1964

April 16

THE COMMISSIONER OF INCOME-TAX, MADRAS

v.

A. GAJAPATHY NAIDU

[K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

Indian Incometax Act, 1922 (11 of 1922), s. 4(1)(b)(*ii*)—*Construction of—Analogy from English Statutes—"Accrue" or "arise", meaning of—Income arising out of earlier transaction—Proper year of assessment.*

A certain sum of money was received by the assessee as payment of compensation for the loss sustained by him in respect of a supply during the previous accounting year. The Income-tax Officer included the amount in the assessment year it was received. Appeals to the Appellate Assistant Commissioner and to the Income-tax Tribunal were unsuccessful. But on a reference, the High Court held that though in fact the right to receive the amount did not accrue during the accounting year of the contract, it should be deemed to have related to the year of contract in respect whereof the amount was paid. On appeal by certificate,

Held: (i) The decision of the High Court was deflected by its reliance on English decisions delivered under circumstances peculiar to that country and on the construction of provisions which were not in *pari materia* with the provisions obtaining in India.

The provisions of the Indian Income-tax Act shall be construed on their own terms without drawing any analogy from English statutes whose terms may superficially appear to be similar but on a deeper scrutiny may reveal differences not only in the wording but also in the meaning a particular expression has acquired in the context of the development of law in that country.

Commissioner of Income-tax v. *Vazir Sultan & Sons*, [1959] Supp. 2 S.C.R., 375, followed;.

(ii) under the definition accepted by this Court of the word "accrue" or "arise" in s. 4(1)(b)(i) of the Indian Income-tax Act, an income accrues or arises when the assessee acquires a right to receive the same.

S. D. Sassoon and Co. Ltd. v. *Commissioner of Income-tax, Bombay City*, [1955] 1 S.C.R. 313, followed.

Rogers Pyatt Shellack & Co. v. *Secretary of State for India* (1925) I.L.R. 52 Cal. 1, approved.

When an Income-tax Officer proceeds to include a particular income in the assessment, he should ask himself, *inter alia*, two questions, namely (i) what is the system of accountancy adopted by the assessee? and (ii) it it is mercantile system of accountancy, subject to the deemed provisions when has the right to receive that amount accrued? If he comes to the conclusion that such a right accrued or arose to the assessee in a particular accounting year, he shall include the said income in the assessment of the succeeding assessment year. No power is conferred on the Income-tax Officer under the Act, to relate

1964

The Commissioner of Income-tax, Madras v. A. Gajapathy Naidu

back an income that accrued or arose in a later year to an earlier year on the ground that the said income arose out of an earlier transaction.

(iii) The meaning of the word "accrue" or "arise" in s. 4(1)-(b)(i) of the Indian Income-tax Act cannot be extended so as to take in amounts received by the assessee in a later year, though the receipt was not on the basis of the right accrued in the earlier year. Such amounts are in law received by the assessee only in the year when they are paid.

J. P. Hall & Co. v *Commissioner of Inland Revenue*, (1921) 12 T.C. 382 and *Severns (H. M. Inspector of Taxes)* v. *Dadawall*, (1954), 35 T. C. 649, referred to.

Commissioner of Income-tax, U.P. v. *P. V. Kalicharan Jagannath*, [1961] 41 I.T.R. 40, approved.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 617 of 1963. Appeal from the judgment and order, dated March 15, 1960, of the Madras High Court in Case referred No. 87 of 1955.

Gopal Singh and *R.N. Sachthey*, for the appellant.

K. Rajinder Chaudhuri and *K.R. Chaudhuri*, for the respondent.

April 16, 1964. The Judgment of the Court was delivered by

Subba Rao, J.

SUBBA RAO, J.—This appeal by certificate is preferred against the order of the High Court of Judicature at Madras holding that a sum of Rs. 12,447/- received by the respondent from the Government during the accounting year 1950-51 was not assessable to tax for the assessment year 1951-52.

Gajapathy Naidu, the respondent, was supplying provisions to the Government Stanley Hospital, Royapuram, Madras. During the financial year April 1, 1948 to March 31, 1949, he entered into a contract with the Government for the supply of bread to the said hospital at the rate of Rs. 0-4-6 per lb. As the respondent was maintaining his accounts on mercantile basis, it is common case that the amount due from the Government under the terms of the said contract was credited in the accounts of the respondent for that year. For the assessment year 1949-50 the Income-tax Officer assessed the respondent to income-tax on the basis of the accounts so made. It appears that some time after March 31, 1949, representations were made to the Government for relieving the respondent from the loss sustained in the supply of bread to the hospital. The Government by its order dated November 24, 1950, directed payment of compensation for the loss sustained by the respondent in respect of the supply of bread to the hospital during the year 1948-49 under the said contract. The respondent re-

