1937

SURAT COTTON SPINNING AND WEAVING MILLS LTD. v. THE SECRETARY OF STATE FOR INDIA

Lord Thankerton

would be unfavourable to the respondent, and that, in consequence, misconduct by complicity in the theft of some servant or servants of the respondent may be fairly inferred from the respondent's evidence. It is unnecessary to refer to the appellants' other contentions, but, except as to the unexplained absence of the policeman, who is said by Rohead to have checked the offside of the train at Arrah, their Lordships were not seriously impressed by the appellants' criticisms as to the non-production of witnesses by the respondent, including Devraj, Vira and others.

Their Lordships will therefore humbly advise His Majesty that the appeal should be allowed, that the judgment and decree of the High Court should be set aside and that the decree of the Subordinate Judge should be restored, the appellants to have the costs of this appeal and their costs in the High Court.

Solicitors for the appellants : Messrs. *Lattey and Dawe.*

Solicitor for the respondent : *The Solicitor, India Office.*

C. S. S.

PRIVY COUNCIL.

J.C.* 1937 *March* 12

THE TATA HYDRO-ELECTRIC AGENCIES, LTD., BOMBAY, APPELLANTS *v.* THE COMMISSIONER OF INCOME TAX, BOMBAY PRESIDENCY AND ADEN, RESPONDENT.

[On Appeal from the High Court at Bombay]

Indian Income-tax Act (XI of 1922), section 10 (2) (ix)—Payments made in pursuance of obligations incurred in acquiring a business, whether may be deducted from profits of business in ascertaining assessable income.

Where an obligation to make payments is undertaken in consideration of the acquisition of the right to earn profits, that is of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business, the

**Present:* Lord Russell of Killowen, Lord Macmillan and Sir John Wallis.

payments cannot be deducted in estimating the profits of the business under section 10 (2) (*ix*) of the Income-tax Act, 1922.

Pondicherry Railway Company v. *Income-tax Commissioner*,[1] distinguished.

Commissioner of Income Tax, Bombay, v. *C. Macdonald & Co.*,[2] discussed.

Test in *Robert Addie & Sons' Collieries, Ltd.* v. *Commissioners of Inland Revenue*,[3] applied.

APPEAL (No. 46 of 1936) from a judgment of the High Court (March 27, 1935) on a Reference by the Commissioner of Income-tax under section 66 of the Indian Income-tax Act, 1922.

By an agreement dated September 24, 1919, between the Tata Power Co. Ltd. and Tata & Sons Ltd., Tata & Sons Ltd. were appointed managing agents of Tata Power Co. Ltd. for 41 years on terms that they should receive a commission of 10 per cent. on the net profits of the company, subject to a minimum of Rs. 50,000 whether the company made any profits or not, and other allowances. The agency was assignable and the company was bound, in the event of assignment, to recognize and, if required to do so, to enter into an agreement with the assignee on the same terms as their agreement with Tata Sons Ltd.

On October 15 and 19, 1926, Tata Sons Ltd. entered into agreements with D and T respectively under which D and T lent money to Tata Power Ltd. on terms that, in addition to interest, they were each to receive under their respective agreements 2 annas in the rupee in all the commission and remuneration (other than office allowances) earned by Tata Sons Ltd. under their agreement with Tata Power Co. Ltd.

On November 21, 1929, Tata Sons Ltd. assigned their rights and interests under their agreement with Tata Power Co. Ltd. to the appellant company, subject to their obligations to D and T, for a cash payment of Rs. 27,25,000 and shares of the nominal value of Rs. 27,25,000.

[1] (1931) L. R. 58 I. A. 239, s. c. 54 Mad. 691.
[2] (1934) 37 Bom. L. R. 126, s. c. 7 I. T. C. 466.
[3] (1924) S. C. 231 at p. 235.

1937

TATA HYDRO-ELECTRIC AGENCIES, LTD. v. THE COMMISSIONER OF INCOME-TAX, BOMBAY

On December 17, 1929, Tata Power Co., having been requested to do so, entered into an agreement with the appellant company on the terms of the agreement with Tata Sons Ltd. and, on February 23, 1932, the appellant company entered into an agreement with D, and, on May 19, 1932, an agreement with the administrator of the estate of T on the terms of the agreements between them and Tata Sons, Ltd.

