
(1989) 02 MAD CK 0031

In the Madras High Court

Case No : Tax Case No. 1090 of 1979 (Reference No. 689 of 1979)

Commissioner of Income Tax

APPELLANT

Vs

Devi Films Pvt. Ltd.

RESPONDENT

Date of Decision : 28-02-1989

Acts Referred:

Income Tax Act, 1961 — Section 36(2)

Citation : (1990) 182 ITR 200

Hon'ble Judges : V. Ratnam, J; Bhakthavatsalam, J

Bench : Division Bench

Advocate : N.V. Balasubramanian, for the Appellant; S.A. Balasubramanian, for the Respondent

Judgement

Ratnam, J.—The assessee is a private limited company engaged in the business of film distribution, exhibition and sale of cine equipment. In

respect of the assessment year 1967-68 (accounting year ended April 13, 1967), the assessment of the assessee was subjected to a number of

additions, one of which was a sum of Rs. 53,741 representing the commission income derived by the assessee from the distribution of some

pictures and that addition alone forms the subject-matter of this reference. It is not in dispute that the assessee has been following the mercantile

system of accounting. The assessee maintained before the Income Tax Officer that the right of distribution of the pictures had been purchased

outright by the assessee with retrospective effect in terms of a letter dated January 10, 1968, written by the assessee to one G. N. Velumani,

modifying the terms of an earlier agreement in that regard entered into between the assessee and G. N. Velmani on April 22, 1966. On a

consideration of the terms of the agreement as well as the letter, the Income Tax

Officer found that a pucca agreement as contemplated by the letter dated January 10, 1968, had not been entered into between the assessee and G. N. Velumani incorporating the arrangement in the letter and, therefore, the purchase of the pictures by the assessee outright should be considered to have taken place only in the subsequent assessment year and, therefore, the distribution commission should also be included, and, accordingly, that amount was included for purposes of assessment.

Aggrieved by this, the assessee preferred an appeal before the Appellate Assistant Commissioner, before whom it was contended that the collections in respect of the pictures had dwindled and the collection figures justified the matter being viewed from the business angle and as such, the distribution commission included should be deleted. The Appellate Assistant Commissioner found that having regard to the collections made as on April 13, 1967, it could not be considered that the potentialities of the pictures had been exhausted so that the appellant was worried about the possibility of his recovering the advances granted and further that the events that had happened subsequent to the accounting year cannot be taken into consideration in determining the total income of the accounting year in question. In that view, the inclusion of the amount of distribution commission in a sum of Rs. 53,741 was upheld. However, on further appeal to the Tribunal, it held that the transaction brought about by the contents of the letter dated January 10, 1968, should be considered in the light of the purchase of the pictures with a view to avoid loss in the investment and the decision to purchase the pictures had been taken owing only to the potentialities of the pictures having become exhausted by then and, therefore, the understanding referred to in the letter dated January 10, 1968, truly reflected the position as it existed before the close of the accounting year itself and in that view, the Income Tax Officer was directed to compute the income or loss in respect of the pictures on the basis of the trading results and a further direction was also given to the Income Tax Officer to proceed on that basis to ascertain the profit or loss in respect of the pictures and take the same as income. The view so taken by the Tribunal has given rise to this reference at the instance of the Revenue u/s 256(2) of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), on the following question of law :

Whether, on the facts and circumstances of the case, the Appellate Tribunal was right in deleting the commission added to the assessee's income

for the assessment year 1967-68 ?

2. Learned counsel for the Revenue, inviting attention to the terms of the agreement dated April 22, 1966 and the letter dated January 10, 1968, as

well as the system of accounting followed by the assessee, contended that during the accounting year in question the assessee remained as a

distributor entitled to the commission in terms of the agreement dated April 22, 1966, and having regard to the accrual of the distribution

commission in terms of the provisions in the agreement, the conferment of totally new rights on the assessee under the letter dated January 10

1968, would not in any manner alter the position and there could be no projection backwards of the rights as an outright purchaser under the letter

dated January 10, 1968, to the date of the distribution agreement, viz., April 22, 1966. The letter dated January 10, 1968, was characterised as a

self-serving letter and it was stated that under the terms of that letter, there was no question of any purchase of the pictures by the assessee

retrospectively and further that the exhaustion of the potentialities of the pictures would not render the distribution commission income earned by

the assessee during the accounting year unaccrued and, therefore, the Tribunal was in error in directing the Income Tax Officer to compute the

income or loss on the basis of the trading results. In support of these submissions, learned counsel for the Revenue invited our attention to some

decisions which will be referred to later in the course of this judgment. On the other hand, learned counsel for the assessee submitted that on a

consideration of the terms of the agreement as well as the letter and the totality of the circumstances and the other materials, the Tribunal rightly

concluded that the income by way of distribution commission should be viewed from a business stand point as that of a trader and on trading

results and, therefore, the conclusion reached by the Tribunal was unassailable.

