

In Re: Chouthmal Golapchand

Court: Calcutta High Court

Date of Decision: July 21, 1938

Acts Referred: Income Tax Act, 1922 " Section 13

Citation: AIR 1939 Cal 559

Hon'ble Judges: Derbyshire, C.J; Costello, J

Bench: Full Bench

Judgement

Derbyshire, C.J.

The facts in this case are set out in the case and in annexure A, dated 8th January 1936. The first question is whether on

the facts of this case the assesseees were entitled to claim a loss on shares by valuing the shares at their market price on the date on which they

were divided up amongst the partners? It has been contended by the assesseees that these shares were sold by the partnership to the outgoing

partners, and not partitioned as the case states. The case, in my opinion, is in accordance with the facts and is conclusive on that point. The shares

in question were acquired sometime previous to the beginning of the accounting year - we are not told how long previous. It is common ground

that they were acquired at a price higher than the price ruling on 8th March or 30th March 1936. They had been shown in the books of the

partnership and carried forward from year to year at the cost price. The assesseees say that there was properly a loss on the disposal of those

shares and that that loss was the difference between the cost price and the price at which they were taken over which is alleged to be the market

price on 8th March 1936. The assesseees say that that loss they are entitled to set off against gains on other parts of the business during the

accounting year.

2. We are not told what the market value of these shares was at the beginning of the accounting year in question. It is only the loss during the year

that can be set off against other gains during the year. We do not know what loss, if any, occurred on these shares during the accounting year in

question. It was pointed out by Lord Buckmaster in AIR 1930 56 (Privy Council) where the question of the valuation of stocks in relation to the

ascertainment of the profits of a business for a particular year was discussed that

Section 13, income tax Act, 1922, says: "Income, profits and gains shall be computed for the purposes of Sections 10, 11 and 12 in accordance

with the method of accounting regularly employed by the assessee".

3. He also says:

The method of introducing stock into each side of a profit and loss account for the purpose of determining the annual profits is a method well

understood in commercial circles and does not necessarily depend upon exact trade valuations being given to each article of stock that is so

introduced. The one thing that is essential is that there should be a definite method of valuation adopted which should be carried through from year

to year, so that in case of any deviation from strict market values in the entry of the stock at the close of one year it will be rectified by the accounts

in the next year.

4. In my opinion, as this stock was at all previous times valued at cost price and was brought into the balance sheet at the beginning of the year at

its cost price, then, when it was taken out of the assets of the company, it also should be valued in the same way at the cost price. The system of

valuation which the assesseees contend for would, it appears to me, have the effect of bringing into the accounts of the year a loss in respect of this

stock which had not occurred during the year. For these reasons I "am of the opinion that Question (a) should be answered in the negative. As to

Question (b) the partnership in question had come to an end on 30th March 1936 by virtue of the deed of dissolution. The deed provides that the

partnership agreement shall cease on that date and "shall not continue "for any reason whatsoever." Therefore, on 9th December 1936, when the

income tax Officer refused to renew registration of the firm, the firm no longer existed in any way and could not be deemed, to use the words of

the deed, to "continue for any reason whatsoever": that includes continuation for purposes of registration under the income tax Act. In my

opinion Question (b) must be answered in the affirmative. The Commissioner is entitled to the taxed costs of this Court including the fees of two

advocates.

Costello, J.

5. The assessment with which we are concerned was made on 9th December 1936 the year of assessment being 1936-37, that is to say it was

made in respect of the period from 31st March 1935 to 30th March 1936 which is the Ram Navami year of the firm. The assesseees are described

as an unregistered firm and there were four partners each of them having one-fourth share in the firm. The assessment was made u/s 23(3) read

with Section 25 (3). The assessee had submitted a return in response to notices u/s 23(2) and Section 22(4). In that return in respect of their

share business or as it was called in the assessment "shares account" they have claimed to be allowed to deduct a loss of Rs. 33,365 said to have

been incurred in respect of the sale of certain shares which constituted part of their stock-in-trade. It has been argued before us that the matter has

to be determined with reference to Section 24(1), income tax Act, which says:

Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in Section 6, he shall be entitled to have the

amount of loss set off against his income, profits or gains under any other head in that year.