During the year ending December 31, 1932, the appellant company received from the Tata Power Co. Ltd. Rs. 5,17,288 as commission and paid Rs. 1,29,322 to D and the administrator of T's estate in equal moieties and claimed that these payments were deductable from their profits under section 10 (2) (*ix*) of the Indian Income-tax Act.

1937 *January* 26 and 28

Needham, K. C., Reginald Hills and *Ralph Parikh*, for the appellants. The question is what exactly the money was paid out for. That is the fundamental question which distinguishes the cases. It is suggested by the respondent that what acted on the mind of the Income-tax officer was the taking over of the business by the appellant company and that it cannot be said that payments made when the new company was in the saddle can be deducted.

Reference was made to *Commissioner of Income-tax, Bombay* v. *C. Macdonald & Co.*(1); *Pondicherry Railway Company* v. *Income-tax Commissioner*(2) and *The Bharat Insurance Co.* v. *Income-tax Commissioner*.(3)

The question may be looked at in this way: Has the other person a share in the profits, is he a co-owner, so to say, in the profits?

In *Last* v. *London Assurance Corporation*,(4) the view of the majority was that the share-holders had purchased a portion of the profits.

(1) (1934) 37 Bom. L. R. 126, s. c. 7 I. T. C. 466.
(2) (1931) L. R. 58 I. A. 239, s. c. 54 Mad. 691.
(3) (1933) L. R. 61 I. A. 41, s. c. 15 Lah. 224.
(4) (1885) 10 App. Cas. 438.

Bejoy Singh Dudhuria v. *Income-tax Commissioner*(1) was a case of assignment of income. It is far removed from the case here. Here there is no assignment of a part of the profits. The money paid out was from the company's earnings. It was paid out as a necessary expenditure in carrying on the business. One of the things the appellant had to do was to negotiate loans and provide financial assistance. A business is a continuous thing and is assessed as one thing. It is the profits of the business that is assessed. Many things have to be done in a business. Expenditure has to be incurred. One cannot attribute items of expenditure to a particular profit. The money was laid out by the appellant company to enable it to make a profit.

The difference between the Indian Act, section 10, and the English Act of 1918, Schedule D, Rule 3, is merely a difference in words. The effect is the same.

Reference was made to Dowell (9th ed.), p. 480, *Usher's Wiltshire Brewery, Limited* v. *Bruce*,(2) *British Insulated and Helsby Cables* v. *Atherton*.(3)

[LORD RUSSELL referred to *Mallett* v. *Staveley Coal and Iron Co.*(4)]

Needham, continuing, referred to *Strong & Co. Limited* v. *Woodifield*.(5) The business of the appellant company comprises the facility of raising loans to finance their principals. Tata Sons could have deducted the amount they paid the lenders from the remuneration they received from Tata Power Co.

[LORD MACMILLAN referred to *Moore* v. *Stewarts & Lloyds, Ltd.*(6)]

Needham, continuing, referred to *Moss' Empires, Ltd.* v. *Inland Revenue Scottish*.(7)

(1) (1933) L. R. 60 I. A. 196, S. C. 60 Cal. 1029, P. C.
(2) [1915] A. C. 433.
(3) [1926] A. C. 205 at pp. 210, 211.
(4) [1928] 2 K. B. 405.
(5) [1906] A. C. 448.
(6) (1906) 6 T. C. 501.
(7) (1936) S. C. 531.

1937

TATA HYDRO-ELECTRIC AGENCIES, LTD. v. THE COMMISSIONER OF INCOME-TAX, BOMBAY

There must be a connecting link between the payments and the making of profits and there is one here. There is nothing in the case to suggest that the appellants were stepping out of their business. This was something done within the normal scope of the business of Tata Sons. The next question is whether on the transfer by Tata Sons to the appellants, the appellants could make the deduction. They are being assessed on the same business. Referred to section 26, Income-tax Act. There is no provision in the Act for treating the business as a change of business.

