

(1996) 04 MAD CK 0068
In the Madras High Court
Case No : T.C. No. 1040 of 1981

T.M. Raghunathan

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 18-04-1996

Acts Referred:

Income Tax Act, 1961 — Section 15, 28

Citation : (1998) 231 ITR 826

Hon'ble Judges : N.V. Balasubramanian, J; K.A. Thanikkachalam, J

Bench : Division Bench

Advocate : Deokinandan, for the Appellant; K.M.L. Majele, for the Respondent

Judgement

K.A. Thanikkachalam, J.—At the instance of the assessee, the Tribunal referred the following question for the opinion of this Court under s. 256(1) of the IT Act, 1961 :

"Whether, on the facts and in the circumstances of the case, the assessee is liable to be assessed on the income of Rs. 25,000 as remuneration from the company of which he was the managing director for the asst. yr. 1973-74 ?"

2. The assessee is the managing director of Falcon Wires (P) Ltd. For the asst. yr. 1973-74, the financial year ending on 31st March, 1973, the assessee's remuneration was fixed at Rs. 2,500 per mensem at a board's resolution, dt. 4th June, 1971. However, by another resolution, dt. 31st December, 1972, the remuneration was reduced for the period from 1st April, 1972 to 31st March, 1973, to Rs. 10,000 per annum, in view of the company's difficult financial position. The case of the assessee is that he is liable only on a sum of Rs. 10,000 as per the latter resolution, dt. 31st December, 1972. He, therefore, offered only this amount of Rs. 10,000 for assessment. The ITO was of the view that the salary for the period from 1st April, 1972 to 31st December, 1972, has to be governed by the first resolution, which was, in his opinion, the only resolution in force during this period. While he accepted the salary of Rs. 10,000 per annum

for the last three months, he reckoned the salary at Rs. 2,500 per mensem for the first nine months. The ITO, therefore, computed the salary at Rs. 25,000 for the year as against Rs. 10,000 returned by the assessee.

3. Aggrieved, the assessee filed an appeal before the AAC. The AAC found that the latter resolution was within the accounting year itself. He was, therefore, of the view that the latter resolution, dt. 31st December, 1972, should be given effect to. However, he found that the assessee had actually drawn a sum of Rs. 12,000 during the accounting year by way of remuneration as seen from the copy of his personal account in the company. The AAC, therefore, adopted the income at Rs. 12,000 as against Rs. 25,000 computed by the ITO and Rs. 10,000 claimed by the assessee.

4. Aggrieved, the Department filed an appeal before the Tribunal. The Tribunal found that the income for the nine months already accrued to the assessee in view of the first resolution and that the subsequent resolution cannot have the effect of reducing the salary retrospectively. The Tribunal was of the view that the resolutions could have only prospective operation. Accordingly, the Tribunal restored the order of the ITO.

5. Learned counsel appearing for the assessee submitted as under :

In the present case, as per the latter resolution, dt. 31st December, 1972, the remuneration was reduced to Rs. 10,000 per annum and this was the amount received by the assessee during the assessment year under consideration. The second resolution was passed within the accounting year. Therefore, the Tribunal was not correct in holding that the remuneration to the assessee accrued at the rate of Rs. 2,500 per mensem for the entire year. Learned counsel further pointed out that the resolution was passed bilaterally within the accounting year and, therefore, the second resolution should be given effect to and the tax should be computed on the remuneration actually received by the assessee, which comes to Rs. 10,000 per annum. Even otherwise, it was pointed out that inasmuch as only a sum of Rs. 10,000 was paid by way of remuneration and the personal account shows a receipt of Rs. 12,000 by the assessee as per the order of the AAC, there is no justification on the part of the Department and the Tribunal to come to the conclusion that the salary should be calculated at the rate of Rs. 2,500 per mensem for the whole year. Alternatively, it was submitted that since the assessee has not received the entire salary income at the rate of Rs. 2,500 per mensem for the whole year, after deducting Rs. 12,000 the assessee is entitled for another deduction of the balance of the amount while determining the income of the assessee for the assessment year under consideration. On the other hand, learned standing counsel appearing for the Department, submitted that as per the provisions of s. 15 of the IT Act, 1961, "any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not, is assessable for the purpose of tax". In the present case, learned standing counsel pointed out that as per the first resolution, dt. 4th June, 1971, the remuneration to the assessee was fixed at Rs.