ceived on that account payment of Rs. 12,447/- during the year of account 1950-51. In the assessment year 1951-52 the Income-tax Officer included the said amount in the assessment of that year. The assessee, *inter alia*, contended that he received the said sum in respect of the contract that was entered into by him with the Government during the accounting year 1948-49 and, therefore, it could not be included in the assessment year 1951-52. This contention was rejected by the Income-tax Officer and, on appeal, by the Appellate Assistant Commissioner and also, on further appeal, by the Income-tax Appellate Tribunal. But the contention received favour with the High Court on a reference made to it under s. 66(1) of the Indian Income-tax Act, 1922, hereinafter called the Act. The following two questions were referred to the High Court:

"1. Whether the sum of Rs. 12,447/- is assessable to income-tax?"

"2. If so, whether it has been rightly assessed in the assessment year 1951-52."

On the first question the High Court held that the said amount was directly related to the business of the assessee and, therefore, was taxable as a trade receipt. It answered the first question in the affirmative. No argument was raised before us on the question of the correctness of this finding. Therefore, nothing further need be said about it.

The High Court answered the second question in the negative. Its conclusion is based upon the following three steps:

1. "The only right of the assessee on the date, when he supplied the bread, was to debit the Government the contract rate. He was entitled to nothing further. The Government Order which raised the rates, came into existence long after payment thereunder was *ex gratia*, and not on the basis of a right. Therefore, the amount of Rs. 12,447 was not, and indeed could not have been debited in the books of the assessee for the year, when the supply of bread was made to the hospital, namely, 1948-49. Those accounts have been closed."

2. But where a receipt is correlated to and arises out of a commercial transaction between the parties, the right or liability should be deemed to have been established in the past accounting period. That principle is based not only on any theory of accrual, because there was no legal right existing then; but being correlated to the transaction, it

1964

The Commissioner of Income-tax, Madras v. A. Gajapathy Naidu

Subba Rao, J.

should properly belong to it, and the account should be re-opened when the payment came in.

3. "Being a receipt of an earlier year, the amount could not be included in the assessment for the year 1951-52."

On the said reasoning the High Court held that though in fact the right to receive the amount did not accrue during the accounting year 1948-49, it should be deemed to have related to the year of contract in respect whereof the amount was paid. The Commissioner of Income-tax has preferred the present appeal against the said order of the High Court.

Learned counsel for the Revenue contended that the High Court misdirected itself on the basis of English decisions and that on its finding that the amount accrued to the assessee only during the accounting year 1949-50 it should have held that the Income-tax Officer had correctly included it in the assessee's income for the year 1950-51. Learned counsel for the respondent argued that the said amount was paid in respect of the contract entered into between the assessee and the Government and, therefore, the said amount should properly belong to the accounting year 1948-49, and should not have been included in the assessment of the year 1951-52. To sustain his argument he relied upon certain English decisions referred to by the High Court which held that in such circumstances the relevant account of the year when the amount was due under the contract could be reopened and the additional amount, though an *ex gratia* payment, could be included therein.

With great respect to the learned Judges of the High Court we must point out that the decision of the High Court is deflected by its reliance on English decisions delivered under circumstances peculiar to that country and on the construction of provisions which are not in *pari materia* with the provisions obtaining in India. Th cobservations made by this *Court in Commissioner of Income-tax* v. *Vazir Sultan & Sons*(1) may usefully be restated:—

> "While considering the case law it is necessary to bear in mind that the Indian Income-tax Act is not in *pari materia* with the British income-tax statutes, it is less elaborate in many ways, subject to fewer refinements and in arrangement and language it differs greatly from the provisions with which the courts in England have had to deal. Little help can therefore be gained by attempting to construe

(1) [1959] Supp. 2 S.C.R. 375.

the Indian Income-tax Act in the light of decisions bearing upon the meaning of the income-tax legislation in England. But on analogous provisions, fundamental concepts and general principle unaffected by the specialities of the English income-tax statutes, English authorities may be useful guides."

The caution administered by this Court shall always be borne in mind in construing the provisions of the Indian statute. The provisions of the Indian Income-tax Act shall be construed on their own terms without drawing any analogy from English statutes whose terms may superficially appear to be similar but on a deeper scrutiny may reveal differences not only in the wording but also in the meaning a particular expression has acquired in the context of the development of law in that country.

The problem raised before us can only be answered on the true meaning of the express words used in s. 4 (1)(b)(i) of the Act. It reads:—

"Subject to the provisions of this Act, the total income of any previous year of any person includes all income, profits and gains from whatever source derived which—

if such person is resident in the taxable territories during such year,—

accrue or arise or are deemed to accrue or arise to him in the taxable territories during such year."

