

(1964) 54 ITR 221(1)

Karnataka High Court

Case No: Income-tax Referred Case No. 7 of 1963

Commissioner of
Income Tax, Mysore

APPELLANT

Vs

K. Doddabasappa

RESPONDENT

Date of Decision: Aug. 28, 1963

Acts Referred:

Income Tax Act, 1961 " Section 13

Citation: (1964) 54 ITR 221(1)

Hon'ble Judges: K.S. Hegde, J; Ahmed, J

Bench: Division Bench

Advocate: D.M. Chandrasekhar, for the Appellant; K.R. Ramamani, for the Respondent

Judgement

Hegde, J.

By these applications, the Commissioner of Income Tax requires the Appellate Tribunal to refer certain questions of law which

are said to arise out of the Tribunal's consolidated order in I.T.As. Nos. 11870 to 11872 of 1959-60, dated December 11, 1961, to the High

Court of Mysore at Bangalore. Inasmuch as, in our opinion of law does arise out of Tribunal's order, we accordingly state an agreed case and

refer it to High Court. As the facts are common consolidated statement of the case is drawn.

2. The assessee is Hindu undivided family. It carried on money-lending business. It maintained its accounts on cash basis. The advances were

mostly to agriculturists on pronotes. The rate of interest varied from 6 to 18 per cent. but the general rate of interest was 12 per cent. Interest

income is accounted by the assessee at the time of final settlement of accounts by the assessee at the time of final settlement of accounts by the

debtors. The whole method adopted by the assessee is as under :

Advances are given to various parties. The account of each is debited with the amount of the advance. When moneys are received from them they

are credited to their accounts. No apportionment between capital and interest is made, if there is continuity of dealings with the dealings with the

debtor. But when the debtor comes for settlement then adjustments are made towards interest. If, for example, there is a continuity of transactions

over a period of 10 years, and in 10th year the account is settled, then interest is taken for credit in the year of receipt for the whole period.

Similarly, if the account is settled in the same year, interest is adjusted in same year. If the settlement is not cash but for other consideration, say, by

way of transfer of land, then the value of the land is credited to the debtor's account and interest is also taken credit. The following transactions of

assessee with one party will serve as an instance.

L.F. 91 : KAMPLY SARANAPPA :

Assessment year Debits Credits

Rs. Rs.

Opening balance 12,428 3,240

1953-54 700 40

1954-55 1,184 128

1955-56 100 -

1956-57 280 -

1957-58 514 (interest) 24,000

12,200

Debits show the advances to the debtor from year to year and the credits, the receipts.

No interest was accounted from the beginning up to 1957-

58. The entries in 1957-58 are for debits for interest. The credit for Rs. 24,000 represented the value of the lands taken over by the assessee from

the debtor. A sum of Rs. 12,200 was paid to square the account as the value of the land taken exceeded the debits inclusive of interest by that amount.

3. The assessee had been following the method described above since 1925-26. It had been accepted by the department till 1955-56.

4. The following table shows the total capital lent out, the gross receipts disclosed by the assessee by way of interest and the average rate of interest.

Previous Capital lent Gross interest Rate of interest

year out receipts on capital lent
out

Rs. Rs. %

1953-54 5,85,000 24,371 4

1954-55 6,89,000 38,330 5.5

1955-56 7,58,000 50,845 6.7

1956-57 7,71,874 34,458 4.5

1957-58 8,31,199 41,410 4.9

1958-59 7,92,613 40,320 5

The assessment years under reference are 1956-57 to 1958-59, the corresponding previous years being the periods ending on April 11, 1956,

March 13, 1957, and March 20, 1958.

5. The following table shows the capital lent out less mortgage loans, gross receipts disclosed by the assessee by way of interest and the average rate of interest :

Assessment year Capital less Gross interest Average rate

mortgage less interest on of interest

loans mortgage

loans

Rs. Rs. Rs.

