CHAPTER - IV

SUPREME COURT DECISIONS

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SUPREME COURT DECISIONS IN RESPECT OF IMPORTANT DEDUCTIONS

Case - 1 : Commissioner of Income-Tax, Kadras
V/s
Indian Overseas Bank Ltd.

Development Rebate - Separate Reserve Fund to be created Banking Company - Reserve Fund under provisions of Banking Companies Act of amount large enough to cover also reserve for development rebate - whether sufficient compliance with statutory provisions - Banking Companies Act, 1949 Sec. 17 - Indian Income-Tax Act, 1922 Sec. 10(2)(vib), prov (b)

The Reserve contemplated by Section 17 of the Banking Companies Act, 1949 and the one contemplated by provis.(b) to Section 10(2)(vib) of the Income-tax Act 1922, are two independent reserves. The entries in the account books required by provis (b) to Section 10(2)(vi b) are not an idle formality. A seperate Reserve Fund has to be created for the purpose of Section 10(2)(vi b).

Where the assessee, a banking company, claimed development rebate under Provis (b) to Section 10(2)(vi b) of the Income tax Act 1922, and contended that a transfer which it had made to a reserve fund was sufficient to meet the requirements of Section 17 of the Banking Companies Act,1949,

as well as proviso(b) to Section 10(2)(vi b) of the Income-tax Act.

Held that the assessee was not entitled to the development rebate. The grant of this rebate was a concession subject to the fulfilment of the condition prescribed under the proviso, and the creation of a reserve fund under Section 17 of the Banking Companies Act was not sufficient compliance with the priviso, even though the amount so carried to the reserve fund might be large enough to cover, both requirements.

Observations of the Madras High Court in Commissioner of Income-tax V/s Veeraswami Nainar (1965) 55 ITR 35 (Mad) approved.

Decision of the Madras High Court in Indian Overseas Bank Ltd. V/s Commissioner of Income-Tax (1967) 63 ITR 733 affirmed on this point.

Case - 2 : Malbar Fisheries Company
V/s
Commissioner of Income-Tax, Kerala

Development Rebate - withdrawal - if machinery sold or "otherwise Transferred" - Firm - Dissolution - Distribution of Assets between partners - Effect - Assets not "Transferred" by firm - Income Tax Act 1961 Sections 2(47), 34(3)(b), 155(5).

A partnership firm under Indian Partnership Act 1932 is not a distinct legal entity apart from the partners constituting it and equally in law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firm's property or the firm's assets all that is meant is property or assets in which all partners have a joint or common interest. It cannot, therefore, be said that, upon dissolution, the firms rights in the partnership assets are extinguished. It is the partners who own jointly or in common the assets of the partnership and, therefore, the consequence of the distribution, division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between partners and there is no question of any extinguishment of the firms rights in the partnership assets amounting to a transfer of assets within the meaning of Section 2(47) of the I.T. Act, 1961. There is no transfer of assets involved even in the sense of any

extinguishment of the firms rights in the partnership assets when distribution takes place upon dissolution.

In order to attract Section 34(3)(b), it is necessary that the sale or transfer of assets must be by the assessee to a person. Dissolution of a firm must, in point of time, be anterior to the actual distribution, division or allotment of the assets that takes place after making accounts and discharging debts and liabilities due by the firm. Upon dissolution the firm ceases to exist, then follows the making up of accounts, then the discharge of debts and liabilities, and thereupon distribution, division or allotment of assets takes place inter se between the erstwhile partners by way of mutual adjustment of rights between them. The distribution, division or allotment of assets to the erstwhile partners, is not done by the dissolved firm. In this sense there is no transfer of assets by the assessee (dissolved firm) to any person.

It is not correct to say that the distribution of assets takes place co-instanti with the dissolution of the firm or that it is effected by the dissolved firm.

A firm consisting of four partners carried on six different businesses. During the accounting periods relevant to the assessment years 1960-61 to 1963-64, it installed various items of machinery in respect of which development rebate was allowed to it under Section 33. The firm was dissolved on March 31, 1963, and under the deed of dissolution one of the firm's businesses was taken over by one of the partners and the remaining five by two of the other partners, and the fourth partner received a sum of Rs. 3,81,082 in lieu of his share in the assets of the firm. The question was whether the rebate allowed to the firm could be withdrawn on the ground that there was a sale or transfer of the machinery within the meaning of Section 34(3)(b) read with Section 2(47).

