(1961) 08 BOM CK 0005

Bombay High Court

Case No: Income-tax Reference No. 5 of 1961

Hukumchand Mills Ltd., Indore		APPELLANT
	Vs	
Commissioner of Income Tax, Bombay		RESPONDENT

Date of Decision: Aug. 28, 1961

Acts Referred:

- Income Tax Act, 1922 - Section 4

Citation: (1963) 47 ITR 169

Hon'ble Judges: Y.S. Tambe, J; V.S. Desai, J

Bench: Division Bench

Advocate: N.A. Palkhivala, for the Appellant; G.N. Joshi, for the Respondent

Judgement

V.S. Desai, J.
This reference arises on a statement of the case u/s 66(4) directed to be made by this court by its order dated 26th June, 1959. By that order this court had called upon the Tribunal to draw up a statement referring the following three questions :

"1. Whether, on the facts and in the circumstances of the applicants" case, the Tribunal was right in holding that the profit of Rs. 7,36,156 on sales to the Government of India was correctly fixed in accordance with the provision of rule 33 of the Income Tax Rules ?

2. Whether, on the facts and in the circumstances of the applicants" case, the Tribunal was right in holding that in respect of sales of Rs. 14,80,059 the profit was correctly determined by the application of rule 33 and one-third of the profits so determined could be said to accrue or arise in British India ?

3. Whether, on the facts and in the circumstances of the applicants" case, the Tribunal was right in holding that a proportionate part of the profits determined on sales ground under items Nos. 3, 4, 5 and 9 in the assessment order by the application of rule 33 was

assessable to Income Tax ?"

2. The facts to be stated are briefly as follows :

3. The assessee is a limited liability company incorporated in the State of Indore. It has a textile mill at Indore and it carries on the business of manufacture and sale of textiles. In the relevant assessment years, namely, 1942-43, 1943-44, 1945-46, 1946-47 and 1947-48, the previous years for which were the calendar years 1941, 1942, 1944, 1945 and 1946, the Income Tax Officer found that certain sales were effected to merchants and others in British India both direct and through brokers and also to be Governmental organisations. In respect of these sales the dispute which ultimately went before the Tribunal related to the computation of profits on sales, which were sales to the Government of India, Supply Department, and also certain other sales, which were effected :

(i) in pursuance of offers or contracts completed by the company''s shops at branches in British India and passed on to Indore for execution,

(ii) in pursuance of offers or contracts completed by brokers or agents in British India and passed on to Indore;

(iii) in cases where merchants and brokers visited Indore but contracts were finally signed in British India; and

(iv) to merchants in British India at the time of their own or their brokers'' visits to Indore.

4. These disputes were common to all the assessment years and only the figures in respect of them differed in the various years. In disposing of the contentions the Tribunal referred to the figures relating to one of the assessment years, namely, 1942-43, and gave its decision. I held that the profits on the sales to the Government of India, Supply Department, were properly computed by the department. As to the other disputed sales it also held that the income on the said sales was properly computed by the department.

5. In addition to these contentions relating to sales, which were agitated before the Tribunal, there was also a further contention raised relating to the assessee''s right to deduct the carried forward balance of the depreciation allowance from the total income of the assessee for the relevant year of assessment. It was claimed by the assessee, who was held to be a non-resident during the material assessment years, that the carried forward balance of the depreciation allowance could be deducted only from the total income and not from the total world income of the assessee. This contention was negatived by the Tribunal. The assessee then made in application to the Tribunal u/s 66(1) requesting it to refer the several questions of law which it alleged arose on the Tribunal''s order. The Tribunal was of the opinion that the only question of law, which arose on its decision, was the one which related to the deduction of the carried forward balance of the depreciation allowance. It accordingly framed a question of law relating to