1956-57 6,56,511 32,556 5.95

1957-58 5,86,380 41,066 7

1958-59 5,97,274 37,418 6.26

The Income Tax Officer considered the average rate of interest on capital lent out as low when compared by the assessee which was generally at

12 per cent. He examined the books in detail. His conclusion on the examination of the accounts was ""that the assessee was advancing monies to

the debtors and realising monies from the debtors continuously year after year but not accounting for any interest income or adjusting interest to the

accounts in the first three years or for a period of a number of years to come. It is only when the debtor comes in for settlement that any interest is

accounted for by way of advances and receipts from the debtors. It is purely a question when the debtors approach the assessee for the settlement

and this is the method of accounting followed by the assessee"".

6. The assessee supported the method adopted by it as under :

As a matter of fact the rate of interest should always be calculated in proportion to the realizations during the years as accounts are maintained on

cash basis. If a loan is over due by 4 or 5 years and if it is realised during the naturally the assessee received the interest for all the years during the

year only, which will work out to 2 to 3 times of original rate of interest to the parties. The total realisations will vary from year to year which will

depend on good yield of crops and favourable prices of produce raised as most of parties belong to village parts who are mostly agriculturists. We

have taken a copy of realisation received from the parties for accounting years 1954-55 and 1955-56 for comparative purposes. The realisations

amounted for the accounting year 1955-56 to Rs 1,02,191 and the interest realizations amounted to Rs 34,458 and it works out at a rate of 33.8

per cent. over realisations towards principal. The corresponding realisations for year 1954-55 were Rs. 1,39,914 and Rs. 50,846 towards interest

receipts respectively. The fall in interest realisations during the accounting year 1955-56 is also due to failure of cotton crop and again it will be

seen that the realisations during the accounting year 1954-55 were the maximum collections during the past three years and as the method of

accounting is on cash basis as mentioned above.

7. The Income Tax Officer rejected the explanation. He considered that the method of accounting adopted by the assessee was such that one

failed to deduce the true income for any one of the accounting years from the books and that the proviso to section 13 applied. In the end he

estimated the interest income at 11 per cent. on the adjusted capital lent out during the previous year. This resulted in an addition of Rs. 39,659.

The order of Income Tax Officer is annexure ""A"" and forms part of the case.

8. For similar reasons the proviso the section 13 was held applicable in regard to the other assessment years, viz., 1957-58 and 1958-59. The

additions were Rs. 23,427 and Rs. 28,274 respectively. These orders are also annexed as annexures ""B"" and ""B-1"" and form part of the case.

9. There were appeals to the Appellate Assistant Commissioner. He referred to the past practice of the assessee. He observed that other rural

money-lenders also followed similar method : that section 13 of the Income Tax Act did not permit subjective or arbitrary assessments and that it

was not open to the Income Tax Officer to impose a new system of accounting upon the appellant. He observed further : ""It is quite true that

agriculturists can pay interest only when they have a good harvest. This is the main reason why the appellant accounts for the interest as and when

agriculturists settle their accounts."" After stating that no single omission either in respect of lent out capital or in respect of interest realisation had

been detected by the Income Tax Officer had referred to certain advantages without referring to the disadvantages of rural moneylender, he held

that there was no justification for rejecting the book result and estimating interest by resorting to the application of proviso to section 13 of Income

Tax Act. The order of Appellate Assistant Commissioner is annexure ""C"" and forms part of case.

10. The department came on appeal to Tribunal. It upheld the order of the Appellate Assistant Commissioner. A copy of the Tribunal's order is

annexure ""D"" and forms part of the case.

11. The question of law is :

Whether, on the facts and circumstances of the case, having regard to the method of accounting adopted by the appellant, the applications of the

proviso to section 13 of the Income Tax Act was proper and justified in law and whether the inclusion of Rs. 39,659, Rs. 23,427 and Rs. 28,274

representing interest was proper and legal ?