2,500 per mensem. In the second resolution, dt. 31st December, 1972, the remuneration was reduced to Rs. 10,000 per annum for the period from 1st April, 1972 to 31st March, 1973. According to learned standing counsel, the second resolution passed by the company, with the consent of the assessee, would have no effect. According to learned standing counsel, the resolution would not operate retrospectively. Therefore, it was submitted that inasmuch as the salary income as determined by the first resolution accrued to the assessee for the first nine months, the salary income for the entire year is to be calculated at the rate of Rs. 2,500 per mensem. In so far as the alternative contention put forward by the assessee is concerned, learned standing counsel appearing for the Department submitted that inasmuch as this plea was not argued before the Tribunal, it is not open to learned counsel appearing for the assessee to make this submission for deduction of the balance of amount while taxing the salary income.

6. We have heard the rival submissions. The issue that arises for consideration is whether the assessee is liable to tax on Rs. 10,000 on the basis of the second resolution or on Rs. 25,000 on the basis that both the resolutions operate prospectively. The assessee has not filed any appeal against the order of the appellate authority, fixing the remuneration at Rs. 12,000 which was actually drawn by the assessee. The question is whether the assessee is assessable on Rs. 25,000 as found by the Tribunal or on Rs. 12,000 as found by the AAC.

7. According to the assessee, in view of the latter resolution, dt. 31st Dec, 1972, salary was determined at Rs. 10,000 per annum and the actual drawings of the assessee in the personal account of the company shows a sum of Rs. 12,000 and, therefore, according to the assessee, this is the amount, which is chargeable to tax in the assessment year under consideration.

8. A similar question came up for consideration before this Court in K. R. Kothandaraman vs. CIT (1966) 62 ITR 348 : TC 58.111. According to the facts arising in this case, the assessee was appointed as the managing director of a company for a period of five years from the date of its incorporation under an agreement, which provided that "the company shall pay to the managing director (the assessee) in respect of each year of account of the company ... a monthly remuneration of Rs. 1,250 plus commission at the rate of five per cent. on the net profits made by the company". The commission was to become due and be paid to him yearly and he was to be entitled to draw the same immediately after the annual accounts of the company of each year were made up and the accounts were laid before the company in general meeting, subject to the provision that the assessee would be entitled to draw his minimum remuneration in monthly instalments of Rs. 1,250. For the accounting year ended 31st December, 1959, the company credited to the assessee a remuneration of Rs. 1,250 every month, but on 31st December, 1959, the company debited the assessee with a sum of Rs. 15,000 which represented the salary for the whole year in pursuance of a resolution of the board of directors, dt. 9th May, 1960,

that in view of the company not making any profit, the company decided to stop payment of remuneration of Rs. 15,000 per annum to the managing director for the year 1959. In respect of the asst. yr. 1960-61, the assessee claimed that he was not entitled to remuneration for the whole year of 1959 by virtue of the resolution and that the credit entries made month after month did not entitle him to remuneration in the circumstances. On these facts a question arose whether on the facts and circumstances, the sum of Rs. 11,250 is assessable under s. 7 of the Indian IT Act, 1922. While answering this question this Court held that even if the resolution in this case was to be read as having the effect of denying the salary during the period of nine months to the assessee, or if it is to be taken that the assessee had waived the accrued remuneration, such denial, withdrawal or waiver occurred subsequent to the assessment year, and it would, therefore, be totally ineffective in the computation of the income for the assessment year, which would be liable to tax under s. 7. The entries made in the folio page relating to the assessee in the books of the company, having particular regard to the terms of the agreement, would appear to be irrevocable entries and it would not be open to the board of directors to cancel these entries in their effect by the resolution. On this view also, the remuneration for the period of nine months can be rightly brought to tax.

Similarly, this Court had an occasion to consider a similar question in *Commissioner of Income Tax Vs. P. Nataraja Sastri*, . According to the facts arising in that case, the assessee as a director of a company was entitled to a remuneration of Rs. 500 per month. In view of the losses suffered by the company for the year ending 31st March, 1963, it was resolved by the directors after the close of the year to waive the remuneration payable to them. The ITO held that the remuneration was includible for assessment in the assessee's hands as it had already accrued to him. The AAC and the Tribunal, however, held that, in view of the retrospective waiver, the amount was not includible. On a reference, this Court held that where income had accrued already to a director or managing director, no waiver of the remuneration or any denial thereof would have the effect of affecting the taxability of the said sum. The entry in the accounts is of neutral consequence except as a piece of evidence. In the case of a managing agency, which is governed by an agreement, the position may be different and it is possible for the parties to meet and agree to modify the agreement either prospectively or retrospectively. Once the income had accrued, its waiver will only be an application of the income. In this view, the amount was rightly brought to tax by the officer and the Tribunal was in error in deleting the addition.

