INCOME-TAX REFERENCE.

Before Sir Owen Beasley, Chief Justice,
Mr. Justice Varadachariar and Mr. Justice King.

THE COMMISSIONER OF INCOME-TAX, MADRAS, PETITIONER,

1937, April 29.

v.

DEWAN BAHADUR S. L. MATHIAS, RESPONDENT.*

Indian Income-tax Act (XI of 1922), sec. 4 (2), proviso 2—Coffee estates in Native State owned by assessee, a resident of British India—Income from produce of—Exemption under sec. 4 (2), proviso 2, in respect of—Assessee's right to—Extent of—Coffee cleaned and sold in British India and sale proceeds received and retained in British India.

The assessee who owned coffee plantations in the Mysore State was a resident of British India (Mangalore). While he maintained an office in the Mysore territory to supervise the cultivation work there, the labour required for the cultivation was recruited in Mangalore, materials required for the estates, like manure, tools, spray materials, crop-bags, etc., were purchased at Mangalore, the harvested crops were brought to Mangalore in their raw state to be dried and cleaned there in the factories of a company, the selling agents of the assessee, and sold there by that company. The sale proceeds were received and retained at Mangalore and a separate staff was maintained by the assessee at Mangalore to attend to the above operations. The point for determination was whether, in respect of the income derived by the assessee from the produce of his coffee estates in Mysore, he could claim exemption under the second proviso to section 4 (2) of the Indian Income-tax Act of 1922 and, if so, to what extent.

Held that the assessee was entitled to claim the benefit of the second proviso to section 4 (2) of the Act and that the whole income derived by the assessee by the sale in Mangalore of the produce of his coffee estates in Mysore was exempt from taxation.

* Original Petition No. 181 of 1936.

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In the matter of the Indian Income-tax Act, XI of 1922.

T. R. Venkatarama Sastri for *M. Subbaraya Ayyar* for assessee.

M. Patanjali Sastri for Commissioner of Income-tax.

The facts necessary for the case and the arguments of Counsel appear from the judgment.

Cur. adv. vult.

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The JUDGMENT of the Court was delivered by VARADACHARIAR J.—The question referred to this Court for decision is whether, on the facts set out in the Commissioner's statement, any part of the income derived by the assessee from the produce of his coffee estates in Mysore is exempt from taxation under the second proviso to clause 2 of section 4 of the Indian Income-tax Act.

The assessee who owns coffee plantations in the Mysore State is a resident of British India (Mangalore); and the case states that, while he maintains an office in the Mysore territory to supervise the cultivation work there, the labour required for the cultivation is recruited in Mangalore, materials required for the estate, like manure, tools, spray materials, crop-bags, etc., are purchased at Mangalore, the harvested crops are brought to Mangalore in their raw state to be dried and cleaned there in the factories of Pierce Leslie & Co., and sold there by Pierce Leslie & Co., the selling agents of the assessee. As the sale proceeds are received and retained at Mangalore and a separate staff is maintained by the assessee at Mangalore to attend to the above operations, the Commissioner was of opinion that the assessee

was liable to be taxed as one carrying on "business" and receiving the income or profits thereof in Mangalore.

As both section 4 and section 6 of the Indian Income-tax Act are qualified by the opening words "save as hereinafter (otherwise) provided", the point for determination is whether the assessee can claim exemption under the second proviso to section 4 (2) and if so, to what extent. The Commissioner has expressed the opinion that proviso 2 to section 4 (2) has no application here, because the profits of the business are received in Mangalore and "the agricultural processes carried on in Mysore" are not in themselves a source of income but merely "an element in the business which produces the income". In support of this view, he has relied on the decisions in *Ponnuswami Pillai* v. *Commissioner of Income-tax, Madras*(1) and *F. L. Smidth & Co.* v. *F. Greenwood*(2) but it must be observed that even in *Ponnuswami Pillai* v. *Commissioner of Income-tax, Madras*(1) the proviso now to be interpreted did not come up and could not have come up for consideration and there can be little doubt that but for that proviso, the assessee in the present case will be liable to be assessed in respect of the profits to the extent determined by the authorities. After this reference had been made, the scope and effect of the proviso was considered by a Division Bench of the Calcutta High Court in *In the Matter of Mohanpur Tea Company, Ltd.*(3) and the judgment is a direct authority in favour of the Commissioner's view. We have

(1) (1929) 3 I.T.C. 378. (2) (1921) 8 T.C. 193, 204.
(3) I.L.R. [1937] 2 Cal. 201.

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carefully considered the reasoning in that judgment but, with all respect to the learned Judges, we are unable to follow that decision.

