

(1972) 07 MAD CK 0003

In the Madras High Court

Case No : Tax Case No"s. 314 and 326 of 1996 (Reference No"s. 79 and 86 of 1966)

Commissioner of Income Tax

APPELLANT

Vs

A.R. Adaikappa Chettiar and Another

RESPONDENT

Date of Decision : 19-07-1972

Acts Referred:

Income Tax Act, 1922 — Section 2(6C), 34(1)

Income Tax Act, 1961 — Section 147, 2(24)

Citation : (1973) ILR (Mad) 124 : (1973) 91 ITR 90

Hon'ble Judges : V. Ramaswami, J;G. Ramanujam, J

Bench : Division Bench

Advocate : V. Balasubramanyan and J. Jayaraman, for the Appellant; S. Swaminathan and K. Ramgopal, for the Respondent

Judgement

Ramanujam, J.—As the question of law involved in both the references is the same, they are dealt with together.

2. One Messrs. G.V. Govindaswami Naidu and Company, a firm of four partners consisting of all the respondents in T. C. No. 326 of 1966, and

the first respondent in T. C. No. 314 of 1966, was the managing agent of Sri Venkatesa Mills Ltd., Udumalpet, hereinafter referred to as "" the

company "", up to the assessment year 1959-60. The four partners were also the shareholders as well as the directors of the said Venkatesa Mills

Ltd. Subsequently, the firm was reconstituted under a partnership deed dated December 11, 1959, with fourteen partners including the above four

persons who continued to be the shareholders as well as directors of the company.

3. The company in its assessment had claimed allowance for the expenses incurred by it during the assessment years 1957-58 to 1962-63 for the

maintenance of its motor cars. The Income Tax Officer, Coimbatore, who made the assessment on the company for the said years disallowed a

portion of the company's claim on the ground that the cars were partly used by the managing agents of the company for their private purposes.

The amounts so disallowed by him were as under:

Rs.

1957-58 13,135

1958-59 16,390

1959-60 12,725

1960-61 12,500

1961-62 7,000

1962-63 8,000

4. This allowance was made u/s 10(4A) of the Income Tax Act, 1922, and Section 40(c) of the Income Tax Act, 1961.

5. The Income Tax Officer, Coimbatore, communicated this information to the Income Tax Officer, Karaikudi, where the respondents in T. C.

No. 314 of 1966 resided, with a view to include the proportionate share of the expenses in their hands as the partners of the managing agency firm

u/s 2(6C)(iii) of the Income Tax Act, 1922. On receipt of this information the Income Tax Officer re-opened their original assessments u/s 34(1)

(b) of the Income Tax Act, 1922, and u/s 147 of the Income Tax Act, 1961. In these reassessment proceedings the assessees contended that the

company's cars have not been used by them for their private purposes and that in fact no benefit or amenity directly or indirectly flowed out of the

amounts disallowed in the company's assessment u/s 10(4A). The Income Tax Officer did not accept these contentions and held that such

contentions should have been raised only in the assessment of the company and not in the assessments of the partners of the managing agency firm

and that the finding of the Income Tax Officer, Coimbatore, who had completed the assessment on the company was final and binding upon him.

He, therefore, treated the one-fourth portion out of the amounts disallowed in each year as the income of the assessees u/s 2(6C)(iii) of the Income

Tax Act, 1922, and u/s 2(24)(iv) of the Income Tax Act, 1961.

6. The assessments in respect of the other partners of the managing agency firm

were similarly reopened by the Income Tax Officer, Coimbatore, for each of the above years by adding one-fourth of the amounts disallowed to the income of each of them.

7. The above four persons, the assesseees, preferred appeals to the Appellate Assistant Commissioner against the orders of the Income Tax

Officers, and contended that the reopening of their original assessments was not justified and that the inclusion of a portion of the car expenses

disallowed in the company's assessment as the income of the assesseees was illegal. The Appellate Assistant Commissioner, however, negatived

both the contentions, and held that the reopening of the original assessments was valid, that the view taken by the Income Tax Officer,

Coimbatore, while making the assessments on the company should be canvassed only in appeals against those orders and that it was not open to

the assesseees to question it in their personal assessments. He, therefore, confirmed the orders of the Income Tax Officer.