There are ample facts on which it can be found that the expenditure was necessarily incurred for the purpose of earning profits.

Hull, for the respondent. I do not rely on the *Pondicherry* case[1] as covering the question here. The first step is to consider the nature of the obligation under which the disputed disbursement was made. Secondly the purpose for which the paying company entered into the obligation.

In answering the first question, it is irrelevant to consider the position of the appellant's predecessors, Tata Sons. The agreement between Tata Sons and the appellants was 3 years after the agreement between Tata Sons and Dinshaw. The appellants bought the agency. They made a payment in cash and an allotment of shares and took over the liability to D and T. At that stage there was no relationship between the appellants and D and T. In 1932 they came under obligations to D and T. This was a new obligation. The answer, then, to the question under what obligation they had to pay D and T must be because they had covenanted to do so in 1932. The appellants entered into the agreement with D and T because they undertook to release Tata Sons. That is all we know about it and one is not entitled to speculate on any other reasons there may have been. Consideration of the motives under which Tata Sons entered

[1] (1931) L. R. 58 I. A. 239, s. c. 54 Mad. 691.

into agreements with D and T, therefore, become irrelevant. The appellants did not undertake the obligation with the object of providing funds for Tata Power Co. They undertook the obligation as necessary to enable them to acquire the agency. They would not have got the business unless they undertook the obligation. They did not pay D and T in order to get the commission, but to get the business which earned the commission. Reference was made to *Commissioners of Inland Revenue* v. *Paterson*.[1]

In *Moore* v. *Stewarts & Lloyds, Ltd.*[2] (*supra*) there was a finding of fact that the payments were made for the purpose of earning profits. That distinguishes the case from the case here. The *Pondicherry* case decided that a payment which depended on the making of profits was not a payment to earn profits. The converse was not considered. Reference was also made to *Union Cold Storage Ltd.* v. *Adamson*[3] and *Bejoy Singh Dudhuria* v. *Income-tax Commissioner*[4] which was referred to in *Currimbhoy Ebrahim Baronetcy Trustees* v. *Income-tax Commissioner*.[5]

Needham, K. C., in reply. On the facts of this case the loan was raised once and for all in 1926, but the effects of the loan remain on the business and its profit earning capacity and the loan cannot be put out of the picture. The payments by Tata Sons to D and T were trading payments. The appellants on buying the business find themselves in a position of having to meet a revenue. The benefit of the loan goes on : *Inland Revenue* v. *Falkirk Iron Co.*[6]

The judgment of the Judicial Committee was delivered by

LORD MACMILLAN. The appellants are a private limited company who carry on the business of managing agents of the Tata Power Company Limited and of certain other

(1) (1924) 9 T. C. 163.
(2) (1906) 6 T. C. 501.
(3) (1930) 16 T. C. 293, s. c. 144 L. T. 140.
(4) (1933) L. R. 60 I. A. 196, s. c. 60 Cal. 1029.
(5) (1934) L. R. 61 I. A. 209, s. c. 58 Bom. 317.
(6) (1933) 17 T. C. 625.

1937

TATA HYDRO-ELECTRIC AGENCIES, LTD. v. THE COMMISSIONER OF INCOME-TAX, BOMBAY

Lord Macmillan

hydro-electric companies in India. They acquired this agency business from their predecessors, Tata Sons Limited, under an assignment dated November 21, 1929, whereby Tata Sons Limited transferred to the appellants their whole rights and interest as agents of the hydro-electric companies under their subsisting agreements with these companies, but subject, as to their rights and interest under their agreement with the Tata Power Company Limited, to their obligations under two agreements with F. E. Dinshaw Limited and Richard Tilden Smith respectively. The assignment was declared to be to the intent that the appellants should thenceforth be and act as the agents of the hydro-electric companies and be entitled to all benefits and advantages contained in and conferred by the agreements between Tata Sons Limited and these companies and should perform and be bound by all the obligations and duties thereby imposed, and further that the appellants should receive all commissions and other remuneration to which Tata Sons Limited were entitled thereunder. The appellants for their part covenanted to carry out and perform the terms and conditions of the agreements with F. E. Dinshaw Limited and Richard Tilden Smith and to indemnify Tata Sons Limited against any consequences of the non-observance thereof. They further undertook, if so required, to enter into separate agreements in their own names with F. E. Dinshaw Limited and Richard Tilden Smith in the same terms.

