

(1938) 09 AHC CK 0034
In the Allahabad High Court

In Re: Kamal Nain Hamir Singh through Seth Gadh Mal Lodha

Date of Decision : 13-09-1938

Acts Referred:

Citation : (1938) 09 AHC CK 0034

Hon'ble Judges : Harries, J

Bench : Single Bench

Final Decision : Disposed Off

Judgement

Harries, J.—This is a reference u/s 66(3), Income Tax Act, 1922, made by the Commissioner of Income Tax, Ajmere-Merwara. The assessee in this case is a joint Hindu family carrying on business in the name of Kamal Nain Hamir Singh. The headquarters of this business is situated at Ajmere, but the firm has branches in other places, both in British India and in Native States, where money lending and other forms of business are carried on. The accounts of this firm have been for a long period maintained from Dewali to Dewali and the assessment in question is for the financial year 1932-33. A return of the income of this business for the year ending 10th November 1931 was submitted on 28th September 1932 for the purpose of assessment to Income Tax for the year 1932-33. In this return the assessable income was shown as Rs. 1,54,601-6-7 and along with the return was submitted a profit and loss account which is printed as Appendix F at page 26 of the paper-book. This return was not accepted as correct by the Income Tax Officer and the assessee was accordingly required to produce account books or any other evidence on which they relied to substantiate their return. During the course of examination of the account books an affidavit was filed by Dip Chand, the Munim of the assessee, in which he stated: (1) That no profits or interest accruing or arising in Tonk, Jaipur or Kotah branches were received in or brought into British India. (2) That the amount of interest shown as debited to the capital account in the account books of Tonk, Jaipur and Kotah branches was not received in or brought into British India but were mere book entries to find out how the business in those branches was flourishing.

2. It must be pointed out that these contentions were raised for the first time, in

this affidavit and had never in previous years been put forward by the assesseees. After examining the accounts and such evidence as was produced, the Income Tax Officer assessed the income of the family at Rs. 2,71,576. This assessment was subsequently modified by the Assistant Commissioner in certain respects but such does not concern us in the present case. The assesseees then called upon the Commissioner either to revise the assessment with respect to various items or to state a case for the opinion of the High Court. With regard to several items with which we are not concerned the Commissioner allowed the applicants' contention and revised the assessment accordingly. With regard to other items the Commissioner disallowed the applicants' objections and refused to state a case on the ground that in his opinion no question of law arose. By an order of 8th September 1936 this Court however directed the learned Commissioner of Income Tax to state a case with regard to the question arising in connexion with interest on capital account credited to the Ajmere head firm in the books of the branches of the Indian States of Tonk and Jaipur respectively. The question of law which arose in the opinion of this Court was stated by the learned Judges in these terms:

Whether in the circumstances of this case the two sums of Rs. 32,723-14-6 and Rs. 1714-2-6 credited in the capital account in the name of the Ajmere firm in the books of the Tonk and Jaipur firms respectively can be said to have accrued or to have been received in or brought into British India by the Ajmere firm so as to render the Ajmere firm liable to pay the Income Tax upon, these sums of money?

3. The learned Commissioner of Income Tax has now stated a case and has expressed his opinion that the question set out above should be answered in the affirmative. The facts as stated by the learned Commissioner have not been disputed and indeed admit of no dispute. It transpires that out of the net income of the Tonk branch a sum of Rs. 32,723-14-6 was transferred to the khata of Ajmere in the capital account. The learned Commissioner observes that the assesseees had two khatas of Ajmere in the Tonk firm, one current account and the other a capital account khata. The amount paid as interest in the current account has not been taken into account in assessing the income of the assesseees, but the amount of Rs. 32,723-14-6 credited in the capital account of the Ajmere firm has been regarded as a profit of the assesseees and assessed accordingly. In the same manner a sum of Rs. 1714-2-6 credited in the capital account of the Ajmere firm in the books of the Jaipur firm has been regarded as profit for the year in question and assessed accordingly. There is no doubt whatsoever that these amounts have been credited to the Ajmere firm in the books of the branches at Tonk and Jaipur. It is however to be noted that there are no corresponding entries in the books at the headquarters of the firm in Ajmere. The learned Commissioner of Income Tax was of opinion that the book entries were tantamount to constructive receipt of these sums in British India and accordingly formed part of the profits of the firm which should be assessed for the year in question.

