
(1984) 10 KAR CK 0004

In the Karnataka High Court

Case No : IT Reference No's. 175 to 180 of 1978

Mysore Bangle Works

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 26-10-1984

Acts Referred:

Citation : (1984) 10 KAR CK 0004

Hon'ble Judges : S.A. Hakeem, J; Mohammad Sharif, J; K. Jagannatha Shetty, J

Bench : Full Bench

Advocate : G. Sarangan, for the Appellant; K. Srinivasan and H. Raghavendra Rao, for the Respondent

Judgement

K. Jagannatha Shetty, J.—These are references u/s 256(1) of the income tax Act, 1961 ("the Act"). The questions referred are common and they relate to the validity of reopening the assessment in regard to the income of the assessee-firm falling u/s 40(b) of the Act. It may be sufficient, if we may refer to the questions referred in IT Reference case No. 175 of 1978. They are:

1. Whether, on the facts and in the circumstances of the case, the Tribunal had rightly added back the sum of Rs. 70,990 to the income of the assessee-firm u/s 40(b) of the Act?
2. If the answer to the above question is in the affirmative, whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessment was validly reopened u/s 147(a) of the income tax Act, 1961?

The assessee was a registered firm and was assessed as such for the assessment years 1962-63, 1963-64, 1966-67 to 1969-70. One Tribhuvandas was one of the partners of this firm in all the previous years relevant to the said assessment years. In the intervening two years relevant to the assessment years 1964-65 and 1965-66, the business was carried on by Tribhuvandas as sole proprietor with which we are not concerned in these matters.

2. For the assessment years 1962-63 and 1963-64, the firm was constituted by an instrument dated 15-11-1960 with three partners including Tribhuvandas. This instrument was silent as to commission payable to Tribhuvandas, but an agreement executed after a couple of days expressly provided for such benefits. In the agreement dated 17-11-1960, the partners agreed that all the goods manufactured by the firm shall be sold through Bitco Sales Service, the proprietary concern of Tribhuvan Das, and he shall be paid commission at the rate of ten percent on the sales effected. It was also stated that the agreement should be supplemental to the instrument of partnership dated 15-11-1960.

3. As mentioned earlier, for the assessment years 1964-65 and 1965-66, the business became the proprietary concern of Tribhuvandas. For the subsequent years, he again converted the establishment into a partnership firm executing an instrument dated 23-11-1964. Clause (4) of this instrument provided that all the products manufactured by the assessee-firm shall be sold only by Bitco Sales Service. Bangalore, Vyayawada or any other branch of which Tribhuvandas is the sole proprietor and that concern shall be paid a sales commission of ten percent. There was a change in the partnership in 1967, but the clause relating to the payment of ten percent commission to Bitco Sales Service was, however, continued. In the actual conduct of the business, the assessee issued sales bill in respect of its products in the name of Bitco Sales Service allowing ten percent commission, but in the trading accounts, the assessee credited only the net amount of the sale proceeds.

4. In the statements filed before the ITO for the purpose of original assessments, the trading accounts of the assessee showed only the net sales without indicating the commission paid to Bitco Sales Service. Even the profit and loss account did not disclose the commission or discount allowed to Bitco Sales Service. There was a separate commission account maintained by the assessee, but that also did not show any commission paid to Bitco Sales Service or to Tribhuvandas.

5. In the course of assessment for the year 1962-63, the ITO found that the assessee had disclosed a low rate of gross profit as against the profit in the earlier years and he asked the assessee to give reason for that. The assessee in the letter dated 6-3-1963 gave the following reason:

All the finished goods manufactured by the assessee are being sold to Bitco Sales Service, Bangalore and Madras at a discount of 10 percent and the sales shown in the accounts are after allowing the discount mentioned above. The net result in the trading account is therefore a gross profit of Rs. 1,04,971 on the net sales of Rs. 4,96,017 which works out to 16.4 percent as against 24.6 percent of the earlier year.

6. In the original assessments made for the six years mentioned earlier, the ITO did not add back the commission paid to Tribhuvan Das u/s 40(b). During the course of assessment for the year 1970-71, he found out that the assessee had paid ten percent commission to Tribhuvandas in all the earlier years also. As a

result, he reopened the assessments for the earlier years u/s 147(a) of the Act and in the reopened assessments included the commission paid to Tribhuvandas u/s 40(6). The amount so added for the various years are as follows:

Assessment year

Commission paid

Rs.

