1921.

SITARAM SAKHARAM v. LAXMAN VINAYAK.

case : and I agree with the learned Chief Justice that the best course is to leave it to the Legislature to alter the language used in that section, if the construction put on it in *Gangadhar Hari Karkare* v. *Morbhat Purohit*[1] is considered to be wrong or undesirable.

Appeal dismissed.

R. R.

(1) (1893) 18 Bom. 525.

APPELLATE CIVIL.

Before Sir Norman Macleod, Kt., Chief Justice, and Mr. Justice Shah.

1921.

February 9.

IN RE THE INCOME TAX ACT (VII OF 1918) AND

IN RE THE AURANGABAD MILLS, LIMITED*.

Indian Income Tax Act (VII of 1918), sections 3 (1), 17 (1) and 51—Income accruing, arising or being received in British India—Company registered and business controlled in British India—Manufacture carried on outside British India—Reference—Costs.

Under section 3, sub-section 1 of the Income Tax Act (VII of 1918), the profits of a Company which are made from manufacture carried on beyond British India cannot be said to accrue or arise in British India on account of the Head Office being in Bombay and because the Directors control the business in Bombay. Nor would the mere fact of the entries in respect thereof being made in the accounts of the Company kept in Bombay entitle the Collector to treat the profits as having been received in British India within the meaning of section 3 (1) of the Act.

The costs of a reference under section 51 of the Income Tax Act, 1918, made at the instance of the Chief Revenue Authority of Bombay within the local limits of the original jurisdiction should be taxed as on the original side.

CIVIL reference made by J. P. Brander, Collector of Bombay and the Chief Revenue Authority under the Income Tax Act, under section 51 of the Act, VII of 1918.

*Civil Reference No. 25 of 1920.

1921.

AURANGABAD MILLS, LIMITED, *In re.*

The Aurangabad Mills, Limited, was a Company registered in Bombay. The Company owned cotton ginning, spinning and weaving mill at Aurangabad situate in the dominions of His Exalted Highness the Nizam of Hyderabad, Deccan. All the processes of manufacture, purchase of raw materials, &c., and in fact all the trading operations of the company were carried on in the Nizam's dominions. The Company had, however, its Board of Directors in Bombay where all the business of the Company was transacted.

On the 31st January 1919 the Company received a notice of assessment for 1918-19 from the Collector of Income Tax for Rs. 14,131-8-0, informing it that under sections 3 (1) and 17 (1) of the Indian Income Tax Act, VII of 1918, total profits of the Company were assessable to ordinary income tax. The Company appealed to the Commissioner of Income Tax on the ground that the income and profits accruing and arising from business in British India for the year ending 31st December 1917 were nil.

The appeal was rejected and the assessment fixed by the Collector was confirmed.

The Company, thereupon, applied to the Chief Revenue authority to refer the case to the High Court for its opinion under section 51 of the Indian Income Tax Act (VII of 1918) on the following among other grounds :—

"(1) As all the trading operations of the Company took place in the dominions of His Exalted Highness the Nizam of Hyderabad, Deccan, no part of the profits of the Company accrues or arises in British India.

(2) That as a matter of fact the bulk of the profits of the Company is not received in British India but only a small portion of the annual profits is received in British India for distribution by way of dividends among the few shareholders of the Company who reside in Bombay.

(3) That the Company is exempt by the very wording of the section 3 (1) of the Indian Income Tax Act (VII of 1918) from liability to income tax as

1921.

AURANGABAD MILLS, LIMITED, *In re.*

regards its *entire* profits but is subject to the tax only on *such portion of its profits as is actually received in Bombay* for the purpose of distribution of dividends among its shareholders residing in Bombay.

