(1962) 01 CAL CK 0001

Calcutta High Court

Case No: Income-tax Reference No. 63 of 1957

COMMISSIONER OF Income Tax, CENTRAL, CALCUTTA		APPELLANT
	Vs	
MOON MILLS LIMITED, CALCUTTA.		RESPONDENT

Date of Decision: Jan. 16, 1962

Acts Referred:

- Income Tax Act, 1961 - Section 10(2)(vii), 66(1)

Citation: (1962) 46 ITR 771

Hon'ble Judges: Ray, J; G.K. Mitter, J

Bench: Full Bench

Judgement

G.K. MITTER J. - This is a reference u/s 66(1) of the Indian Income Tax Act. The only question involved in this case is whether the word "received" in the fourth proviso to section 10(2)(vii) of the Act means "receivable" in the case of an assessee who keeps his accounts on the mercantile system.

The facts of this case lie within a very narrow compass. A fire broke out in the mills of the assessee on August 6, 1948, destroying substantial portions of its stock-in-trade, machinery and buildings. The said assets were covered by several insurance policies of the General Assurance Society Limited : (1) in respect of general specification, (2) specific stock policies and (3) consequential loss policies for an aggregate sum of Rs. 1,48,92,390. Re-insurance had been effected by the said insurance company with other companies. The assessee preferred a claim on the insurance company, which appointed assessors to survey the same. On November 27, 1948, the assessee company wrote to the insurance company offering to accept Rs. 65,00,000 in full settlement of all its claims with stipulation that the offer should be accepted within fifteen days of the said date and the amount should be paid by January 15, 1949. The offer was accepted by the insurance company on December 7, 1948, and confirmed in a final meeting of the company held on December 13, 1948.

Whatever be the reason the assessee did not receive payment of its claim before March 27, 1950. The assessee who observed the mercantile system of accounting, took of Rs. 9,93,938 representing the estimated value of stock destroyed and Rs. 3,75,000 for consequential loss into its profit and loss account for the calendar year 1948. It however, kept out Rs. 27,06,593 determined u/s 10(2)(vii) as compensation for loss suffered in respect of building and machinery from the profit and loss account for the year 1948, on the ground that the compensation had actually not been received until March 27, 1950. According to the Income Tax Officer the "deemed profit" also should have been taken into account in the calendar year 1948, as in the case of stock destroyed and consequential loss policies. The Income Tax Officers contention was that as the mercantile system of book-keeping was observed by the assessee the "deemed profit" became receivable and the insurance company became the assessees debtor on December 13, 1948. The assessees contention, however, is that the compensation received for destruction of the machinery an buildings was not a revenue receipt but represented a capital receipt and in normal circumstances would not be taken into account in computing its profits and that as it was only be a fiction of the law that the excess indicated in the proviso to section 10(2)(vii) became profit it could assume that character in the words of the section only when it was actually received. The question of law referred to this court is :
"Whether on the facts and in the circumstances of this case the sum of Rs. 27,06,593 was assessable as a profit of the assessee company of the previous year relevant to the assessment year 1949-50 in accordance with the fourth proviso to section 10(2)(vii) of the Indian Income Tax Act ?"

Section 13 of the Act lays down that income, profits and gains of an assessee are to be computed, for the purpose of sections 10 and 12, in accordance with the method of accounting regularly employed by the assessee. As the assessee employs the mercantile system of accounting it had to bring into credit what was due immediately it became legally due and before it was actually received and it also had to bring into debit expenditure the amount for which a legal liability had been incurred before it was actually disbursed.

Reliance was placed on the observations of Bhagwati J. in Keshav Mills Limited v. Commissioner of Income Tax that "the profits or gains of the business which are thus credited are not realised but having been earned are treated as received though in fact there is nothing more than an accrual or arising of the profits at that stage. They are book profits. Receipt being not the sole test of chargeability and profits and gains that have accrued or arisen or are deemed to have accrued or arisen being also liable to be liable to the charged for Income Tax the assessability of these profits which are thus credited in the books of account arises not because they are received but because they have accrued or arisen." It was argued that according to the above, it was not necessary that the money should actually be in

hand and as soon as the relationship of a debtor and creditor arose between the assessee and third party the same had to be entered in the books of account of the assessee and profits computed on the basis of such entries.