3. Before we proceed to consider these rival submissions, it would be necessary to refer to the relevant clauses in the agreement dated April 22,

1966, and also the contents of the letter dated January 10, 1968. Under clause 7 of the agreement dated April 22, 1966, entered into between the

assessee and G. N. Velumani in consideration of the grant of distribution rights of

one of the pictures which was then being produced by G. N.

Velumani, in respect of the revenue districts of Coimbatore and Nilgiris, the assessee agreed to advance a sum of Rs. 2,25,001. Clause 9 of the

agreement provided for the recoupment of the advances so made by the assessee from out of the realisation of the pictures in the following manner

: -

(a) Firstly pay itself the distribution commission as mentioned hereunder;

(b) Pay itself the advances made by the assessee, the cost of extra prints, if any, and the advertisement expenses or any other amounts due to it.

(c) To remit to G. N. Velumani every month the balance due before the 15th of the succeeding month.

4. The rates of commission payable under sub-clause (a) referred to above were agreed to as under :

(a) 15% up to Rs. 2,25,001;

(b) 20% over and above Rs. 2,25,001 up to Rs 2,75,000;

(c) 25% thereafter.

5. Clause 10 of the distribution agreement provided that the assessee (as a distributor) is entitled to a commission calculated as per clause 9(a), (b)

and (c) on the producer's net share of the realisations made from time to time by distribution, exploitation and exhibition of the pictures and the

producer's net share of the realisation represented the amount actually collected by the distributors by way of picture share. On January 10, 1968,

the assessee wrote a letter to G. N. Velumani, stated to be in confirmation of an understanding arrived at. According to that, two pictures in

respect of which the assessee was given distribution rights, one for Trichy, Thanjavur and Coimbatore areas and the other for Trichy, Thanjavur,

Madurai, Ramanathapuram, Tirunelveli, Kanyakumari, Salem, Kerala and Mysore areas, will be converted into outright basis, the consideration for

the same being Rs. 4,15,000 and Rs. 3,75,000 and the conversion will come into effect from the date of release of the pictures in the above areas.

Paragraph 9 of that letter provided that a pucca agreement incorporating the above arrangements shall be entered into between the concerned

parties as early as possible. There is an endorsement in the letter dated January 10, 1968, to the effect that the terms have been gone through and

agreed to, presumably at the instance of G. N. Velumani. It is in the background of the terms of the agreement and the letter referred to above, that

the question whether the claim of the assessee that the distribution commission should not have been included in its income for the assessment year

1967-68, but that it should be viewed on the basis of the trading results, is correct, has to be considered. In respect of the distribution commission

payable to the assessee from out of the realisations of the pictures, under the terms of clause 9(a) of the agreement read with the rate of

commission as provided thereunder and clause 10, the assessee became entitled to such commission as and when collections were made by the

distribution and exploitation of the pictures on producer's net share. In other words, by reason of clauses 9 and 10 of the agreement, without

anything more, the distribution commission payable to the assessee became determined and quantified with reference to the producer's net share

of the realisations made. It is seen from the assessment order that the distribution commission payable to the assessee had also been ascertained,

though those amounts had not been taken to an account styled as "Commission account", and that even while finalising the accounts for the

accounting year ended April 13, 1967, the assessee had not given any retrospective effect to the terms of the subsequent letter dated January 10,

1968. Considering the system of accounting followed by the assessee and the terms of the agreement referred to earlier and also the ascertainment

of the distribution commission by the assessee on the basis of the terms of the agreement and the omission to give retrospective effect in the

accounts to the terms of the letter dated January 10, 1968, we are of the view that the income by way of distribution commission had accrued to

the assessee in the course of the accounting year ending April 13, 1967. It is in this context that the decision of the Supreme Court reported in

