

A **COMMISSIONER OF INCOME-TAX, CALCUTTA**

v.

M/S. MOON MILLS LTD.

October 26, 1965

B [K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

Income-tax Act (11 of 1922), s. 10(2) (vii), 4th proviso—Capital asset destroyed by fire—Right to receive insurance amount—If amount taxable.

C As a result of a fire breaking out and destroying its stock-in-trade, machinery and buildings, the assessee received Rs. 65 lakhs from the Insurance Company in full settlement of its claim. Though the Insurance Company finally accepted the claim on 13th December 1948, the amount was paid only on 27th March 1950. Out of that amount, a sum of Rs. 27 lakhs and odd represented the loss in respect of buildings and machinery, and it was not included in the return of assessee for the assessment year 1949-50. The Income-tax Officer, on the ground that the said amount became receivable by the assessee in December 1948, included it in the taxable income for the assessment year 1949-50. The **D** Appellate Assistant Commissioner allowed the assessee's appeal holding that the amount could only be assessed to tax under the 4th proviso to s. 10(2)(vii) of the Income tax Act, 1922, when the assessee actually received the amount. The Appellate Tribunal and the High Court on a reference, agreed with the Appellate Assistant Commissioner.

E In his appeal to this Court, the Commissioner contended that the assessee maintained its accounts on mercantile basis and therefore, its profits and gains should be computed in accordance with that method of accounting; and if so computed, the assessee acquired a right to receive the amount in December, 1948 with the result that it became a part of the taxable income of the assessee during the accounting year.

F HELD : As the compensation for the loss of machinery and buildings by fire was not actually received by the assessee during the accounting year the said amount could not be assessed during the assessment year. [401 H]

G The profit and loss of a business concern is ascertained on commercial principles. Section 13 of the Act imposes a duty on the Revenue to compute the profits of a business in accordance with the method of accounting adopted by an assessee under the said principles. But the concept of assessable income under the Act is different from profit and loss in a commercial sense. Though profit and loss ascertained under the system adopted by an assessee is the basis, the assessable income is arrived at by adopting some artificial rules incorporated in s. 10(2). Under the 4th proviso to s. 10(2)(vii), when insurance money is received in respect of any building, machinery or plant which has been destroyed, and it exceeds the difference between the written down value and the scrap value, so much of the excess as mentioned therein will be deemed to be the profits of the previous year in which such money is received. Though **H** in fact the said compensation represents a capital asset, because compensation received from an insurance company towards loss of a capital asset does not represent profit in a commercial sense, to the extent mentioned in the proviso, the compensation is deemed to be the profits of the previous year in which such money is received. The proviso therefore,

introduces a fiction that what is not a profit in the previous year is deemed to be a profit in that year. Since the fiction serves the purpose of section it cannot be enlarged by importing another fiction, namely that if an amount was receivable during the previous year it must be deemed to have been received during that year. Further, the definition of the expression "paid" in s. 10(5) incorporating the concepts of mercantile system of accountancy into it, is a clear indication that in the case of the other terms such as "received" etc., in s. 10(2), the Legislature intended to give those expressions their natural meanings. There is, therefore, no scope for holding that the expression "received" means "receivable". [398 E-H; 399 D-G; 401 E, F]

Case law referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 839 of 1964.

Appeal from the judgment and order dated January 16, 1962 of the Calcutta High Court in Income-tax Reference No. 63 of 1957.

S. V. Gupte, Solicitor-General, R. Ganapathy Iyer, R. H. Dhebar and R. N. Sachthey, for the appellant.

A. V. Viswanatha Sastri, S. Murthy and B. P. Maheshwari, for the respondent.

The Judgment of the Court was delivered by

Subba Rao, J. The Income-tax Appellate Tribunal, Calcutta Bench, referred the following question under s. 66(1) of the Indian Income-tax Act, 1922, hereinafter called the Act, for the decision of the High Court of Calcutta :

"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."