4. It has been contended by Sir Tej Bahadur Sapru on behalf of the assesseees that the profits in question did not arise or accrue in British India and as they have not been received or brought into British India they do not form part of assessable profits of the assesseees. He has contended that the mere fact that these sums are credited to the account of the headquarters at Ajmere which is in British India does not amount to a bringing in or a receipt of these profits in British India. On the other hand it has been contended on behalf of the Income Tax authorities that the crediting of these accounts to the Ajmere firm in the circumstances of this case is tantamount to a receipt of these profits in British India. It has been found by the learned Commissioner that the accounts in all the various branches of this firm were maintained by the assesseees on the mercantile system and that the assesseees had always in past years submitted their returns in accordance with the profit and loss account prepared in precisely the same manner as the profit and loss account for the year in question which is printed at page 26 of the paper-book. The learned Commissioner points out that in past years the assesseees had always included in their income the interest credited to their capital account in the books of the branches situate in Indian States and did in fact include such income in their return for the year now in question. As we have pointed out earlier, it was only when the Income Tax Officer had called for the books of account that this question was raised for the first time. Section 4, Income Tax Act, deals with the scope of the Act. Section 4(1) of the Act is in these terms:

Save as hereinafter provided this Act shall apply to all income, profits or gains, as described or comprised in Section 6, from whatever source derived, accruing or arising, or received in British India or deemed under the provisions of this Act to accrue, or arise, or to be received in British Indian.

5. Section 4(2) provides that income, profits and gains accruing or arising outside British India to a person resident in British India which are received or brought into British India shall be deemed to have accrued or arisen in British India and to be income, profits and gains for the year in which they were so received subject to the provisions of the proviso immediately following. Then follows an Explanation which is in these terms:

Income, profits or gains accruing or arising without British India shall not be deemed to be received or brought into British India within the meaning of this sub-section by reason only of the fact that they are taken into account in the balance sheet prepared in British India.

6. Section 6 sets out the heads of income, profits and gains which are chargeable to Income Tax and these include the head "Business" and Section 10 (1) of the Act provides that the tax shall be payable by an assessee under the head "Business" in respect of profits or gains of any business carried on by him. According to the assesseees' contention the sums in question which have been credited to the account of the Ajmere firm in the books of the Tonk and Jaipur firms were profits which arose or accrued outside British India. Further, it is

argued that nothing which has occurred in this case can amount to a bringing in of these profits into British India or a receipt of the profits by the assessee in British India. It has been argued that the profits made by the Tonk and Jaipur branches respectively were not profits arising or accruing in British India and reliance is placed upon the case in AIR 1938 232 (Privy Council) In that case the assessee carried on the business of a broker at Bombay and in the course of his business he entered into transactions in cotton in Liverpool, London, New York and elsewhere. Some of those transactions proved profitable but no attempt was made to bring such profits into British India. The Income Tax authorities at Bombay assessed the assessee on such profits but their Lordships of the Privy Council held that the profits made on transactions entered into in foreign places were not profits which accrued or arose in British India. This point has not been contested by counsel for the Income Tax authorities. He conceded that the profits made at Tonk and Jaipur were not profits which accrued or arose to the assessee in British India. He however argued that they had been brought into or received in British India and were therefore assessable.

7. On behalf of the assessee it is urged that there has been no bringing in or receipt of these profits in British India. It is argued that the mere crediting of the sums in question to the capital account of the Ajmere firm in the books of the Tonk and Jaipur branches cannot amount to bringing in the profits to British India or to a receipt of such in British India. According to the assessee in order that profits made outside British India should be taxable in British India such profits must actually have been physically received in British India and a mere book entry cannot amount to such receipt. It is further pointed out that in this case no entries corresponding to the entries in the books of the Tonk and Jaipur branches appear in the books of the Ajmere firm. The meaning of the phrase Received in the United Kingdom in relation to interest arising from foreign securities was considered in *Gresham Life Assurance Society Ltd. v. Bishop* (1902) A.C. 287. In that case a life assurance society carried on business in England and abroad. The head office was in London where the accounts and balance sheets were made out, the profits ascertained and the dividends paid. The interest upon the society's foreign securities paid abroad was received there by their agents and part of it was applied abroad for the purposes of the society. All the interest on foreign securities was however taken into account in the balance sheets upon which the profits were ascertained. The House of Lords held that interest arising upon foreign securities and paid abroad was not "received in the United Kingdom" within the meaning of the Income Tax Act, 1842, Section 100, Schedule D, and was therefore not chargeable with Income Tax under that clause, unless it was remitted to the United Kingdom. Further that taking such interest into account was not equivalent to a receipt in the United Kingdom and that Income Tax was not chargeable upon such part of the interest which was not remitted to the United Kingdom. It is to be observed that the English Income Tax Act, 1842, contained a very similar phrase to that contained in Section 4, Indian Income Tax Act, viz. "received in the United Kingdom" and there can be no doubt

that the House of Lords held that the mere showing of such interest or profits in the balance sheets prepared in the United Kingdom did not amount to receipt. At page 292, Lord Macnaghten observed:

I do not understand what is meant by constructive receipt in such a case as this, or how any sums can be said to have been received in the United Kingdom unless they have been brought to the United Kingdom or unless there has been a remittance "payable in the United Kingdom." ...The circumstance that the business of the society is "one indivisible business," and that the society in the statement of its affairs and in its dealings with the share holders and customers takes into consideration its foreign assets and liabilities, seems to me to be immaterial to the present question. As my noble and learned friend Lord Robertson, when Lord President, observed in *Forbes v. Scottish Provident Institution* (1895) 23 Rettie 322, "every man and every company having foreign or colonial investments of course knows of the interest arising from them, takes note of it, and enters it in any statement of affairs which may require to be made up." But that, as I think, and as the Lord President thought, is a very different thing from bringing the interest home, a very different thing from the receipt of the money here, either in specie or as represented by a remittance payable in this country.

8. It has been contended that the cases in *Gresham Life Assurance Society Ltd. v. Bishop* (1902) A.C. 287 and AIR 1938 232 (Privy Council) already referred to, establish beyond all doubt that the profits in the present case cannot be said to have been received by the Ajmere firm in British India. We must observe at this stage that the case in AIR 1938 232 (Privy Council) does not really touch the question in issue in this case because it was admitted in that case that the Income Tax authorities were bound to fail unless it could be shown that the profits in question accrued or arose in British India. In the opening portion of the judgment of the AIR 1938 232 (Privy Council) Sir George Rankin observed:

The assessee disputes his liability in respect of such profits on the ground that they were not profits "accruing or arising in British India." It is conceded that they are not otherwise chargeable; they have not been received in British India nor do they come under any of the provisions whereby they can be deemed to accrue or arise or be received in British India.

9. It is therefore clear that in AIR 1938 232 (Privy Council) their Lordships of the Privy Council were not called upon to consider whether the profits made in transactions: in Liverpool, London and New York could be deemed to have arisen or accrued or be received in British India. The case in *Gresham Life Assurance Society Ltd. v. Bishop* (1902) A.C. 287 is however in point because it deals with the meaning of the phrase "received in the United Kingdom." In our view however, the English authorities can be of little assistance in this case because the statute which was under consideration in *Gresham Life Assurance Society Ltd. v. Bishop* (1902) A.C. 287 did not contain everything which is contained in Section 4(1), Indian Income Tax Act. As we have already pointed out that sub-

section provides that the Act is to apply not only to income, profits or gains accruing or arising or received in British India but also to all such income, profits and gains which are deemed under the provisions of the Act to accrue or arise or be received in British India. There was nothing corresponding to this latter provision in the Income Tax Act, 1842, which was under consideration in the House of Lords case to which we have referred. It has been argued on behalf of the Income Tax authorities that though it might be said that the profits of the Tonk and Jaipur branches arose and accrued out of British India they must now be deemed to have accrued or arisen or to have been received in British India. Counsel for the Income Tax authorities has to concede that there has been no physical handing over of this sum, but he contends that under the provisions of the Income Tax Act the profits must now be deemed to have accrued or arisen or to have been received in British India.

10. As we have pointed out earlier in this judgment, the accounts of the Tonk and Jaipur branches, as indeed the accounts of all the branches of this firm, were kept on the mercantile system and further that the assessee had for many years past shown the sums credited to the Ajmere firm in the books of the branches in Native States as part of the profits of the firm for the year during which they were so credited. These are findings of fact which cannot be challenged and are indeed not challenged in this case. Section 13, Income Tax Act provides that

income, profits and gains shall be computed for the purposes of Sections 10, 11 and 12 in accordance with the method of accounting regularly employed by the assessee.