COMMISSIONER OF Income Tax, MADRAS Vs. K. R. M. T. T. THIAGARAJA CHETTY and COMPANY., , relied on by learned counsel

for the Revenue, is relevant. In that case, the assessee, under the terms of the managing agency agreement, was entitled to monthly remuneration, a

commission of 10% on the net profits of the company as well as a small percentage on sales and purchases, which also provided that the assessee

was at liberty to retain, reimburse and pay themselves out of the funds of the company, moneys expended on otherwise. For the accounting year

ending March 31, 1942, the assessee, who had followed the mercantile method of accounting, became entitled to a commission of Rs. 2,26,850

and the assessee wrote to the company requesting that a debt owed by the assessee to the company should be written off, which was declined and

it was resolved by the company to keep the amount of Rs. 2,26,850 in a suspense account without paying it. The question was whether, for the

assessment year 1942-43, the assessee was liable to pay tax on Rs. 2,26,850 and the authorities held that the income was assessable, whether

received or not. However, the Tribunal held that the income had not accrued to the assessee and, therefore, the sum should be excluded from the

assessment as not having been received in the accounting year. On a reference u/s 66 of the Indian Income Tax Act, 1922, in Commissioner of

Income Tax, Madras Vs. K.R.M.T.T. Thiagaraja Chetty and Co., Madura, , there was a difference of opinion. Satyanarayana Rao J. took the

view that the amount was not money at the assessee's disposal nor could it be considered as having been held by the assessee for its benefit and

use, while Viswanatha Sastri J., held that the sum having been irrevocably entered as a disbursement of commission to the assessee and had been

appropriated towards the assessee's dues, it belonged to the assessee and had to be included in the computation of the profits and gains unless the

assessee had regularly kept its accounts on cash basis which was not the case. Adverting to this difference of opinion between the learned judges,

the Supreme Court upheld the view taken by Viswanatha Sastri J. and held that the sum of Rs. 2,26,850 was income which had accrued to the

assessee and that it did not cease to be income by reason of the fact that it was carried to the assessee's suspense account by a resolution of the

directions of the company and, therefore, it was assessable to tax. We may usefully refer to the following observations of the Supreme Court at

page 533 :

Lastly, it was urged that the commission could not be said to have accrued, as the profit of the business could be computed only after 31st March,

and, therefore, the commission could not be subjected to tax when it is no more than a mere right to receive. This argument involves the fallacy that

profits do not accrue unless and until they are actually computed. The computation of the profits whenever it may take place cannot possibly be

allowed to suspend their accrual... The quantification of the commission is not a condition precedent to its accrual.

6. We may also refer in this connection to the decision in *State Bank of Travancore Vs. Commissioner of Income Tax, Kerala*, , relied on by

learned counsel for the Revenue. After referring to *COMMISSIONER OF Income Tax Vs. SHRIMATI SINGARI BAI.*, and *The Commissioner*

of Income Tax, Madras Vs. A. Krishnaswami Mudaliar and Others, , and considering the scope of the concept of real income, the Supreme Court

observed at page 146 as follows :

... Under the cash system it was only actual cash receipts and actual cash payments that were recorded as credits and debits; whereas under the

mercantile system, credit entries were made in respect of the amounts due immediately they became legally payable and before they were actually

received. Similarly, the expenditure items for which legal liability had been incurred were immediately debited even before the amounts in question

were actually disbursed. This position was reiterated by this court in 1971, after taking into consideration various decisions of this court. In our

view, therefore, the concept of real income cannot be so used as to make accrued income non-income simply because after the event of accrual,

the assessee neither decides to treat it as bad debt nor claims deductions u/s 36(2) of the Act, but still enters the same with a diminished hope of

recovery in the suspense account. Extension of the concept of real income to this field to negate accrual after the amount had become payable is

contrary to the postulates of the Act.

7. We are of the view that considering the system of accounting adopted by the assessee in this case, the same principle would be applicable and

the income by way of distribution commission had accrued to the assessee as a distributor during the accounting year in question by reason of the

terms of the agreement as and when collections were made and, as pointed out earlier, such distribution commission had also been ascertained in

the accounts of the assessee, whether received or not, though not taken to a separate commission account as such. We, therefore, hold that the

distribution commission in terms of the agreement had accrued to the assessee during the accounting year in question.