8. The assesseees preferred further appeals to the Income Tax Appellate Tribunal, and in those appeals the assesseees did not challenge the validity

of the reassessment proceedings u/s 34(1)(b) of the Act of 1922 and u/s 147 of the Act of 1961, but only questioned the legality of the inclusion of

the proportionate expenses in the income of the assesseees u/s 2(6C)(iii) of the old Act and u/s 2(24)(iv) of the new Act. The Tribunal posed for

itself the following two questions for its consideration:

(1) Whether the amounts in question were benefits or perquisites obtained by the assesseees from the company ? and

(2) Whether the assesseees came within the category of the persons described in Section 2(6C)(iii) of the Indian Income Tax Act, 1922, or Section

2(24)(iv) of the Income Tax Act, 1961 ?

9. With regard to the first question the Tribunal was of the view that the use of the cars by the assesseees for their private purposes could not have

been under an arrangement with the company, that the unauthorised use of the company's cars by the assesseees could not be called a benefit or

perquisite obtained from the company within the meaning of Section 2(6C)(iii) of the old Act, and Section 2(24)(iv) of the new Act and that the

fact that a portion of the car expenses were disallowed in the company's assessment on the ground that the cars were not always used for the

business of the company did not straightaway lead to the conclusion that the amount disallowed constituted a benefit or perquisite so far as the assesseees were concerned. The Tribunal further held that, in the absence of evidence, it could not be assumed that all the above four partners of the managing agency firm had made equal use of the company's cars for their private purposes and that, therefore, the apportionment of a one-fourth share of the expenses to each of the four partners was not justified.

10. As regards the second question, the Tribunal observed that in the assessments of the company, a portion of the claim for expenses was allowed only on the ground that the cars were partly used by the managing agents of the mills for their private purposes, that such benefit or perquisite, if any, received by the assesseees was only in their capacity as managing agents of the mills, that in view of the fact that the assesseees did not hold shares carrying 20 per cent. of the voting power, they could not be brought in under the category of "any other person who has a substantial interest in the company" described in Section 2(6C)(iii) of the old Act, or u/s 2(24)(iv) of the new Act and, that therefore, the one-fourth of the disallowed portion of the car expenses cannot be included in the assessee's income.

11. The view of the Tribunal on both the questions has been challenged by the revenue in these two references. Therefore, the common question for consideration before us is:

Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in deleting the additions made u/s 2(6C)(iii) of the Indian Income Tax Act, 1922, and u/s 2(24)(iv) of the Income Tax Act, 1961, to the income of the assesseees in respect of the assessment years 1957-58 to 1962-63 ?

12. Before proceeding to consider the above question, we have to point out that in the question of law referred in T. C. No. 314 of 1966, reference to Section 40(c) of the new Act is a mistake for Section 2(24)(iv).

13. Section 2(6C) of the old Act is as follows :

" Income" includes-

(i) dividend ;

(ii) the value of any perquisite or profit in lieu of salary taxable u/s 7 ;

(iii) the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by any other

person who has a substantial interest in the company (that is to say, who is concerned in the management of the business of the company, being the

beneficial owner of shares, not being shares .entitled to a fixed rate of dividend whether with or without a right to participate in profits, carrying not

less than twenty per cent. of the voting power), and any sum paid by any such company in respect of any obligation which but for such payment

would have been payable by the director or other person aforesaid.

14. Section 2(24) of the new Act, which is the correct provision, reads:

" Income " includes-

(i) profits and gains;

(ii) dividend;

(iii) the value of any perquisite or profit in lieu of salary taxable under Clauses (2) and (3) of Section 17 ;

(iv) the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who

has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any

obligation which, but for such payment, would have been payable by the director or other person aforesaid;.....