9. Again, a similar question came up for consideration before this Court in *Commissioner of Income Tax Vs. V.R. Rajaratnam*, . According to the facts arising in this case, the assessee was appointed managing director of a company on a salary of Rs. 2,000 per month. As the company was not faring well, he did not draw any salary for the months, September to December, 1964, and for the year 1965, he agreed to draw a salary at the rate of Rs. 500 p.m. The company

passed a resolution on 30th April, 1965, to the effect that the assessee had waived his remuneration for the four months, September to December, 1964. Another resolution was passed on 27th May, 1966, to the effect that he had agreed to draw a salary of Rs. 500 per month for the year 1965. The assessee was re-appointed from 1st January, 1967, at the rate of Rs. 1,000 per month by a resolution, dt. 27th February, 1967. In his assessment for 1965-66, corresponding to the accounting period ending on 31st March, 1965, the assessee's claim that he was assessable only on a salary of Rs. 2,000 per month for April to August, 1964, and Rs. 500 per month for January to March, 1965, he having waived the salary for the months September to December, 1964, was rejected by the officer, who assessed him on a salary calculated at Rs. 2,000 per month. Similarly for 1966-67, the assessee's claim for assessment on a salary of Rs. 500 per month from April to December, 1965, and at Rs. 1,000 per month for January to March, 1966, was also negatived and he was assessed on the basis of Rs. 2,000 per month. Though the AAC confirmed the assessments, the Tribunal held that the debt which the company owed to the assessee after August, 1964, was equal to the reduced amounts paid to the assessee and not a sum of Rs. 2,000 per month, and consequently accepted the assessee's claim. On a reference, this Court held that there was nothing in the resolutions or anywhere else to show that there was an understanding arrived at between the managing director and the company before the accrual of the remuneration payable to him, regarding the waiver of the remuneration, the resolution itself being after the relevant year, the assessee was entitled to the remuneration at the rate of Rs. 2,000 per month. Though he unilaterally waived it wholly for some months and partly for others, the assessee was liable to be taxed on the amount to which he was entitled. While referring to *K. R. Kothandaraman vs. CIT* (supra) and *CIT vs. P. Nataraja Sastri* (supra), in this decision this Court pointed out that : "In these two cases, it has been held that the waiver of the amount due to the assessee would only be an application of the income of the assessee. As the income of the assessee had accrued, he was liable to be taxed whatever he may have done in the form of waiver of a part of income."

10. There is also another decision of this Court in *M.K. Abdul Rahiman Vs. Commissioner of Income Tax*, . According to the facts arising in this case, the assessee was entitled to remuneration on the basis of a resolution of the board of directors of a company, which resolution had not been subsequently modified. The ITO held that the salary had accrued to the assessee and brought the same to tax, even though the assessee claimed that they had waived the salary and, hence, were not liable to be taxed on the said amount. Though the AAC accepted the assessee's contention, the Tribunal upheld the assessment, on the ground that the salary had already accrued to the assessee. On a reference, this Court held that (headnote) : "the salary accrued to the assessee under the terms of the resolution and there was no waiver of the same before the accrual. Therefore, there was a debt due by the company to the assessee which could have been enforced by them in view of the resolution subsisting during the

relevant year and the Tribunal was right in upholding the assessment of the same".

11. Insofar as the alternative contention put forward by the assessee that the balance of amount not received by the assessee should be deducted from the salary income is concerned, this Court, in the decision in *M. K. Abdul Rahiman vs. CIT (supra)*, had an occasion to consider the same in the following manner :

"The learned counsel for the assessee drew our attention to a passage in the decision of the Gujarat High Court in *Commissioner of Income Tax, Gujarat II Vs. Bachubhai Nagindas Shah*, and wanted us to make an observation similar to those made therein. It has been pointed out by the learned Judges of the Gujarat High Court that when the amount was not received, appropriate relief must be given by way of deduction to the assessee concerned, as otherwise the very basic principle of accrual will be violated. However, having regard to the nature of the questions referred to us, we do not think it necessary or proper to go into this aspect."