The method of accounting employed by the assessee was the one regularly employed by him. There is no dispute on that point. Hence, prima facie,

the assessee's case comes within the main part of section 13 of Indian Income Tax Act, 1922. The controversy centers round the question

whether the method employed by him is such that the Income Tax Officer could have justifiably opined that from that method, income, profits and

gains of the assessee cannot be properly deduced. The Income Tax Officer, no doubt, opined that from the method of accounting employed by the

assessee, his income, profits and gains cannot be properly deduced. But that view of the Income Tax Officer was not shared by the Appellate

Assistant Commissioner as well as by the Tribunal. This is an important circumstance. The fact that the authorities like the Appellate Assistant

Commissioner and the Appellate Tribunal have come to the conclusion that from the method of accounting employed by the assessee his income,

profits and gains can be properly deduced is of the utmost importance. It is not the case of the department that any income, profits and gains

accrued to the assessee has escaped assessment. The department cannot be heard to complain that if a particular method of accounting had been

employed, there was possibility of the assessee earning more income, profits and gains. That is a matter entirely for the assessee. It may be that the

method of accounting employed by the assessee would give him benefit in certain years. The law permits the assessee to so arrange his affairs as to

get the maximum permissible relief.

12. The decision of the Andhra High Court in *S.R.V.G. Press Co. v. Commissioner of Excess Profits Tax*, bears on the point under consideration.

Therein, it was laid down that u/s 13 of Income Tax Act, the assessee is free to choose a proper method of accounting and the profits and gains

have to be computed in accordance with the method of accounting regularly employed by the assessee; the assessing authority is bound by the

assessee's choice of a method of accounting regularly employed by him, unless the income, profits and gains cannot properly be deduced

therefrom; the name by which a method of accounting is called is not so important nor is it important whether the system of accounting adopted by

the assessee conforms to the requirements of a known method of accounting so long as the profits of business could fairly and properly be

determined from the accounts. In that case, in respect of payment made for sales tax, the assessee followed the system of deducting from its

income the actual amount paid in a particular year in pursuance of provisional assessment of sales tax and including the refunds and rebates in the

income of the year in which they were received. That system was followed regularly and accepted by the authorities for Income Tax and excess

profits tax purposes until the year 1945; in the official year ending 31st March, 1945, an amount of Rs. 47,276 was paid under a provisional

demand for sales tax; the whole of the amount was allowed for Income Tax purposes as usual, but as the Excess Profits Tax Act expired on the

31st March, 1946, the Excess Profits Tax Officer, purporting to exercise his powers under rule 12 of Schedule I of the Excess Profits Tax Act,

allowed only a sum of Rs. 17,055 which in his opinion represented the actual liability for the tax apportioned on time basis for the turnover of the

chargeable accounting period in question on the basis of the final assessments and refunds made in April, 1946, and that decision was upheld by

the Tribunal. The Division Bench consisting of Subba Rao C.J. (as he then was) and Visvanatha Sastry J. held that the assessee had followed a

regular method of accounting and that method of accounting was accepted by the authorities. Hence, it was not open to them to reject that method

merely because the Excess Profits Tax Act expired on the 31st March, 1946, and it would be advantageous to the revenue to disregard the

payments of the provisional sales tax made during the official year ending 31st March, 1945, by bringing into the account of that year the rebates

or refunds granted on 18th April, 1946, and entering the same in the assessee's books under that date.

13. It will be useful to quote a passage from the above decision (found at page 590) :

As pointed out by the Judicial Committee in Commissioner of Income Tax v. Sarangpur Cotton Manufacturing Co, section 13 relates to a method

of accounting regularly employed by the assessee for his own purposes and does not relate to a method of making up the statutory return for

assessment to Income Tax. The section clearly makes such a method of accounting a compulsory basis for computation unless in the opinion of the

Income Tax Officer the income, profits and gains cannot properly be deduced therefrom. It may be that the account maintained by the assessee is

neither purely on a cash basis nor purely on mercantile basis but is a mixture of the two methods, one method being adopted in respect of one class

of transactions and the other in respect of different category. If the assessee employs such different methods regularly and consistently the profits

would have to be computed in accordance with the respective methods provided a proper determination of true profits could be arrived at.

