LL.B. VI Term

LB-604 Taxation Law

Cases Selected and Edited by
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Paper – LB – 604 – Principles of Taxation Laws

Prescribed Legislation : The Income Tax Act, 1961

Prescribed Book :

1. Vinod K. Singhania & Kapil Singhania, **Taxmann's *Direct Taxes* – Law & Practice**
2. Girish Ahuja & Ravi Gupta, ***Direct Taxes – Law and Practice***

Topic 1: Introduction

Concept of – Tax, Cess, Surcharge; Types of taxes: Direct Taxes, Indirect Taxes; Definition of Income [Section 2(24)] – Application of Income or diversion by overriding title - Capital Receipt v. Revenue Receipt - Tests to distinguish (with special reference to 'Salami'); Assessee; Previous Year (section 3); Assessment year; Basis of charge (Receipt, Accrual, and Arisal); General Scheme of Income Tax Act, 1961

Topic-2 : Agricultural Income – Meaning of Agricultural Income [Section 2(1A), 10(1)]

Topic-3 : Residence and Scope of Total Income

Tests for the determination of residential status of Assessee (section 6); Total income of assessee (sections 4 and 5); Income deemed to accrue or arise in India (section 9); Incidence of tax varies with residential status of an assessee?

<u>Topic-4 :</u> **<u>Heads of Income (Sections 14-59)</u>**

Heads of Income (section 14), Rationale; Heads, whether mutually exclusive

<u>Head A :</u> **<u>Salaries</u>** (Sections 15 to 17) **–** Chargeability **-** Meaning of Salary; Perquisites; Profits in lieu of salary

[**<u>Head B</u> :** Omitted by the Finance Act, 1988 with effect from 1-4-1989]
<u>Head C :</u> **<u>Income from House Property</u>** (Sections 22 to 27) - Ingredients of section 22 - Annual Value how to be determined - Deductions under section 24 - Deemed owner (section 27)

<u>Head D :</u> **<u>Profits and Gains of Business and Profession</u>** (Sections 28 to 44) –Applicability - Deductions - Bad debts

Business Expenditure – Allowability - Tests of distinctions between Business expenditure and Capital expenditure [section 37(1)]

<u>Head E:</u> **<u>Capital Gains</u>** (Sections 45 to 55) – Definition of capital assets [section 2(14)]; Short term capital assets [section 2(42A)]; Short term capital gains [section 2(42B)]; Long term capital assets and Long term capital gain [section 2(29A) and 2(29B)]; Meaning of 'Transfer'[section 2(47)]; computation (section 45); Transactions not amounting to transfer (sections 46 and 47); Mode of computation (section 48); Meaning of 'adjusted', 'cost of improvement' and 'cost of acquisition'(section 55)

<u>Head F:</u> **<u>Income from Other Sources</u>** (Sections 56 to 59)

<u>Topic 5 :</u> **<u>Income of Other Persons included in Assessee's Total Income</u>** (Sections 60 to 64) - concept of clubbing of income – justifiability - throwing of separate property into the common stock of Joint Hindu Family and subsequent partition of the same section 64(2)

<u>Topic 6 : Assessment -</u> Best Judgment Assessment; Income escaping assessment (Sections 139, 142, 143, 144, 145(2), 147, 148, 149, 150, 151 and 153)

<u>IMPORTANT NOTE</u>:

1. The topics and cases given above are not exhaustive. The teachers teaching the course shall be at liberty to add new topics/cases.

2. The students are required to study the legislations as amended up-to-date and consult the latest editions of books.

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Answers may be written either in English or in Hindi but the same medium should be used throughout the paper.'

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C.I.T. v. *G.R. Karthikeyan*

1993 Supp (3) SCC 222

B.P. JEEVAN REDDY, J. - The question referred under Section 256(1) of the Income Tax Act reads as follows:

> Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the total sum of Rs 22,000 received by the assessee from the Indian Oil Corporation and All India Highway Motor Rally should not be brought to tax?

