Beni Prasad Sidh Gopal Vs. Commissioner of Income-tax

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Court : Allahabad

Decided On : May-16-1983

Reported in : (1983)37CTR(All)35; [1984]148ITR760(All); [1983]15TAXMAN191(All)

Judge : R.M. Sahai and ;V.K. Mehrotra, JJ.

Acts : Income Tax Act

Appeal No. : Income-tax Reference Nos. 185 of 1973, 1231 of 1976 and 108 of 1982

Appellant : Beni Prasad Sidh Gopal

Respondent : Commissioner of Income-tax

Advocate for Def. : M. Katju, Adv.

Advocate for Pet/Ap. : R.K. Gulati, Adv.

Judgement :

R.M. Sahai, J.

1. Claim of allowability of interest and commission in 1959-60 and 1960-61 (ITR No. 108 of 1982), expenditure on litigation and establishment in 1961-62 to 1965-66 (ITR No. 185 of 1973), and bad debt in 1966-67 (ITR No. 1231 of 1976) by the assessee shall principally depend on the construction of the agreement, dated October 26, 1954, entered into between the assessee, a firm registered and constituted with the object of carrying on business as sole distributors for sale of yarn and cloth manufactured by three textile mills, and B.R. & Sons, their sole selling agents, and the award given by the Tribunal of Arbitration, Federation of Indian Chambers of Commerce and Industry, on August 27, 1964, in a dispute between them.

2. Although these references arise out of different orders passed by the Tribunal, they stem out of the same transaction, and therefore, they are being disposed of by this common order. Under an agreement of 1954, the assessee was to invest Rs. 25 lakhs for distribution and sale of products, manufactured by textile mills which amount was always to remain invested. On delivery of goods to the assessee on consignment basis against advance payment, the assessee was entitled to 5% interest from the date of payment till the sale of goods. Assessee was also entitled to 66 2/3 of the expenditure incurred by it on establishment, etc. And on sale of goods it was to get commission of 1 1/2% of sales. The agreement appears to have remained in operation till November, 1958, when B.R. Sons wrote a letter to the assessee complaining that it was not fulfilling its obligation and responsibility under the agreement. Similar letters were repeated on 1st and 9th December, 1958. Ultimately, the dispute was referred to arbitration in 1959. Claims and counter-claims were made. In July, 1964, an award was given directing the assessee to pay Rs. 2,50,000 in full and final settlement. None of these letters are on record nor were they produced by the learned standing counsel despite a specific order of this court on the application of the assessee and grant of adjournments. But as the contents are mentioned in one or the other of the references, it is sufficient for disposal of these references.

3. In assessment year 1959-60, the assessee had debited a sum of Rs. 1,75,509'87 by way of interest to the account of M/s. B.R. Sons and B.R. Kothi in its books of head office and branches and had taken these amounts to its profit and loss accounts. Certain other amounts by way of travelling expenses, insurance and bank commissions, etc., were also shown as recoverable from M/s. B.R. Sons. Consequently, they were debited in the books of the assessee in the account of M/s. B.R. Sons. In the books of B.R. Sons Ltd., a sum of Rs. 2,88,237.77 had been provided towards establishment, brokerage, distributor's commission, interest, etc. Of this, a sum of Rs. 2,88,237.77 was due to the assessee. These various amounts had been debited and charged to the profit and loss account of the company and liability thereof was shown as 'Liability for expenses'. In the balance-sheet, it was noted, the figure of Rs. 12,79,362-04, includes a provision of Rs. 2,85,266.01 by the company. 'Disputed'. Thus from the account books of B.R. Sons it is clear that the amount shown as debited in the name of the assessee was not admitted but disputed. When the assessee filed its return for 1959-60 for the periodending June 10, 1959, it showed an income of Rs. 3,07,431, but in January, 1964, the assessee filed a revised return showing loss of Rs. 5,63,087. Along with the revised return a covering letter of January 23, 1964, was also sent to the ITO, Central Area, Kanpur, stating that as a dispute had arisen between M/s. B.R. Sons and the assessee in respect of interest, as also expenses claimed, the assessee did not have any income in the assessment year in dispute but rather had suffered huge losses. The deduction of Rs. 5,90,711 was also claimed as B.R. Sons had claimed the same from the assessee in respect of loss on consignment of goods, interest, etc. The revised return appears to have been filed due to various claims raised by B.R. Sons in a dispute raised before arbitrator. Similarly, for assessment year 1960-61, the assessee had debited a sum of Rs. 13,06,824.60 by way of interest in the account of M/s. B.R. Sons Ltd. and a return showing an income of Rs. 77,634 was filed on December 23, 1960. But on March 4, 1964, a revised return showing a loss of Rs. 4,96,371 was filed again on the same basis, i.e., the dispute raised before the arbitrator.