Held, that Section 34(3)(b) was not applicable to the case and the development rebate allowed to the firm could not be withdrawn.

Decision of the Kerala High Court Reversed.

BARR. BALASAHEB KHARDEKAR LIBRARY
SHIVAJI UNIVERSITY, KOLHAPUR.

Case - 3 : Commissioner of Income-Tax (Central) Madras
V/s
Southern Roadways Pvt. Ltd.

Development Rebate - Road Trnasport Vehicles - Amendment withdrawing rebate with effect from April 1,1960- New Diesel Engines fitted in to Road Transport Vehicles - whether qualify for development rebate - Indian Income-Tax Act, 1922, S.10(2)(vi b), prov (ii) (After amendment in 1960) Income-Tax Act, 1961. Sec. 33.

The respondent, a company engaged in Road Transport business, fitted new diesel engines on its road transport vehicles during the accounting periods relevant to the assessment years 1961-62 and 1962-63 and claimed development rebate under Section 10(2)(vi b) of the Indian Income-tax Act, 1922 and Section 33 of the Income-Tax Act, 1961 respectively. The High-Court, on a reference, upheld the respondents claim applying the decision of the Supreme Court in Mir-Mohammad Ati's case (1964) 53 ITR 165, on appeal to the Supreme Court.

Held, reversing the decision of the High Court,

(i) that in view of the second proviso to Section 10(2)(vi b) of the 1922 Act, inserted in the clause with effect from April 1, 1960, the respondent was not entitled to development rebate for the assessment year 1961-62.

(ii) That as the provision allowing development rebate in Section 33 of the 1961 Act itself left out road transport vehicles from its scope the respondent was not entitled to development rebate for the assessment year 1962-63.

Case - 4 : Depreciation Allowance -
Standard Vacuum Refining Co. V/s Commissioner of Income Tax

Depreciation - Development rebate - Actual cost - Interest paid on amount borrowed for acquiring and installing machinery and plant for a period prior to commencement of production - whether part of actual cost - "Actual Cost", meaning of - Rules of Accountancy whether should be adopted - Income-tax Act 1922 Sec. 10(2)(vi)(vi b)(5) Companies Act 1956, Sec. 208.

Business Expenditure - wealth tax - Decision of Supreme Court holding wealth tax to be allowable - Amendment of the law making wealth-tax not allowable - Saving relating to case of assessee decided before July 15, 1972 - Appeal of assessee heard along with other appeals but judgement not delivered before July 15, 1972. But directed to be heard by another bench - whether benifit saving available - Income-tax (Amendment) Act, 1972 Sections 2,4,5.

Interest paid before the commencement of production on amounts borrowed by the assessee for the acquisition and installation of Plant and Machinery forms part of the "actual cost" of the assets to the assesse within the meaning of the expression in Section 10(5) of the Indian Income-tax Act 1922, and the assessee will be entitled to depreciation allowances and development Rebate with reference to such interest also.

As the expression "actual cost" has not been, it should be constructed in the sense which no commercial man would misunderstand. For this purpose, it would be necessary to ascertain the connotation of the expression in accordance with normal rules of accountancy prevailing in commerce and industry. The accepted accountancy rule for determining cost of fixed assets is to include all expenditure necessary to bring such assets in to existance and to put them in working condition. In case of money is borrowed by a newly started company which is in the process of constructing and errecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the Fixed Assets created as a result of such expenditure.

Decision of the Andhra Pradesh High Court in CIT V/s Challapalli Sugars Ltd. (1970) 77 ITR 392 reversed.

Decision of Calcutta High Court in CIT V/s Standard Vaccum Refining Co. of India Ltd.(1966) 61 ITR 799 affirmed on this point.

CIT V/s Balakrishnan and Brothers Pvt. Ltd. (1974) 95 ITR 284 (Mad) and CIT V/s J.K. Cotton Spinning and Weaving Mills Ltd.(1975) 98 ITR 153 (All) approved.

