner was incorrect in law. On reference,

the High Court held that the order of the Tribunal was an interlocutory one and that an application to make a reference to the High Court did not lie.

Dismissing the appeal to this Court.

HELD: (1). The Tribunal, instead of dealing with the substance of the matter had been unduly influenced by procedural technicalities. The conclusion of the Tribunal that the appeal memorandum was not in accordance with law was also not correct as no specific formula is necessary for seeking relief at the hand of any court or tribunal if the necessary grounds are taken. [955D-E]

(2) But the view of the Appellate Assistant Commissioner was correct and there was no necessity to decide whether the Tribunal erred in dismissing the appeal summarily. [958F-G] It is a well accepted principle of law that an assessee can so arrange his affairs as to minimise his tax burden. Hence, if the assessee in this case arranged its affairs in such a manner as to reduce its tax liability by starting a subsidiary company and transferring its shares to that subsidiary company and thus forgoing part of its own profits and at the same time enabling its subsidiary to earn some profits, such a course is not impermissible under law. [957E-F]

Commissioner of Income Tax, Gujarat, v. A. Raman and Co. 67 I.T.R. II followed.

Sri Ramalinga Choodambikai Mills Ltd. v. Commissioner of Income-tax, Madras, 28 I.T.R. 952, approved.

Sharkey (Inspector of Taxes) v. Wernker, 1956 Appeal Cases, 58 and Dooar's Tea Co. Ltd. v., Commissioner of Agricultural West ,Bengal, 44, I.T.-R. G, distinguished and explained, 953

#### JUDGMENT:

CIVIL APPELLATE JURISDICTION : C.A.No. 495 of 1970. Appeal by certificate from the judgment and order dated July 25, 1969 of the Calcutta High Court in Income-Tax Reference No. 61 of 1966.

S.C. Manchanda, S. P. Nayar and R. N. Sachthey, for the appellant. Sachin Chaudhuri, M. C. Chagla, T. A. Ramachandran and D. N. Gupta, for the respondent. The Judgment of the Court was delivered by HEGDE, S.-This is an appeal by certificate. It arises from the decision of the Calcutta High Court in a reference under S. 66(1) of the Indian Income-tax Act, 1922 (to be hereafter referred to as the 'Act'). Three questions of law were referred to the High Court for ascertaining its opinion. Those questions are :--

- (1) Whether in view of the fact that the Tribunal's order dated 22nd July 1964 was an interlocutory order the Tribunal was competent to entertain an application purported to be under Section 66(1) of the Indian Income Tax Act, 1922, in respect of such order
- ? (2) If the answer to question No. 1 above be in the, affirmative, whether on the facts

and in the circumstances of the case the Tribunal exercised its discretion judicially in not allowing the applicant's petition for raising the additional grounds ?

(3) Whether on the facts and in the circumstances of the case, the Tribunal erred in dismissing the appeal summarily on the grounds stated in its appellate order dated 3-9-1964 ?

The High Court answered the first question in favour of the assessee and came to the conclusion that it was unnecessary to answer the remaining two questions. Mr. Manchanda, learned counsel for the Revenue did not seek to get any answer from us on questions 1 and 2. His arguments were confined to question No. 3.

The material facts of the case as could be gathered from the case stated by the Tribunal are as follows-- Herein we are concerned with the assessment of the assessee for the assessment year 1947-48, relevant accounting year being the financial year 1946-47, The assessee company floated a subsidiary company named Messrs. Clive Row Investment (Hold-

L797Sup.CI/73 ing) Co., Ltd., during the relevant previous year and transferred to that subsidiary company various shares held by it. In return the subsidiary company transferred to the assessee company its shares of the value of Rs.1- 38,81,173/-. The book value of the shares transferred by the assessee company to its subsidiary was Rs., 1,66,69,391/-. Thus the assessee company sustained a loss of Rs. 27,02,398,- but it did not claim that loss in the return made on, the ground that the transfer in question was made to its own subsidiary. The Income Tax Officer valued the shares transferred by the assessee company to its, subsidiary at the market rate and on that basis came to the conclusion that the assessee company must be deemed to have made a profit of Rs. 1,02,40,546/-. The Income Tax Officer did not hold that the transaction between the assessee company and its subsidiary was not a bona fide transaction or the assessee company had made any secret profits out of that transaction. In other words, according to the Income Tax Officer even though the assessee company had not made any profits in fact, it must be deemed to have made a profit of Rs. 1,02,40,546/- solely on the ground that the market value of the shares transferred by the assessee company to its subsidiary is much more than their book value.