15. As the scope of the above provisions are substantially the same, we will consider the matter in the light of Section 2(6C)(iii) of the old Act. The

Income Tax Officer, Coimbatore, who made the assessments on the company disallowed a portion of the expenditure on the motor cars u/s

10(4A) of the old Act and Section 40(c) of the new Act as benefits allowed to the managing agents. He has not, however, chosen to reopen the

assessments made on the managing agency firm, but has reopened or caused the reopening of the assessments of the assessees who were the

partners of the said firm. In view of the fact that the managing agency firm is found to have had the benefit of the use of the cars of the company

during the relevant years, it has been contended by the learned counsel for the assessees, that even if the user of the cars by the managing agency

firm is established as found by the Income Tax Officer, there cannot be any reopening of the individual assessments of the partners without

reopening the assessments on the firm and including the alleged benefit in the income of the firm. The learned counsel for the assessee also

contended that there is no specific finding by any of the authorities that the assessee had in fact made use of the cars and that without such a

finding the Authorities below have proceeded to assume the use of the company's cars by the assessee and have equally apportioned the value of

the alleged benefit to each of the assessee. It is also urged by the assessee that the Income Tax Officer and the Appellate Assistant

Commissioner proceeded on the basis that the assessee had made use of the cars as partners of the managing agency-firm and, therefore, the

value of such benefit obtained from the company is includible in the income of the assessee in their capacity as managing agents, and not in their

capacity as directors of the company, and that the Tribunal is justified in holding that Section 2(6C)(iii) cannot be invoked in the case of the

petitioners as they are not persons who have substantial interest in the company (that is to say, who is concerned in the management of the business

of the company, being the beneficial owner of the shares, carrying not less than 20 per cent. of the voting power).

16. The learned counsel for the revenue, however, submits that the Tribunal has found that the cars have been partially used by the assessee, but

that the company has not authorised the user of the same by the assessee, and that even unauthorised user will constitute a benefit u/s 2(6C)(iii) of

the old Act. The learned counsel for the revenue, though concedes that the assessee cannot be brought in u/s 2(6C)(iii) as "" any other person who

has a substantial interest in the company (that is to say, who is concerned in the management of the company, being the beneficial owner of the

shares, carrying not less than 20 per cent. of the voting power) "" submits that they would squarely come under that section as directors who had

obtained a benefit from the company. As regards the contention of the assessee that without reopening the assessment of the managing agency firm

and including the disallowed portion of the expenditure on cars in the income of the firm, it is not possible for reopening the assessments of the

partners, the learned counsel for the revenue contends that the said point was not raised before the authorities below at any earlier stage, and that,

therefore, such a point should not be allowed to be raised now.

17. In the face of these rival contentions it has to be considered whether the assessee obtained any benefit or perquisite from the company and, secondly, whether the assessee comes within either of the category of persons described in Section 2(6C)(iii). The basic fact to be found out is as to whether the assessee had used the company's cars for their private purposes. The learned counsel for the assessee appears to be right in his submission that there is no finding by any of the authorities including the Tribunal that there was in fact such user. Both the Appellate Assistant Commissioner as well as the Income Tax Officers have proceeded on the basis that the finding given by the Income Tax Officer who partially disallowed the expenditure on cars in the assessments of the company on the ground that the managing agents have partly used the cars for their own purposes is binding on them. The Tribunal also did not go into that question as to whether in fact the user of the company's cars by the assessee for their private purposes has been established. But it proceeds to hold that even if the user is established, it should have been unauthorised as the revenue has not established any arrangement between the company and the assessee to set apart the company's cars for the private use of the assessee. The Tribunal is of the view that such an unauthorised use of the company's cars by the assessee would not come within the category of benefit or perquisite obtained from the company, as the benefit or perquisite was not under a regular arrangement between the assessee and the company. The Tribunal also held that on the disallowance of the claim of the company towards the expenditure on cars on the ground that the cars have not always been used for the business of the company, it does not automatically follow that the amount disallowed constituted a benefit or perquisite in the hands of the assessee, that even assuming that the unauthorised use of the car by the assessee could be called a benefit or perquisite, the value of that benefit or perquisite has still got to be determined so far as each of the assessee is concerned, that it cannot be assumed that all the four assessee made equal use of the cars for their private purposes, that the Income Tax Officer has not considered the question of the value of the benefit in the case of each assessee and that his assumption that all the four partners made equal use of the company's cars for their private purposes without any material was not justified. Though there is no specific finding that the assessee had made

use of the company's cars partly for their private purposes, the Tribunal proceeded to dispose of the case on the basis that the user, if any, should

have been unauthorised and that such an unauthorised user will not constitute a benefit or perquisite as contemplated in Section 2(6C)(iii) of the old

Act. We also propose to dispose of the case on the basis that the assessee had made use of the company's cars for their own purposes but that

such user was without authority of the company for purpose of considering the question as to whether Section 2(6C)(iii) of the old Act or Section