The appeal of Standard Vaccum Co. on the point of the allowability of wealth tax as a deduction under Section 10 of Indian Income-tax Act, 1922, was heard by a constitution

bench of the Supreme Court along with the appeals of Indian Alluminium Co. and Standard Vaccum Oil Co. The Supreme Court reserved judgement in the appeals of Indian Alluminium Co. and Standard Vaccum Co. But because an additional question relating to the inclusion of interest on borrowed moneys in the calculation of actual cost for the purposes of depreciation and development allowance arose in the appeal of the Standard Vacuum Refining Co after hearing arguments, the Supreme Court directed that the appeal of that Company be heard by a Division Bench after pronouncement of judgement in the appeals of the other two companies judgements in regard to these two companies were pronounced on March 29, 1972. The appeal of Standard Vacuum Refining Co. was heard sub-sequent to the passing of the Income-Tax (Amendment) Act 1972.

Held, that the effect of the decision given by the Supreme Court in other two cases was that the question whether wealth-tax paid by the assessee was permissible deduction no longer remained the subject of contraversy in in the appeal of Standard Vacuum Refining Co. Though the appeal of Standard Vacuum Refining Co. was not disposed of before July 15, 1972, that Company was entitled to the benefit of Section 5 of the Income-tax (amendment) Act,1972. The fact that the judgement in which the finding was recorded

was given in the appeals of the other two companies which were heard together with the appeal of the Standard Vacuum Refining Co. and the further fact that the Company's appeal was not disposed before July 15, 1972, did not take the case of that company out of the purview of Section 5.

Case - 5 : Depreciation Allowance

Guzdar Kojora Coal Mines Ltd.
V/s
Commissioner of Income-Tax, Calcutta.

Depreciation - Actual cost to assessee - purchase of assets - price mentioned or allocated in deed of conveyance- when can be rejected or allocated - Goodwill not expressly mentioned - price whether can be allocated to Goodwill - Indian Income Tax Act,1922 S. 10(2)(vi), (5).

The original cost to the assessee of a particular asset is a question of fact which has to be determined on the evidence or material placed before or available to the income-tax authorities. Any document or formal deed - mentioning the consideration or the cost paid for the purchase of an asset by the assessee would be a piece of evidence and prima facie the statements or figures given therein would show how much the cost of the asset to the assessee is. But, if circumstances exist showing that a fictitions price has been put on the asset or there is fraud or collusion between the vendar and the assessee and there has been inflation or deflation of value for ulterior purposes it is open to the income-tax authorities to refuse to accept the price mentioned or allocation given in the deed or alleged by the assessee and to ascertain what the actual cost was or to determine the allocation between depreciable and non depreciable assets.

Pindi Kashmir Transport Co. V/s Commissioner of Income-Tax (1954) 26 ITR 595 (Lab.Pak.) and

Kalooram Govindram V/s Commissioner of Income-Tax (1965) 57. ITR 335; 1965 3 SCR 641 (S.C.) followed.

It is, therefore, open to the Income-tax authorities to determine and to the assessee to show whether the goodwill of the business taken over by the assessee is or is not included in the consideration or the price paid for the assets. Even if it is not expressly mentioned that goodwill has been sold it can be shown and ascertained by evidence whether the same has been purchased or not by the assessee.

In the deed of conveyance executed in favour of the assessee by the liquidators of the Vendor Company the consideration of Rs.6 lakhs paid by it was allocated as follows : (a) Machinery, Plant, Stores and other movables, Rs.3,50,000/-. (b) Buildings and structures Rs. 1,50,000/-; and (c) other assets not capable of being passed by delivery of Rs.1,00,000/-. For the assessment years 1946-47 to 1951-52 depreciation was allowed to the assessee on the old written down values. For the years 1952-53 and 1953-54 the assessee claimed depreciation on the basis of the valuation in its balance-sheets and accounts. In his report called for by the appellate tribunal the income-tax officer found, inter alia, that (i) some of the directors and shareholders of the assessee and the vendor-company were the same and connected; (ii) the valuation of depreciable assets and consumable stores were written up whereas the valuation of

the non-depreciable assets were written down; (iii) though the vendor - company had been making good profits no provision had been made for the goodwill of the business. He allocated the consideration of Rs. 6 lakhs of follows : (a) good-will Rs. 2,56,960/-, (b) mines and development as per balance-sheet of the Vendor Company Rs. 2,48,323/-, (c) stores and stock Rs. 60,744/- and worked out the value of other depreciable assets at Rs.33,973/-. The Appellate Tribunal rejected the the assessee's claim holding, inter-alia, that the allocation in the deed of conveyance was arbitrary. On a reference of of the question whether the Income-tax Officer was competent to go beyond the conveyance and fix a valuation of the assets on his own, the High Court answered the question in the affirmative. On appeal to the Supreme Court.