2**.** The assessment year concerned is 1974-75. The assessee, G.R. Karthikeyan, assessed as an individual, was having income from various sources including salary and business income. During the accounting year relevant to the said assessment year, he participated in the All India Highway Motor Rally. He was awarded the first prize of Rs 20,000 by the Indian Oil Corporation and another sum of Rs 2000 by the All India Highway Motor Rally. The Rally was organised jointly by the Automobile Association of Eastern India and the Indian Oil Corporation and was supported by several Regional Automobile Associations as well as Federation of Indian Motor Sports Clubs and the Federation of Indian Automobile Associations. The rally was restricted to private motor cars. The length of the rally route was approximately 6956 kms. One could start either from Delhi, Calcutta, Madras or Bombay, proceed anti-clockwise and arrive at the starting point. The rally was designed to test endurance driving and the reliability of the automobiles. One had to drive his vehicle observing the traffic regulations at different places as also the regulations prescribed by the Rally Committee. Prizes were awarded on the basis of overall classification. The method of ascertaining the first prize was based on a system of penalty points for various violations. The competitor with the least penalty points was adjudged the first-prize winner. On the above basis, the assessee won the first prize and received a total sum of Rs 22,000. The Income Tax Officer included the same in the income of the respondent-assessee relying upon the definition of 'income' in clause (24) of Section 2. On appeal, the Appellate Assistant Commissioner held that inasmuch as the rally was not a race, the amount received cannot be treated as income within the meaning of Section 2(24)(*ix*). An appeal preferred by the Revenue was dismissed by the Tribunal. The Tribunal recorded the following findings:

> (*a*) That the said rally was not a race. It was predominantly a test of skill and endurance as well as of reliability of the vehicle.
>
> (*b*) That the rally was also not a 'game' within the meaning of Section 2(24)(*ix*).
>
> (*c*) That the receipt in question was casual in nature. It was nevertheless not an income receipt and hence fell outside the provisions of Section 10(3) of the Act.

3. At the instance of the Revenue, the question aforementioned was stated for the opinion of the Madras High Court. The High Court held in favour of the assessee on the following reasoning:

> (*a*) The expression 'winnings' occurring at the inception of sub-clause (*ix*) in Section 2(24) is distinct and different from the expression 'winning'. The expression 'winnings' has acquired a connotation of its own. It means money won by gambling or betting. The

expression 'winnings' controls the meaning of several expressions occurring in the sub-clause. In this view of the matter, the sub-clause cannot take in the receipt concerned herein which was received by the assessee by participating in a race which involved skill in driving the vehicle. The rally was not a race. In other words the said receipt does not represent 'winnings'.

(*b*) A perusal of the memorandum explaining the provisions of the Finance Bill, 1972, which inserted the said sub-clause in Section 2(24), also shows that the idea behind the sub-clause was to rope in windfalls from lotteries, races and card games etc.

(*c*) Section 74(A) which too was introduced by the Finance Act, 1972 supports the said view. Section 74(A) provides that any loss resulting from any of the sources mentioned therein can be set off against the income received from that source alone. The sources referred to in the said section are the very same sources mentioned in sub-clause (*ix*) of Section 2(24) namely lotteries, crossword puzzles, races including horse-races, card-games etc.

5. The definition of 'income' in Section 2(24) is an inclusive definition. The Parliament has been adding to the definition by adding sub-clause(s) from time to time. Sub-clause (*ix*) which was inserted by the Finance Act, 1972 reads as follows—

(*ix*) any winnings from lotteries, crossword puzzles, races including horse-races, card-games and other games of any sort or from gambling or betting of any form or nature whatsoever.

6. We may notice at this stage a provision in Section 10. Section 10 occurs in Chapter III which carries the heading "*Incomes* which do not form part of total income". Section 10 insofar as is relevant reads thus:

10. *Incomes not included in total income*.- In computing the total income of a previous year of any person, any *income* falling within any of the following clauses shall not be included - ………..

(3) any receipts which are of a casual and non-recurring nature, not being winnings from lotteries, to the extent such receipts do not exceed one thousand rupees in the aggregate.

