[1962] 46 ITR 144 (SC)

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SUPREME COURT OF INDIA

Commissioner of Income-tax

v.

Shoorji Vallabhdas & Co.

M. HIDAYATULLAH AND J.C. SHAH, JJ.
CIVIL APPEAL NO. 419 OF 1961
MARCH 27, 1962

Section 5 of the Income-tax Act, 1961 [Corresponding to section 4(1) of the Indian Income-tax Act, 1922] - Income - Accrual of - Assessment year 1948-49 - Assessee-firm was managing agents of two companies - It was entitled to receive as its commission, 10 per cent of freight charged - In 1948 on request of managed companies assessee agreed to reduce commission to 2½ per cent from 10 per cent - In assessment proceedings, ITO took view that amount of larger commission had already accrued during relevant previous year and same was thus assessable - Whether since reduction in share of commission was part of agreement entered into by assessee-firm to secure long-term managing agency agreement for two companies, High Court was right incoming to conclusion that larger income neither accrued nor was received by assessee during relevant assessment year - Held, yes

FACTS

The assessee-firm was the managing agents of several shipping companies including the M Ltd. and the N Ltd. Under these agreements, the assessee firm was entitled to receive as its commission, 10 per cent of the freight charged. Between 1-4-1947 and 31-12-1947, the amount of commission at the rate of 10 per cent of the freight was Rs. 1,71,885 from the M Ltd., and Rs. 2,56,815 from the N Ltd. These amounts were credited in the books of account of the assessee firm to itself with a corresponding debit to the shipping companies.

In 1947, the assessee firm floated two private limited companies, called S Ltd. and P Ltd. The assessee-firm desired to substitute these two companies as the managing agents of the shipping companies, one for each, and on 20-11-1947, expressed its desire to resign from the managing agency and to have the private limited companies appointed on the same terms. Two shareholders of the M Ltd. objected to the rate of commission. They suggested that the commission should be either 10 per cent of the profits of the managed company or 2½ per cent of the freight received. The board of directors of the M Ltd. accordingly invited the assessee firm to make an offer to reduce the managing agency commission to 2½ per cent of freight for the current year as also for the for the future years. As a result, the assessee firm offered to reduce its commission to 2½ per cent.

A similar procedure was followed in the case of the N Ltd. As a result, the assessee firm gave up 75 per cent of its earning during the relevant years of account, which amounted to Rs. 1,36,903 (M Ltd.) and Rs. 2,00,625 (N Ltd.). In the assessment which followed, the ITO and the AAC came to the conclusion that the amount of larger commission had already accrued during the previous year ending 31-3-1948, and was thus assessable. The amount given up was also claimed by the assessee firm as an expenditure under section 10(2)(*xv*) of 1922 Act, but was disallowed. The Tribunal held that even though the actual reduction took place after the year of account was over, there was, in fact, an agreement to reduce the commission even during the currency of the account year, and the larger income neither accrued nor was received by the assessee firm.

On reference, the High Court held the two sums of Rs. 1,36,903 and Rs. 2,00,625 were not income of the 'previous year' ending 31-3-1948.

On appeal to the Supreme Court :

HELD

Income-tax is a levy on income. 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. This was exactly what had happened in instant case. Here the agreements within the previous year replaced the earlier agreements, and altered the rate in such a way as to make the income different from what had been entered in the books of account. A mere book-keeping entry cannot be income, unless income has actually resulted, and in the instant case, by the change of the terms the income which accrued and was received consisted of the lesser amounts and not the larger. This was not a gift by the assessee firm to the managed companies. The reduction was a part of the agreement entered into by the assessee firm to secure a long-term managing agency arrangement for the two companies which it had floated.*

The High Court was right in coming to the conclusion that on the facts of this case the larger income neither accrued nor was received by the assessee firm.

The appeal was dismissed.

Note: Decision was in favour of assessee.