Held, on the facts, that there was no error or infirmity that would justify interference by the Supreme-Court.

Case - 6 : (Dep.) Allowance

Pandit Laxmikanta Jha
V/s
Commissioner of Income-tax, Bihar & Orissa.

Depreciation - Balancing charge - Business carried on by assessee sold as going concern to company in consideration of Allotment of Allotment of fully paid up shares - Balancing charge whether laviable - legal character of transaction whether can be ignored - Income-Tax - General principles - substance against form of Transaction - Indian Income-Tax Act, 1922. Sec. 10(2)(vii) Prov.(ii).

It is now well-settled that in taxing a receipt to Income-tax the authorities are only concerned with the legal effect or character of the transaction and not with the substance of it.

The assessee sold his business of publication of two newspapers as a going concerned along with its assets and liabilities to a company formed by him in consideration of the allotment of fully paid up shares. Out of 25000 shares in the Company, all but 50 shares were held by the assessee and the remaining 50 were held by his nominees. The sale-deed, executed subsequent to the transfer of possession, recited the value of the movables including machinery and plant of the business. The Income-tax authorities sought to

treat the excess over the written down value up to the original cost of the plant and machinery as profit under the second proviso to Section 10(2)(vii) of the Income-tax Act 1922, and it was contended on behalf of the assessee that the Vendor and the purchaser being the same, the profits arising therefrom were not taxable.

Held, rejecting the contention, that the transaction which gave rise to the receipt sought to be brought to tax was of the nature of sale and that, therefore, the excess could be assessed under the second proviso to Section 10(2)(vii).

Commissioner of Income-Tax V/s B.M. Kharwar (1969) 72 ITR 603. (S.C.) applied.

Decision of Patna High Court in Maharàjadhiraj Sir Kameshwar Singh V/s Commissioner of Income-Tax (1963) ITR 483 affirmed.

Case - 7 : Netherlands Steam Navigation Co. Ltd.
V/s
Commissioner of Income-Tax, West Bengal.

Non-Resident - shipping - business within and outside India - Taxable profits not determined as a proportion of world income - By applying second method in rule 33 - Additional Depreciation for new ships brought into trade - whether available - Indian Income-tax Act, 1922 S.10(2)(vi a)- Indian Income-Tax Rules 1922, Rule 33.

The income of the applellant, a nonresident company engaged in the shipping business, was computed as the proportion of Indian Port Receipts to total port receipts of the profits earned in round voyages made by its ships which touched Indian ports. It did not furnish particulars of its world income and the second method of rule 33 of Indian Income-tax Rules, 1922, was not applied. It claimed additional Depreciation under Section 10(2)(vi a) of the Indian Income-Tax Act 1922, in relation to new ships introduced in its shipping business in the trade but bought to use in Indian Waters in the year subsequent to its introduction in the Trade.

Held, that the appellant was not entitled to additional depreciation. The appellant could not while accepting determination of the taxable profits in a manner not warranted by the second method under rule 33, claim that additional depreciation should be allowed.

Case - 8 : Commission

Shahzada Nand and Sons
V/s
Commissioner of Income-Tax, Patiala.

Business profits - Deductions - Commission - Reasonableness - Test - Commercial expediency - whether Extra Services to be rendered - Income-tax Act, 1961. Sec.36(1)(ii).

Section 36(1)(ii) of the income-tax act, 1961, does not postulate that there should be any extra services rendered by an employee before payment of commission to him can be justified as an allowable expenditure. If services were in fact rendered by the employee it is immaterial that the services rendered by the employee was in no way greater or more one than the services rendered by him in the earlier years. Of course, the circumstance that no additional services were rendered by the employee would undoubtedly be of some relevance in determining the reasonableness of the amount of commission but it would have to be considered alongwith other circumstances.