the said contention of the assessee and declined to frame the other questions of law which the assessee had asked for. The questions of law referred to by the Tribunal relating to the deduction of the carried forward balance of the depreciation allowance came before this court in Income Tax Reference No. 56 of 1958 for the first time on 26th June, 1959, when, in view of the notice of motion, which was taken out by the assessee praying that certain other questions which also arose on the Tribunal''s order, and which the Tribunal had refused to frame and refer to the High Court, should be directed to be referred by the Tribunal to the High Court, this court ordered the Tribunal to draw up a statement and refer to the High Court the three questions, which we have set out above. The Income Tax Reference No. 56 of 1958 has been already disposed by us and we are now dealing with the three questions directed to be referred under the supplementary statement, which are the subject-matter of the present Reference No. 5 of 1961. In respect of the sales of Rs. 7,36,156 to the Government of India, Supply Department, in the assessment year 1942-43, the profits which were taxed on accrual basis were determined as the amount which bore the same ratio to the total profits of the company as the said sales bore to the total sales of the company. It was conceded by the assessee before the Tribunal that the quantum of profits on the said sales as determined by the Income Tax Officer was excessive. Before the Income Tax Officer, however, no material was placed by the assessee showing that the margin of profits on the said sales to the Government of India, Supply Department, was less than the other sales effected by the company. Although no specific ground of appeal was taken before the Appellate Assistant Commissioner challenging the quantum of profits determined on the said sales by the Income Tax Officer, the assessee alleged that at the time of the hearing of the appeal it had furnished to the Appellate Assistant Commissioner details showing the cost of producing the goods which were supplied by the assessee to the Government. If any such data was produced before the Appellate Assistant Commissioner, it does not appear to have been taken on record by the Appellate Assistant Commissioner nor does the order of the Appellate Assistant Commissioner mention any such details having been furnished by the assessee. Before the Tribunal a ground was taken that the Appellate Assistant Commissioner had erred in omitting to take into consideration the facts and figures placed before him at the time of the hearing showing the cost price of the goods supplied to the Government of India, the selling price and profit derived therefrom. The Tribunal considered that the ground was vague and did not further consider it. As to the contention, which was urged before the Tribunal, namely, that a different rate of computation of profits should have been adopted on those sales to the Government since the margin of profits on those sales was lower than in other sales, the Tribunal observed that there was in fact no warrant to come to such a conclusion. It pointed out that as the assessee did not maintain sectional accounts to show that the margin of profits on sales to the Government was lower than the margin of profits derived by the assessee in the other varieties and in the absence of such material it was not possible to verify the learned counsel''s statement. Since the company only maintained a consolidated profit and loss account and the proportionate profit had been worked out on the basis of the consolidated statement of profit and loss, in the absence of the clear-cut separate

accounts, it was not possible to theories that the margin of profit on supplies made to the Government was lower than in other categories. It, therefore, held that the contention, which was urged by the assessee in respect of the said sales could not be accepted.

6. Mr. Palkhivala, the learned counsel appearing for the assessee, has argued that it is true that before the Income Tax Officer proper data had not been furnished by the assessee but before the Appellate Assistant Commissioner the necessary material had been furnished by it and the Appellate Assistant Commissioner, after permitting the assessee to produce the said material before him, had failed to consider the same. It may be in the discretion of the Appellate Assistant Commissioner either to allow the production of the material or not to allow, but once he had allowed the production of the material on record, he was bound to apply his mind to the same and if he failed to do so, the assessee was entitled to make a legitimate grievance about it. According to Mr. Palkhivala such a grievance was made by the assessee in its grounds of appeal before the Tribunal. The Tribunal, however, had also not considered the said material nor has it considered the question as to whether the Appellate Assistant Commissioner had erred in not taking into consideration the said material.