6. The contention put forward on behalf of the assessee was that the shares in question had originally cost Rs. 85,331 and that was the figure

which had appeared in their accounts apparently on more than one occasion, and certainly at the opening of the accounting year - the tax year

1992. It was then said that upon the dissolution or rather, in contemplation of a dissolution of the partnership as provided for in an agreement dated

8th January 1936, these shares were disposed of (for the moment I use a neutral word) and had produced the sum of Rs. 51,966 showing the

difference between that sum and the cost price - a sum of Rs. 33,365 which I have mentioned. The case as originally put forward by the assessee

is to be found set forth in the decision - the appellate order and ground of decision as it is called - of the Assistant Commissioner given on 12th

February 1937 in which he said:

The learned pleader has tried to argue that there was an actual sale of the shares as between the partners. I am afraid that I cannot accept this

contention, for, as a matter of fact the books show that the partners' accounts were debited with the value of the shares allocated to each of them

and that there was a payment of small amount of ready cash to make up the small difference which arose from the distribution of the shares.

7. The learned Assistant Commissioner further said:

The reason for the income tax Officer not allowing the loss on shares, I find, was due to the fact that he found that there were no actual sales of

shares in the year of account, and that the business having been discontinued, the assets were distributed among the partners who received an

allocation of shares which were priced at the ruling market rate.

8. Apparently, the assessee endeavoured to induce the Commissioner of income tax to put a question of law before this Court in a form which

would suggest that there had actually been a sale of the shares in question, because we find that the question of law dated 26th April 1937, as

formulated by the assessee was as follows:

Where the partners of an assessee firm having Bhare business agreed on 8th January 1936 to dissolve the firm on 30th March 1936 and in the

meantime realize the assets thereof and divide the proceeds amongst themselves and where for that purpose the stock of shares was sold by the

firm at market rate resulting in a loss of Rs. 33,365 as the market rate was very much lower than the cost price, whether in assessing the firm the

income tax Officer is competent in law to disallow such loss as capital loss only arising out of alleged allocation of shares as stranger buyers having

not been obtained on suitable terms for depressed market the shares were sold to the four new firms of the families of the partners started after the

said date 8th January 1936.

9. This seems to indicate to my mind that the assessee in some way anticipated that they would find themselves in difficulties if they came before

this Court in the position of having to found an argument upon a set of facts which included in it a statement that the shares were actually divided up

or shared out or distributed amongst the four persons who originally composed the partnership. It is obvious, to my mind, that the question

formulated by the assessee was intended to suggest, and in fact ""did suggest, that there had been an actual sale of the shares to third parties in the

shape of new firms and that the old partners had then distributed amongst themselves the proceeds of that sale. We find however that even as far

back as the assessment to which I have already referred, the Income, tax Officer himself took an entirely different view and he said commenting on

the shares account:

There was no sale in the year of account. The business has been closed and assets have been transferred to the partners at alleged market price.

Shares were purchased at a time when prices were rather high and the assessee has all along valued his closing stocks at cost price. Due to over-

valuation of the opening stock for the same reason the assessee is claiming losses as above. It is due entirely to depreciation in the capital value of

shares held and as there was no sale I disallow the claim.

10. When the assessee had succeeded in persuading the Commissioner of Income, tax to put the matter before this Court, in the case which the

Commissioner put forward we find it stated:

The facts regarding this share account are that the assessee was doing business in shares and held at the beginning of the accounting year an

opening stock of shares valued at cost Rs. 85,331. Their stock of shares had always been valued at cost. During the year there had been no

transaction in shares. On 9th March 1936 in the course of the partition abovementioned the shares were allotted to the four partners at a valuation

agreed upon by the partners.

11. Then he sets out the values assigned to the shares and explains that small amounts of cash are paid to make up the differences in the allotment.