The facts leading up to the said reference may briefly be stated. Messrs. Moon Mills Ltd., the respondent herein, hereafter referred to as the Company, is a joint stock limited company and it owns a factory at Bombay. On August 6, 1948, a fire broke out in the factory premises of the assessee resulting in the destruction of the stock-in-trade, machinery and buildings. The assets of the Company were covered by several insurance policies, issued by the General Assurance Society Ltd. in respect of (i) general specification policies, (ii) specific stock policies, and (iii) consequential loss policies, for an aggregate sum of

- A** Rs. 1,48,92,390. The Company received Rs. 65 lakhs from the insurance company in full settlement of its claim under the said policies. The said amount was received by the Company only on March 27, 1950. Out of the said amount, the sum of Rs. 27,06,593 represented the loss in respect of the buildings and machinery—Rs. 4,24,205 in respect of the buildings and
- B** Rs. 22,82,388 in respect of the machinery. For the assessment year 1949-50, the Company did not include the said amount in its return as it was received by it only on March 27, 1950. The Income-tax Officer, on the ground that the said amount became receivable by the Company on December 13, 1948, included the
- C** same in the taxable income of the assessee-Company for the assessment year 1949-50. On appeal, the Appellate Assistant Commissioner came to the conclusion that the said amount could only be assessed to tax under the fourth proviso to cl. (vii) of sub-s. (2) of s. 10 of the Act when the Company actually received it. On appeal preferred by the Revenue against the said Order, the
- D** Income-tax Appellate Tribunal agreed with that view. Thereafter, the Appellate Tribunal referred the aforesaid question to the High Court for its decision and the said Court upheld the view of the Appellate Tribunal. The Revenue on a certificate issued by the High Court has preferred the present appeal.

- E** Learned Solicitor General, on behalf of the Revenue, contended that the Company maintained its accounts on mercantile basis and, therefore, the profits and gains of its business should, under s. 13 of the Act, be computed in accordance with the said method of accounting. If so computed, the argument proceeded, the claim
- F** made by the Company for the said compensation amount having been finally accepted by the Insurance Company in its meeting held on December 13, 1948, the Company acquired a right to receive the same on that date, with the result that it became a part of the taxable income of the Company during the accounting year.

- G** Mr. A. V. Viswanatha Sastri, learned counsel for the Company, contended that there was a real distinction between the computation of profits on the principles of commercial accounting and the working out of the statutory allowances under s. 10(2) of the Act : while under the former when an assessee maintained the accounts on mercantile basis, irrespective of receipt or realization, profits must be computed on the accrual basis, under the third proviso to s. 10(2) (vii) of the Act the compensation amount could be
- H** brought to tax only when it was actually received in terms of the said proviso.

The solution to these two conflicting contentions depends upon a clear appreciation of the scope of s. 13 and s. 10(2) (vii) of the Act. They read : A

Section 13. "Income, profits and gains shall be computed, for the purposes of sections 10 and 12, in accordance with the method of accounting regularly employed by the assessee." B

Section 10. (1) The tax shall be payable by an assessee under the head "Profits and gains of business, profession or vocation" in respect of the profit or gains of any business, profession or vocation carried on by him.

(2) Such profits or gains shall be computed after making the following allowances : C

Section 13 *ex facie* is only concerned with the computation of the profits of the business on the principles of accountancy adopted by the assessee. It deals with commercial profits and not with assessable income. Though the commercial profit is the basis for ascertaining the taxable income, the latter can be arrived at only after making the statutory allowances provided under s. 10(2) of the Act. In *Gresham Life Assurance Society v. Styles (Surveyor of Taxes)*⁽¹⁾, the expression "profits" has been succinctly defined. Halsbury, L. C., said therein that "the word 'profits', I think, is to be understood in its natural proper sense—in a sense which no commercial man would misunderstand". Lord Herschell observed : "When we speak of the profits and gains of a trader we mean that which he had made by his trading". This Court in *Calcutta Co. Ltd. v. Commissioner of Income-tax, West Bengal*⁽²⁾ said much to the same effect when it said that the expression "profits and gains" is to be understood in its commercial sense. This Court in *Kesav Mills Ltd. v. Commissioner of Income-tax, Bombay*⁽³⁾ explained how in a commercial sense the profits and loss are ascertained. Dealing with two main systems of accounting, it observed: D E F

"The mercantile system of accounting or what is otherwise known as the double entry system is opposed to the cash system of book keeping under which a record is kept of actual cash receipts and actual cash payments, entries being made only when money is actually collected or disbursed. That system brings into credit what is due, immediately it becomes legally due and before it is G H

(1) (1892) 3 T.C. 185, 188, 194.

(2) [1960] 1 S.C.R. 185.