Aggrieved by the decision of the Income Tax Officer the assessee went up in appeal to the Appellate Assistant Commissioner. The Appellate Assistant Commissioner opined that the basis adopted by the Income Tax Officer was unsustainable and hence set aside the order of the Income Tax Officer and remitted the case back to that Officer for finding out whether the assessee had really made any profits in the transaction in question. As against that order the Income Tax Officer went up in appeal to the Income Tax Appellate Tribunal. In the appeal memo the, Income Tax Officer took only three grounds, namely :

"(1) For that on the facts and in the circumstances of the case the learned Appellate Assistant Commissioner of Income-tax should have held that the shares transferred by the assessee company to its subsidiary during the year of account should be valued, for the purposes of assessment under the Indian Income-tax Act, at their

market price.

(2) For that the learned Appellate Assistant Commissioner of Income-tax misappreciated the facts of the present case and wrongly applied the decision of the ,Madras High Court in 28 I.T.R. 952.

(3) For that the learned Appellate Assistant Commissioner, ignored the principle that the cases of the present type the sum to be taken for the disposal of the stock-in trade of the assessee is not what the assessee has chosen to treat as his receipt but what he would normally have received for it in the due course of trade."

He did not plead that the order of the Appellate Assistant Commissioner was incorrect in law and therefore, should be set aside. It appears that at the hearing the counsel for the assessee took the plea that as the Income Tax Officer had not taken the ground that the order of the Appellate Assistant Commissioner was not in accordance with law, consequently it should be set aside, the Tribunal could not grant the relief asked for by the Income Tax Officer. At that stage, as, seen from the records, the Income Tax Officer applied for amending his appeal memo but that prayer was rejected by the Income Tax Appellate Tribunal. Ultimately the Tribunal dismissed the appeal of the Income Tax Officer summarily on the ground that necessary pleas have not been taken. Thereafter, at the instance of the Revenue the questions, set out earlier were referred to the High Court.

The procedure adopted by the Tribunal appears to us to be somewhat strange. The Tribunal instead of dealing with the substance of the matter appears to have been unduly influenced by procedural technicalities. We are also not impressed with the conclusion of the Tribunal that the appeal memo was not in accordance with law. No specific formula, is necessary for seeking relief at the hands of any court or Tribunal if the necessary grounds are taken in the appeal memo.

Had we come to the conclusion that the decision of the Income Tax Appellate Commissioner was wrong in law we would have had no hesitation in answering the three questions formulated above in favour of the Revenue and directing the Tribunal to reconsider the matter. But, in the view that we are taking the answers to those questions would become purely academic.

The Appellate Assistant Commissioner came to the conclusion that the assessee and its subsidiary were two different legal entities. This conclusion was not and could not be challenged. All the authorities under the Act have come to the conclusion that the transaction between the assessee and its subsidiary company was a bona fide transaction and the assessee had not made any secret profits out of the transaction in question. It may be that the assessee had transferred its valuable shares at cost price to its subsidiary in order to so arrange its affairs as to reduce its tax burden. The question whether such an arrangement is permissible or not, we shall presently examine.

As seen earlier the Appellate Assistant Commissioner came to the conclusion that unless the Income Tax Officer on the basis of material before him is able to come to the conclusion that the assessee had really made profits in the transaction, it is not permissible for him to add back to the assessee's return any fictional income. In our opinion that conclusion is fully in accordance with law. The question that when an assessee transfers some of his stock-in trade to another person at a price less

than the market price, whether that assessee can be considered to have made any profit merely because he has transferred some of his stock-in trade not at the market price but at a lesser price, came up for consideration before the High Court of Madras in *Sri Ramalinga Choodambikai Mills Ltd. v Commissioner of Income-tax, Madras*(1) The facts of 'that case as set out in the head-note are a limited company sold certain goods showed in its stock-in trade to its managing agency firm and to another firm in which one of its directors was interested. The sales in question were held to be bona fide sales. At the same time it was held that the goods were sold at a concessional rate. The Income Tax Officer sought to tax the assessee therein after computing the profits earned by that firm on the basis of the market price of the goods, sold and not the actual price at which those goods were sold. The assessee challenged the said basis. The Tribunal upheld the contention of the assessee. It came to the conclusion that the assessee had, in reality, made no profits at all. The High Court agreed with the conclusion reached by the Tribunal. It opined that in the absence of any evidence to show either that the sales were sham transactions or that the market prices were in fact paid by the purchasers, the mere fact that the goods were sold at a concessional rate to benefit the purchasers at the expense of the company would not entitle the Income-tax department to assess the difference between the market price and the price paid by the purchasers, as profits, of the company.

