

(1980) 10 KL CK 0018

In the High Court Of Kerala

Case No : Income-tax Reference No's. 16 and 17 of 1977 and 34 and 35 of 1980

Commissioner of Income Tax

APPELLANT

Vs

Marikar (Motors) Ltd.

RESPONDENT

Date of Decision : 24-10-1980

Acts Referred:

Income Tax Act, 1961 — Section 41(1)

Citation : (1981) 22 CTR 93 : (1981) 1 ILR (Ker) 340 : (1981) 129 ITR 1

Hon'ble Judges : V. Balakrishna Eradi, C.J.;K. Bhaskaran, J

Bench : Division Bench

Advocate : P.K. Ravindranatha Menon, for the Appellant; S.A. Nagendran, N.N.D. Pillai and K.B. Subramani, for the Respondent

Judgement

Bhaskaran, J.—These references arising out of the order of the Income Tax Appellate Tribunal, Cochin Bench, disposing of I.T.A. Nos. 354 and 371 (Coch)/74-75, relate to the assessment year 1971-72. ITR Nos. 16 and 17 of 1977 are u/s 256(1) and ITR Nos. 34 and 35 of 1980 are u/s 256(2) of the I.T. Act, 1961 ("the Act").

2. The assessee is a dealer in automobiles and automobile spare parts. Sale of motor lorry chassis on hire purchase system is one of the business activities carried on by the assessee. Under that system the assessee enters into an agreement with the customer who makes an initial deposit, and makes payment of the balance consideration in instalments over a number of months. When all the instalments are paid off, the customer gets an option for buying the vehicle. On his exercising that option the sale becomes completed and the property passes to him. Though the taxable event occurs only when the last instalment is paid and the sale is completed as aforesaid, in practice the assessee collects from the customer an amount equal to the sales tax liability on the entire price of the lorry as though the property passes to the customer even at the time when the agreement is entered into. During the accounting years 1958-59 to 1964-65 the sales tax department had assessed the assessee on such transactions to

sales tax to the tune of Rs. 13,04,025 and against those assessments, the assessee had paid a sum of Rs. 8,55,355 to the Government. This court, however, on challenge by the assessee in writ petitions, set aside those assessment orders, directing a fresh assessment to be made according to law; consequently an amount of Rs. 8,52,686 was received by the assessee by way of refund during the period relevant for the assessment year 1971-72.

3. The practice of the assessee during the material time was to credit the amount equal to the sales tax liability collected from the customers as aforesaid to an account called " deposit against contingent liability " without it being credited to the profit and loss account. So also, the payment to the sales tax department was not effected by debiting it to the profit and loss account; instead, what was done was to debit an account styled " general sales tax account ". The result, therefore, was that neither the receipts nor the payments figured in the profit and loss account. The payments were also not claimed by the assessee as a deduction in the assessment years relevant to the accounting years 1958-59 to 1964-65.

4. The ITO assessed the amount obtained by the assessee by way of refund of sales tax in the assessment year 1971-72 u/s 41(1) of the Act; in doing so, he held that the sales tax payment was an expense and any refund of the same was income, rejecting the contention of the assessee that since no expenditure had been allowed, the provisions of Section 41(1) of the Act were not attracted. Annexure to the statement of the case is the copy of the order of the ITO dated March 28, 1974.

3. The assessee carried the matter in appeal before the AAC with partial success ; the AAC, while upholding the inclusion of the amount covered by the refund, pointed out that the assessee had to pay sales tax only in respect of the sales effected to the customers at the reduced or written down value; in this view he allowed deduction of sales tax payable on 50% of the value of the vehicles. Annexure " B " to the statement of the case is the copy of the order of the AAC dated September 30, 1974.

4. Not being satisfied with the relief restricted to 50% of the value of the vehicles, the assessee preferred I.T.A. No. 354 (Coch)/74-75 ; and aggrieved by the relief to the extent of 50% of the value of the vehicles granted to the assessee, the ITO filed I.T.A. No. 371 (Coch)/74-75, before the Income Tax Appellate Tribunal, Cochin Bench. The Appellate Tribunal in its order dated January 20, 1976, a copy of which is annex. "C" to the statement of the case, purporting to place reliance on the decision of the Supreme Court in Keshav Mills Ltd. Vs. Commissioner of Income Tax, Bombay, , held that the amount of Rs. 8,52,686 received by the assessee in the assessment year 1971-72 was not a trading receipt of that year; it was also held that inasmuch as no such expenditure was allowed by the ITO, he was not entitled to invoke the provisions of Section 41(1) of the Act.