(3) [1953] S.C.R. 950, 958.

- A actually received and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed. 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 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."
- B
- C

It is, therefore, clear that profits have to be ascertained within the meaning of s. 13 of the Act on the basis of the system maintained by an assessee, whether mercantile, cash or any other system.

- D In either system of accountancy, compensation paid by an insurance company in respect of loss of capital assets is not brought into account for ascertaining the profit and loss of the company. In Batliboi's book on *Advanced Accounting*, 21st Edn., at p. 1062, an illustration is given to explain how the necessary entries will have to be made in the accounts in respect of claims under insurance
- E arising from destruction of stock, fixtures, plant, building, etc., as also claims relating to loss resulting from fire. It will be seen from illustration 207 that while the item of compensation received for stock destroyed or damaged is carried to profit and loss account, the item relating to compensation received for loss by fire in respect of building and machinery is to be entered into building account
- F and plant and machinery account. It is stated therein, being the loss of fixed assets represented by buildings and plant and machinery destroyed by fire, it is transferred to a special account. This example indicates that in commercial accountancy, while the compensation for loss incurred in respect of stock is an item of profit and loss account, that incurred in respect of building and machinery is
- G outside it. It is so because what is destroyed is a capital asset.

Section 10(2) of the Act deals with statutory allowances as distinguished from deductions that will be made in commercial practice for ascertaining the profits of a business. The relevant part of cl. (vii) of s. 10(2) of the Act reads :

- H "in respect of any such building, machinery or plant which has been sold or discarded or demolished or destroyed, the amount by which the written down value

thereof exceeds the amount for which the building, machinery or plant, as the case may be, is actually sold or its scrap value :

A

Provided further that where any insurance, salvage or compensation moneys are 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 the amount, if any, by which the difference between the written down value and the scrap value exceeds the amount of such moneys :

B

C

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 allowable under this clause shall be the amount, 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 :

D

E

Under this clause where any building, machinery or plant is discarded, demolished or destroyed, an allowance is given in respect of the amount by which the written down value of the said building, machinery or plant exceeds the amount for which it is sold or its scrap value. But the 4th proviso introduces a fiction that in case any insurance, salvage or compensation money received in respect of the said property exceeds the difference between the written down value and the scrap value, so much of the excess as mentioned therein will be deemed to be the profits of the previous year in which such money is received. Though in fact the said compensation represents a capital asset, to the extent mentioned in the proviso the compensation is deemed to be the profits of the previous year in which such money is received. The proviso, therefore, introduces a fiction. What is not a profit in the previous year is deemed to be a profit in that year. The previous year is that year in which such moneys were received. The fiction is an indivisible one. It cannot be enlarged by importing another fiction, namely, that if an amount was receivable during the previous year it must be deemed to have been received during that year. In dealing with the

F

G

H

- A scope of the fiction in s. 10(2) (vii), proviso 2, this Court in *Commissioner of Income-tax, Madras v. Ajax Products Ltd.*⁽¹⁾ observed :

B “Though the surplus contemplated by the proviso is not in the technical sense of the term profits of the previous year, it is deemed to be the profits of the previous year.”

The same idea is developed thus :

C “The fiction in the second proviso is a limited one. The surplus is deemed to be the profits of the previous year. As we have pointed out earlier, it adequately serves the purpose of the section To sustain the argument of the revenue, it has to be enlarged in its scope. Many words have to be read into it which are not there. We cannot accept this argument.”

D So too, in the instant case the fiction serves the purpose, if the said compensation was deemed to be the profits of previous year or of the year in which it was received. This fiction cannot be enlarged by giving the expression “received” a technical meaning which it may bear in the mercantile system of accountancy.

E Further, the various clauses in s. 10(2) of the Act use different words for fixing the date of the realization of the income, such as, “paid”, “sold”, “received”, etc. While the Legislature gave an extended meaning to the expression “paid” in s. 10(5) of the Act, no definitions of the other expressions are given in the Act. Section 10(5) of the Act says that in sub-s. (2) “paid” 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”.

F If the concepts of mercantile system of accountancy were incorporated by implication in the various clauses of s. 10(2), the definition of “paid” in s. 10(5) would be redundant. We cannot attribute redundancy to the Legislature unless for compelling reasons. On the other hand, the definition of the expression “paid” is a clear indication that in the case of the other terms the Legislature intended to give those expressions their natural meanings.