We are not concerned in this case with the expression "deemed to accrue or arise to him", as that expression refers to cases set out in the statute itself introducing a fiction in respect of certain incomes. In regard to the question when and whether an income accrues or arises within the meaning of the first part of the said clause, we have a decision of this Court which has clearly enunciated the principles underlying the said expression: that is the decision in *E. D. Sassoon and Company, Ltd.*, v. *The Commissioner of Income-tax, Bombay City*(1). In that decision this Court accepted the definition given to the words "accrue" and "arise" by Mukerji, J., in *Rogers Pyatt Shellack & Co.* v. *Secretary of State for India*(2), which is as follows: —

"..... both the words are used in contradistinction to the word "receive" and indicate a right to

(1) [1955] 1 S.C.R. 313, 342:(1954) 26 I.T.R. 27, 50.
(2) (1925) 1 I.T.C. 363, 371:(1925) I.L.R. 52 Cal. 1.

1964

The Commissioner of Income-tax Madras
v.
A. Gajapathy Naidu

Subba Rao, J.

receive. They represent a stage anterior to the point of time when the income becomes receivable and connote a character of the income which is more or less inchoate."

Under this definition accepted by this Court, an income accrues or arises when the assessee acquires a right to receive the same. It is common place that there are two principal methods of accounting for the income, profits and gains of a business; one is the cash basis and the other, the mercantile basis. The latter system of accountancy "brings into credit what is due immediately it becomes legally due and before it is actually received; and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed." The book profits are taken for the purpose of assessment of tax, though the credit amount is not realized or the debit amount is not actually disbursed. If an income accrues within a particular year, it is liable to be assessed in the succeeding year. When does the right to receive an amount under a contract accrue or arise to the assessee i.e., come into existence? That depends upon the terms of a particular contract. No other relevant provision of the Act has been brought to our notice—for there is none—which provides an exception that though an assessee does not acquire a right to receive an income under a contract in a particular accounting year, by some fiction the amount received by him in a subsequent year in connection with the contract, though not arising out of a right accrued to him in the earlier year, could be related back to the earlier year and made taxable along with the income of that year. But that legal position is sought to be reached by a process of reasoning found favour with English courts. It is said that on the basis of proper commercial accounting practice, if a transaction takes place in a particular year, all that has accrued in respect of it, irrespective of the year when it accrues, should belong to the year of transaction and for the purpose of reaching that result closed accounts could be reopened. Whether this principle is justified in the English law, it has no place under the Indian Income-tax Act. When an Income-tax Officer proceeds to include a particular income in the assessment, he should ask himself *inter alia*, two questions, namely, (i) what is the system of accountancy adopted by the assessee? and (ii) if it is mercantile system of accountancy, subject to the deemed provisions, when has the right to receive that amount accrued? If he comes to the conclusion that such a right accrued or arose to the assessee in a particular accounting year, he shall include the said income in the assessment of the succeeding assessment year. No power is conferred on the Income-tax Officer under the Act, to relate back an income that accrued or arose in a

subsequent year to another earlier year on the ground that the said income arose out of an earlier transaction. Nor is the question of reopening of accounts relevant in the matter of ascertaining when a particular income accrued or arose. Section 34 of the Act empowers the Income-tax Officer to assess the income which escaped assessment or was under-assessed in the relevant assessment year. Subject to the provisions of the section and following the procedure prescribed thereunder, he can include the escaped income and re-assess the assessee on the basis of which the earlier assessment was made. So too, under s. 35 of the Act the officers mentioned therein can rectify mistakes either of their own motion or when such mistakes are brought to their notice by a party to the proceedings. For that purpose the correct item may be taken into consideration in the matter of assessment. But strictly speaking even in those cases there is no reopening of the accounts of the assessee, but a re-assessment is made or the mistake is corrected on the basis of the actual income accrued or received by the assessee. We do not see any relevancy of the question of reopening of accounts in considering the question when an assessee acquired a right to receive an amount.