The basis of the Calcutta decision and of the Commissioner's opinion is that when a person who owns lands outside British India sells the produce of those lands in British India, no income, profits, or gains can be said to arise or accrue *until the produce is sold* and that in such cases there is accordingly no room for the application of the proviso which only relates to "income . . . . arising or accruing" in an Indian State. The learned Judges emphasise the distinction between the *place* where the income accrues and the *source* from which it accrues and point out that the proviso is not concerned with the source. As a corollary, they think that if the sale also had taken place outside British India, the income thus realised, even if subsequently received in British India, would be exempt as income from agriculture that had arisen or accrued in the State, within the meaning of the proviso. Whatever may be said as to "profits" or "gains", the view that "*income* from agriculture" can be said to arise or accrue only when and where the produce is sold and converted into money seems to us, with all respect, difficult to reconcile with the reasoning in *Commissioners of Taxation* v. *Kirk*(1).

Reliance was placed before us in this connection on the observation of the Judicial Committee in *Commissioner of Income-tax, Bengal* v. *Shaw, Wallace and Company*(2) that the term "income" in the Indian Income-tax Act connotes a "periodical monetary return" coming in with some sort

(1) [1900] A.C. 588. (2) (1932) L.R. 59 I.A. 206 ; I.L.R. 59 Cal. 1343.

of regularity or expected regularity from definite sources ; but their Lordships were then laying emphasis not on the distinction between receipt in money and receipt in kind but between *recurring* receipts from a business continuously carried on and an occasional receipt of the kind then in question. On the other hand, they refer in the course of their judgment to income being likened to the "crop of a field". In *Commissioner of Income-tax, Bihar and Orissa* v. *Maharajadhiraj of Darbhanga*(1) the Privy Council affirm that "a receipt in kind may be taxable income" ; they only add that what is received in kind should be money's worth. It was admitted before us by Mr. Patanjali Sastri that in respect of the produce of land in British India, the Indian Income-tax Act recognises the receipt of income or rent *in kind* as receipt or accrual of income ; it is difficult to see why, as a matter of language, the expressions "receipt" or "accrual" of income should not have the same significance when used in connection with the receipt of produce from lands outside British India.

In *Kirk's* case(2), the question arose as to the assessment to be levied in New South Wales on a company which extracted ore from mines owned by it in New South Wales and converted it into a merchantable product there but carried the product to Victoria for sale, the sale proceeds being received either in London or in Melbourne. The Judicial Committee overruled the view taken by the New South Wales Court that "the income was not earned in New South Wales because the finished products were sold exclusively outside

(1) (1933) I.L.R. 12 Pat. 318, 336 (P.C.). (2) [1900] A.C. 588.

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that Colony". Referring to the several steps which had to be gone through, from the extraction of the ore to the receipt of moneys on the sale of the merchantable product, their Lordships held that to the extent of two of the steps, viz., extraction of the ore from the soil and conversion thereof into a merchantable product, "the income was earned and arising and accruing in New South Wales". In the Calcutta case, the learned Judges distinguish this decision as turning on the language of the particular statute and take it as only relating to the *source* from which the income accrued and not to the place where it accrued. With all respect, it seems to us that this way of distinguishing *Kirk's* case(1) fails to take note of certain portions of the argument as well as of the judgment. In the New South Wales Act, there was an exemption [section 27 (3)] to the effect that no tax shall be payable in respect of income earned *outside* the Colony of New South Wales. On the strength of this provision, it was contended before their Lordships, on behalf of the assessee, that "the income was derived from the sales, that is from the business carried on outside the Colony". This argument they repel with the remark that it is fallacious as "leaving out of sight the initial stages and fastening attention exclusively on the final stage in the production of the income". These relevant parts of that judgment do not seem to us to turn on any peculiarity of the New South Wales Act but to recognise that as a matter both of language and of business, receipt of produce *in kind* may well be spoken of

(1) [1900] A.C. 588.

as receipt or accrual of income at the place where the produce is received.

Mr. Patanjali Sastri had to concede that on the principle of the decision in *Commissioners of Taxation* v. *Kirk*(1), the assessee in this case might well be held by the Mysore State to have received the income within that State, but he contended that the remedy for any hardship arising from that possibility must be had by invoking the provisions of the Act relating to double taxation. We are not concerned here with any question of double taxation or hardship caused thereby ; but we refer to this aspect of the matter only to point out that if for assessment in Mysore, the assessee can in the ordinary sense of the words (and not by any fiction of law) be held to have received the income in Mysore, there is no reason why for purposes of the second proviso to section 4(2) the income should not in this case be held to have arisen or accrued in Mysore. The decision in *In re Port Said Salt Association, Ltd.*(2) does not materially help the Referring Officer in this connection. The learned Judges recognised in that case that *part* of the profits might have been "earned" elsewhere, but they held that if the whole is "received" in British India, no portion could escape taxation unless there be a convention to limit the claim of one State against the nationals of others. The second proviso is in a sense the result of such a convention ; the case cannot throw light on the interpretation of the scope of that convention.