4. The ITO did not find any merit in the claim of the assessee as the dispute between the assessee and M/s. B. R. Sons had arisen after November, 1958, the previous year relevant to the assessment year 1959-60. Before the ITO numerous claims had been raised but when the matter came up before the AAC, the assessee modified its claim and sought deduction of Rs. 2,34,197 only. Out of this, Rs. 1,75,510 was in respect of interest debited to M/s B.R. Sons in books of account of the assessee. Rupees 17,224 was in respect of commission and Rs. 13,441 was for brokerage. The miscellaneous expenses claimed were Rs. 28,022. The claim of the assessee was that, in view of the award given by the arbitrators, the assessee was not entitled to get any amount from B.R. Sons. It was apparent, therefore, that the amount shown in the accounts of the assessee as income was incorrect. According to the assessee, these entries were made on the assumption that the assessee was entitled to receive the same from M/s B.R. Sons under different heads but once the claim was negatived by the arbitrator, it shall be deemed to reflect back in the assessment years in dispute and as nothing was found due against M/s B.R. Sons, the assessee could not be deemed to have any income from this business. According to the assessee, what could be brought to tax was real income and not income which was only notional. The AAC accepted the claim. On further appeal to the Tribunal by the Department, the appellate order was set aside and it was held that the award given by the arbitrator did not abrogate or abridge the rights of the assessee to interest or commission to which it was entitled in the agreement, dated October 26, 1954. The award was given in the context of the large claims made by M/s B.R. Sons and the counter-claims made by the assessee of Rs. 60 lakhs odd. Inother words, the Tribunal was of the opinion that the award had nothing to do with interest and commission claimed by the assessee. It was also found that the dispute before the arbitrator was confined to claims and counter-claims in respect of the volume of business carried on by the assessee. It did not touch the controversy in respect of interest, brokerage and commission. Against this order, the assessee filed an application under Section 256(1) which was rejected by the Tribunal, but it was allowed by this court and the Tribunal on direction of this court referred the following questions of law : Assessment year 1959-60 :

'Whether, on the facts and in the circumstances of the case, the amount of Rs. 1,75,510 being interest merged in the profit and loss account but not actually realised could be assessed as income on accrual basis ?' Assessment year 1960-61 :

'Whether, on the facts and in the circumstances of the case, the amount of Rs. 2,42,118 being interest and commission merged in the profit and loss account, but not actually realised could be assessed as income on accrual basis ?'

5. In assessment years 1961-62, 1962-63, 1964-65 and 1965-66, the dispute was slightly different. Agreement of 1954 had come to an end. Assessee returned losses while in the year 1963-64, it declared a small profit. In all these years principal source of income was money lying with the erstwhile principals on which interest was earned. Major portion of the expenses claimed every year was on litigation. Other expenses were on establishment, rent, travelling, telephone, stationery, etc. The ITO held that since the assessee did not carry on any business during these years it was not entitled to claim these expenses as business expenditure. But as the assessee had income from other sources, an estimated sum was allowed. In the same years, fees paid for income-tax representations was also allowed. Order was affirmed on appeal. On further appeal, the Tribunal held that the business of the assessee was sale and distribution and not financing, and, therefore, it was not entitled to claim expenditure incurred on recovery of advance payments made to principal for lifting of goods nor could it claim expenditure incurred on establishment, for this purpose, as there was complete closure of business. Inference was drawn against the assessee, as, after 1958, goods were lifted not on consignment basis but against cash payment. Litigation expenses were disallowed as it was not necessary for earning income from interest. Nor was it satisfied that the assessee was required to incur any expenditure for earning interest on money lying with the principal. On the application of the assessee under Section 256(1), the Tribunal referred the following questions of law :

'1. Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that interest income assessed for the years 1961-62 to 1965-66 was income from 'other sources' assessable under Section 36 of the Income-tax Act, 1961 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was correct in limiting the allowable expenditure to the amount of Rs. 1,000 in the assessment years 1961-62 and 1963-64 and to Rs. 1,300 in assessment years 1962-63, 1964-65 and 1965-66 and disallowing the rest of the expenses including litigation expenses incurred by the assessee in conducting the arbitration proceedings before the Federation of Indian Chambers of Commerce and Industry, New Delhi ?'