G

H The distinction between the scope of commercial accountancy for the purpose of ascertaining the trading profits and that of the statutory allowances is brought out by this Court in *Commissioner of Income-tax, Bombay City v. Bipinchandra Maganlal & Co. Ltd.*⁽²⁾ Shah, J., speaking for the Court, made the following reservations :

(1) [1965] 1 S.C.R. 700.

(2) [1961] 2 S.C.R. 493.

"There is no definable relation between the assessable income and the profits of a business concern in a commercial sense. Computation of income for purposes of assessment of income-tax is based on a variety of artificial rules and takes into account several fictional receipts, deductions and allowances."

A

If the contention advanced on behalf of the Revenue is accepted, this distinction is effaced. The decision of the House of Lords in *Green (H.M. Inspector of Taxes) v. J. Gliksten & Son, Ltd.*⁽¹⁾, which is relied upon by the learned counsel for the Revenue, does not support his contention. There, the Company's timber, its stock-in-trade, was destroyed by fire. It received from the insurers a large sum of money as compensation towards the said loss. A part of the said amount was not entered in the profit and loss account but was shown as a reserve in the balance sheet. The House of Lords held that the whole sum recovered was a trading receipt to be taken into account in computing the profits assessable to income-tax under Case 1 of Schedule D and to Corporation Profits Tax. In the context of those facts, Lord Buckmaster observed :

B

C

D

"What has happened has been this, that the timber which the Appellants held has been converted into cash. It is quite true it has been converted into cash through the operation of the fire, which is no part of their trade, but loss due to it is protected through the usual trade insurance, and the timber has thus been realised. It is now represented by money, whereas formerly it was represented by wood. If this results in a gain, as it has done, it appears to me to be an ordinary gain—a gain which has taken place in the course of their trade...."

E

F

Viscount Dunedin puts the same idea in different words thus :

"The whole point is that the business of the Company is to buy timber and to sell timber, and when they sell timber they turn it into money. This particular timber was turned into money, not because it was sold, but because it was burned and they had an insurance policy over it. The whole question comes to be whether that is a turnover in the ordinary course of their business. I think it was....."

G

H

The result of this fire was that they got rid of so much timber and got the insurance money at that figure, and

(1) (1929) 14 T.C. 364, 384.

- A that seems to me precisely in the same position as if they got rid of it by giving it to a customer."

Lord Warrington of Clyffe stated much to the same effect, though he emphasized the commercial method. He said :

- B "... the normal commercial method of dealing with moneys recovered by a trader under a policy of insurance, in respect of stock destroyed by fire, was to include the actual amount received in the accounts as an ordinary trading receipt in the same way as the proceeds of an ordinary sale of stock."

- C These observations were made in the context of destruction by fire of stock-in-trade. The House of Lords unanimously held that the compensation received was only a trading receipt, for it represented the timber which was part of the stock-in-trade lost by fire. Far from helping the Revenue, this decision brings out with clarity the distinction between loss by fire of stock-in-trade and of a capital asset. The compensation received from an insurance company towards the loss of capital asset does not represent profit in a commercial sense : it was made a profit by fiction under the Act.

- D The legal position may be stated thus : The profit and loss of a business concern is ascertained on commercial principles. Section 13 of the Act, subject to the proviso, imposes a duty on the Revenue to compute the profits of a business in accordance with the method of accounting adopted by an assessee under the said principles. But the concept of assessable income under the Act is different from profit and loss in a commercial sense. Though profit and loss ascertained under the system adopted by an assessee is the basis, the assessable income is arrived at by adopting rules, some artificial, incorporated in s. 10(2) of the Act. *Prima facie*, the allowances, deductions and deemed profits shall be ascertained in terms of the statutory provisions, unless the statute itself accepts the principles of commercial accountancy in a particular case.

- E In the present case, the compensation to the extent mentioned in the proviso received only in the accounting year was by fiction treated as profit. There is, therefore, no scope for holding that the expression "received" means "receivable".

- G For the aforesaid reasons, we hold that, as the compensation for the loss of machinery and buildings by fire was not actually received by the Company during the accounting year, the said amount could not be assessed during the assessment year.

- H In the result, the appeal fails and is dismissed with costs.

Appeal dismissed.