CASE REVIEW

The judgment of Bombay High Court in *CIT* v. *Shoorji Vallabhdas & Co.* [1959] 36 ITR 25 - *Affirmed.*

CASES REFERRED TO

CIT v. *Chamanlal Mangaldas & Co.* [1960] 39 ITR 8 (SC), *CIT* v. *Chamanlal Mangaldas & Co.* [1956] 29 ITR 987 (Bom.) and *CIT* v. *Shoorji Vallabhdas & Co.* [1959] 36 ITR 25 (Bom.).

N.D. Karkhanis and **D. Gupta** *for the Appellant.*

A.V. Viswanatha Sastri, B. Parthasarathy, J.B. Dadochanji, O.C. Mathur and **Ravinder Narain** *for the Respondent.*

JUDGMENT

Hidayatullah, J.—This is an appeal on a certificate of fitness under section 66A(2) of the Indian Income-tax Act by the High Court of Bombay, against its judgment dated October 1, 1958. The appellant is the Commissioner of Income-tax, Bombay, and the respondent, Messrs. Shoorji Vallabhdas and Co. (referred to hereinafter as the assessee firm).

We are concerned with the assessment year 1948-49, corresponding to the previous year ending March 31, 1948. The assessee firm consisted of three partners, Shoorji Vallabhdas and his two sons, Pratapsinh and Vikramsinh. The assessee firm was the managing agents of several shipping companies including the Malabar Steamship Co. Ltd., and the New Dholera Steamships Ltd. With the Malabar Steamship Co. Ltd. the assessee firm had entered into an agreement on September 16, 1938 (modified on December 7, 1943), and with the New Dholera Steamships Ltd. on June 8, 1946. Under these agreements, the assessee firm was entitled to receive as its commission, 10 per cent. of the freight charged. Between April 1, 1947, and December 31, 1947, the amount of commission at the rate of 10 per cent. of the freight was Rs. 1,71,885 from the Malabar Steamship Co. Ltd. and Rs. 2,56,815 from the New Dholera Steamships Ltd. These amounts were credited in the books of account of the assessee firm to itself with a corresponding debit to the shipping companies.

In 1947, the assessee firm floated two private limited companies, called Shoorji Vallabhdas Ltd. and Pratapsinh Ltd. The assessee firm desired to substitute these two companies as the managing agents of the shipping companies, one for each, and on November 20, 1947, expressed its desire to resign from the managing agency and to have the private limited companies appointed on the same terms. Two shareholders of the Malabar Steamship Co. Ltd. objected to the rate of commission, and wrote a letter on November 27, 1947, in protest. They suggested that the commission should be either 10 per cent. of the profits of the managed company or 2½ per cent. of the freight received. This letter was considered by the board of directors of the Malabar Steamship Co. Ltd., and they invited the assessee firm to make an offer to reduce the managing agency commission to 2½ per cent. of freight for the current year as also for the future years. As a result, the assessee firm made an offer as follows:

> "That whilst we will continue to insist on our right to receive the full managing commission, however, in order to put the company on a firm financial basis, and because we are interested both as shareholders and managing agents in the prosperity of the company, we shall voluntarily agree to a reduction in the managing agency commission both in respect of the current year as also in future years as may be mutually agreed between the board and ourselves or between the company and ourselves to the extent of 2½ per cent. of the total freight."

A similar procedure was followed in the case of the New Dholera Steamships Ltd., though all the documents are not in the record.

On December 30, 1947, extraordinary general meetings of the two managed companies were held, and the two private limited companies were appointed as the managing agents from January 1, 1948. It appears, therefore, that the offer contained in the letter of the assessee firm was accepted. Later, at the annual general meetings of the two managed companies held in December, 1948, the commission was reduced from 10 per cent. of the freight to 2½ per cent. as already agreed. As a result, the assessee firm gave up 75 per cent. of its earnings during the relevant years of account, which amounted to Rs. 1,36,903 (Malabar Steamship Co. Ltd.) and Rs. 2,00,625 (New Dholera Steamships Ltd.).

