that the first defendant is conducting his defence in a manner adverse to his interest or is otherwise not properly conducting the defence, liberty is reserved to Rajarama Sastri to move the Court for directions to enable him to contest the plaintiff's claim without reference to the first defendant.

Solicitor for first respondent: *N. T. Shamanna.*

G.R.

INCOME-TAX REFERENCE.

Before Sir Lionel Leach, Chief Justice, Mr. Justice Madhavan Nair and Mr. Justice Varadachariar.

COMMISSIONER OF INCOME-TAX, MADRAS, PETITIONER,

v.

P. R. A. L. M. MUTHUKARUPPAN CHETTIAR, RESPONDENT.*

1938, November 14.

Indian Income-tax Act (XI of 1922), sec. 26 (2)—"Assessment" in—Meaning of—Process of determining amount of profit or loss on which tax is to be levied, if included in—Foreign business—Applicability of sec. 26 (2) to.

The word "assessment" is used in two senses in the Indian Income-tax Act of 1922—the process of determining the amount of profit or loss and the process of levying tax—but, if there is nothing repugnant in the context, the word refers to the process of determining the amount of profit or loss. As under sub-section 2 of section 26 of the Act the assessment is to be made on the person succeeding as if he had been carrying on the business throughout the year of account and as if he had made the whole of the profits for that year, the sub-section must be held to include the process of computing the amount on which tax is to be paid. The sub-section not

* Original Petition No. 254 of 1937.

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only fixes the liability for payment of the tax but governs the computation of the tax.

S. V. Karuppaswami Mooppanar v. *The Commissioner of Income-tax, Madras*(1) followed.

Quaere whether section 26 (2) applies to a foreign business of a person who is chargeable to income-tax in British India.

Arunachalam Chettiar v. *Commissioner of Income-tax, Madras*(2) considered.

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

P. R. Srinivasan for assessee.—The question is as to the effect of the application of section 26 (2) of the Indian Income-tax Act of 1922 in the present case. The succession is for income-tax purposes antedated to the commencement of the year of account.

[THE CHIEF JUSTICE.—The real purpose of antedating is to enable the Crown to recover the tax from the successor.]

What is sought to be done under this section is to treat the successor as being subject to the burdens and as entitled to the rights of the person to whom there is a succession. *S. V. Karuppaswami Mooppanar* v. *The Commissioner of Income-tax, Madras*(1) is a direct decision on this point.

[THE CHIEF JUSTICE.—What is the effect of the antedating?]

The successor becomes the sole owner of the business as from the commencement of the year of account. The contention of the Crown is that the succession is deemed to have occurred at the date of the commencement of the account year only for the purpose of finding out the person on whom the assessment is to be made. This contention is not in accordance with the wide language of the section. Further, the Act is concerned with a full year and therefore the assessment is to be antedated and, if it is to be antedated, the antedating must be for all purposes.

M. Patanjali Sastri for Commissioner of Income-tax.—The fiction of treating the succession as having taken place at the commencement of the year of account is applicable only for the purpose of reaching the person liable to pay the tax and is inapplicable for the purpose of computing the income liable to be taxed. For that purpose the succession is

(1) (1934) 7 I.T.C. 283. (2) (1929) 3 I.T.C. 441.

ignored and the previous owner is regarded as having continued to be owner throughout the whole of the year of account. The predecessor's capital cannot by reason of the succession become the successor's capital.

[VARADACHARIAR J. referred to the judgment of the Chief Justice in *S. V. Karuppaswami Mooppanar* v. *The Commissioner of Income-tax, Madras*(1).]

[THE CHIEF JUSTICE.—The Judges in that case say in plain and unmistakable words that the successor becomes the owner for all purposes.]