7. It is not easy to define income. The definition in the Act is an inclusive one. As said by Lord Wright in ***Kamakshya Narayan Singh* v. *CIT*** [(1943) 11 ITR 513 (PC)] "income ... is a word difficult and perhaps impossible to define in any precise general formula. It is a word of the broadest connotation". In ***Gopal Saran Narain Singh* v. *CIT*** [(1935) 3 ITR 237 (PC)] the Privy Council pointed out that "anything that can properly be described as income is taxable under the Act unless expressly exempted". This Court had to deal with the ambit of the expression 'income' in ***Navinchandra Mafatlal* v. *CIT*** [AIR 1955 SC 58]. The Indian Income Tax and Excess Profits Tax (Amendment) Act, 1947 had inserted Section 12(B) in the Indian Income Tax Act, 1922. Section 12(B) imposed a tax on capital gains. The validity of the said amendment was questioned on the ground that tax on capital gains is not a tax on 'income' within the meaning of Entry 54 of List 1, nor is it a tax on the capital value of the assets of individuals and companies within the meaning of Entry 55 of List 1 of the Seventh Schedule to

the Government of India Act, 1935. The Bombay High Court repelled the attack. The matter was brought to this Court. After rejecting the argument on behalf of the assessee that the word 'income' has acquired, by legislative practice, a restricted meaning - and after affirming that the entries in the Seventh Schedule should receive the most liberal construction - the Court observed thus:

> What, then, is the ordinary, natural and grammatical meaning of the word 'income'? According to the dictionary it means 'a thing that comes in'. In the United States of America and in Australia both of which also are English speaking countries the word 'income' is understood in a wide sense so as to include a capital gain. In each of these cases very wide meaning was ascribed to the word 'income' as its natural meaning. The relevant observations of learned Judges deciding those cases which have been quoted in the judgment of Tendolkar, J. quite clearly indicate that such wide meaning was put upon the word 'income' not because of any particular legislative practice either in the United States or in the Commonwealth of Australia but because such was the normal concept and connotation of the ordinary English word 'income'. Its natural meaning embraces any profit or gain which is actually received. This is in consonance with the observations of Lord Wright to which reference has already been made…. The argument founded on an assumed legislative practice being thus out of the way, there can be no difficulty in applying its *natural and grammatical meaning to the ordinary English word 'income'. As already observed, the word should be given its widest connotation in view of the fact that it occurs in a legislative head conferring legislative power.*

8. Since the definition of income in Section 2(24) is an inclusive one, its ambit, in our opinion, should be the same as that of the word income occurring in Entry 82 of List I of the Seventh Schedule to the Constitution (corresponding to Entry 54 of List I of the Seventh Schedule to the Government of India Act).

9. In ***Bhagwan Dass Jain* v. *Union of India*** [(1981) 2 SCC 135] the challenge was to the validity of Section 23(2) of the Act which provided that where the property consists of house in the occupation of the owner for the purpose of his own residence, the annual value of such house shall first be determined in the same manner as if the property had been let and further be reduced by one-half of the amount so determined or Rs 1800 whichever is less. The contention of the assessee was that he was not deriving any monetary benefit by residing in his own house and, therefore, no tax can be levied on him on the ground that he is deriving income from that house. It was contended that the word income means realisation of monetary benefit and that in the absence of any such realisation by the assessee, the inclusion of any amount by way of notional income under Section 23(2) of the Act in the chargeable income was impermissible and outside the scope of Entry 82 of List 1 of the Seventh Schedule to the Constitution. The said contention was rejected affirming that the expression income is of the widest amplitude and that it includes not merely what is received or what comes in by exploiting the use of the property but also that which can be converted into income.