(4) That the levy of income tax from the Company on its *entire* profits is apparently due to a misapprehension regarding the effect of section 17 of the Indian Income Tax Act (VII of 1918), which applies only to the duty of the Companies to make returns of their total income and not to the incidence of the taxation governed solely by section 3 (1) of the said Act, which makes the Act applicable to "all income from whatever source it is derived, if it *accrues* or *arises* or *is received in British India*, or is under the provisions of this Act, deemed to *accrue or arise or to be received in British India.*

(5) That the interpretation of the Commissioner that the words "to be received" means for income tax purposes "to be brought into account" is wholly erroneous, opposed to the ordinary acceptance of the words used by the Legislature and is entirely unsupported by any judicial decisions or any definitions within the Income Tax Act itself.

The points on which the opinion of the High Court was invited were :—

(1) Whether income can be said to accrue or arise in British India within the meaning of section 3 (1) of the Income Tax Act, 1918 (VII of 1918), if the seat of the management is in British India.

(2) Whether income can be said to be received in British India within the meaning of the above section if it is finally accounted for in British India.

(3) Whether as regards points 1 and 2 it is not a question of fact to ascertain in what circumstances income can be said to accrue or arise or be received in British India, and, as such, is a question determination of which rests with the executive officers concerned and does not fall within the purview of section 51 of the Income Tax Act (VII of 1918).

Advocate General instructed by *Solicitor* to *Government*, for the Chief Revenue Authority.

Inverarity and *B. J. Desai* instructed by *Bhaishankar Kanga and Girdharlal*, for the Aurangabad Mills.

MACLEOD, C. J. :—This is a reference made by the Chief Revenue Authority under the Income Tax Act, Bombay, under section 51 of the Indian Income Tax

Act (VII of 1918). The facts are that the Aurangabad Mills, Limited, is a Company registered in Bombay, having its Board of Directors in Bombay, where all the business of the Company is transacted other than the manufacturing part of its business. That is carried on in the territory of His Exalted Highness the Nizam.

The question which has arisen between the Company and the Income Tax Authorities is whether the profits of the Company which they made from the manufacture carried on at Aurangabad can be said to accrue or arise in British India on account of the Head Office being in Bombay and because the Directors control the business in Bombay. The important section is section 3, sub-section (*1*) of the Act (VII of 1918) "Save as hereinafter provided, this Act shall apply to all income from whatever source it is derived, if it accrues or arises or is received in British India, or is, under the provisions of this Act, deemed to accrue or arise or to be received in British India." It is admitted that none of the provisions of the Act which deal with the question whether income shall be deemed to accrue or arise in British India apply to this case. And it is also admitted by the Company that they are bound to pay income tax on the income which is received in British India. This reference, therefore, applies to those profits which accrue or arise from the manufacture carried on at Aurangabad and which are distributed outside British India.

The Chief Revenue Authority is of opinion that these profits must be taxed because it was expressly intended by the Legislature by the present Income Tax Act to alter the law, and in effect to tax the profits derived from a business carried on outside British India as if they had accrued or arisen in British India, wherever the business was controlled by a Company or an

1921.

AURANGABAD MILLS, LIMITED, *In re.*

individual having a Head Office in British India. He relies upon the change made in section 17 (*1*) of Act VII of 1918. "The principal officer of every Company shall prepare, and, on or before the 15th day of June in each year, deliver or cause to be delivered to the Collector a return in the prescribed form and verified in the prescribed manner of the total income of the Company during the previous year". Under section 11 of Act II of 1886 the statement to be prepared by the principal officer in British India of every Company was a statement of the net profits made in British India. Because the statement required to be made under the present Act is a statement of the total income of the Company instead of only the net profits made in British India, it cannot be said that thereby a change was made with regard to the income which should be taxed, or that income which had previously been exempted from taxation should thereafter be taxed. Section 3 which defines what income shall be taxed re-enacts the corresponding section of the Act of 1886, and it had to be admitted by the learned Advocate General that unless he could show that these profits could have been taxed under Act II of 1886 they could not now be taxed under Act VII of 1918. He was, therefore, forced to contend that the profits from the manufacture carried on at Aurangabad must be held by the Court to accrue or arise in British India because the affairs of the Company were directed from Bombay. No authorities have been cited for the proposition that because the affairs of a Company are directed from a particular place while the actual business of the Company is carried on in another, therefore the profits accrue or arise in the former place. In the *Commissioners of Taxation* v. *Kirk*[1] a question arose where the profits of a Company could be said to have been