14. Relying on the decision of Supreme Court in S. N. Namasivayam Chettiar v. Commissioner of Income Tax, it was urged on behalf of the

department that the power to compute profits under the proviso to section 13 arises only where no method of accounting has been regularly

employed by the assessee or where the method employed is such that the income, profits and gains cannot properly be deduced therefrom; it

means that the method adopted by the assessee must, prima facie, prevail where it is regularly employed, though the Income Tax Officer can resort

to the proviso if the method is such that true profits cannot be correctly determined therefrom; in other words, even if the assessee has regularly

employed a method of accounting, it can be discarded under the proviso if the method does not show correct profits of the year. I fail to see how

this decision helps the department. In the instant case, there is no gainsaying the fact that method of accounting employed by the assessee was

regularly employed. He has been employing that method for years. Therefore, it is for the department to demonstrate before discarding that

method, that the method in question does not show the correct income, profits and gains of the year.

15. As observed by the Judicial Committee in *Commissioner of Taxes v. Melbourne Trust Limited* :

As regards the question of when a profit is earned their Lordships' view is that profit can be said to be earned when it is dealt with as a profit. In

ordinary cases this synchronizes with the realization of the sums which swell the assets of the person or company, and which entering the account

(whether on the creditor or debtor said will depend on the particular account in view) go to bring out the balance which is deemed profit. But for

the reasons already given their Lordships think that in a case like this the company are entitled to hold at least a part of their realizations in suspense

- as indeed they have done in their accounts - and that it is only when finally the same is given to the shareholders that the final impress of profit is,

so to speak, stamped upon it, and that therefore, for the purposes of the Act, that is the time at which it is earned.

16. In Commissioner of Income Tax v. Maharajadhiraja Kameshwar Singh of Darbhanga the Judicial Committee observed :

Where an assessee keeps his books on a cash basis disclosed to the revenue authorities and the officer accepts that basis, it is clear that the

calculation must be based on actual receipts in the year of computation. Here, however, the assessee kept his books on hybrid system and it was

his practice to enter sums as he received them in deposit register not made available to the revenue authorities, without discriminating between

interest and capital and payments, and then subsequently to allocate and treat as income certain portions of these sums which he attributed to

interest. What the officer is directed to compute is not the assessee's receipts but the assessee's income and in dubio what the assessee himself

chooses to treat as income may well be taken to be income and to arise when he so chooses to treat it.

Next, reliance was placed on the decision in Ghanshyamdas Permanand v. Commissioner of Income Tax, in support of department's contention

that the sufficiency of the accounts for the purposes of deducing the income, profits and gains therefrom is left by the proviso to section 13 of the

Act, to judgment of the Income Tax Officer; once the judgment has been exercised by the officer against the assessee, it cannot be assailed unless

it can be demonstrated that the action was not ""judicial"" but ""capricious"". But this contention overlooks the further observation made in that case

that though the officer is not expected to lead evidence in refutation of books his action should have some foundation; it is impossible to say as a

matter of law what should be the ""material"" on which the officer would be entitled to apply the proviso to an assessee, regard being had to the

infinite variety of cases likely to come up for decision; ordinarily if there is any ""material"", that is to say, good ground for such action, the application

of the proviso cannot be questioned; further, the superior officers and the Appellate Tribunal at the end would be the venue for the correction of

any capricious action.

17. The existence or the sufficiency of the material on which an Income Tax Officer has come to the conclusion that the method of accounting

employed is not such as to disclose the true income, profits and gains is undoubtedly open to review by the appellate authorities. The opinion of the

Income Tax Officer on that question should be based on good grounds. His conclusion in that regard can be challenged before the appellate

authorities.

18. For the reasons mentioned above, our answer to the question referred to us is in negative and in favour of assessee.

19. The department shall pay the costs. Advocate's fee Rs. 250.

20. Question answered in favour of the assessee.