He had previously stated that the partition was completed on 29th March 1936. It may be said at the outset that there can be no doubt that a

business firm which is liable to be assessed to income tax is under, an obligation to maintain a system of accounts with regularity and it is not

permitted to change the system except upon a proper application being made to the income tax authorities in that behalf. We find it laid down in

para. 51(ii) of the income tax Manual as follows:

The cases in which an assessee desires to change his accounting system should be rare and where such a request is made, the income tax Officer in

considering it should, as in the similar case of a demand for a change in the "previous year", if he is prepared to allow the change, take steps to

secure that no profits escape taxation on account of the change. While Section 13 leaves it to the discretion of the income tax Officer to decide

whether a particular system of accounting should be accepted or whether a change in the system of accounting should be allowed, the discretion of

the income tax Officer in this matter can be questioned in the course of an appeal against an assessment u/s 30, that is, it may be made one of the

grounds of appeal in contesting the assessment of the profits.

12. In the case now before us no application was made to change the accounting system and, in fact, no change was made. We find, as I have

already stated, that at the beginning of the tax year 1992 (Ramnavami) the value of these shares was put in the accounts of the firm as at the cost

price. There is another rule which is of great importance in a matter of this kind and that is that every tax year is a self-contained period and the

profits earned or the loss sustained either before that year or after that year are not at all relevant for the purpose of an assessment relating to a

particular year. In that connexion I must briefly call attention to the case in AIR 1932 178 (Privy Council) Lord Russell of Killowen, delivering the

opinion of the Board, said:

Although the Act nowhere in terms authorises the deduction of bad debts of a business, such a deduction is necessarily allowable. What are

chargeable to income tax in respect of a business are the profits and gains of a year; and in assessing the amount of the profits and gains of a year

account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains. But the losses must be losses

incurred in that year. You may not, when setting out to ascertain the profits and gains of one year, deduct a loss which had, in fact, been incurred

before the commencement of that year. If you did you would not arrive at the true profits and gains of the year. For the purpose of computing

yearly profits and gains each year is a separate self-contained period of time in regard to which profits earned or losses sustained before its

commencement are irrelevant.

13. Then in a subsequent paragraph at page 297 Lord Russell said:

Whether a debt is a bad debt, and, if so, at what point of time it became a bad debt, are questions which in their Lordships' view are questions of

fact to be decided in the event of dispute by the appropriate tribunal, and not by the ipse dixit of any one else.

14. Lastly at p. 299 the noble and learned Lord said:

In their Lordships' opinion the question which was referred to the Court in relation to bad debts should have been answered as follows: The

assessee has no "option" of declaring debts bad. Whether a debt is bad, and when it became bad, are questions of fact to be determined in case of

dispute not by the assessee or by the exercise of any "option" on his part, but by the appropriate tribunal upon a consideration of all relevant and

admissible evidence....

15. In the same way, in my opinion, it follows that it is not open to an assessee by his own ipse dixit to decide that a particular transaction entails

loss of a kind which may be set off against profits or gains made in respect of other transactions. In this particular instance these assessee were

asking the Court to hold that because the shares in question were bought at one price and then dealt with on the basis of another and lower price,

that was necessarily a business loss of the kind contemplated by Section 24. As it was the practice of this firm, or apparently was the practice to

put in the value of that part of their stock-in-trade which consisted of shares, equally with the rest of their stock-in-trade at cost price at the end of

one accounting year and at the opening of the next, it follows from what I have already said, and the authority to which I have referred, that the

cost price of the shares must be taken as the starting point or, as I called it in the course of argument, the datum line for the purpose of ascertaining

whether or not there has been an increase or a decrease in the value of the shares in question.