Under the agency agreement between Tata Sons Limited and the Tata Power Company Limited, which was dated September 24, 1919, and the benefit of which the appellants thus acquired, the remuneration of Tata Sons Limited for their services consisted of a commission of 10 per cent. on the annual net profits of the Tata Power Company Limited, with a minimum of Rs. 50,000 whether that company should make any profits or not, and they were also entitled to have their expenses reimbursed. In

return for this remuneration Tata Sons Limited undertook to use their best endeavours to promote the interests of the Tata Power Company Limited. The agreement was declared to be assignable and the Tata Power Company Limited undertook to recognise any assignees as their agents and, if required, to enter into an identical agency agreement with such assignees. It was also declared to be lawful for Tata Sons Limited to assign the whole or any part of their earnings under the agreement.

It appears that in 1926 the Tata Power Company Limited were urgently in need of financial assistance to the extent of over a crore of rupees. Tata Sons Limited, their then managing agents, who, as the Commissioner of Income-tax puts it in his statement of facts, "had to find the money", approached F. E. Dinshaw Limited and Richard Tilden Smith who agreed to provide the necessary funds. One of the conditions on which they agreed to do so was that, in addition to the interest payable by the Tata Power Company Limited for the loan, they should each receive from Tata Sons Limited two annas in the rupee, or 12½ per cent. of the commission earned by Tata Sons Limited under their agency agreement with the Tata Power Company Limited. Two agreements embodying this obligation were entered into between Tata Sons Limited and F. E. Dinshaw Limited and Richard Tilden Smith respectively, dated October 15 and 19, 1926, being the agreements referred to in the assignment by Tata Sons Limited of their agency business to the appellants. It will be observed that as the remuneration of Tata Sons Limited depended, subject to a minimum, on the prosperity of the Tata Power Company Limited, they had an interest in assisting the Tata Power Company Limited to obtain the financial accommodation required for the conduct of their business.

After the acquisition of the agency business by the appellants the Tata Power Company Limited, in fulfilment of their obligation under their agreement with Tata Sons

1937

TATA HYDRO-ELECTRIC AGENCIES, LTD. v. THE COMMISSIONER OF INCOME-TAX, BOMBAY

Lord Macmillan.

Limited, entered into a new agency agreement with the appellants dated December 17, 1929, in terms identical with those of their previous agreement with Tata Sons Limited, and the appellants also entered into agreements with F. E. Dinshaw Limited and the administrator of the estate of Richard Tilden Smith (who had meantime died), dated February 23 and May 19, 1932, respectively, in terms identical with those of the previous agreements between Tata Sons Limited and these parties.

By this series of transactions complete novation was effected with the result that the appellants came in room and place of Tata Sons Limited in all respects both as regards the right to receive from the Tata Power Company Limited the stipulated agency remuneration and as regards the obligation to pay out of that remuneration 12½ per cent. to F. E. Dinshaw Limited and 12½ per cent. to Richard Tilden Smith's administrator.

In the year 1932 the appellants duly earned and received payment from the Tata Power Company of their commission of 10 per cent. on the net profits of that company and duly paid over to F. E. Dinshaw Limited and to Richard Tilden Smith's administrator 12½ per cent. thereof each, or 25 per cent. in all.

The assessment of the appellants' income for tax purposes for the fiscal year to March 31, 1934, which is in question in the present appeal, is based on their income, profits and gains for the year 1932 and the question is whether in the computation for tax purposes of their income, profits and gains for that year they are entitled to deduct a sum representing the 25 per cent. of the commission earned and received from the Tata Power Company Limited which they paid over to F. E. Dinshaw Limited and Richard Tilden Smith's administrator under the agreements above mentioned. The gross commission received by the appellants was Rs. 5,17,288 and the one-fourth thereof which they claimed to deduct was Rs. 1,29,322.