6. In 1966-67, the dispute related to the claim made by the assessee that payment made by it in pursuance of award, dated August 27, 1964, was revenue loss allowable as deduction. It was repelled by the Tribunal as business had ceased in 1958. Further, the Tribunal held that claim of interest and commission in 1959-60 and 1960-61 having been repelled, it shall be deemed that the assessee received that amount and payment in pursuance of award having been made for outstandings of B. R. Sons, the assessee could not claim it as revenue loss. For this year, the Tribunal referred the following question of law ;

'Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the two sums of Rs. 1,75,510 and Rs. 2,52,118 claimed as bad debts or business loss and the sums of Rs. 2,50,000 and Rs. 17,812 representing payment and interest on the same as per terms of the award were not allowable items of expenditure or business loss ?'

ITR No. 108 of 1982 (1959-60 and 1960-61) :

7. It was found by the Tribunal that the agreement dated October 26, 1954, between the assessee and its principals came to an end in November, 1958. Further, no credit note was issued by B.R. Sons in favour of the assessee in respect of interest and commission. But the claim of the assessee was rejected as the 'award given by the arbitrators did not abrogate or abridge the rights of the assessee to the interest or commission to which it was entitled under the agreement'. It also did not find any merit in the claim of the assessee that the amount having not been paid, it had no real income which could be taxed 'as nothing happened in the relevant previous years to show that the assessee ceased to have the right to interest and commission, as provided in the agreement'. The letter dated November 17, 1958, cannot be held to have such an effect. It

only deferred the payment on account of the dispute.

8. In the assessment, interest and commission, therefore, were included as income not because they were received but because the assessee was entitled to it. Is taxability under the I.T. Act on entitlement or income If it is on the former, then the Tribunal, undoubtedly, was correct in its approach. But the charge under Section 4 of the Act is 'on total income of the previous year'. Although what would amount to income has been left to be determined, as in Sub-section (24) of Section 2, definition of income is inclusive and not exhaustive, yet before it can be brought to tax, it must accrue or arise. That is in the year in which it is sought to be taxed the assessee must earn it actually or constructively. That is fundamental. And that is not altered by the method of accounting. Under Section 145, one may adopt any system, cash or mercantile, for convenience of computation. But taxability arises only when income accrues. In one it is received in the year in dispute, in the other it is assumed to have accrued irrespective of payment. The assumption may, however, be erroneous or it may turn out that nothing accrued by act of parties or by operation of law. Such error or happening reflects back resulting in non-accrual. If it has not accrued, that is, no income was earned, then it cannot be subjected to charge and the occasion for taxing it becomes non-existent.

9. Even assuming that the award did not abrogate or abridge the rights of the assessee to the entitlement of interest and commission, did it accrue in year in dispute True, a debit entry was made on the assumption that the amount was due from M/s. B.R. Sons. But no corresponding credit note was issued. The other side treated the agreement to have come to an end which could be terminated after three years by either of the parties. Such income has been described by the Supreme Court in CIT v. Shoorji Vallabhdas and Co. : [1962]46ITR144(SC) as 'hypothetical income'. Whether such income can be taxed and, if so, when, has been discussed thus (p. 148):

'No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account..... A merebook-keeping entry cannot be income, unless income has actually resulted....'

10. The Tribunal assumed accrual of income from entry in account book. Mere entitlement could not result in income; 'hypothetical income' should have materialised. In the absence of any finding to this effect, rather circumstances being otherwise, the order of the Tribunal cannot be upheld. Argument of learned counsel for the Revenue on the strength of Karnani Properties Ltd. v. CIT : [1971]82ITR547(SC) , has no substance as the order of the Tribunal has been found to be erroneous on facts found by it.

I.T.R. No. 185 of 1973 (1961-62 to 1965-66) :

11. In all these years, it has been found by the Tribunal that the principal source of income was interest on money lying with the erstwhile principals. But the income having been held to be from other sources, the claim of the assessee for deduction of expenses incurred by it on establishment, etc., as expenditure wholly and exclusively for business purposes was repelled. It also did not find any merit in the plea of the assessee that along with business of distribution it also undertook financing and, therefore, even after closure of distribution business, the business of financing continued. The Tribunal, relying on Clause (5) of the agreement, held that entire capital investment by the assessee was solely for the purposes of distribution business and although the assessee was required to make advance payments to the principals before lifting goods yet that was as part of business arrangements and not a case of financing. It found that in the absence of business of distribution, the business of financing could not stand, and, therefore, the claim of the assessee that it was carrying on two businesses, one of distribution and the other of financing, could not be accepted.