In the assessment which followed, the Income-tax Officer and the Appellate Assistant Commissioner came to the conclusion that the amount of larger commission had already accrued during the previous year ending March 31, 1948, and was thus assessable. The amount given up was also claimed by the assessee firm as an expenditure under section 10(2)(*xv*) of the Indian Income-tax Act, but was disallowed. On appeal to the Appellate Tribunal, the Accountant Member was of the opinion that the appeal should be rejected. The Judicial Member, however, took the opposite view. The case was then laid before the President, who agreed with the Judicial Member. According to the President, even though the actual reduction took place after the year of account was over, there was, in fact, an agreement to reduce the commission even during the currency of the account year, and the larger income neither accrued nor was received by the assessee firm. In accordance with the opinion of the President, the assessment was reduced by deleting the extra commission from the computation. Two questions were, however, referred at the instance of the Commissioner of Income-tax to the High Court, and they were :

> "(1)Whether the two sums of Rs. 1,36,903 and Rs. 2,00,625 are income of the 'previous year' ended March 31, 1948 ?
>
> (2)If the answer to the first question is in the affirmative, whether they represent an item of expenditure permissible under the provisions of section 10(2)(*xv*) of the Indian Income-tax Act, 1922, in computing the assessee's income of that 'previous year' from its managing agency business ?"

The High Court agreed with the view of the President, and answered the first question in the negative, and declined to answer the second. The case was, however, certified as fit under section 66A(2), and the present appeal has been filed.

The contentions before us (as also in the High Court) were that the income had already accrued to the assessee firm in the year of account, and was thus assessable, that the arrangement amounted to a voluntary gift by the assessee firm to the shipping companies, and that the books being kept on a mercantile basis showed the commission as each amount of freight was entered. It was also contended that the managed companies dealt with the accounts only in December, 1948, long after the previous year was over, and that what had happened in the subsequent year did not alter the position in the relevant previous year.

The Bombay High Court relied upon an earlier decision of the same court reported as *Commissioner of Income-tax* v. *Chamanlal Mangaldas & Co.* [1956] 29 ITR 987 and held that the events during the account year were themselves sufficient to show that the income neither accrued to the assessee firm nor was received by it so as to become assessable. The decision of the Bombay High Court was approved by this court in *Commissioner of Income-tax* v. *Chamanlal Mangaldas & Co.* [1960] 39 ITR 8 (SC).

In *Chamanlal Mangaldas & Co.'s* case (*supra*), the assessee was also the managing agent of a company, and under the agreement was entitled to receive commission at a certain rate. By another agreement, the commission earned by the managing agent for the calendar year 1950 was reduced by Rs. 1 lakh. That agreement took place during the previous year, and the resolution of the board of directors of the managed company was also in the previous year. It was, however, made final on April 8, 1951, at a meeting of the board of directors, but that was beyond the previous year. The High Court of Bombay held that by reason of the resolution during the currency of the previous year, the right of the assessee to commission ceased to be under the original agreement and depended upon and arose only after the decision of the board of directors to reduce the commission. The assessee was, therefore, not held liable on the larger sum which, it was held, was only a hypothetical income, which it might have earned if the old agreement had continued to subsist. The facts of the present case are almost identical, and the principle applied by the Bombay High Court governs this case. The reason is plain. Income-tax is a levy on income. 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. This is exactly what has happened in this case, as it happened in the Bombay case *Commissioner of Income-tax* v. *Chamanlal Mangaldas & Co.* [1956] 29 ITR, which was approved by this court. Here too, the agreements within the previous year replaced the earlier agreements, and altered the rate in such a way as to make the income different from what had been entered in the books of account.' A mere book-keeping entry cannot be income, unless income has actually resulted, and in the present case, by the change of the terms the income which accrued and was received consisted of the lesser amounts and not the larger. This was not a gift by the assessee firm to the managed companies. The reduction was a part of the agreement entered into by the assessee firm to secure a long-term managing agency arrangement for the two companies which it had floated.

In our opinion, the High Court was right in coming to the conclusion that on the facts of this case the larger income neither accrued nor was received by the assessee firm.

In the result, the appeal fails, and is dismissed with costs.