But the decision in the case was that for the purpose of computing the income the fiction of antedating is not applicable. [*S. V. Karuppaswami Mooppanar* v. *The Commissioner of Income-tax, Madras*(1) was then explained.] *Ram Rakha Mal and Sons, Limited* v. *Commissioner, Income-tax, Punjab*(2) is an exact decision on the point and is in favour of the contention of the Crown. The successor's ownership is material as regards (i) the person liable for the tax and (ii) the rate at which the tax is leviable. Apart from these two purposes the fiction of antedating succession is inapplicable. What are profits must be determined on the footing of the predecessor's ownership. [Reference was made to page 342, Question No. 6, in *Ram Rakha Mal and Sons, Limited* v. *Commissioner, Income-tax, Punjab*(2).] *S. V. Karuppaswami Mooppanar* v. *The Commissioner of Income-tax, Madras*(1) takes up precisely the same position though there are one or two loose sentences in the judgment. The assessee wanted to introduce the fiction into the computation of the profits but the Full Bench in that case refused to do so.

[VARADACHARIAR J.—Suppose in section 26 (2) you omit the words "as if . . ." would not the idea you are now contending for have been made clear if the only purpose of the fiction is to ascertain the person liable for the tax ?]

But for the qualifying words the successor could not be got at at all. The assessment complained against in the present case is not under section 26 (2). Even with regard to the assessee's foreign profits he is not sought to be assessed as successor under section 26 (2). It is the assessee that is trying to use that section to lend a different colour to the

(1) (1934) 7 I.T.C. 283. (2) (1936) I.L.R. 18 Lah. 325.

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foreign remittance. [Reference was made to *Arunachalam Chettiar* v. *Commissioner of Income-tax, Madras*(1).]

[THE CHIEF JUSTICE.—We cannot treat this decision as *obiter*.]

The fiction under section 26 (2) cannot be introduced for the purpose of computing profits; *Commissioner of Income-tax, Bombay* v. *The Mazagaon Dock, Ltd.*(2). The profits must be calculated on the actual basis without introducing the fiction under that section.

P. R. Srinivasan in reply.—[*Commissioner of Income-tax, Bombay* v. *The Mazagaon Dock, Ltd.*(2), *S. V. Karuppaswami Mooppanar* v. *The Commissioner of Income-tax, Madras*(3) and *Arunachalam Chettiar* v. *Commissioner of Income-tax, Madras*(1) were explained and page 159, paragraph 10 of the last section, of the latest edition of the Income-tax Manual was referred to.]

Assessment means only computation of income. [*Commissioner of Income-tax, Bombay* v. *Khemchand Ramdas*(4) was referred to as to the meaning of assessment.] *Bhogilal Hargovandas Patel* v. *The Commissioner of Income-tax, Bombay*(5) is not quite consistent with *Commissioner of Income-tax, Bombay* v. *The Mazagaon Dock, Ltd.*(2) cited by the other side. The predecessor's loss is by reason of the fiction treated as the successor's loss.

[THE CHIEF JUSTICE.—The fiction is applied for purposes of computation of profits as well as for purposes of reaching the person liable for the tax.]

The decision in *Ram Rakha Mal and Sons, Limited* v. *Commissioner, Income-tax, Punjab*(6) is only concerned with the meaning of the expression "original cost" and is based solely on the decision of the Privy Council in *Commissioner of Income-tax, Madras* v. *The Buckingham and Carnatic Co., Ltd.*(7). The decision does not consider the broad aspect of the question arising in the present case and it does not consider the authorities.

Cur. adv. vult.

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(1) (1929) 3 I.T.C. 441, 448.
(2) I.L.R. [1938] Bom. 374, 380, 397 (S.B.).
(3) (1934) 7 I.T.C. 283.
(4) (1938) L.R. 65 I.A. 236; I.L.R. [1938] Bom. 487.
(5) (1935) 9 I.T.C. 110, 113. (6) (1936) I.L.R. 18 Lah. 325.
(7) (1935) I.L.R. 59 Mad. 175 (P.C.).