7. Now, if Mr. Palkhivala was right in his submission that the Appellate Assistant Commissioner, after having allowed the production of the material at the appellate stage, had thereafter failed to apply his mind to it, the assessee could rightly make a grievance about the said action of the Appellate Assistant Commissioner. We do not, however, agree with him that the Appellate Assistant Commissioner had, in fact, allowed before him. As has been pointed out by the Tribunal, the departmental representative did not accept the position that the material sought to be produced by the assessee was allowed to be produced by the Appellate Assistant Commissioner. There was nothing on the record of the Appellate Assistant Commissioner to show that either an application for the production of the further material was made to him or that the further material was filed before him or was admitted by him on any particular date. The additional material was also not to be found on the record of the Appellate Assistant Commissioner. The Tribunal, therefore, could not be said to have erred in not entertaining this contention of the assessee. As pointed out by the Tribunal even ground No. 4 taken by the assessee in his memorandum of appeal to the Tribunal was vague and did not clearly state that the material was allowed to be produced and thereafter not taken into consideration by the Appellate Assistant Commissioner. It is not disputed that apart from the said additional data, which the assessee desired to produce before the Appellate Assistant Commissioner, there was no other material on the record for coming to the conclusion that the margin of profits on sales to the Government was less than the margin of profits on the other sales. In our opinion, therefore, the Tribunal was right in holding that the profit of Rs. 7,36,156 on the sales to the Government of India in the assessment year 1942-43 was correctly fixed in accordance with the provisions of rule 33 of the Indian Income Tax Rules and the first question, therefore, must be answered in the affirmative.

8. The other two questions, namely, questions Nos. 2 and 3, relate to the computation of profits on certain sales. The amount of the sales effected in the assessment year 1942-43 was Rs. 14,80,059 and the profits on these sales was computed by the application of rule 33 and one-third of the profits so determined were held attributable to the activities in British India and as such taxable in the hands of the company. Question No. 3 was whether the Tribunal was right in holding that a proportionate part of the profits determined on sales under items Nos. 3, 4, 5 and 9 in the assessment order by the application of rule 33 was assessable to Income Tax and question No. 2 was whether the Tribunal was right in holding that in respect of the said sales the profit was correctly determined by the application of rule 33 and that one-third of the profits could be said to arise or accrue in British India. Now, the determination of these two questions will depend on whether the income in respect of these sales had accrued or arisen in British India and it was, therefore, taxable on such accrual basis.

9. As we have pointed out earlier, the total sales of Rs. 14,80,059 fell under four categories. The first of these categories was of sales effected in pursuance of the business canvassed by the company''s representative in British India and the amount of sales in respect of this category is Rs. 6,46,028. The modus operandi in respect of these sales was, as stated by the Tribunal in its statement, as follows :

''The assessee had a paid representative at Bombay who canvassed on behalf of the company to British India merchants. The orders were sent by such merchants to Indore. On acceptance of orders by the company at Indore the compete prepared the contracts, signed them and forwarded the same for being signed by the customer. One contract was signed by the customer and returned to the assessee. Thus the company signed at Indore and the customer signed in British India. The contracts were signed on company''s forms. On some contracts there were stamps of Holkar State. On the others there were British India stamps.... The goods under the contracts were delivered f.o.r. Indore. The relevant railway receipt made in the name of ''Self'' was endorsed in favour of the customer and was handed over to the Imperial Bank of India, Indore, for being delivered to the merchant. Sale proceeds were received at Indore through the Imperial Bank of India, Indore.''

10. The Tribunal had taken the view that although sales were effected in Indore, the groundwork for the sales was done in British India and it was quite possible that in respect of sales recorded as effected in Indore, some operations were carried on in British India and, therefore, the Appellate Assistant Commissioner was right in bringing the income earned by the assessee to tax on a proportionate basis.