Reliance was also placed by Mr. Patanjali Sastri on the observation in *Jiwan Das* v. *Income-tax*

(1) [1900] A.C. 588. (2) (1932) I.L.R. 59 Cal. 1226.

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Commissioner, Lahore(1) to the effect that the place where the sale is effected and the price realised is the principal place, if not *the* place, of the accrual of profits. That statement must be understood in the light of the fact that the case then under consideration related to the liability of a British Indian assessee who only *purchased* goods in British India but sold them outside and never received or brought the proceeds into British India. Following *Sulley* v. *Attorney-General*(2), the learned Judges held that the mere purchase of goods will not amount to the carrying on of trade (except in the cases provided for in section 42) and in the circumstances there was nothing like receipt of income or gains or profits in British India. There was no question in that case of the receipt of produce from one's own estate ; but the way the learned Judges deal with *Kirk's* case(3) shows that if the facts before them had been similar to those in *Kirk's* case(3) or to those in the present, they would have held that the receipt of the produce would amount to receipt of income.

Accepting our interpretation of the decision in *Kirk's* case(3), Mr. Patanjali Sastri advanced an alternative argument. Assuming that the income might be held to have "accrued" or "arisen" to the assessee in Mysore, he maintained that it might nevertheless be held to have been "received" by the assessee in British India not merely within the meaning of clause 2 of section 4 but even within the meaning of the first part of clause 1. The purpose of this argument was in any event to exclude the operation of the second

(1) (1929) I.L.R. 10 Lah. 657 (F.B.). (2) (1860) 2 T.C. 149.
(3) [1900] A.C. 588.

proviso which is worded as a proviso only to sub-section 2 and not to sub-section 1. The first clause deals with two kinds of receipt in British India: one, receipt in the ordinary sense of that word and the other, in an artificial or extended sense and the second clause defines the artificial or extended meaning. If the second proviso qualifies only this "artificial" sense of receipt, it would have no operation in cases where the receipt of income in British India can be held to amount to "receipt" in its natural or ordinary sense. In support of the contention that income may "accrue" or "arise" in one place and yet be held to have been "received" in another place, he relied on the decision of the Judicial Committee in *Pondicherry Railway Company* v. *Commissioner of Income-tax, Madras*(1).

We may observe at the outset that in the *Pondicherry Railway Company's* case(1), their Lordships were not called upon to decide whether the "receipt" of income by the Company was a receipt in the grammatical sense or in the extended or artificial sense, because the Company's contention was that there was no receipt at all, by or on their behalf, in British India and that they received the income only in London. If that decision gives us any guidance at all in the present case, it may well be held that on the facts here, the receipt of the produce in Mysore itself by the assessee's men on the spot will correspond to the receipt by Mr. Rothera in the *Pondicherry Railway Company's* case(1) and the assessee's receipt of the income in British India can only be a receipt in the secondary stage, just like the receipt

(1) (1931) I.L.R. 54 Mad. 691 (P.C.).

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by any Nattukkottai Chetti here of profits earned by a business carried on on his behalf in foreign countries. Even apart from this view of the facts, it does not seem to us necessary or reasonable to read clauses 1 and 2 of section 4 as mutually *exclusive*. The first clause comprises "receipts" falling under the second clause as well and when the facts of a case clearly bring it within the terms of the second proviso, it is obviously a case which on grounds of policy the Legislature intended to exempt and it does not seem to us right to deprive the subject of this exemption by holding that the "receipt" in British India is in the primary sense and not in the secondary sense especially when the second clause as well as the second proviso speak only of "accruing" or "arising" outside British India and not also of being "received" outside British India. There can be no doubt that in this case the income "accrued or arose" outside British India and was "received or brought into British India". We would give the same answer to the argument founded on clause 3 of section 42 which provides for the taxability in British India of profits or gains from the sale in British India of merchandise exported to British India from outside. Reading the clause as a whole, it is evident that it refers to a person who sells goods *purchased* by him and not to one who sells the produce of his own lands. It is significant that the clause deals only with "profits" or "gains" and not with *income* generally.