1962-63

70,990

1963-64

83,076

1966-67

1,44,469

1967-68

1,29,882

1968-69

1,98,146

1969-70

1,91,924

7. In the reassessment proceedings, the assessee contended that the amounts paid to Bitco Sales Service could not be added back u/s 40(b) since there was no payment of commission as such to Tribhuvandas, but only discount was given to him and net sales were shown after deducting the discount at ten percent. The ITO rejected this plea.

The assessee then challenged the reassessment orders before the AAC on two grounds : (i) that the reopening of the assessments u/s 147(a) was illegal; and (ii) that the amounts, in any event, could not be added back u/s 40(b). Both these grounds were rejected by the AAC who confirmed all the reassessments made by the ITO.

8. The assessee preferred second appeals to the Tribunal repeating the said two-fold contention. In support of the first contention, it was urged that all the primary facts were given at the original assessment stage and, therefore, the provisions of section 147(a) were not applicable. In support of the second contention, it was urged that since there was no payment of commission as such but only trade discount was allowed to Tribhuvandas, there was no warrant for reopening the assessments.

9. The Tribunal also did not accept these contentions. On the basis of the material on record, the Tribunal came to the conclusion that the assessee was allowing commission at ten percent of the sales to its partner Tribhuvandas who was the proprietor of Bitco Sales Service and, therefore, section 40(b) was attracted to such payment.

With regard to the applicability of section 147(a), the Tribunal observed that there was no indication whatever from which the ITO could come to a conclusion that any commission has, in fact, been paid to the partner Tribhuvandas which could be disallowed u/s 40(6). The ITO was actually misled by the statement of accounts maintained by the assessee. There then the Tribunal concluded:

...We are, therefore, satisfied that it was because of the failure of the assessee to disclose fully all the information on the basis of which the income tax Officer could have come to the conclusion that section 40(b) was applicable on the facts of the case that resulted in escapement of income and, therefore, section 147(a) was clearly applicable.

10. The first question that falls for decision is whether any commission was paid by the assessee to the partner Tribhuvandas within the scope of section 40(b). Without deciding this question, it would be difficult to consider the second question as to whether the assessee had placed before the ITO truly and fully all the material facts necessary for the purpose of assessment.

Section 40(b) of the Act provides:

Notwithstanding anything to the contrary in sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession,

(a) ****

(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm;

This clause prohibits any allowance in respect of any payment by way of interest, salary, bonus, commission or remuneration made by a firm to any of its partners. The prohibition contained in this section is absolute and it apparently makes no distinction between the payments by way of interest, commission, remuneration, etc., made to a partner as a partner, and such payments made to him although in a different capacity as the proprietor of an independent concern. This Court in *N.M. Anniah and Co. Vs. Commissioner of Income Tax, Mysore*, while taking a similar view has observed that section 40(b) is absolute in its terms and is applicable to all cases irrespective of the character in which a person has become a partner of a firm.

11. On the first question that arises for consideration, it would be too difficult to accept the contention urged by Shri Sarangan, the learned counsel for the assessee, that there was no commission as such paid to Tribhuvandas. The

agreement dated 17-11-1960 expressly states that the goods manufactured by the assessee-firm shall be sold through Bitco Sales Service by proprietor Tribhuvandas who shall be paid commission at the rate of ten percent on the sales effected. The agreement also states that it shall be read as part of the instrument of partnership executed on 15-11-1960. The instrument of partnership dated 23-11-1964 also provides that all the products manufactured by the assessee-firm shall be sold only by Bitco Sales Service of which first partner Tribhuvandas was the sole proprietor and Bitco Sales Service shall be paid a selling commission of ten percent.

In view of these clear recitals in the said agreement and also in the instrument of partnership, it would be unreasonable to state that no commission was paid or payable by the firm to Tribhuvandas.

12. The next contention of Shri Sarangan relates to the arrangement regarding the payment agreed upon between the assessee and the Bitco Sales Service. He urged that all the sales of the products manufactured by the assessee-firm were effected through Bitco Sales Service and the latter received the sale consideration and paid back the net price to the assessee-firm. The assessee in its account book also has recorded only such actual receipts. Since the sale proceeds were received by Bitco Sales Service and since the assessee-firm did not pay at the end of the year or periodically, any sum by way of commission to Bitco Sales Service, the payment retained by Bitco Sales Service, according to the learned counsel, cannot be regarded as commission paid within the scope of section 40(6). The counsel also submitted that Bitco Sales Service was also doing business on behalf of other concerns and it was, therefore, not a special feature of the assessee's business to give a trade discount.