The JUDGMENT of the Court was delivered by LEACH C.J.—The assessee carries on business as a money-lender at Paganeri in the Ramnad district and at various places outside British India. Until the month of February 1936 the assessee was a partner in the firm of P.R.A.M. carrying on business at Singapore. In that month the partnership was dissolved and the assessee took over the business. On 23rd March 1931 the P.R.A.M. firm advanced Rs. 1,00,000 to the S.P.K.A. firm of Zigon, Burma. On 10th February 1934 the S.P.K.A. firm repaid the loan with the interest then due, in all Rs. 1,22,659. The loan was discharged by payment of the amount to the assessee through the S.P.K.A.A.M. firm of Rangoon. The assessee retained the money in Rangoon, it being held on his behalf by the S.P.K.A.A.M. firm. The repayment of the loan to the P.R.A.M. firm was effected by the debiting of the assessee's personal account in that firm and crediting the Zigon firm with the amount. This was done on 12th April 1935. The amount debited to the assessee and credited to the P.R.A.M. firm was actually Rs. 1,26,463, the difference between this sum and the Rs. 1,22,659 representing the interest which had accrued between 15th October 1934 when the assessee received the money and 12th April 1935 when the loan to the S.P.K.A. firm was closed in the books of the P.R.A.M. firm. The Commissioner of Income-tax has treated the deposit of the Rs. 1,22,659 in the books of the S.P.K.A.A.M. firm as a remittance to British India of profits made by the assessee outside British India and this reference is concerned with the legality of the decision. The questions referred are as follows :—

"(*a*) Whether by applying the provisions of section 26 (2) of the Act the petitioner should not be considered as having become the sole owner of the debt originally advanced by the

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firm and whether the sum of Rs. 1,22,659 was not assessable as realization of the debt by the petitioner in British India.

(*b*) Whether apart from the applicability of section 26 (2) of the Income-tax Act in any event the sum of Rs. 1 lakh (out of the sum of Rs. 1,22,659) advanced more than three years prior to the account year was not assessable as a return of capital or profits earned more than three years prior to the account year."

Before us the learned Advocate for the assessee has conceded that the assessee is liable to tax on the Rs. 22,659 the amount of the interest gained on the Rs. 1,00,000 whether section 26 (2) applies or not.

It will be convenient to take the second question first and its decision does not require much discussion. The assessee had admittedly profits lying to his credit in the books of the Singapore firm in excess of the amount which he retained in Rangoon. The repayment to the assessee by the S.P.K.A. firm in Burma, of course, operated to discharge the S.P.K.A. firm and, if the assessee had remitted the money to Singapore, no question would have arisen. But, instead of sending the money to Singapore, the assessee retained it in Burma for his own purposes and, so far as the P.R.A.M. firm was concerned, the repayment came from his account with that firm. By doing this, the assessee in effect transferred the sum of Rs. 1,22,659 from Singapore to Burma and, as Burma was then within British India, it amounted to a transfer of profits to British India. It has been accepted that, if the amount is to be treated as a remittance of profits, it must be regarded as a sum having been received in British India within three years of the period in which the profits were earned.

The main question is that relating to section 26 (2) of the Income-tax Act. Both the assessee and the Commissioner of Income-tax say that this section

applies to a foreign business of a person who is chargeable to income-tax in British India and the first question referred must therefore be answered on this footing. At the same time I wish to make it clear that in discussing the provisions of section 26 (2) it must not be taken that we are in fact holding that it does apply to a foreign business. In *Arunachalam Chettiar* v. *Commissioner of Income-tax, Madras*(1) this Court took the view that the section did apply, but we consider that the question calls for further consideration in a suitable case. The Commissioner of Income-tax contends that section 26 (2) merely operates to fix the liability for payment of the tax. The assessee, on the other hand, says that it not only fixes the liability but governs the computation of the tax. In other words, the Commissioner of Income-tax says that the assessment must be based on the method which would apply if the P.R.A.M. firm had continued to be a partnership throughout the year of account, whereas the assessee says that the assessment should be on the footing that he became the owner of the business on the first day of the year of account.

In *Ram Rakha Mal and Sons, Limited* v. *Commissioner, Income-tax, Punjab*(2) a Bench of the Lahore High Court accepted the opinion put forward by the Commissioner of Income-tax. In the *Commissioner of Income-tax, Bombay* v. *The Mazagaon Dock, Ltd.*(3) RANGNEKAR J. also read the section in this way, but BLACKWELL J. took the opposite view. BEAUMONT C.J. answered the reference without dealing specifically with the question, but in *Bhogilal Hargovandas Patel* v. *The Commissioner of Income-tax, Bombay*(4) the learned CHIEF JUSTICE sitting with BLACKWELL J.