Under section 10 (*2*) of the Indian Income-tax Act the profits or gains of any business carried on by the assessee are to be computed after making allowance for " IX, any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains ".

The Income-tax Officer refused to allow the appellants to deduct the sum in question in the computation of the profits or gains of their business and the Assistant Commissioner took the same view. The appellants then requested the respondent to refer to the High Court the legal question of the admissibility of the deduction. The respondent in doing so, expressed, as required by the Act, his own opinion which was also to the effect that the deduction was inadmissible. He founded his opinion on the case of the *Pondicherry Railway Company* v. *Income-tax Commissioner*[1] which he submitted was on all fours with the present case and he also referred to the case of the *Bharat Insurance Company* v. *Income-tax Commissioner*[2] in which the *Pondicherry* case[1] was followed.

The questions of law as formulated by the Commissioner of Income-tax were as follows :—

(1) Whether in the circumstances of the case and in view of the provisions of sections 4 (*1*) and 10 of the Act, the assessee company has been correctly assessed on the total amount of Rs. 5,17,288 received by it as profits and gains of the business carried on by it as the managing agents of the Tata Power Co. Ltd.

(2) Whether under the provisions of section 10 of the Act or under any other provision thereof the assessee company is entitled to have a deduction from the said profits and gains amounting to Rs. 5,17,288 to the extent of Rs. 1,29,322 paid by it to certain parties under the agreements, exhibits F and G [being the agreements between the appellants and F. E. Dinshaw Limited and Richard Tilden Smith's administrator respectively] on the ground that this latter amount was nothing but expenditure incurred solely for the purpose of earning the said profits or gains or on any other ground.

In the High Court the appellants were also unsuccessful. The Chief Justice Sir John Beaumont in his judgment held

[1] (1931) L. R. 58 I. A. 239, s. c. 54 Mad. 691.

[2] (1933) L. R. 61 I. A. 41, s. c. 15 Lah. 224.

1937

TATA HYDRO-ELECTRIC AGENCIES, LTD. v. THE COMMISSIONER OF INCOME-TAX, BOMBAY

Lord Macmillan

that the whole 10 per cent. commission received by the appellants from the Tata Power Company Limited was properly included without deduction in the assessment of the profits or gains of the appellants' business, in conformity with the decision in the case of *Commissioner of Income-tax, Bombay* v. *C. Macdonald & Co.*[1] within which the learned Chief Justice said that the present case exactly fell. He further expressed the opinion that the question whether the expenditure in question was incurred solely for the purpose of earning the profits or gains of their business was a question of fact and that as there was no finding of fact on which the Court could hold that the deduction claimed was one falling within the statute, the question must be answered in the negative. By their order of March 27, 1935, the High Court accordingly answered the first of the questions stated by the Commissioner in the affirmative and the second in the negative.

In the case of *C. Macdonald & Co.*,[1] to which the learned Chief Justice refers, the assessees carried on the business of managing agents of another company from whom they received a commission for their services. This commission the assessees were bound under an agreement to share with certain third parties and they claimed that the shares of their commission which they paid over to these third parties should be excluded or deducted in the computation of the profits or gains of their agency business. The Court held that the case was governed by the decision in the *Pondicherry* case[2] and that the whole commission received by the assessees must be included without deduction in the computation of their income for tax purposes.

Before their Lordships counsel for the Crown did not seek to support the judgment of the High Court in the present case on the ground that it was ruled by the decision in the *Pondicherry* case,[2] and in their Lordships' view he was well-advised in recognising the clear distinction between

[1] (1934) 37 Bom. L. R. 126, s. c. 7 I. T. C. 466.