13. While appreciating the first part of the contention of Shri Sarangan, we have to necessarily examine the right of Bitco Sales Service to retain ten percent out of the sale proceeds. That right was the right of Tribhuvandas who was the proprietor of Bitco Sales Service. He has acquired that right under the said agreement and by the terms of the partnership in which he was a partner. It is, therefore, not correct to state that ten percent commission payable to Tribhuvandas was just a trade discount allowable to any trader. But for the rights conferred on Tribhuvandas under the said agreement between the partners, Bitco Sales Service had no right to retain ten percent of the sale proceeds. If there was no such agreement, the assessee-firm would have been entitled to the whole of the sale proceeds.

14. Apart from that, the payment of ten percent commission to Bitco Sales Service on all the sales effected cannot also be disputed in view of the despatch memos issued by the assessee-firm. The assessee-firm thereunder did allow ten percent commission to Bitco Sales Service. It would be, therefore, incorrect to state that Bitco Sales Service was not paid ten percent commission. Such a payment cannot cease to be a commission paid to Tribhuvandas merely because Bitco Sales Service was also doing similar business on behalf of other

manufacturers as well. The other business of Bitco Sales Service has nothing to do with the question arising in this case. In this view of the matter, it is unnecessary to consider the decision of the Madras High Court in Commissioner of Income Tax Vs. Gemini Productions, relied upon by Shri Sarangan in support of his contention.

15. The next question to be considered is whether there was full and true disclosure of all primary facts by the assessee in the course of the original assessment. It is now well settled that once all the primary facts are placed before the assessing authority, the assessee's responsibility ceases and the assessing authority's duty begins. In Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another, , the Supreme Court observed:

...Once all the primary facts are before the assessing authority, he requires no further assistance by way of disclosure. It is for him to decide what inferences of facts can be reasonably drawn and what legal inferences have ultimately to be drawn. It is not for somebody else-far less the assessee-to tell the assessing authority what inferences, whether of facts or law, should be drawn. Indeed, when it is remembered that people often differ as regards what inferences should be drawn from given facts, it will be meaningless to demand that the assessee must disclose what inferences-whether of facts or law-he would draw from the primary facts. If from primary facts more inferences than one could be drawn, it would not be possible to say that the assessee should have drawn any particular inference and communicated it to the assessing authority. How could an assessee be charged with failure to communicate an inference, which he might or might not have drawn?" (p. 201)

16. Shri Sarangan urged that the assessee in this case has placed the agreement dated 17-11-1960, the partnership deed dated 23-11-1964, and the despatch memos issued by the assessee-firm to Bitco Sales Service before the assessing authority, and if they had been properly perused by him, an inference would be inescapable that Tribhuvandas was entitled to ten percent commission.

17. But we do not think that the assessee by just producing those documents could legitimately contend that it had placed all the primary facts. It will be seen that in the statement of accounts filed by the assessee before the ITO, no mention was made anywhere about the commission paid to Tribhuvandas or Bitco Sales Service. No entry to that effect has been made in the account books maintained by the assessee. The assessee also did not produce the total trade receipts, much less the ten percent commission account, so as to enable the ITO to determine the taxable income of the assessee. There was a separate commission account maintained by the assessee, but that also did not show any commission paid to Bitco Sales Service or to Tribhuvandas. Hence the ITO was not told that the assessee had paid commission to Tribhuvandas.