The circumstances in which the second proviso came to be inserted do not suggest any intention to make the kind of differentiation now insisted

on by the Referring Officer. Prior to 1933, it was only "profits or gains of business" outside British India that were taxed when brought into British India. The amending Bill of 1932 sought to make *all income* (not merely profits from business) accrued outside British India taxable if and when brought into British India; the Bill therefore sought to amend only clause (2) of section 4. The kind of income exempted by the second proviso is undoubtedly *foreign* income and when the Legislature resolved to exempt foreign income of the particular kind dealt with in that proviso, it seems to have been thought sufficient to enact the exemption as a proviso to the second clause which was then being amended for the very purpose of including "foreign income" generally. We are accordingly of opinion that the assessee in this case is entitled to claim the benefit of the second proviso to section 4 (2).

It remains to determine the *extent* of the exemption which the assessee can claim. It was contended on his behalf that the *whole* of the price realised by him by the sale of the Mysore coffee in Mangalore should be excluded, but it was maintained on behalf of the Referring Officer that the assessee is at best only entitled to a deduction of the value of the coffee beans in a raw state in Mysore. The statement of the Commissioner and an affidavit of Mr. Kirkbride, Manager of Pierce Leslie & Co., set out in detail what happens to the beans between the time when they are picked and the time they are actually sold. If the processes subsequent to the picking can be regarded as in the nature of *manufacture*, the assessee will, on the analogy of the rule applicable

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to tea [see *Killing Valley Tea Company, Ltd.* v. *Secretary of State for India*(1) and Rule 24 of the Rules framed under section 59 of the Act], be entitled to deduct only the agricultural part of the income. But the affidavit states that in the case of coffee, the process is not in the nature of a "manufacturing" process but only a process "ordinarily employed by the cultivator to render the produce fit to be taken to the market" [see section 2 (1) (*b*) (ii)]. The learned Counsel appearing for the assessee definitely asserted that in respect of coffee grown on assessed lands in British India, this is the view adopted in practice by the Income-tax authorities and we have been shown nothing to the contrary. We have accordingly come to the conclusion that if the assessee can claim to be treated as on the same footing with one selling coffee grown on one's own land in British India, he is entitled to exemption in respect of the *whole* price realised by the sale of his coffee. This leads us to the consideration of the question whether the exemption under the second proviso to section 4 (2) is of the same scope as the exemption applicable to "agricultural income" as defined in section 2 (1) of the Act.

Mr. Patanjali Sastri is certainly right in his contention that the statutory definition of "agricultural income" does not in terms apply to cases falling within the proviso now in question. If the definition in the Act is one which is intended to include what will not otherwise be ordinarily comprehended in the meaning of the expression "agricultural income", the assessee in the present case cannot claim the benefit of the full scope of

(1) (1920) I.L.R. 48 Cal. 161.

the definition because it applies only to income derived from lands in British India. But we are inclined to agree with the learned Counsel for the assessee that the statutory definition involves no artificial extension but merely embodies the significance attaching in a business sense to the word "income" when applied to agriculture. As pointed out by ROWLATT J. in *Back* v. *Daniels*(1), if a farmer is entitled to sell his produce in the village he is equally entitled to take it to a market town and it cannot be said that he is "commencing a new business from the time when he took his crops from the farm on the way to market". The same principle must apply to what he may do to make it fit for the market unless it involves such a distinct process as to justify its being regarded as in the nature of a manufacturing process. In the Court of Appeal, SCRUTTON L.J. took the view that even if cultivation of land to grow produce for the purpose of sale is to be regarded as a trade, the State, by its separate system of taxing land, may reasonably be taken not to have intended to deal with it as a trade; *Back* v. *Daniels*(2). Mr. Patanjali Sastri pointed out that our conclusion would practically amount to reading the proviso in section 4 into the definition of "agricultural income" when the Legislature had not (as it might well have done) included in that definition income from assessed lands in Indian States. Having regard to the manner in which amendments have been from time to time inserted in the Act, the argument founded on the particular place where an amendment is inserted cannot have the same force here

(1) [1924] 2 K.B. 432. (2) [1925] 1 K.B. 526, 543.

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as in the case of a provision which formed part of the original scheme of the Act. As we have already explained, section 4 (2) might well have been thought to be the proper place for the insertion of the proviso. On the other hand, we have not been shown any reason why the proviso was inserted at all and why it should have been limited to lands paying assessment to an Indian State if it was not the intention to treat the owners of such lands as on the same footing as owners of assessed lands in British India. The policy clearly was to avoid double taxation ; not double taxation in the sense of payment of income-tax in two places but of taxing a person who in respect of the same subject-matter has already paid a reasonably heavy land-tax, whether in British India or in an Indian State.

Our answer to the question referred is that the whole income derived by the assessee by the sale in Mangalore of the produce of his coffee estates in Mysore is exempt from taxation. The assessee will be entitled to Rs. 250 for his costs and also to refund of the deposit of Rs. 100.

A.S.V.