We shall now proceed to notice some of the decisions cited at the Bar. *J.P. Hall & Co.* v. *Commissioner of Inland Revenue*(1) is a decision of the Court of Appeal under s. 38 of the Finance (No. 2) Act, 1915 (5 & 6 Geo. V, c. 89) dealing with excess profits duty. There it was held that for the purpose of Excess Profits Duty, the profits from the contracts for the purchase and sale of the control gear arose to the appellant-company in the accounting years in which the gear was actually delivered and not in the pre-war period ending the 30th June, 1914, in which the contracts were made. The price of the control gear in that case was increased later without there being any contractual obligation but purely by a voluntary act of the purchaser. Though the additional amounts accrued to the assessee in a later year, it was regarded as analogous to a trade debt due in respect of the trading operation of the earlier year. On that principle the accounts were reopened in order to bring the increase into profits of the assessee in the year of transaction. This decision was accepted and extended in *Severns (H.M. Inspector of Taxes)* v. *Dadswell*(2). As this decision is the basis for the High Court's view we shall give its facts in some detail. The respondent therein was granted a licence to mill flour in October, 1941, and carried on the trade of flour milling until September, 1945. As he had not been a

(1) (1921) 12 T.C. 382. (2) (1954) 35 T.C. 649.

1964

The Commissioner of Income-tax, Madras
v.
A. Gajapathy Naidu

Subba Rao, J.

miller at the outbreak of war, he was not entitled to the benefit of a remuneration agreement whereby millers were compensated by the Ministry of Food for losses incurred under wartime arrangements for the purchase of wheat and sale of flour. Having, however, been informed by the Ministry in 1943 and twice later that the remuneration of millers who had begun milling during the period of control was under consideration, he made a claim in 1949 on the same basis as that laid down in the remuneration agreement and received payments in settlement. The respondent contended that the sums received in 1949 were not trading receipts but *ex gratia* payments, and alternatively, that they were received after the cessation of his trade and that if there was a debt arising to the trade at the date of cessation its value at that date was nil. The Court held that the said payments were *ex gratia;* and it further held that, if on the discontinuance of a trade payment for work already done in a year had not been finally settled, accounts for that year could be reopened so as to bring in a gratuitous payment for such work made in a subsequent year. This judgment certainly supports the respondent. Though it could be distinguished on the ground in that case it was found that the payment for the work already done had not been finally settled whereas in the present case there is nothing on the record to disclose that it was not finally settled. We would prefer to base our conclusion on the ground that we cannot extend the meaning of the word "accrue" or "arise" in s. 4(1)(b)(i) of the Act so as to take in amounts received by the assessee in a later year, though the receipt was not on the basis of the right accrued in the earlier year. Such amounts are in law received by the assessee only in the year when they are paid. We cannot apply the English decisions in the matter of construction of the provisions of the Indian Act, particularly when they have received an authoritative interpretation from this Court, in this view, it is not necessary to consider further English decisions cited by learned counsel for the respondent in support of his contention. Before a Division Bench of the Allahabad High Court in *Commissioner of Income tax, U.P.* v. *Kalicharan Jagannath*(1), when a similar question arose, learned counsel appearing for the Revenue relied upon the said English decisions, but the High Court, rightly, refused to act on them on the ground that they were not relevant in interpreting s. 4 of the Indian Income-tax Act. It further made an attempt to distinguish those decisions on grounds based upon the alleged difference in the scope of the provisions of the respective countries. It was said that under the relevant English Act the excess profits duty was payable on computation of profits arising from a trade or business in different chargeable accounting periods and, therefore, the emphasis there was more

(1) (1961) 41 I.T.R. 40.

upon the carrying on of the trade within the chargeable period than on the income accruing during that period. But we do not propose to express our view on this aspect of the question, as the relevant sections of the English Acts have not been placed before us. The learned Judges, after having rightly refused to rely upon the English decisions, construed the provisions of the Indian statute. There. during the accounting period April 1, 1945 to March 31, 1946, the assessee entered into a contract with and supplied fruits and bullock carts to, the military authorities at two different places at rates fixed by the agreement. The assessee incurred a loss and he submitted a petition for review under the terms of the agreement. On November 6, 1947, the military authorities sanctioned the payment of an additional sum which was paid to the assessee on February 17 and 24, 1948. The Income-tax Department sought to include this additional sum in the assessment for the accounting year 1945-46. The High Court held that until the order of review the only right that the assessee had was to claim the money payable at the rates laid down in the agreement itself and that the additional amount became payable to the assessee not by virtue of any right conferred by the agreement, but because of the order passed in review directing the payment of the amount and thus creating a right to this amount in favour of the assessee. As the right to receive the payment of the additional sum arose after the closing of the accounting year 1945-46. the High Court proceeded to hold that the income did not accrue or arise to the assessee in the accounting year. It may be pointed out that in that case the original agreement gave a right to apply for review and notwithstanding that fact the court held that the additional payment could not be held to have accrued during the accounting year. For the reasons already stated by us, we are entirely in agreement with the view expressed by the Allahabad High Court.

In the result, we hold that the High Court in the present case should have answered the second question referred to it in the affirmative. The order of the High Court is set aside and the appeal is allowed with costs.

Appeal allowed.