(1) (1929) 3 I.T.C. 441.
(2) (1936) I.L.R. 18 Lah. 325.
(3) I.L.R. [1938] Bom. 374 (S.B.).
(4) (1935) 9 I.T.C. 110.

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regarded the section as covering the method of computation. The reading of the section as the assessee would have it read was accepted by this Court in *S. V. Karuppaswami Mooppanar* v. *The Commissioner of Income-tax, Madras*(1) and by the Income-tax authorities in presenting the case. The matter related to the assessment of a person who had continued the business of a partnership. He sought to deduct interest which had been paid on additional capital supplied by the outgoing partners. The Income-tax Officer refused to allow the deduction and the question was referred to the Court. In his statement of the case the Commissioner of Income-tax observed:

> "The plain meaning of the sub-section is that the place of the predecessor as the proprietor of the business during the previous year must be regarded as having been occupied by the successor, the other things remaining the same. Thus during the period of the previous year, the predecessor's capital becomes the successor's capital, the predecessor's acts and transactions the acts and transactions of the successor and the predecessor's profits the profits of the successor. In other words the profits of the business have to be computed as though there had been no change and the profits arrived at treated for assessment purposes as profits made by the successor."

I have quoted this passage in full as Mr. Patanjali Sastri has contended that the Commissioner of Income-tax did not adopt in that case a different attitude to the attitude which he now takes up, but this cannot be accepted. As it was said that the predecessor's capital becomes the successor's capital, the predecessor's acts and transactions the acts and transactions of the successor and the predecessor's profits the profits of the successor, the contention was clearly one that the section applied for all purposes and

(1) (1934) 7 I.T.C. 283.

moreover this is shown to be the case in the judgment of BEASLEY C.J. who observed :

"The plain reading of the sub-section is, in my opinion, that the predecessor's capital becomes the successor's capital and that for all purposes the succeeding partner is to be regarded as the former firm. I agree with the reasons given by the Income-tax Commissioner for taking the view opposed to that put forward by the petitioner."

The argument put forward by the petitioner in that case was that the loans from the ex-partners should be treated as loans from strangers, whereas the Court decided that the whole of the capital was to be deemed to be the capital of the successor and he could not be allowed deductions by way of interest on his own money. This decision is binding on us and if section 26 (2) does apply to a foreign business, the section is wide enough to admit of this view. The section says that assessment shall be made on the person succeeding

"as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year".

The word "assessment" is used in two senses in the Act—the process of determining the amount of profit or loss and the process of levying tax—but, if there is nothing repugnant in the context, the word refers to the process of determining profit or loss. And this is the view of the Income-tax authorities; *vide* the Income-tax Manual (7th edition), page 159. As the assessment is to be made as if the person had been carrying on the business throughout the year of account and as if he had made the whole of the profits for that year, it is difficult to see how it can be said that the sub-section does not include the process of computing the amount on which tax is to be paid. Unless a contrary intention is to be drawn

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from the section itself, the assessee is entitled to have it read in this way.

The parties having agreed that section 26 (2) does apply to the present case, and as we hold that it does cover the process of computation, the assessee must be regarded as the lender of the Rs. 1,00,000 to the S.P.K.A. firm and deemed to have received repayment of the loan. The amount which he received covered both principal and interest and as the payment was made to him in British India, the interest is taxable but not the principal.

The reference will be answered in the sense indicated and as the assessee has succeeded in the main part of the claim, he will be entitled to his costs, which we fix at Rs. 250, and to the return of the deposit.

A.S.V.

INCOME-TAX REFERENCE.

Before Sir Lionel Leach, Chief Justice, Mr. Justice Madhavan Nair and Mr. Justice Varadachariar.

1938, October 26.

S. N. NARAYANAN CHETTIAR, PETITIONER,

v.

COMMISSIONER OF INCOME-TAX, MADRAS, RESPONDENT.*

Indian Income-tax Act (XI of 1922), sec. 4 (2)—Foreign businesses carried on by assessee—Profits, if have resulted from—Mode of finding out—Losses in some of businesses—Deduction of, from profits earned in others—Necessity.

Where an assessee carries on two money-lending businesses outside British India, both being his sole businesses having current transactions and controlled by him, and where one of

* Original Petition No. 118 of 1937.