5. The Commissioner of Income Tax filed two reference applications before the Income Tax Appellate Tribunal, R.A. Nos. 246 and 247/Coch/ 75-76 against the order dated January 20, 1976, disposing of I.T.As. Nos. 354 and 371. The question sought to be referred to this court for opinion in both the reference applications was the same, and that reads as follows:

" Whether, on the facts and in the circumstances of the case and also considering the method of accounting maintained by the assessee in the matter of sales tax, the Income Tax Appellate Tribunal is right in law in holding that the sum of Rs. 8,52,686, being the sales tax refund received during the year, is not assessable to Income Tax ? "

6. The Appellate Tribunal, having been satisfied that a question of law did arise, drew up a statement of the case, but did not, however, refer the question suggested by the department as, in its opinion, it was widely worded ; instead the following question of law, which is the subject-matter of I.T.Rs. Nos. 16 and 17 of 1977, was referred to this court unders. 256(1) of the Act:

" Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was justified in holding that no expenditure towards payment of sales tax was allowed by the department in the assessment years 1959-60 to 1964-65 and, therefore, the provisions of Section 41(1) cannot be invoked to tax the refunds received during the accounting year relevant to the assessment year 1971-72 ? "

7. This court, however, in and by the judgment dated October 9, 1978, in O.Ps. Nos. 2341 of 1977-K and 2364 of 1977-H, both at the instance of the revenue, directed the Tribunal to refer the following question of law as arising out of the common order in I.T.As. Nos. 354 and 371 (Coch)/74-75 dated January 24, 1976.

" Whether, on the facts and in the circumstances of the case, and also considering the method of accounting maintained by the assessee in the matter of sales tax, the Income Tax Appellate Tribunal is right in law in holding that the sum of Rs. 8,52,686, being the sales tax refund received during the year, is not assessable to Income Tax ? "

8. The Tribunal has by the order dated January 7, 1980, referred to this court u/s 256(2) of the Act the above question which is the subject-matter of I.T.Rs. Nos. 34 and 35 of 1980.

9. We would presently take u,p the question of law referred to this court in I.T.Rs. Nos. 34 and 35 of 1980. The contention of the revenue is that inasmuch as the sum of Rs. 8,52,686 was received during the period relevant for the assessment year 1971-72, there is nothing preventing the ITO from taking that into account while computing the taxable income of the assessee for that assessment year. The counsel for the assessee on the other hand submitted that the refund received by the assessee during the period relevant to the assessment year 1971-72 really represented portions of the amount collected by the

assessee from the customers by way of deposits towards what was described as " other charges " to cover the sales tax liability during the accounting years 1958-59 to 1964-65, and those amounts being " trading receipts " of the assessee, as is seen to have been found by the AAC himself in para. 2 of his order, such receipts (of refund) could utmost be treated as income for those accounting years only, without it being treated again as income of the assessment year 1971-72 during the relevant accounting period in which the refund was received, as, according to him, the same amount cannot be income both in the year in which it was collected as " other charges " and the year in which it was received back in the form of sales tax refund.

10. To support his contention reliance was placed by the counsel for the assessee on the following observation of Shah J., as he then was, in the Supreme Court case in Benares State Bank Ltd. Vs. Commissioner of Income Tax, Uttar Pradesh, :

" There can be no doubt that for the purpose of the Income Tax Act the same income cannot be received more than once."

11. The facts of that case were as follows: The appellant, whose year of account was the calendar year, had its registered office in the Benares State which merged with the Indian Union on December 1, 1949. The company which had its head office at Ramnagar in the Benares State and in which the appellant had shares declared dividend on July 25, 1949. Cheques issued in favour of the appellant for Rs. 69,000 in payment of the dividend were encashed by the appellant on December 31, 1949. There was no material on record as to when the cheques were handed over to the appellant even though the High Court had observed in its judgment that dividend warrants were delivered to the appellant on August 3, 1949. It was contended that the appellant could not be assessed to tax in respect of the dividend which accrued to it at a time when it was a non-resident. On the facts and in the circumstances of the case, the Supreme Court held that the State of Benares after merger on December 1, 1949, formed part of the State of U.P. and was part of the " taxable territories " by virtue of the definition in Section 2(14A) of the Indian I.T. Act, 1922, and even assuming that the dividend accrued within an Indian State, it was received in the taxable territories on December 31, 1949, and by the express words contained in Section 14(2)(c) of the Act it was not exempt from liability to payment of tax. One of the questions that arose for consideration was whether for the purpose of taxation under the Indian I.T. Act, 1922, the amount covered by the dividend warrant was received or deemed to have been received on 25th July 1949, on which date the dividend was declared, or on 3rd August, 1949, on which date the High Court found that the dividend warrant was delivered to the assessee, or on December 31, 1949, on which date the dividend warrant was encashed. It is during the course of the discussion on this point that the observation sought to be relied on by the counsel for the assessee happened to be made by Shah J. We do not think that this observation, when read and understood in its proper context, would in

any way advance the case of the assessee.