[2] (1931) L. R. 58 I. A. 239 s. c. 54 Mad. 691.

that case and the present case. In the *Pondicherry* case[1] the assessees were under obligation to make over a share of their profits to the French Government. Profits had first to be earned and ascertained before any sharing took place. Here the obligation of the appellants to pay a quarter of the commission which they receive from the Tata Power Company Limited to F. E. Dinshaw Limited and Richard Tilden Smith's administrator is quite independent of whether the appellants make any profit or not. Indeed, if on their year's operations as a whole they were to make a loss and incur no liability to income tax they would nevertheless have to pay away a quarter of the commission in question to the parties named. The commission in truth is not profit or gain; it is only an item or factor in the computation of the appellants' profits or gains. Their Lordships regard this as a fundamental distinction. In the case of *C. Macdonald & Co.*[2] it would rather appear that the commission which was received by the assssees and which they were bound to share with certain other parties was the sole source of income of the assessees, but, be this as it may, the decision in that case cannot be supported by the authority of the *Pondicherry* case[1] on whatever other ground it may be justified.

It was not questioned by counsel for the Crown that, if the present question had arisen with Tata Sons Limited, they would, under section 10 (2) (*ix*), have been entitled on the facts stated to deduct their payments to F. E. Dinshaw Limited and Richard Tilden Smith as being expenditure incurred solely for the purpose of earning their profits or gains. But he submitted that after the acquisition of the agency business by the present appellants the payments assumed a different character. The appellants, he said, did not take any part in obtaining the loans nor did they incur the liabilities in question in the course of rendering

[1] (1931) L. R. 58 I. A. 239, s. c. 54 Mad. 691.

[2] (1934) 37 Bom. L. R. 126 s. c. 7 I. T. C. 466

1937

TATA HYDRO-ELECTRIC AGENCIES, LTD. v. THE COMMISSIONER OF INCOME-TAX, BOMBAY

Lord Macmillan

any services to their principals. The obligation to make the payments in question was taken over by them as part of the transaction whereby they acquired the agency business from Tata Sons Limited and the payments were therefore made not for the purpose of earning profits in the conduct of the agency business but in fulfilment of the terms on which they purchased the business.

Their Lordships recognise and the decided cases show how difficult it is to discriminate between expenditure which is, and expenditure which is not, incurred solely for the purpose of earning profits or gains. In the present case their Lordships have reached the conclusion that the payments in question were not expenditure so incurred by the appellants. They were certainly not made in the process of earning their profits; they were not payments to creditors for goods supplied or services rendered to the appellants in their business; they did not arise out of any transactions in the conduct of their business. That they had to make those payments no doubt affected the ultimate yield in money to them from their business but that is not the statutory criterion. They must have taken this liability into account when they agreed to take over the business. In short the obligation to make these payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business. If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party, irrespective of whether the business yields any profits or not, it would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business. It would seem to make no difference that the annual sum should be made payable out of a particular receipt of the business, irrespective of the earning of any profit from the business as a whole. The case of

a transferee of a business undertaking liability, for example, for the rents under current leases of the premises in which the business was carried on by the transferor and is to be carried on by the transferee is quite a different case, for the rents paid are clearly an outlay necessary for the earning of profit. In the case of *Robert Addie & Sons' Collieries, Ltd.* v. *Commissioners of Inland Revenue,*(1) the Lord President Clyde, dealing with corresponding words in the British Income-tax Act, says at p. 235 :

> " What is ' money wholly and exclusively laid out for the purposes of the trade ' is a question which must be determined upon the principles of ordinary commercial trading. It is necessary, accordingly to attend to the true nature of the expenditure, and to ask oneself the question, Is it a part of the Company's working expenses; is it expenditure laid out as part of the process of profit earning ? "

Adopting this test their Lordships are of opinion that the deduction claimed by the appellants is inadmissible as not being expenditure incurred solely for the purpose of earning the profits or gains of the business carried on by the appellants. They thus reach the same result as the learned Judges of the High Court but on different grounds, and they would only add in conclusion that with all respect they do not share the view expressed by the learned Chief Justice that the question whether the payments in question were admissible deductions under section 10 (2) (*ix*) was not open to argument in the High Court on the facts as found.

Their Lordships will accordingly humbly advise His Majesty that the appeal be dismissed and the order of the High Court of March 27, 1935, be affirmed. The respondent will have his costs of the appeal.

Solicitors for the appellants : Messrs. *Stanley Johnson and Allen.*

Solicitor for the respondent : *The Solicitor, India Office.*

C. S. S.

(1) (1924) S. C. 231.