8. We now proceed to consider whether the letter dated January 10, 1968, stated

to have been written by the assessee to G. N. Velumani would in any manner affect the distribution commission that had accrued to the assessee during the relevant accounting year. We do not consider it necessary to go into the question whether this letter is a self-serving one or not, for, it would suffice for purposes of this reference to consider its effect even on the assumption that such a letter had been written by the assessee to G. N. Velumani. The execution of a pucca agreement modifying and incorporating the terms of the arrangement come to in that letter had been envisaged in and by paragraph 9 of the letter. It is not in dispute that such an agreement had not been executed. Apart from it, in paragraph 2 of the letter, the conversion into outright basis as opposed to the right of distribution granted under the agreement dated April 22, 1966, is stated to be effective from the date of release of the pictures in the respective areas. We may point out that when even the parties had agreed to enter into a pucca agreement and that had not been executed, no outright purchase rights in the pictures could be claimed by the assessee merely on the strength of the letter dated January 10, 1968. We may also observe that the right conferred on the assessee under the agreement dated April 22, 1966, and those purported to be conferred under the letter dated January 10, 1968, are different in that one related to distribution rights for a period of 5 years from the date of release of the pictures and the other to an outright purchase of rights in the pictures. Further, we may also point out that by reason of the terms of the letter which had come into being after the close of the accounting year on April 13, 1967, enlargement of rights under the agreement dated April 22, 1966, cannot be recognised in order to negate the accrual of distribution commission to the assessee under the terms of the agreement dated April 22, 1966. The letter dated January 10, 1968, can at best be considered to be an attempt by the assessee to efface the effect of the accrual of the commission income after the close of the accounting year, which cannot be countenanced. We are also not inclined to agree with the view taken by the Tribunal that the letter dated January 10, 1968, reflected the position as it existed before the close of the accounting year on April 13, 1967, for the modification of the earlier arrangement regarding the distribution rights into one of outright purchase. There is no indication in the letter dated

January 10, 1968, as to what the position was with reference to the collections in respect of the pictures at the end of the accounting year. Nothing is also mentioned about the distribution commission which had already accrued to the assessee in terms of the provisions in the agreement dated April 22, 1966. To support the view that the contents of the letter dated January 10, 1968, reflected the position as it existed on April 13, 1967, the Tribunal has proceeded to refer to the exhaustion of the potentialities of the pictures and the avoidance of loss in investment. When commission income had accrued to the assessee, as per the terms of the distribution agreement, the tax treatment of the distribution commission so accrued cannot be defeated by the assessee by projecting different rights by means of a letter several months after the closing of the accounting year, when the accounts themselves did not reflect that the contents of the letter dated January 10, 1968, providing for retrospective effect had been given effect to. Further, from the date of the agreement, i.e., April 22, 1966, till the end of the accounting year, i.e., April 13, 1967, the assessee could not have had rights as a distributor and also as a owner, as it is difficult to conceive of such a co-existence of rights. We may usefully refer in this connection to the observations in Commissioner of Income Tax, Tamil Nadu-II Vs. S. Ramal Ammal, , relied on by learned counsel for the Revenue. It was contended that the Tribunal was entitled to go behind the form and see the reality of a transaction for purposes of ascertaining the tax treatment of any consideration. This argument was repelled on the ground that so far as taxation is concerned, the substance of a transaction is how the parties thereto have thought it fit to bring it about by translating it into words and it is not open to the Tribunal to rewrite the same for the parties for, to do so, would be to rob the transaction of its substance and to stultify it. The Tribunal, in the course of its order, has read more into the letter dated January 10, 1968, than what is really found therein. We are, therefore, unable to agree that the letter dated January 10, 1968, in any manner reflected the position that obtained on April 13, 1967, and that it supports the view that the income or loss should be computed on the basis of the trading results and not on the basis of accrual of distribution commission.

9. We may also observe that the question whether the distribution commission earned by the assessee is liable to be subjected to assessment or

not will depend upon the terms of the agreement and the law relating thereto and not the view the assessee may take of its rights and that cannot certainly be decisive or conclusive of the matter. We are unable to accept the contention of learned counsel for the assessee that on a consideration of the totality of the circumstances and the materials, the Tribunal has come to a right conclusion. The Tribunal has not adverted to the terms of the distribution agreement in the context of the accrual of distribution commission to the assessee as per the system of accounting followed by the assessee. Instead, the Tribunal had proceeded to decide the question on the basis of conjectures and surmises relating to loss of potentialities, which, even if acceptable,, would not in any manner render the distribution commission earned by the assessee unaccrued. We may also point out that the conclusions arrived at by the Tribunal on conjectures and surmises cannot be sustained, more so in this case, as the Tribunal has omitted to consider the terms of the agreement dated April 22, 1966, and the letter dated January 10, 1968, and its effect upon the accrual of distribution commission income to the assessee as a distributor during the relevant accounting year. We, therefore, answer the question referred to us in the negative and in favour of the Revenue. The Revenue is entitled to the costs of this reference. Counsel's fee Rs. 500.