10. Sub-clause (*ix*) of Section 2(24) refers to lotteries, crossword puzzles, races including horse-races, card games, other games of any sort and gambling or betting of any form or nature whatsoever. All crossword puzzles are not of a gambling nature. Some are; some are not. See ***State of Bombay* v. *R.M.D. Chamarbaugwala*** [AIR 1957 SC 699]. Even in card games there

are some games which are games of skill without an element of gamble [See ***State of A.P.* v. *K. Satyanarayana***, AIR 1968 SC 825]. The words “other games of any sort” are of wide amplitude. Their meaning is not confined to games of a gambling nature alone. It thus appears that sub-clause (*ix*) is not confined to mere gambling or betting activities. But, says the High Court, the meaning of all the aforesaid words is controlled by the word ‘winnings’ occurring at the inception of the sub-clause. The High Court says, relying upon certain material, that the expression ‘winnings’ has come to acquire a particular meaning viz., receipts from activities of a gambling or betting nature alone. Assuming that the High Court is right in its interpretation of the expression ‘winnings’, does it follow that merely because winnings from gambling/betting activities are included within the ambit of income, the monies received from non-gambling and non-betting activities are not so included? What is the implication flowing from insertion of clause (*ix*)? If the monies which are not earned — in the true sense of the word - constitute income why do monies earned by skill and toil not constitute income? Would it not look odd, if one is to say that monies received from games and races of gambling nature represent income but not those received from games and races of non-gambling nature? The rally in question was a contest, if not a race. The respondent-assessee entered the contest to win it and to win the first prize. What he got was a ‘return’ for his skill and endurance. Then why is it not income - which expression must be construed in its widest sense. Further, even if a receipt does not fall within sub-clause (*ix*), or for that matter, any of the sub-clauses in Section 2(24), it may yet constitute income. To say otherwise, would mean reading the several clauses in Section 2(24) as exhaustive of the meaning of ‘income’ when the statute expressly says that it is inclusive. It would be a wrong approach to try to place a given receipt under one or the other sub-clauses in Section 2(24) and if it does not fall under any of the sub-clauses, to say that it does not constitute income. Even if a receipt does not fall within the ambit of any of the sub-clauses in Section 2(24), it may still be income if it partakes of the nature of the income. The idea behind providing inclusive definition in Section 2(24) is not to limit its meaning but to widen its net. This Court has repeatedly said that the word ‘income’ is of widest amplitude, and that it must be given its natural and grammatical meaning. Judging from the above standpoint, the receipt concerned herein is also income.

May be it is casual in nature but it is income nevertheless. That even the casual income is ‘income’ is evident from Section 10(3). Section 10 seeks to exempt certain ‘incomes’ from being included in the ‘total income’. A casual receipt - which should mean, in the context, casual income - is liable to be included in the total income, if it is in excess of Rs 1000, by virtue of clause (3) of Section 10. Even though it is a clause exempting a particular receipt/income to a limited extent, it is yet relevant on the meaning of the expression ‘income’. In our respectful opinion, the High Court, having found that the receipt in question does not fall within sub-clause (*ix*) of Section 2(24), erred in concluding that it does not constitute income. The High Court has read the several sub-clauses in Section 2(24) as exhaustive of the definition of income when in fact it is not so. In this connection it is relevant to notice the finding of the Tribunal. It found that the receipt in question was casual in nature but - it opined - it was nevertheless not an income receipt and fell outside the provision of Section 10(3) of the Act. We have found it difficult to follow the logic behind the argument.

11. For the above reasons we hold that the receipt in question herein does constitute ‘income’ as defined in clause (24) of Section 2 of the Act. The appeal is accordingly allowed and the question referred by the Tribunal under Section 256(1) of the Act is answered in the negative i.e. in favour of the Revenue and against the assessee.

* * * * *

CIT v. *Sitaldas Tirathdas*

(1961) 2 SCR 634

HIDAYATULLAH, J. - The Commissioner of Income Tax, Bombay City II, has filed this appeal with a certificate under Section 66-A(2) of the Income Tax Act, against the judgment and order of the High Court of Bombay dated September 20, 1957, in Income Tax Reference No. 15 of 1957.

2. The question referred to the High Court for its opinion by the Income Tax Appellate Tribunal, Bombay was:

> "Whether the assessee is entitled to a deduction of Rs 1350 and Rs 18,000 from his total income of the previous year relevant to Assessment Years 1953-54, 1954-55?"

