

(1921) 10 BOM CK 0016

Bombay High Court

Case No: Civil Reference No. 12 of 1921

In Re: The Tata Industrial Bank
Ltd.

APPELLANT

Vs

RESPONDENT

Date of Decision: Oct. 10, 1921

Acts Referred:

- Income Tax Act, 1918 - Section 51, 9

Citation: (1922) 24 BOMLR 118 : 66 Ind. Cas. 979

Hon'ble Judges: Shah, J; Norman Macleod, J

Bench: Division Bench

Judgement

Norman Macleod, Kt., C.J.

This is a reference by the Chief Revenue Authority, Bombay, u/s 51 of the Indian Income Tax Act, with regard to the interpretation of Section 9 of the Act.

2. The Tata Industrial Bank was assessed by the Collector of Income Tax for the year 1920-21 on profits amounting to nearly thirteen lacs. I omit all mention of super-tax as unnecessary. On appeal to the Commissioner a slight reduction was made, but before both authorities an important question was raised by the Bank since they claimed to deduct from the taxable profits a sum of Rs. 2,98,000 said to be 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. This deduction was not allowed on the ground that the only allowances and deductions to be made from the gross income in order to arrive at real assessable profits were those mentioned in Sub-section 2 of Section 9.

3. The following questions were referred to the High Court for decision:-

(1) Whether on a true construction of the Indian Income Tax Act of 1913 and in particular Section 9, the only allowances and deductions to be made from the gross income in order to arrive at real assessable profits are those mentioned in

Sub-section 2 of Section 9 and whether the said Section 9 prohibits any allowances or deductions other than those specifically mentioned therein.

(2) Whether on a true construction of the said Act and in particular Section 9, the assessing officer is not entitled in his discretion to allow a deduction which is proper and necessary to be made in addition to those specifically enumerated in Sub-section 2 in order to ascertain the real assessable profits,

(3) Whether the deduction of Rs. 12,98,000 (being the amount of depreciation on war bonds and securities) out of the gross earnings of the assessee is a deduction proper and necessary to be made in order to ascertain the real assessable profits under the said Act, and,

(4) Whether the Act attaches to the expression "profits" a meaning different from what is known as commercial profits.

4. Section 5 of the Act includes among the classes of income which shall be chargeable to income tax "Income derived from business."

5. u/s 9(1) the tax shall be payable by an assessee under the head "Income derived from business" in respect of the profits of any business carried on by him.

6. u/s 9(2) such profits shall be computed after making the following allowances in respect of sums paid or in the case of depreciation debited.

7. Items I to V, VIII and IX are items of actual expenditure, item VII deals with the case of machinery sold at a less price than the cost less depreciation, item VI deals with the depreciation of machinery, plant and buildings.

8. It would appear, therefore, that with regard to assets owned by the assessee other than machinery, plant and buildings, a debit for depreciation is not allowed.

9. The difficulty in the case arises from the fact that various meanings can be ascribed to the word "profits".

10. The petitioners have relied on the definition of "profits" as laid down in *In re Spanish Prospecting Company, Limited* [1911] 1 Ch. 92. The claimants agreed to serve the Company at a fixed salary which they were not to be entitled to draw except out of profits (if any) arising from the business of the Company. The Company went into voluntary liquidation. After all the creditors except the claimants were paid and all the capital subscribed was paid to the share-holders, there remained a surplus in the hands of the liquidators which the claimants contended should be treated as profits within the terms of their agreement. Two contributories took out a summons asking for a declaration that the claimants were not entitled to prove in respect of the surplus on the ground that profits should be restricted to profits realized by the Company on a going concern.

11. Fletcher Moulton L.J. said (p. 98):-

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 an 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. For practical purposes these assets in calculating profits must be valued and not merely enumerated...A depreciation in value, whether from physical or commercial causes, which affects their realizable value is in truth a business loss...But though there is a wide field for variation of practice in these estimations of profits in the domestic documents of a firm or a company, this liberty ceases at once when the rights of third parties intervene. For instance, the revenue has a right to a certain percentage of the profits of a company by way of income tax. The actual profit and loss accounts of the company do not in any way bind the Crown in arriving at the box to be paid.

12. No doubt in the balance sheet of a business the excess of assets over liabilities or vice versa, is represented by a credit or debit to the profit and loss account, so as to make the totals even. There is not much difficulty in calculating the liabilities, the value of the balance sheet depends on the correct valuation of the assets. It is the reckless or over-sanguine valuation of assets which is the precursor of ruin. Now if it had been intended by the Act that the profits for any particular year should be calculated by the gain in the excess of assets over liabilities during that period nothing would have been easier than to give expression to that intention. But, on the one hand difficulties would arise in the case of every assessment in ascertaining that the assessee had made a fair valuation of his assets while, on the other, the assessee would be taxed on every appreciation in the market value of his assets, and that is certainly not the object of an Income Tax Act. It must be remembered that the word "profit" is only used for explaining the method by which taxable income is to be computed. I am, therefore clearly of opinion that we are not concerned with the legal definition of "profits" as laid down by Fletcher Moulton L.J. in the case above cited.