12. In *CIT vs. Bachubhai Nagindas Shah (supra)*, the Gujarat High Court also had an occasion to consider a similar point as arising in the present case. According to the facts arising in that case, the assessee was appointed a director of a private company on a remuneration of Rs. 400 p.m. In 1962, for which the assessment year was 1963-64, the company incurred losses and on 18th March, 1963, the board of directors resolved that the directors should waive their remuneration for 1962. Accordingly, the assessee waived his right to remuneration in the sum of Rs. 4,800, which had become due to him for the calendar year 1962. But the ITO included the amount of Rs. 4,800 in the income for the asst. yr. 1962-63. However, in second appeal, the Tribunal came to the conclusion that the assessee having forgone the remuneration due to him, the question of assessing the same in his hands did not arise and deleted the amount of Rs. 4,800. On a reference, while answering the question, whether, on the facts and circumstances of the case, the Tribunal was justified in law in reducing the income of the assessee from Rs. 58,000 to Rs. 10,200, the Gujarat High Court held as under (headnote) :

"That the amount of Rs. 4,800 was on the basis of remuneration to be paid to the assessee as a director and the remuneration was on the basis of salary being paid by the company to the director for regularly working for the company. This amount was to be received by the assessee as an employee of the company and would be liable to be brought to tax under the head "Salary" under s. 15 of the IT Act, 1961. Unlike incomes falling under other heads of income, as regards salaries, the principle under s. 15 is that the income becomes chargeable to tax with reference to the previous year in which it fell due, not on the basis of actual receipt but on the basis of the amount becoming due. The position as regards income falling under the head "Salaries" is altogether different from the income falling under the head "Income from business", because what can be deducted from the commercial point of view under s. 28 is not available in the case of

salaries. The waiver of salary which occurred subsequent to the assessment year would be totally ineffective in the computation of the income for the assessment year. The concept of "real income" in a case like the present one where the income falls under the head "Salaries" cannot help the assessee and his waiver cannot amount to anything more than the disposal of the income already received by the assessee. The Tribunal erred in law in coming to the conclusion that the remuneration of Rs. 4,800 forgone by the assessee was not income liable to tax."

13. Our attention was drawn to a decision of the Supreme Court in *Commissioner of Income Tax, Bombay City I Vs. Shoorji Vallabhdas and Co.*, . According to the facts arising in that case, the assessee firm was the managing agent of two shipping companies and under the managing agency agreement, it was entitled to receive as commission 10 per cent. of the freight charges. Between 1st April, 1947, and 31st December, 1947, an amount of Rs. 1,71,885 from one company and Rs. 2,56,815 from another company became due to the assessee as commission at the rate of 10 per cent., and in the books of account of the assessee, these amounts were credited to itself and debited to the managed companies. In November, 1947, the assessee desired to have the managing agency transferred to two private companies and in this connection agreed in December, 1948, to accept 2 1/2 per cent. as commission and gave up 75 per cent. of its earnings. The Department sought to assess the amounts of Rs. 1,36,903 and Rs. 2,00,625 being the 75 per cent. which the assessee had given up on the ground that commission at 10 per cent. had already accrued to the assessee in the year of account and the agreement in December, 1948, after the close of the previous year to give up a portion of that income, could not save that portion from liability to Income Tax. On these facts, the Supreme Court held that (headnote) : "the subsequent agreement had altered the rate of commission in such a way as to make the income which really accrued to the assessee different from what had been entered in the books of account. This was not a case of a gift by the assessee to the managed companies of a portion of income which had already accrued, but an agreement to receive a lesser remuneration than what had been agreed upon. The assessee had, in fact, received only the lesser amount in spite of the entries in the account books and this lesser amount alone was taxable". This decision was concerned with taxing the commission payment payable to a managing agency company. The question of taxing the salary income does not arise in this case. Therefore, the Supreme Court held on the facts that whatever amount was actually received, that alone should be taxable and not on the basis of an accrual or due as contemplated under s. 15 of the IT Act, 1961.

14. Based on the observation given by the Gujarat High Court in *M. K. Abdul Rahiman vs. CIT* (supra), learned counsel appearing for the assessee submitted that the amount which was not received should be given as a deduction while determining the income from salary. This plea was not raised either before the authorities below or before the Tribunal. Further, the amount which was not

received by the assessee is also not an expenditure incurred wholly and exclusively for the purpose of earning the salary income. Therefore, on that score, deduction is not possible.

15. No doubt, in the present case, the second resolution, dt. 31st December, 1972, was passed within the accounting year. The Tribunal has pointed out that in view of the decisions in E.D. Sassoon and Company Ltd. Vs. The Commissioner of Income Tax, Bombay City, and SHIV PRAKASH SETH Vs. COMMISSIONER OF Income Tax, AMRITSAR., , no resolution can be passed with retrospective effect. It is under these circumstances, the second resolution passed in the present case on 31st December, 1972, was given effect to only for a period of three months. For the rest of the nine months, income was determined on the basis of the first resolution, dt. 4th June, 1971. Thus, on a careful consideration of the facts arising in this case, in the light of the judicial pronouncements cited supra, we are unable to find any error in the order passed by the Tribunal in setting aside the order passed by the AAC and restoring the order passed by the ITO. Accordingly, we answer the question referred to us in the affirmative and against the assessee. No costs.