The three factors laiddown by the proviso to Section 36(1)(ii) are not really conditions on the fulfilment of which alone the amount of commission paid to an employee can be regarded as reasonable. They are merely factors to be taken into account by the revenue authorities in determining the reasonableness of the amount of commission. It may be that one of these factors yields a negative response. To take an example, there may be no general practice in similar

business or profession to give commission to an employee, but, yet, having regard to the other circumstances, the amount of commission paid to the employee may be regarded as reasonable. What the proviso required is merely that the reasonableness of the amount of commission shall be determined with reference to the three factors. But it is well settled that these factors are to be considered from the point of view of normal, prudent businessman. The reasonableness of the factors has to be judged not on any subjective standard of the assessing authority but from the point of view of commercial expendency. What is the requirement of commercial expendency must be judged, not in the light of the 10 Century laissez Faire doctorine which regarded man as an economic being concerned only to protect and advance his self interest, but in the context of current socio-economic thinking which places the general interest of the community above the personal interest of the individual and believes that a business or undertaking is the product of the combined efforts of the employer and employees and where there is sufficiently larger profit, after providing for the salary or remuneration of the employer and the employees and other prior charges such as interest on Capital, depreciation, reserves etc. a part of it should in all fairness go to the employees.

It is not necessary, for commission paid to an employee to be allowable under Section 36(1)(ii), that it should be paid under a contractual obligation.

It is now well-settled that the mere fact that the commission is paid ex-gratia would not necessarily mean that it is unreasonable.

Held, on the facts, that the commission paid to the two employees of the assessee was reasonable having regard to all the circumstances of the case and was allowable as a deductible expenditure under Section 36(1)(ii).

Case - 9 : Commission

J.K. Woollen Manufacturers
V/s
Commissioner of Income-Tax, U.P.

Business Expenditure - Manufacture and sale of Blankets and other woolen cloth - General Manager - Commission on profits - Dissallowance of part - whether permissiable - Indian Income-Tax Act, 1922 Sec. 10(2)(xv).

In applying the test of commercial expendiency for determining whether an expenditure was wholly and exclusively laid out for the purpose of the assessee's business, reasonableness of the expenditure has to be judged from the point of view of the businessmen and not of the income-tax department. It is, of course, open to the Appellate Tribunal to come to a conclusion either that the alleged payment is not real or that it is not incurred by the assessee in the character of a trader or it is not laid out wholly and exclusively for the purposes of the business of the assessee and to disallow it. It is not the function of the tribunal to determine the remuneration which in their view should be paid to an employee of the assessee.

The appellant, a firm which carried on business of manufacture and sale of blankets and other woollen cloth, had appointed V as its general manager at a salary of Rs.1,000/- per month and commission of $12\frac{1}{2}$ % on the net profits and certain other benefits. In case the profits exceeded Rs.1 lakh the commission was payable at 25 % . Vggot no commission in

the first year as the appellant suffered a loss. In the next year V earned a commission of Rs.4,063/-. In the year relevant to the assessment year 1948-49 V was paid a commission of Rs.75,465 (at 25 % of the profits). After death of V the firm was converted in to a Company and the post of General Manager abolished and a Director, with a total remuneration of Rs.24,000/- per annum, managed the affairs of the company. The income-tax officer allowed only a sum of Rs.5,000/- as reasonable commission and disallowed the balance of Rs.70,465/-. The Appellate Assistant Commissioner held that commission at $12\frac{1}{2}$ % was reasonable and increased the allowance to Rs. 37,733/-. The Appellate Tribunal disallowed Rs.37,733/-. Out of the commission of Rs.75,465/- on the view that the commission paid to V in excess of Rs.24,000/- was not really paid wholly for the purpose of carrying on business. The case of the appellant was (i) that the mill was old and unbalanced and it never worked satisfactorily in the past and the commission on profits clause was incerted in order to create special interest of V for accomplishment of the task entrusted to him; and (ii) that V introduced for the first time a new design of civilian rugs manufactured in its mills in the relevant year which resulted in large profits.

Held, the entire amount of Rs.75,465/- paid to V was an amount laid out wholly and exclusively for the purpose of the appellant's business.

T A B L E

Sr.No.	Particulars of Deduction	Section	Supreme Court Decision
1	Development Rebate	33	512 ITR 77 1970
2	,, ,,	33	120 ITR 49 1979
3	,, ,,	33	205 ITR 98 1975
4	Depriciation Allowance	32	167 ITR 98 1975
5	,, ,,	32	599 ITR 85 1972
6	,, ,,	32	790 ITR 75 1970
7	,, ,,	32	72 ITR 74 1969
8	Commission	36(ii)	612 ITR 72 1969
9	,,	36(i)(ii)	358 ITR 108 1977