13. As the learned Lord Justice points out, a firm or a company has a wide field for variation in practice in its estimation of its profits but that liberty ceases when the rights of a third party intervene. And in the case of income tax the Legislature prescribes the manner in which the taxable amount is to be calculated. The income of a business may be defined as the gross earnings either actually received or properly considered as if they had been received, after deducting all ordinary expenses incurred in the earning. These expenses must come under one of the items I to V, VIII and IX of Section 9(2) When the questions arise how the income is to be disposed of, the distinction between income and profits as legally defined above will be clearly seen, and profits may be fairly accurately described as that

amount which can be taken out of the business for dividends or private expenses without impairing its efficiency. Of course out of that amount something may still be left in the business by way of reserve but it is not disputed that any sum credited to reserve is liable to be taxed. It may also be as well to note that we are not concerned with the case of a business which deals in stocks and shares, looking solely for its income to the gains made by buying and selling, for it seems to be admitted that then anticipated losses may be deducted. We have been referred to the corresponding provisions of the English Income Tax Act but it would appear that the Indian Legislature has deliberately refrained from adopting those provisions, and instead of detailing allowances which cannot be deducted mentions specifically those which can. At the same time no English case has been cited to us in which a deduction for depreciation such as is now claimed has been allowed. In the rules applicable to cases I and II of Schedule D of the Income Tax Act, 8 & 9 Geo. V, c. 5, the only rule which deals with depreciation is rule 6 in which a deduction for depreciation of machinery and plant can be allowed from the profits or gain of a trade.

14. Apart from that the only deductions which would be allowed if not prohibited would be expenses incurred solely for the purpose of earning the profits, and any other debits for depreciation would not come within this category. It seems to me, therefore, that in construing Sections 5 and 9 of the Act, chargeable income is synonymous with profits and Section 9(2) prescribes how those profits are to be ascertained. From the gross income only certain debits for depreciation are to be allowed and this debit asked for by the Bank not being mentioned therein cannot be allowed.

15. I think this was the obvious intention of the Legislature, since, while depreciation of machinery, plant and buildings can easily be calculated as provided in the Act, it would be a very different matter to have to enter into such calculations with regard to assets other than these. But this much is clear that if the profits of a business are to be calculated according to the legal definition of profits, that method of calculation must be Continued from year to year, and an assessee would not be allowed to write down his assets in a year when market values had declined without writing them up when values had increased.

16. I would answer the questions propounded in the reference as follows :-

1. Profits in Section 9 of the Act mean chargeable income and must be computed from the gross income after allowing for the sums paid and debited as detailed in Sub-section (2).

2. The assessing officer is not entitled to allow any deduction for sums paid or debited other than those properly paid and debited as detailed in Sub-section (2),

3. No.

4. "Profits" in the Act means chargeable income.

17. The Bank will have to pay the costs of the reference.

Shah, J.

18. On this reference the position appears to me to be simple and clear, though on account of the way in which the questions have been formulated it has become unnecessarily difficult. On the interpretation of Section 9, it seems to me to be clear that the tax under the head "Income derived from business" is payable in respect of the profits of the business carried on by the assessee. The meaning of the word "profits" is not defined : but I agree with the learned Chief Justice on this point in holding that it is the gross income of the business. Even then it may be open to the assessing authority to take into consideration the nature of the business and the losses, if any, in determining the profits or the gross income of the business. The section does not make any provision as to how the profits are to be determined. But it seems to me that where a deduction is proper and necessary to be made in order to ascertain the "profits" or gross income of any business, the assessing authority may allow it in his discretion.

19. The section, however, makes provision for making allowances in respect of certain sums paid or in the case of depreciation debited by the Company or the individual concerned. They are stated in Section 9, Sub-section (2) and it is clear that those are the only allowances which the party could claim as of right. The Collector is not bound to make any other allowances in favour of the party, nor is the party entitled thereto as of right. In the present case the depreciation claimed by the Company is not covered by any clause of Section 9(2) and cannot be allowed as such. This position is not seriously contested before us on behalf of the Company. But it is urged that as an item of loss it is open to the Collector to allow it in calculating the profits or the gross income of the business during the year in question. As stated in the letter of reference, the attitude taken up by the Company before the Revenue Authorities was to claim only depreciation as such without agreeing to take into account appreciation, if any. As regards this point the position for the Crown has been very fairly and in my opinion correctly stated by the Chief Revenue Authority in paragraph 12 of the reference. This reference must, therefore, be dealt with on the footing that the deduction claimed by the Company is in respect of depreciation as such and not as an item of loss or gain in the business during the year. This will prejudice neither the right of the Company to claim, nor the power of the Revenue Authorities to make, due allowance for any loss or gain in virtue of depreciation or appreciation of the various securities in the course of and as part of the business in determining the amount of the profits or gross income of that business, if the facts essential for making such allowance are established. It is not easy, in my opinion, to formulate categorical replies to the questions some of which are general. Treating the reference, however, as limited to the claim made before the Revenue Authorities for depreciation as such, I concur in the answers proposed by my Lord the Chief

Justice to the questions raised in this reference as also in the order as to costs.

20. ON the 4th November 1921, the Bank's attorney moved for an order fixing up the scale of costs.

Norman Macleod, Kt., C.J.

21. Following our decision in [In Re: The Aurangabad Mills Ltd.](#), the costs will be taxed as on the Original Side. But in order to avoid any question being raised in future whether the Court has jurisdiction in references of this nature to direct costs to be taxed on the Original Side scale, it will be advisable to consider whether a rule should be framed under the Bombay Pleaders' Act XVII of 1920.