2(24) of the new Act will stand attracted in this case. We are not inclined to go into the question of fact as to whether the assessee had in fact

used the company's cars for their private purposes. Though the assessee would contend before us that the authorities below were in error in

assuming that the disallowance of a portion of the expenditure on cars in the company's assessment will automatically establish the actual user of

the company's cars by the assessee, they have not invited the Tribunal to give a specific finding on such a question of fact. We, therefore,

proceed to consider the question referred on the basis that there has been an unauthorised user of the company's cars by the assessee. In the light

of the provisions in Section 2(6C)(iii) it is to be seen whether such an unauthorised user was a benefit or perquisite obtained by the assessee, and

whether the assessee obtained such benefit or perquisite in their capacity as directors.

18. The contention of the learned counsel for the revenue is that any benefit or perquisite obtained willy-nilly, whether authorised or unauthorised,

will attract the above section. We are not inclined to accept the above contention. In our view, the benefit or perquisite obtained should be by

some sort of arrangement with the company so as to attract Section 2(6C)(iii). If the submission that even unauthorised benefit would attract the

said section is accepted, it would mean that even an Article or money of the company misappropriated or forcibly taken against the wishes of the

company by a director or other person referred to in that section will come within the scope of that section. The words "" benefit or perquisite

obtained "" from a company would take in, in our opinion, only such benefit or perquisite which the company had agreed to provide and which the

person concerned could claim as of right based on such agreement and that a mere advantage derived from the company without its authority or

knowledge will not amount to a benefit or perquisite obtained. We are not in a position to agree with the contention of the revenue that the word

obtained"" occurring in the said section need not be agreement-oriented, that the word "" obtained "" merely meant "" taken "" and that if the directors

are in a position to take a benefit with a view to help themselves, even without the authority of the company or against its wishes, they will be

governed by the above provision, and that both authorised and unauthorised benefits taken or received are to be treated alike for the purpose of

this section. If the contention of the revenue is accepted, it will mean that an advantage taken by a director or other person without the authority of

the company or against the wishes of the company will constitute a benefit or perquisite obtained from the company by such director or other

person. If there is an unauthorised taking of an advantage or a benefit by a director from the company without its authority or knowledge, the

company can always insist on the restitution of such advantage or benefit taken by a director and enforce the same legally in a court of law. In such

cases there is a definite legal obligation to restore the advantage or benefit taken by a director without the authority of the company and it is not

possible to hold that such advantage or benefit can be brought to charge.

19. Before a person could be said to have obtained a benefit or perquisite from a company, there should be some legal or equitable claim, even

though it be contingent or contested in nature. A mere receipt of money or property which one is obliged to return or repay to the rightful owner as

in the case of a loan or credit, cannot definitely be taken as a benefit or perquisite obtained from the company. The benefit or advantage which

might have been taken by a director or other person from a company without any claim of right has to be repaid or returned to the company if the

company discovers the unauthorised taking and seeks to enforce its restitution.

20. The principle laid down in Commissioner of Internal Revenue v. Wilcox, 90 L.Ed. 752. is this. Taxable gain is conditioned upon the presence

of a claim of right to the alleged gain and the absence of definite obligation to repay or return that which would otherwise constitute a gain ; and it

does not accrue from the mere receipt of property or money which one is obliged to return or repay to the original owner. Tax liability may rest

upon the enjoyment by the taxpayer of privileges and benefits so substantial and

important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis. One who so uses another's property as to secure a gain or profit therefrom may, even though he did so wrongfully, be subjected to Income Tax to that extent. Embezzled money does not constitute taxable income to the embezzler although he had used it for his own purposes and though the embezzlement may give rise to a deductible loss to the owner. In that case the court, while construing Section 22(a) of the Internal Revenue Code denning "" gross income "" to include gains, profits and income derived from. . . . dealings in property. . . . growing out of the ownership or use of or interest in such property. . . . also from the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source, whatever, expressed the view that a wrongful acquisition of funds by an embezzler cannot be included in the statutory phrase "" gains or profits and income derived from any source whatever"" and that taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain, and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. The Supreme Court in Commissioner of Income Tax, Kerala and Coimbatore Vs. L.W. Russel, while considering the scope of the word "" salary"" in Section 7(1) of the old Act has expressed the view thus:

The expression " perquisites which are allowed to him by or are due to him, whether paid or not, from, or are paid by or on behalf of. a company " in Section 7(1) of the Indian Income Tax Act, 1922, applied only to such sums in regard to which there was an obligation on the part of the employer to pay and a vested right on the part of the employee to claim ; it could not apply to contingent payments to which the employee had no right till the contingency occurred. The employer's contribution towards the premiums were not perquisites allowed to the employee by the employer or amounts due to him from the employer within the meaning of Section 7(1) read with Clause (v) of the Explanation thereof.