16. It is quite certain and, indeed, it is clear law that if a trader puts into his accounts one value at the end of any accounting year, he must start his

next year's accounts with precisely the same value. In this connexion I would mention the case in Commissioner of Income Tax Vs. Chengalvaroya

Chetti and Another, . Having put in the value of these shares as at cost and being in the position that they were not able, and in fact did not seek to

change the system of accounting in this particular case, we must take the cost price of these shares as the starting point. It seems to me therefore

that if there had been any real sale of these shares in the course of the year 1992 (Ramnavami), it might have been open to the assessee to say

that it was between the cost and the sale price that there was this difference of Rs. 33,365. But there never was a sale. It is quite obvious, and in

any event we must accept the statement of facts put before us by the learned Commissioner, that there was no sale, but what was loosely called a

"partition". I say loosely because "partition" in this country is a technical expression which has in it implicit number of legal ideas and legal

consequences which are not applicable in a case of the kind we are now considering. Therefore, I prefer to say that there was a division of these

shares and that division took place, as the learned Commissioner states, on 9th March 1936. The partners for their own purposes chose to say

that they would take over the shares or rather their portion of the shares. What they said as regards a loss seems to me to be definitely an ipse

dixit. They have sought to take credit to themselves - credit in its commercial sense - for the difference between the buying and the selling price

based upon a valuation which they themselves had chosen to put upon these shares and in regard to which, as far as one can see, there was no

evidence as to its accuracy. In those circumstances, the matter seems to me to fall well within the ambit of the decision in *In re Tata Industrial Bank*

Ltd. (1921) 1 I.T.C. 152, the head-note of which runs as follows:

A banking concern having been assessed for income tax on profits amounting to Rs. 12,54,130 it claimed to deduct from the taxable profits a sum

of Rs. 2,98,000 being the amount of depreciation on war bonds and securities belonging to the bank, arrived at by comparing the market rates

with the valuations in the books of the bank.

17. That seems to me very much the same kind of operation as was performed or was sought to be performed by the assessee in the present

instance. In the course of his judgment Macleod C.J. discussed the case on which Mr. Bose relied in his argument before us, namely that in *In re*

Spanish Prospecting Co. Ltd. (1911) 1 Ch. 92, where at p. 98 Fletcher-Moulton L.J. said:

The word "profits" has in my opinion a well-defined legal meaning, and this meaning coincides with the fundamental conception of profits in general

parlance, although in mercantile phraseology the word may at times bear meanings indicated by the special context which deviate in some respects

from this fundamental signification. "Profits" implies a comparison between the state of a business at two specific dates usually separated by a

interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a

comparison of the assets of the business at the two dates.

18. At p. 99 the learned Lord Justice said:

We start therefore with this fundamental definition of profits, namely if the total assets of the business at the two dates be compared, the increase

which they show at the later date as compared with the earlier date (due allowance of course being made for any capital introduced into or taken

out of the business in the meanwhile) represents in strictness the profits of the business during the period in question.

19. Now, Mr. Boae at the opening of his argument invited our attention to that definition. It seems to me that in the present instance the assesses

have overlooked the fact that they were taxed in respect of trading operations for the period beginning on 31st March 1935 and ending on 30th

March 1936. The "self-contained period" referred to by Lord Russell in the passage which I quoted earlier in this judgment was the period

between those particular dates. In other words, before the Ramnavami year 1992 had come to an end, part of the assets of the business had been

taken out of the business, namely these particular shares which, as we have seen, were distributed amongst the four partners on 9th March 1936.

That is one way of looking at it and upon that view of the matter there could be no question of loss, because you cannot compare anything that

happened when the shares were disposed of as against the cost price of those shares as appearing in the opening stock account at the beginning of

the Ramnavami year 1992. I entirely agree with the view put forward by my Lord the Chief Justice with regard to that.

20. Looking at the matter from the other aspect which I have discussed, it seems to me that the assesses were not entitled to say "we have shown

the value of these shares year after year as cost price: we now propose to show the value of them as at the market price." To state the matter

succinctly, I agree that if these shares were put into the accounts of cost they ought to have been taken out of the accounts at cost. It follows

therefore that the first question propounded for the consideration of this Court should be answered in the negative. I need say very little with regard

to the second question. In my opinion, merely to state that the application was made in December and the partnership had been dissolved, and

irrevocably dissolved, as on 30th March 1936 is quite sufficient to indicate that the answer to that question should be in the affirmative.