Section 13 of the Act, however, lays down the computation is to take place in terms of section 10 and 12. Consequently, the provisions of section 10 must complied with. u/s 10(1) an assessee has to pay tax in respect of profits and gains of any business, profession or vocation carried on by him. Sub-section (2) enumerates allowanced admissible for the purposes of computation of profits and gains. Ordinarily moneys received by way of compensation from and insurance company for loss capital assets would not figure at all in the computation of income and profits but inasmuch as an assessee is entitled to allowances for depreciation year after year the Legislature thought that the entire amount of compensation should not be left untouched. Section 10(2)(vii) permits allowances as follows :

"In respect of any such building, machinery or plant which has been sold or discarded or demolished or destroyed, the amount be which the written down value thereof exceeds the amounts for which the buildings, machinery or plant, as the case may be, is actually sold or its scrap value :

Provided that such amount is actually written off in the books of the assessee :

Provided further that where the amount for which any such building, machinery or plant is sold, whether during the continuance of the business or after the cessation thereof, exceeds the written down value, so much of the excess as does not exceed the difference between the original cost and the written down value shall be deemed to be profits of the previous year in which the sale took place :

Provided further that where any insurance, salvage or compensation moneys ar received in respect of any such building, machinery or plant which has been discarded or demolished or destroyed, and the amount of such moneys does not exceed the written down value, the amount allowable under this clause shall be that amount, if any, by which the difference between the written down value and the scrap value exceeds the amount of such moneys :

Provided further that where any insurance, salvage or compensation moneys are received in respect of any such building, machinery or plant as aforesaid, and the amount of such moneys exceeds the difference between the written down value and the scrap value no amount shall be allowable under this clause and so much of the excess as does not exceed the difference between the original cost and the written down value less the scrap value shall be deemed to be profits of the previous year in which such moneys were received :

Provided further that for the purposes of this clause the original cost of a building, the written down value of which is determined in accordance with the first proviso to sub-section (5) shall be deemed to be the written down value so determined a sat

the date of its being brought into use for the purposes of the business, profession or vocation."

In this case we are only concerned with the fourth proviso under which any compensation received in respect of buildings, machinery or plant exceeding the difference between the written down value and the scrap value is not to be allowed at all and so much of this excess as does not exceed the difference between the original cost and the written down value less the scrap value is to be deemed to be profits of the previous year in which the moneys were received. It will be noticed, therefore, that the effect of the proviso is not only to take away the benefit of the allowances which an assessee might otherwise claim but to make the assessee assessable to tax in respect of the excess mentioned. The legislature here has introduced a fiction for taking away from the assessee the benefit of something which was not a trading receipt. The legislature has however made it clear that the fiction will only come into play when moneys are received irrespective of the system of accounting. This, to my mind, is amply borne out by sub-section (5) of section 10 under which the word "paid" in sub-section (2) means "actually paid" or "incurred" according to the method of accounting upon the basis of which the profits or gains are computed under this section. An assessee maintaining account on the mercantile system must, therefore, bring into account any amount for which he has incurred a liability and if he keeps his account on the mercantile system must taken into account the amount when it is actually paid. If it was the intention of the legislature that the word "received" in section 10(2)(vii) should have received a similar meaning, the legislature would have provided for it.
It was argued that the interpretation of the word "paid" in section 10(5) was ex abundanti cautela and the result would have been the same even if the word "paid" was not interpreted as provided for. I find myself unable to accept this contention. There was no need to give such an interpretation at all in that event. As the taxation of what is not trading receipt is the result of a fiction the scope of the same ought to be strictly limited. It is legitimate to infer that the legislature thought that it would not be right to take ways a portion of the insurance moneys even before the same were actually received.

On behalf of the assessee it was argued that the proper way to look at it was to treat a portion of the insurance moneys as profit only in case it reached the hands of the assessee and in my view this construction should be upheld. The question should therefore, be answered in the negative. The assessee will have the costs of the reference.

RAY J. - I agree.

Question answered in the negative.