11. It is argued on behalf of the Income Tax authorities that the income or profits of this firm must be computed in accordance with the method of accounting regularly employed by the firm and admittedly such method of accounting has been on the mercantile system. By that method of accounting, the sums credited to the account of the Ajmere firm in the books of the Tonk and Jaipur branches have always been treated as profits of the Ajmere firm, and it is now contended that it is too late for the assessee to attempt to change their method of accounting so as to render these profits not taxable in British India. The mercantile system of accounting was discussed by a Bench of this Court in *Shiva Prasad Gupta Vs. Commissioner of Income Tax, Mukerji J.* described the mercantile accountancy system in these terms:

That system is this. In any particular year the amounts that have become recoverable are shown as the income actually received and the liabilities incurred are shown as amounts actually disbursed. Under this system, the merchant, in order to ascertain his income which is really a "book income" deducts from the profit accrued according to his books, the losses that he has suffered, also according to his books. The balance is a net book income. u/s 13, Income Tax Act, this net "book income" may be accepted by the Income Tax Officer as a fair estimate of the merchant's income. The reason will be two-fold. The merchant

himself uses this method of ascertaining his own income and secondly the method is not an unfair one.

12. According to the case stated, the assessee in order to ascertain their income have for many years deducted from the profit earned according to their books the losses which they have suffered also according to their books and have treated the balance as a net book income and they have been assessed year after year upon this basis. Counsel for the Income Tax authorities therefore contends that as this has been the assessee's own system, they cannot now seek to change it. A perusal of the profit and loss account printed at p. 26 of the paper-book shows that the assessee has treated as profits sums credited to the account of the Ajmere firm in the books of the branches situate outside British India and further have shown as losses, losses incurred by those firms outside British India. The assessee has by their system of accounting treated the profits made outside British India as profits received in British India and have also treated losses incurred outside British India as losses of the firm in British India.

13. It has been contended on behalf of the Income Tax authorities that no distinction can be drawn between the present case and the case in *Commissioner of Income Tax, Madras v. Subramaniam Chettiyar* A.I.R (1927) Mad. 841. In that case an assessee who had a business of his own in Rangoon and a partnership business at Penang advanced a sum of money from the Itangoon firm to the Penang business; it appeared that interest on that advance was credited in the account of the Rangoon business, though no amount was actually received from Penang; the assessee had chosen to adopt the mercantile basis in his accounts. On his being assessed to Income Tax in respect of such interest, the assessee contended that he was not liable as it was not income which accrued, arose or was received in British India. A Pull Bench of the Madras High Court however held that the interest in question was not profit or gain arising without British India but was income which properly accrued or arose in British India within Section 4(1), Income Tax Act (Act 11 of 1922). The assessee having chosen to adopt the mercantile basis of accountancy in keeping his accounts, it was upon that basis, and upon that basis alone, that he was to be assessed to Income Tax under Sections 10 and 14 of the Act.

14. It appears to us that one distinction of fact and only one can be drawn between the present case and the Madras Pull Bench case. In the present case the sums in question were credited in the books of the Tonk and Jaipur branches respectively to the account of the Ajmere firm but apparently unlike the Madras case no corresponding entries appear in the books of the Ajmere firm. The fact that no corresponding entries were made in the books of the Ajmere firm cannot in our view however affect the question if we are satisfied that the system of accountancy followed in this case was that known as the mercantile system. The assessee cannot avoid the consequences by merely omitting to make an entry in the books of the Ajmere firm. The entries were made in the books of the Tonk

and Jaipur firms and further the sums credited to the Ajmere firm were shown year after year as part of the profits of the Ajmere firm and similarly the losses of the branches situate outside India were also shown as the losses of the Ajmere firm. In our view there is no real distinction between the present case and the Madras Pull Bench case to which we have referred and further in our view the Pull Bench of the Madras High Court correctly laid down the law. In our judgment though the profits making up the two sums in question in this case did not actually arise or accrue in British India and were not physically transferred to or received in British India, such profits however must be deemed by reason of Section 13 of the Act to have arisen or accrued in British India or to have been received in British India. The assesseees have always in the past treated such profits as having been received in British India and their accounts on that basis have always been accepted by the taxing authorities. By reason of Section 13 of the Act, they cannot now seek suddenly to change their method of accounting in order to avoid liability for payment of tax upon these sums. In our judgment the view expressed by the learned Commissioner of Income Tax is right and accordingly we answer the question submitted in the affirmative. The assesseees must pay the costs of these proceedings which we assess at Rs. 200.