11. Mr. Palkhivala has urged that the view taken by the Tribunal is erroneous. He contends that in the case of these sales, the contracts were concluded at Indore, the goods were delivered in Indore and the money was also received at Indore. There was nothing, therefore, which was done in British India by reason of which the profits in respect of these sales could be said to have accrued or arisen in British India. We are

here dealing with a case of actual accrual of the profits and since the contracts are both entered into and performed outside British India, the profits could not be said to have accrued within British India. The only connection on the basis of which the Tribunal has held that a proportionate part of the income could be said to have accrued in British India is the canvassing for the orders which was made by representative of the assessee company. But this court has held in Income Tax Reference No. 5 of 1951 Rajkumar Mills Ltd. v. Commissioner of Income Tax decided on the 5th of September, 1956, that even in case of profits on the sale of goods through a non-resident company"s employees in British India such profits cannot be said to have accrued or arisen in British India where the contracts were made in Indore and the sale of goods was effected in Indore and not in British India.

12. In our opinion, on the facts as found in the present case, no part of the profits of the said sale could be said to have accrued or arisen in British India. The mere circumstance that the company"s representative has canvassed for orders in British India will not have the effect of making the accrual of any part of the income to take place in British India, where the formation of the contract and its complete performance has taken place in Indore and not in British India.

13. Mr. Joshi, the learned counsel for the revenue, has contended that in the present case the contracts were not concluded in Indore but only in British India. No doubt the statement of the Tribunal mentions that the orders were accepted at Indore but what it really means according to Mr. Joshi is that the orders were received by the company expressing the willingness of the buyers to purchase the goods from the company at Indore. It was thereafter that the company, having decided to entertain the same, prepared on their forms the contracts for the sale and purchase of the goods mentioned in the said orders of the customers and sent those forms for the signature of the customers in acceptance of the same. According to Mr. Joshi, it was the contract form sent by the company to the customer, which contained the offer and it was on the acceptance by signature on the said form by the customer in Bombay that the contract was concluded. According to Mr. Joshi, therefore, the contract of sales, in the present case, which was effected through the representative of the company in British India, took place in British India and not in Indore.

14. We do not think we can accept this contention of Mr. Joshi. All throughout from the Income Tax Officer to the Tribunal the matter has been considered on the basis that the sales had been effected in Indore and the contracts had taken place there. It was only on the basis that in the formation of these contracts the representative of the company in Bombay had taken some part by canvassing orders for the company that a part of the profits was held liable to tax in British India. As we have already in British India is not sufficient to make any part of the profits subject to tax in British India.

15. In our opinion, therefore, no part of the profits in respect of the sales covered under the first category could be said to have accrued in British India.

16. As to the second category, the position is the same excepting that the contracts in respect of these sales had been brought about by certain free-lance brokers. The orders in respect of these sales also were accepted by the company at Indore and the mode of delivery of the goods as also the receipt of the payment in respect of the same was also similar as in the case of sales in the first case. The circumstance that these sales have been brought about through brokers would not make any material difference so as to regard the profits in respect of such sales to have accrued in British India.

17. In the third category are sales to the extent of Rs. 3,85,214 which have taken place when Indian merchants and customers had gone to Indore for negotiations and placing orders. Everything in connection with these sales had taken place in Indore. The contracting parties met at Indore, contracts were concluded at Indore, and goods were delivered at Indore. It is impossible to hold that any part of the profits in respect of these sales could be said to have accrued or arisen in British India.

18. The sales effected under the fourth category, which amounted o Rs. 3,13,306 are hardly distinguishable from those under the third category. The only difference is that, whereas in the third category, the merchants or other customers had gone to Indore to negotiate and place orders, in the case of these sales the merchants or their brokers on their personal visits to Indore have entered into the contracts.

19. In our opinion, therefore, the view taken by the Income Tax authorities and the Tribunal in respect of the profits on sales of the categories enumerated above, which in the relevant assessment year amounted to Rs. 14,80,059 is erroneous, and no part of the profits on the said sales could be said to have accrued in British India so as to make rule 33 of the Indian Income Tax Rules applicable to the same.

20. The result, therefore, is that question No. 3 must be answered in the negative. In view of our answer to question No. 3, question No. 2 does not survive and need not, therefore, be answered. There will be no order as to costs.

21. Questions answered accordingly.