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

"derived". I quote from the judgment at page 592: "Their Lordships attach no special meaning to the word 'derived', which they treat as synonymous with arising or accruing. It appears to their Lordships that there are four processes in the earning or production of this income—(1) the extraction of the ore from the soil; (2) the conversion of the crude ore into a merchantable product, which is a manufacturing process; (3) the sale of the merchantable product; (4) the receipt of the moneys arising from the sale. All these processes are necessary stages which terminate in money, and the income is the money resulting less the expenses attendant on all the stages. The first process seems to their Lordships clearly within sub-section 3, and the second or manufacturing process, if not within the meaning of 'trade' in sub-section 1, is certainly included in the words 'any other source whatever' in sub-section 4. So far as relates to these two processes, therefore, their Lordships think that the income was earned and arising and accruing in New South Wales."

There might have been some doubt in that case whether the profits were not derived at a place where the third and fourth processes were carried out. That question would not arise in this case because all the four processes are carried out in the territories of His Exalted Highness the Nizam. Therefore it seems to me clear that the profits of this Company arise or accrue in the territory of His Exalted Highness the Nizam outside British India, and cannot be said to accrue or arise in British India because it happens that the Board of Directors manage the business from Bombay. It does not appear to me to make much difference of what nature their control is over the management of the mills at Aurangabad, whether the Manager there has in effect supreme control over the purchase of cotton and the sale of cloth, or whether he has to submit to the directions of the Board in Bombay.

1921.

AURANGÆBAD MILLS, LIMITED, *In re.*

From the record of this case it appears that though the Directors in Bombay can be said to control the business, still they have by Power of Attorney constituted their Manager at Aurangabad the principal authority for carrying on the business. In my opinion no change whatever has been made in the law by Act VII of 1918 with regard to the income which can be assessed for taxation. It has never been suggested before this Act was passed that these profits could have been taxed under Act II of 1886, and if it had been intended by the Legislature that the profits of Companies like the petitioning Company which are certainly derived outside British India should now be taxed, special provision would have been made in the Act VII of 1918. Undoubtedly if the English law had applied to this case the profits could have been taxed. But under the English law, the test is, where does the Company carry on business, and not, where are the profits derived. And the Chief Revenue Authority has erred in thinking that the English Cases he has cited are applicable to this case, for, in England a Company is said to carry on its business where it has its registered office irrespective of where its profits are derived. I would answer the first and the second questions in the negative.

In answer to the 3rd question I would say that the question whether income can be said to accrue or arise in British India would ordinarily be a question of fact, but whether income accruing outside British India can be taxed as accruing in British India because the Company is registered in British India is a question of law and certainly falls within the purview of section 51 of the Indian Income Tax Act.

The assessee is entitled to his costs of the reference.

As regards the question of costs there are no rules which lay down as to whether a reference under the

Indian Income Tax Act should be treated as being heard on the Appellate Side or on the Original Side. This reference is made to the High Court at the instance of the Chief Revenue Authority of Bombay within the local limits of the original jurisdiction of the Court and I think, therefore, the proper order is that the costs should be taxed as on the Original Side.

SHAH, J. :—I agree. I desire to add a word with reference to the argument, which has been stated in the reference by the Chief Revenue Authority but which has not been pressed before us, that the profits which have arisen or accrued at Aurangabad must be taken to have been received in British India in virtue of the entries having been made in respect of such profits in the accounts of the Company kept in British India. It is clear that the mere fact of the entries being made for the purpose of proper account-keeping would not entitle the Collector to treat the profits as having been received in British India within the meaning of section 3 (*1*) of the Act.

As regards costs, I feel clear that the assessee should be allowed his costs ; and in the absence of any rules as to the scale of costs applicable to such references, I agree that under the circumstances the costs may be allowed as on the Original Side.

Answered accordingly.

J. G. R.