12. One other decision relied on by the counsel for the assessee in support of the same contention is B.M. Kamdar, B. M. KAMDAR, IN RE., , The facts of the case were as follows : The assessee who carried on a business of furniture-maker and was practising as a consulting engineer sold his furniture business to a private limited company on February 15, 1938, and discontinued his practice as a consulting engineer from that day onwards. He was assessed for the assessment year 1939-40 (accounting year being calendar year 1938) on a certain sum which included Rs. 12,302 representing outstanding professional fees earned from his practice as a consulting engineer prior to discontinuance and realised by him during calendar year 1938. The assessee was keeping his accounts on the cash basis and he contended that as he had discontinued his profession in the accounting year 1938, the source had come to an end and the sum of Rs. 12,302 was not income liable to Income Tax. The Bombay High Court, by the majority judgment (Kania and Chagla JJ., forming the majority and Stone C.J., delivering the dissenting judgment) held that the sum of Rs. 12,302, less the permitted deductions u/s 10 of the Indian I.T. Act, 1922, was income of the assessee liable to Income Tax. The passage relied on by the counsel for the assessee is the following sentences in the judgment of Kania J., at page 39 of the report:

" It cannot be disputed that the words used in Section 4(1)(a) relate to the first receipt after the accrual of income. Once it is received by the party entitled to it, in respect of any subsequent dealing with the said amount, it cannot be said to be " received " as income on that occasion."

13. This observation, again, in our opinion, does not advance the case of the assessee. Refund of sales tax, stated simply, could be considered as a recoupment of the whole or part of the amount collected from the assessee without legal authority and what was regarded as an outgoing and, therefore, a deduction from the profits. It represents the receipt of what had gone out of the business, not what was received earlier. The question of subsequent dealing with the amount does not arise at all in this case. The observation of the Full Bench of the Bombay High Court in the case cited, taken out of context, has absolutely no relevance to the facts of the case on hand.

14. It would, at this juncture, be useful to refer also to the Supreme Court decision in Keshav Mills Ltd. Vs. Commissioner of Income Tax, Bombay, , wherein (at pages 241, 242 of the report) Bhagwati J., who delivered the majority judgment, has referred with approval to the view expressed by Kania J. in the Bombay decision in B. M. KAMDAR, IN RE., , as that is seen to have been relied on by the Tribunal (para. 3 of annex. " C ") in support of the conclusion that the " assessment of Rs. 8,52,000 as trading receipt in this accounting year is incorrect ", The facts of the case before the Supreme Court could be briefly stated as follows: The assessee was a company registered in the Baroda State as it then was prior to its merger with India. It manufactured textile goods at Petlad in the Baroda State, and after the goods were manufactured they were sold by the

company ex-mills. The company employed M/s. Jaganmohandas Ramanlal & Co. as guaranteed brokers. That firm guaranteed the sale price of goods sold by the assessee-company ex-mills to the purchasers and received commission as consideration for the guarantee and the work which it did for the company. The company was a non-resident and its accounts were maintained according to the mercantile system. In the assessment year 1942-43 (the previous year being the calendar year 1941) the total sales of the goods by the company amounted to Rs. 39,68,808. In making the assessment on the company for that assessment year the following three amounts were considered for the purpose of determining the company's liability to British Indian tax:

(a) Sale proceeds received through M/s. Jagmohandas Ramanlal and Co.--Rs. 12,68,480.

(b) Sale proceeds through British Indian Banks and shroffs received by means of drafts or hundies drawn on by the company--Rs. 4,40,878.

(c) Sale proceeds received by cheques on British Indian banks and hundies on British Indian shroffs and merchants and collected by the banks and shroffs--Rs. 6,71,735.