21. Though the observations in the said case were made in a slightly different context, they apply with equal force to the situation on hand. The words "" benefit or perquisite "" occurring in Section 2(6C)(iii) of the old Act can only take in those authorised by the company. It is not possible to

treat both authorised and unauthorised benefits alike as urged by the revenue. We are, therefore, of the view that the unauthorised user of the

company's cars by the assessee will not attract Section 2(6C)(iii) as it will not constitute a benefit or perquisite obtained from the company.

22. The learned counsel for the assessee then contends that the only ground for disallowance given by the Income Tax Officer at the time when he

disallowed the expenditure on cars in the company's assessment was that the managing agents have used the cars and that, therefore, without

taxing the managing agency firm the partners cannot straightaway be taxed in respect of such disallowed portion of the expenditure on cars. He

relied on the decision in Commissioner of Income Tax, Bombay City Vs. Dwarkadas Vassanji, wherein it was held that where a firm had already

been assessed and its total income ascertained, it was not open to the department to separately assess the assessee as a partner of the firm on his

partnership income which did not form part of the total income of the firm as ascertained by the department u/s 23(5)(a) of the Indian Income Tax

Act, 1922. It is pointed out that there has been an assessment u/s 23(5)(a) on the total income of the firm, and that without reopening that

assessment on the firm the revenue cannot reach the partners directly treating the disallowed portion of the expenditure as income of the partners.

In our view this contention has considerable force. Once the managing agency firm has been assessed, the partners thereof can be assessed only

on their share of the partnership income. Even if the unauthorised use of the company's cars by the managing agents is taken to be a benefit or

perquisite, unless the managing agency firm is assessed on such income the partners' assessments cannot be reopened. It, therefore, appears that

without reopening the assessments on the managing agency firm the partners' assessments cannot be reopened. In this case admittedly the

assessment on the managing agency firm has not been reopened and, therefore, the reopening of the assessment of the partners does not appear to

be legal. Further, the disallowance in respect of the expenditure on cars was made on the specific ground that the managing agents had used the

company's cars for their personal purposes and that the authorities have proceeded only on that basis. Therefore, the Tribunal was right in its view

that the ground given for the disallowance cannot be ignored and that the user cannot be treated as that of the directors. Therefore, the benefit or

perquisite, if any, cannot be said to have been obtained by the assesseees in their capacity as directors of the mills.

23. The learned counsel for the revenue invites this court to assume that the assesseees had used the cars of the company in their capacity as

directors and not in their capacity as managing agents as found by the Income Tax Officer who made the assessment on the mills. But, it is not

possible for us to ignore the finding given by the Income Tax Officer which formed the basis for the reopening of the assessments of the assesseees

and to assume that the assesseees had made use of the cars of the company only in their capacity as directors. There were many other directors

apart from the assesseees. Therefore, it is not possible for us to hold that the assesseees had made use of the company's cars in their capacity as

directors of the mills. It must, therefore, be held that Section 2(6C)(iii) cannot be brought in aid in this case where the unauthorised user of the cars

of the company, if any, was by the assesseees as managing agents of the mills and not in their capacity as directors. As already stated, the Income

Tax Officer and the Appellate Assistant Commissioner who made the reassessments had only proceeded on the basis that the assesseees used the

cars in their capacity as managing agents. In our view, it is not open for the revenue now to change the front and say that the use of the cars by the

assesseees was as directors, merely because they could not be brought in under that section as persons who have substantial interest in the

company. We, therefore, accept the view taken by the Tribunal in this case as correct. The questions referred in both the cases are, therefore,

answered in the affirmative and against the revenue. The assesseees will be entitled to their costs of the reference in T.C. No. 314/66. Counsel's

fees Rs. 250.