A somewhat similar question came up for consideration before this Court in *Commissioner of Income Tax, Gujarat v. A. Raman and Co.* (2) It is unnecessary to set out the facts of that case and it is sufficient to refer to the relevant observations in the judgment. Shah J. (as he then was), speaking for the Court stated the law at page 17 of the Report thus:-

"The plea raised by the income-tax officer is that income which could have been earned by the assessee was not earned, and a part of the income was earned by the Hindu undivided families. That according to the Income-tax Officer was brought about by a subterfuge (1) 28 I. T. R. 952.

(2) 67 I. T. R. 11 or contrivance. Counsel for the Commissioner contended that if by resorting to a 'device or contrivance' income which would normally have been earned by the assessee is divided between the assessee and another person, the Income-tax Officer would be entitled to bring the entire income to tax as if it had been earned by him. But the law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands : income which he could have, but has not earned, is not made taxable as income accrued to him. By adopting a device, if it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous assessment a case for commencing a proceeding for reassessment under section 147 (b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A tax payer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act.

Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented.' It is a well accepted principle of law that an assessee can so arrange his affairs as to minimise his tax burden. Hence, if the assessee in this case has arranged his affairs in such a manner as to reduce his tax liability by starting a subsidiary company and transferring its shares to that subsidiary company and thus foregoing part of its own profits and at the same time enabling its subsidiary to earn some profits, such a course is not impermissible under law. Mr. Manchanda contented that a person should not be allowed to adopt a device by which he gives up something through the tight hand and receives the same through the left hand. According to him there is no difference between the assessee and its subsidiary and, therefore, when the assessee tries to make profits through its subsidiary, we must presume that the profits were made by the assessee itself. In support of that contention he sought to place reliance on the decision of the House of Lords in *Sharkey (Inspector of Taxes) v. Wernher*(1). Therein, the assessee was a breeder of horses. She also had racing stables. She transferred some horses from her stud to (1) [1956] Appeal Cases 58.

the stables. In so doing she debited in her accounts only the cost of breeding the horses and not their market price. The question arose, whether in computing her income the market price of those horses or merely the cost of breeding them should be taken into consideration. The House of Lords upheld the contention of the Revenue by majority that in computing the profits of the assessee the market price of those horses should be taken into consideration. The ratio of this decision is similar to the ratio of the decision of this Court in *Dooar's Tea Co. Ltd. v. Commissioner of Agricultural Income-tax, West Bengal*(1). Therein, a tea garden owner raised in his own garden bamboo, thatch and some other agricultural produce. He utilised those products for the purpose of its tea business. The question arose whether while assessing the tea garden owner under the Bengal Agricultural Income-tax, Act the cost of raising bamboo, thatch, etc., should be taken into consideration or their market price should be taken into consideration. 'This Court upheld the contention of the Revenue that the market price of those products should be taken into consideration in computing the agricultural income of the assessee. The ratio of the decision in *Warnher's* as well, as in *Dooar's Tea Co.'s* case does not bear upon the question of law arising for decision in this case. Therein what the courts had to consider was where a person carrying on a trade disposes of a part of his goods not by way of sale in the course of trade but for his own use, whether the production cost of such goods or the market price of those goods should be taken into consideration. But, in the present case we are called upon to consider the question whether when one trader transfers his goods to another trader at a price less than the market price, the taxing authority can take into consideration the market price of those goods, ignoring the real price fetched. As mentioned earlier the latter question is no more *res Integra*. It is concluded by the decision of this Court in *A Raman and Co.'s Case* (supra).

For the reasons mentioned above we are of the opinion that the conclusion reached by the Appellate Assistant Commissioner is in accordance with law and it would be an exercise in futility to answer the third question set out above in favour of the Revenue and remit the case back to the Tribunal. In this view of the matter we do not propose to answer that question.

In the result this appeal fails and the same is dismissed with no order as to costs.

P.V.S.

Appeal dismissed.

(1) 44 1 T. R. 6.