Nor did it agree that the agreement of 1954 did not completely come to an end and it was only temporarily suspended. It found that the assessee adopted the year ending Asarh Sudi 2, as its accounting year, which normally falls between 20th June and 19th July. And the agreement to carry on distribution business came to an end in 1958. This finding was arrived at on the recitals in the claims and counter-claims made before arbitration.

12. In order to appreciate the correctness or otherwise of the finding recorded by the Tribunal, it is necessary to mention some clauses of the agreement of 1954. In Clause (4) it was provided 'that the distributors distinctly understand that the output of the three companies for the sale whereof they are responsible to make arrangement to reach a figure of 15 crores of rupees or more in a year and they assured that they will be in a position to finance the same' ; In Clause (5) it was provided 'that the assessee shall initially invest a capital of Rs. 25 lakhs which was always to be kept invested' in the business of sales and distribution of the products of the three companies. 'If at any time they have surplus financing, it maytemporarily be invested.' Other terms regarding payment of interest and commission have already been noticed earlier. There was thus no independent agreement for financing. But as held by the Bombay High Court in CIT v. Favre-Leuba & Co. Ltd. : [1979]120ITR897(Bom) , even in the absence of a specific agreement, it could be inferred from 'the nature of business and the advance paid by the assessee'. Business of the assessee was no doubt distribution of cloth manufactured by the textile mills. But for carrying it on, the assessee had not only to invest Rs. 25 lakhs but to make payment in advance of goods lifted on consignment basis. It was also entitled to 66 2/3% of establishment expenses, namely, rent of premises, payment to staff, etc. Even the Tribunal has found that the assessee had to make advance payment. But it rejected the assessee's claim because there was no such agreement. However, from these circumstances and clauses of agreement quoted earlier, it appears, the expenditure was incurred by the assessee as commercial expediency and business necessity. Activity of manufacturing is closely associated with sale and distribution. They are parts of same and are integrated. In the absence of effective and proper distribution, the activity of manufacturing was bound to be hampered. It could be carried on by the manufacturer or he could entrust it to others. A person carrying on business of distribution is only an agent and works on behalf of a person whose goods are to be marketed. For carrying it on effectively if the assessee invested funds or, to use the words of Tribunal, made advance payment due to business consideration, there is no reason to hold that it did not amount to financing. Learned standing counsel for the Commissioner urged that this being not the question referred, the assessee was not entitled to raise it. In order to satisfy if the contention of learned counsel was correct, the questions raised in applications under Section 256 were examined and from that it appeared that these questions were also raised but the Tribunal referred only two questions as it appeared to it to cover the entire controversy raised by the parties.

13. Learned counsel for the assessee appears to be right in the submission that investment under the agreement was stock-in-trade. And by the termination of agreement, the nature did not change. The Tribunal itself found that principal source of income of assessee was interest from investment made. If it was stock-in-trade, then the assessee was entitled to claim expenditure incurred by it for its recovery as business expenditure. In South Asia Industries (P.) Ltd. v. CIT : [1981]132ITR144(Delhi) , amount spent by the assessee for purposes of preserving its business, even though it was for appearing before the Commission of Enquiry, was allowable as business expenditure. As dispute had arisen between the assessee and its principals and the assessee had to incur expenditure on litigation for recovering the amount invested by it, the expenditure was in connection with business. It is not the claim of the Department that it was excessive. The assessee, therefore, was entitled to claim deduction on litigation as well. I.T.R. No. 1231 of 1976 (196&67):

14. Claim of assessee that interest and commission in 1959-60 and 1960-61 did not accrue having been rejected by the ITO, it claimed the deduction of these amounts as bad debt in the year in dispute in view of the award, dated August 27, 1964, and payment made under it. As while deciding Reference No. 108 of 1982, it has been found that these amounts did not accrue at all, the question of claiming them as bad debt has become academic only.

15. For reasons stated above, questions referred to in the three references are answered as under :

I.T.R. No. 108 of 1982:

16. Both the questions for 1959-60 and 1960-61 are answered in the negative, in favour of the assessee and against the Department by saying that the amount of interest and commission which was not actually realised could not be assessed as income on accrual basis. I.T.R. No. 185 of 1973:

17. Both the questions are answered in the negative in favour of assessee and against the Department. I.T.R. No. 1231 of 1976:

18. In view of the answer to the questions referred in I.T.R. No. 108 of 1982, the question has been rendered academic and needs no answer.

19. The assessee shall be entitled to its costs which are assessed at Rs. 200 in each reference.