15. Whether the sum of Rs. 12,68,480 and Rs. 4,40,878, if they were sale proceeds, were received in British India was one of the questions referred to the High Court and which ultimately came for the consideration of the Supreme Court. The Supreme Court found that the moneys were neither received by the company nor could be deemed to have been received when the entries were made in the books of account at Petlad : they had merely accrued or arisen to it and so far as the receipt thereof is concerned, they were first received in British India when they were received by M/s. Jag-mohandas Ramanlal & Co., or by the various banks or shroffs in British India ; the first receipt of the moneys was, therefore, when they were paid as such by the merchants to M/s. Jagmohandas Ramanlal & Co., or to the various banks or shroffs as above. What Bhagwati J. observed in the penultimate paragraph of the judgment (at pp. 242 and 243 of the report), extracted below, we believe, is of considerable assistance for applying the correct principle to the peculiar facts of the case on hand :

" Mr. Kolah pressed into service the argument based on Section 13 of the Act that the mercantile system of accounting regularly adopted by the assessee was obligatory on the Income Tax authorities for computation of his income. While agreeing generally with that submission in case of residents, we doubt whether that position would be available to a nonresident, who maintains his books of account outside British India according to the mercantile system. The section would only be relevant where the total profits of the assessee have to be computed in which event he would be entitled to claim that they should be computed according to the system of accounts maintained by him. But the section would hardly be relevant where stray items of income are caught in the taxable territories as received in the taxable territories by a non-resident. The

entries in the present case were put in merely to prove that the sale proceeds were received outside British India where the entries were made. The contention, however, could not be sustained, as Section 4(1)(a) is concerned with cases of actual receipt and not with cases of paper receipts."

16. The significance of the observations, from the point of view of the present case, lies in the fact that there could be cases, however rare they might be, where even when the accounts are maintained on the mercantile system, and a particular amount is shown to have been received on a particular date on accrual in the accounts of the assessee, it need not, as an invariable rule, be taken to have been received on that date while computing the taxable income of the assessee. Turning to the case on hand, in the normal course, the sales tax amounts collected from the customers on hire purchase transactions ought to have been treated as trading receipts. This aspect has been stressed by the AAC in para. 2 of his order (annex. " B "), though we do not agree with the argument of the counsel for the assessee that he had already entered a finding of fact that they were trade receipts. The assessee has no case that these amounts were treated in his books of account as trading receipts during the years in which they were received. The admitted case is that they were never credited in the profit and loss account. Naturally, therefore, the assessee could not have debited the payments made to the sales tax department out of these collections to the profit and loss account, which, in turn, resulted in the assessee not claiming or obtaining deduction for such payments in his Income Tax returns or assessments. It is by taking advantage of this position that the assessee now pleads that the application of Section 41(1) of the Act is not attracted to the amounts received in the assessment year 1971-72 by way of sales tax refund. The truth obviously is that the assessee, in the peculiar method of accounting adopted by him had never, before his receiving the sales refund, treated the amount as trade receipt in the course of business. The assessee cannot be allowed to blow hot and cold at the same time and to escape from tax liability with respect to an amount which has come to his hands as income in the course of business for which he had not been subjected to tax at any stage prior to the receipt of the refund.

17. The legal position with respect to the taxability of the amount obtained on refund in that particular assessment year cannot be different from that of the amount recovered out of what was lost to the business due to embezzlement by the employees. It would be advantageous in this context to refer to the decision of the King's Bench Division in *Gray (H.M. Inspector of Taxes) v. Lord Penrhyn* [1937] 21 TC 252. In that case it was discovered in 1934 that officials employed at a slate quarry owned by the respondent (Lord Penrhyn) had misappropriated money from 1928 to 1934 by falsifying the wages accounts. The respondent's auditors admitted negligence on the part of their staff in not making certain enquiries, and paid over to him in November, 1934, a sum equal to the amount misappropriated since their first audit after the defalcations commenced. The amount so paid was credited in the quarry accounts for the year ended 31st

December, 1934, as to part, as recovery in respect of wages defalcations for all the years to 31st December, 1933, and as to the balance, by reducing the wages debit for 1934 by the amount misappropriated in that year. The respondent was assessed to Income Tax for the year 1935-36 in respect of the profits of the quarry in a sum which included the full amount received from his auditors, and, on an alternative basis, additional assessments were raised on him for the years 1930-31 to 1934-35 inclusive, to disallow that part of the deductions allowed for wages which represented misappropriations in those years. It was held in that case that the whole amount paid by the auditors was a trading receipt of the respondent to be taken into account in the computation of the assessment for the year 1935-36. Finlay J. observed as follows (p. 262) ;

