

**REFERENCE BY THE BOARD OF
REVENUE.**

Before Woodroffe, Greaves and B. B. Ghose J.J.

BENGAL NAGPUR RAILWAY COMPANY, LTD.

1922

v.

Feb. 7.

THE SECRETARY OF STATE FOR INDIA.*

Income Tax—Income Tax Act (VII of 1918) s. 9 (2) (iii)—Capital supplied by the owner to the Managing Company of a concern—Surplus profits—Extent of liability of the Company to pay income tax.

Where the Secretary of State as owner had the Bengal Nagpur Railway constructed and managed by a Company :—

Held, that the liability to pay tax must be determined with reference to the special agreement between the two parties and the nature of their relation to one another ; that the Company was liable only in respect of its share of the surplus profit received in return for its service in the management of the railway.

The Collector of Income Tax, Calcutta, having assessed the Bengal Nagpur Railway Company on an income of Rs. 1,72,60,595, the Company objected to it on the ground that out of it a sum of Rs. 1,57,98,766 represented interest paid on borrowed capital and as such should have been deducted under s. 9 (2) (iii) of the Indian Income Tax Act (VII of 1918). It was conceded however that a sum of Rs. 37,31,945 payable on account of interest on debentures, stock etc. should be deducted but it was contended that interest paid to the Secretary of State on the amount of his open line capital as also payment to him of the amount of guaranteed interest did not constitute interest on borrowed capital and was therefore taxable income.

* Reference by the Board of Revenue under section 51 (1) of the Income Tax Act (VII of 1918).

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The Company applied to the Board of Revenue under s. 51 (1) of the Income Tax Act to refer the matter to the High Court for its decision.

Mr. Langford James, for the applicant. The Company is a mere manager and should be taxed for what it gets as a servant, it is liable only for the commission it gets. The expression "business carried on by him" in section 9 means business carried on by the owner, no matter how he carries out the business, whether by agent or any other person. ~~The question~~ is who owns the Bengal Nagpur Railway. The assets belong to the Secretary of State, he takes out all the money and gives to people what has got to be paid.

Mr. B. L. Mitter, for the opposite party. The Bengal Nagpur Railway Company is an assessee; it is carrying on business and so is liable to pay taxes. The question is what is its profits. Its income does not arise out of borrowed capital; ~~neither the share~~ holders nor the Company can be regarded as creditor, there is no borrower and so there is no "borrowed capital."

Mr. Langford James, in reply.

Cur. adv. vult.

WOODROFFE J. This is a reference under section 51 (1) of the Indian Income Tax Act (VII of 1918). The Bengal Nagpur Railway Company have been called upon to pay tax on Rs. 1,72,60,585 income. This represents earnings of the Railway allocated for payment of the Company's share of surplus profits under the terms of agreement with the Secretary of State, namely, Rs. 14,63,387 and Rs. 1,57,98,766 allocated in payment of :—(A) A sum of Rs. 1,07,59,381 being the interest debitable to the undertaking of the Secretary of State's open-line capital. This sum is the interest

due to the Secretary of State on 15½ million pounds capital found by him.

(B) A sum of Rs. 13,07,440 being the payment to the Secretary of State in rupee currency of the amount of the guaranteed interest payable by him on the share of the capital of the Company. This interest is paid on 3 million pounds share capital found by the Bengal Nagpur Railway Company and made over to the Secretary of State to be held by the latter absolutely as his property and repayable only in the event mentioned in section 94 of the agreement between the Secretary of State and the Bengal Nagpur Railway Company.

(C) A sum of Rs. 37,31,945 payable on account of interest on borrowed capital raised by issue of debenture stock and debentures. No claim to tax is made by the Government in respect of this sum which item, therefore, need not be further considered.

The Board has held that tax is payable on sums (A) and (B). Apparently it has treated this matter as if it were the case of a Company owning in the ordinary way a railway as a private venture and has therefore held it to be liable to tax on all earnings save such sums as may be deducted under section 9 (2) (iii) of the Income Tax Act. In this view only sum (C) could be deducted as representing interest on borrowed capital but not sums (A) and (B) which represent capital contributed by the Secretary of State and the Company respectively and not interest on borrowed capital. But I think the matter cannot be so dealt with, but the liability to tax must be determined with reference to the special agreement between the two parties and the nature of their relation to one another. From this point of view it is conceded that the Secretary of State is the owner of the Bengal Nagpur Railway which has been constructed and is now managed for him by the Company.

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This is their business, on the income of which tax is leviable. In my opinion the principle applicable is that the Company should pay tax on what they get. The question then is—what is that sum? It is conceded by Government that sum (C) is to be excluded. It is conceded by the Company that they are taxable in respect of the sum of Rs. 14,63,387 representing their share of surplus profits which they get in return for their service in the management of the railway. The question then is—are they liable in respect of any further sum, which means do they get anything else? In my opinion, they are not liable in respect of sum (A). This is interest due to the Secretary of State on 15½ million capital found by him. It is true that this capital has been the means whereby profits have been earned in which the Company share. But this is not the Company's property. It, as also three million pounds supplied by the Company are the property of the Secretary of State, and all receipts earned by the use of these two sums are paid to Government Account. Thereout the Government supply what sums are necessary to defray expenditure under the contract. Out of such receipts the Government repays itself the interest on the capital sum supplied by it. And this interest is deducted before the profits in which the Company are entitled to share can be ascertained. It is this share of surplus profits which is income earned by the Company and so liable to tax. Sum (B) represents interest which the Company get for their three million capital money and which has to be deducted before surplus profits can be ascertained. This is deducted in order that the Secretary of State may meet his obligations to the Company in respect of the three million pounds they have made over to him. It is stated that that money was borrowed in England and the liability is to pay interest in England. It is stated

in the case of the Company that the sum of Rs. 13,07,440 is payment to the Secretary of State in rupee currency of the amount of the guaranteed interest payable by him on the share capital of the Company. The guaranteed interest on the Company's share capital is payable and paid in London as in the case of a debenture obligation by the Secretary of State and is independent of the earnings of the Railway. The payment, it is contended, of the sum of Rs. 13,07,440 constitutes the payment of a debt due from the Company to the Secretary of State. In effect the transaction is one in which the Secretary of State pays in London certain monies to the Company which he recoups himself in this country out of the earnings of the Railway. In that view of the case I am of opinion that the Company is not liable for tax in respect of this sum.

I answer then the reference by saying that, in my opinion, the Company is liable only to tax on the sum stated in the reference as being their share of surplus profits.

A copy of this judgment is directed to be given to the Revenue Authority.

GREAVES J. I agree.

B. B. GHOSE J. I agree.

Attorneys for the applicant : *Orr, Dignam & Co.*

Attorney for the opposite party : *G. C. Gooding*
offg. Solicitor to the Govt. of Bengal.

A. S. M. A.

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