18. The case on hand, in our opinion, squarely falls within the ratio of the

decision of the Supreme Court in *Malegaon Electricity Co. P. Ltd. Vs. Commissioner of Income Tax, Bombay*, . It will be useful to advert to the facts in that case. There the assessee-company sold its assets to another company and the entire consideration which was much more than the written down value of the assets was paid in cash. In its return for the relevant assessment year 1952-53, the assessee did not show any profits u/s 10(2)(vii) of the Indian Income-tax Act, 1922, nor did it show the price received in excess of the written down value of the assets in Part I of section D of the return. In the course of the original assessment proceedings, the assessee informed the ITO about the sale and how the sale price was determined and also brought to his notice the minutes of the board meetings of the assessee and of the purchasing company including the agreement between them. It also submitted a statement of unabsorbed depreciation which set out the depreciation accrued as well as that allowed. After setting off the unabsorbed depreciation, the ITO determined the assessee's income to be nil observing : "on going through these documents and the copies of the resolution passed by the shareholders of the purchasing company it is seen that no adjustment is necessary in the matter....." Subsequently, the ITO reopened the assessment u/s 34(1)(a) of the 1922 Act, and taxed the profits earned by the assessee u/s 10(2)(vii).

19. The AAC confirmed that order. On further appeal, the Tribunal did not go to the question whether any part of the sale proceeds could be deemed to be profits u/s 10(2)(vii), but held that the assessee had placed before the ITO all primary facts for its assessment and the action u/s 34(1)(a) could not be, therefore, sustained. On a reference, the High Court of Bombay answered the question related to. the validity of reopening of the assessment in favour of the revenue.

20. In the appeal against the decision of the Bombay High Court, the Supreme Court observed:

In our judgment the Tribunal erred in declining to decide the question whether any portion of the sale price came within the scope of section 10(2)(vii). That question should have been examined at the very outset for the purpose of considering whether the assessee had placed before the income tax Officer truly and fully all material facts necessary for the purpose of its assessment. If it is found that any portion of that sale price are profits then in our opinion the High Court was right in holding that the assessee had failed to place before the income tax Officer during the original assessment truly and fully all material facts necessary for the purpose of assessment. Admittedly, the price realised at the sale in excess of the written down value of the assets sold, had not been included as profits in the return submitted by the assessee. It had also not shown the same in Section D of Part I of the return. It may also be noted that the assessee had not shown either in its return or in any of the documents submitted to the income tax Officer, the written down value of the assets sold. Hence, not only the income tax Officer was not told that the assessee had earned any profit u/s 10(2)(vii) nor even the essential fact, viz., the written down value

of the assets sold was supplied to him so as to enable him to find out the price in excess of the written down value realised by the assessee. It is true that if the income tax Officer had made some investigation, particularly if he had looked into the previous assessment records, he would have been able to find out what the written down value of the assets sold was and Consequently he would have been able to find out the price in excess of their written down value realised by the assessee. It can be said that the income tax Officer if he had been diligent could have got all the necessary information from his records. But that is not the same thing as saying that the assessee had placed before the income tax Officer truly and fully all material facts necessary for the purpose of assessment...." (p. 471)

21. The facts in the present case are not different. They lie in close parallel with the facts found by the Supreme Court in Malegaon Electricity Co.'s case (supra). Therefore, in the light of the principles enunciated by the Supreme Court in that case and having regard to the facts found in this case, it seems to us that the assessee herein has failed to disclose fully and truly all material facts necessary for the purpose of assessment.

22. There is, however, one redeeming feature in regard to the assessment for the year 1962-63. In the course of assessment for the year 1962- 63, the ITO specifically asked the assessee to give reason for the low rate of profit. The assessee in its reply dated 6-3-1963, gave the reasons as follows:

All the finished goods manufactured by the assessee are being sold to Bitco Sales Service, Bangalore and Madras at a discount of 10 percent and the sales down in the accounts are after allowing the discount mentioned above. The net result in the trading account is therefore a gross profit of Rs. 1,04,971 on the net sales of Rs. 4,96,017 which works out to 16.4 percent as against 24.6 percent of the earlier year.

23. The ITO himself got these necessary material facts as to the payment of ten percent commission to Bitco Sales Service. If he had been little more diligent, he could have ascertained and computed the total amount of commission paid by the assessee to Bitco Sales Service. We cannot, therefore, hold that the assessee for the assessment year 1962-63 had failed to disclose fully and truly all the material facts necessary for the purpose of assessment. The reassessment for the year 1962-63 cannot, therefore, be sustained.

24. In the result, we answer the first question in the affirmative and against the assessee. We also answer the second question in the affirmative and against the assessee in all references except in IT Reference case No. 175 of 1978.

25. In IT Reference Case No. 175 of 1976, for the assessment year 1962-63, we answer the second question in the negative and in favour of the assessee. In the circumstances of the case, we make no order as to costs.