" It seems to me that, looking at it from the point of view of the recipient, it is equally a business receipt, something which comes in the course of the business. The substance of my view can be quite concisely put by saying that I think that there is a strong presumption that the two things, so to speak, balance ; that is to say, looking at it first from the point of view of Lord Penrhyn, that since as an outgoing to these fraudulent people it was allowed, so, when that outgoing is made good, the thing ought to be cancelled out and that ought to be done, if not by the reopening of previous years, then, as I prefer because it is simpler, by the bringing in of the receipt when it comes in. Looked at from the point of view of the chartered accountants and Lord Penrhyn, it seems to me that as the sum is an outgoing of the chartered accountants, so, looking at it from the other side, it is a receipt on the part of Lord Penrhyn. "

18. The Bombay High Court had occasion to consider a case almost similar to the one referred to above. In UNION BANK OF BIJAPUR AND SHOLAPUR LTD., IN RE., , the assessee, a bank, claimed in the assessment year 1935-36, a certain amount as loss by reason of embezzlement on the part of an employee, u/s 10(2) (ix) of the Indian I.T. Act, and the I.T. authorities treating it as a business loss allowed it to be set off against the remainder of profits. In the accounting year 1937-38, the assessee recovered from the heirs of the employee a sum of Rs. 8,790 from the amount embezzled, and the I.T. authorities, after deducting the law charges and certain other deductions from Rs. 8,790, included a net sum of Rs. 4,737 in the total income of the assessee for the assessment year 1938-39, on the ground that the assessee having treated the loss as a revenue loss and obtained relief on that basis, any recovery made in respect of that loss must be regarded as a revenue gain as and when it occurred. On these facts and in the circumstances of the case it was held by the High Court that the sum of Rs. 4,737 out of the sum of Rs. 8,790 recovered from the heirs of the employee, being part of the amount embezzled by him, was a revenue gain and was assessable to tax as part of the total income of the assessee for the assessment year 1938-39. Beaumont C.J., who delivered the judgment, observed as follows (p. 25):

" The embezzlement was, no doubt, substantially more than the income of that

year. In a subsequent year a sum is found to have been recovered in respect of that embezzlement, and it seems to me that the assessee, having alleged that the embezzlement was an embezzlement of income, which could properly be set off against income in a previous year cannot affirm in another year that it was not income, and that a recovery in respect of it is a casual appreciation of capital, as he seeks to do. "

19. A Division Bench of the Patna High Court in Sheikh Rahmat Ali Vs. The Commissioner of Income Tax, has taken the view that just as the amount of licence fee paid by an assessee for carrying on his business is an outgoing and a deduction from the profits of the business for the year in which the amount was paid, the recoupment by way of refund of the whole or part of the licence fee paid by the assessee for any reason is a revenue receipt includible in the taxable profits for the year in which it was received.

20. The argument of the, counsel for the assessee that the amount of refund received could not be treated as income for the assessment year 1971-72 cannot be accepted. It is not the assessee's case that the amounts collected by way of deposits towards "other charges" had ever been credited to the profit and loss account of the business; that being the position it cannot be argued that the same amount was treated as income before the refund was received during the period relevant for the assessment year 1971-72. There is absolutely no foundation, either in law or on facts, for the argument that the same amount has been treated as income more than once.

21. If the asscssee's interpretation of the law were to be upheld, a sum which clearly represents receipt in the course of business would escape assessment though it is not exempted under any provision of the Act. The assessee who maintains account on the mercantile system has no case that this amount had already been accounted for as income of the business or credited in the profit and loss account in the accounting years 1958-59 to 1964-65. If the amount is not includible in the taxable income of the period relevant for the assessment year 1971-72 also it is patent that the amount escapes assessment completely. An interpretation which produces a result of this nature could not be correct. Under the scheme of the Act all income, profits and gains are liable to taxation unless specifically exempted ; and even if the income in question is held to be not taxable under the head " Business, profession or vocation ", it would still be taxable under the head " Other sources".

22. In the light of the foregoing discussion we answer the question referred to us in I.T.Rs. Nos. 34 and 35 of 1980 in the negative, i.e., in favour of the revenue and against the assessee. In this view it is not necessary to answer the question referred to us in I.T.Rs. Nos. 16 and 17 of 1977, and we decline to answer it. We direct the parties to bear their respective costs in the circumstances of the case.

23. A copy of this judgment under the seal of the court and the signature of the Registrar shall be sent to the Income Tax Appellate Tribunal, Cochin Bench.