3. The assessee, Sitaldas Tirathdas of Bombay, has many sources of income, chief among them being property, stocks and shares, bank deposits and share in a Firm known as Messrs Sitaldas Tirathdas. He follows the financial year as his accounting year. For Assessment Years 1953-54 and 1954-55, his total income was respectively computed at Rs 50,375 and Rs 55,160. This computation was not disputed by him, but he sought to deduct therefrom a sum of Rs 1350 in the first assessment year and a sum of Rs 18,000 in the second assessment year on the ground that under a decree he was required to pay these sums as maintenance to his wife, Bai Deviben and his children. The suit was filed in the Bombay High Court (Suit No. 102 of 1951) for maintenance allowance, separate residence and marriage expenses for the daughters and for arrears of maintenance, etc. A decree by consent was passed on March 11, 1953, and maintenance allowance of Rs 1500 per month was decreed against him. For the account year ending March 31, 1953 only one payment was made, and deducting Rs 150 per month as the rent for the flat occupied by his wife and children, the amount paid as maintenance under the decree came to Rs 1350. For the second year, the maintenance at Rs 1500 per month came to Rs 18,000 which was claimed as a deduction. No charge on the property was created, and the matter does not fall to be considered under Section 9(1)(*iv*) of the Income Tax Act. The assessee, however, claimed this deduction on the strength of a ruling of the Privy Council in ***Bejoy Singh Dudhuria* v. *CIT*** [(1933) 1 ITR 135]. This contention of the assessee was disallowed by the Income Tax Officer, whose decision was affirmed on appeal by the Appellate Assistant Commissioner. On further appeal, the Tribunal observed:

> "This is a case, pure and simple, where an assessee is compelled to apply a portion of his income for the maintenance of persons whom he is under a personal and legal obligation to maintain. The Income Tax Act does not permit of any deduction from the total income in such circumstances."

The Tribunal mentioned in the statement of the case that counsel for the assessee put his contention in the following words:

> "I claim a deduction of this amount from my total income because my real total income is whatever that is computed, which I do not dispute, less the maintenance amount paid under the decree."

The assessee appears to have relied also upon a decision of the Lahore High Court in ***Diwan Kishen Kishore* v. *CIT*** [(1933) 1 ITR 143]. The Tribunal, however, referred the above question for the opinion of the High Court.

4. The High Court followed two earlier decisions of the same Court reported in ***Seth Motilal Manekchand* v. *CIT*** [(1957) 31 ITR 735] and ***Prince Khanderao Gaekwar* v. *CIT*** [(1948) 16 ITR 294] and held that, as observed in those two cases, the test was the same, even though there was no specific charge upon property so long as there was an obligation upon the assessee to pay, which could be enforced in a court of law. In ***Bejoy Singh Dudhuria*** case, there was a charge for maintenance created against the assessee, and the Privy Council had observed that the income must be deemed to have never reached that assessee, having been diverted to the maintenance-holders. In the judgment under appeal, it was held that the income to the extent of the decree must be taken to have been diverted to the wife and children, and never became income in the hands of the assessee.

5. The Commissioner of Income Tax questions the correctness of this decision and also of the two earlier decisions of the Bombay High Court. We are of opinion that the contention raised by the Department is correct.

6**.** Before we state the principle on which this and similar cases are to be decided, we may refer to certain rulings, which illustrate the aspects the problem takes. The leading case on the subject is the decision of the Judicial Committee in ***Bejoy Singh Dudhuria*** case. There, the stepmother of the Raja had brought a suit for maintenance and a compromise decree was passed under which the stepmother was to be paid Rs 1100 per month, which amount was declared a charge upon the properties in the hands of the Raja, by the Court. The Raja sought to deduct this amount from his assessable income, which was disallowed by the High Court at Calcutta. On appeal to the Privy Council, Lord Macmillan observed as follows:

> "But Their Lordships do not agree with the learned Chief Justice in his rejection of the view that the sums paid by the appellant to his step-mother were not 'income' of the appellant at all. This in Their Lordships' opinion is the true view of the matter.
>
> When the Act by Section 3 subjects to charge 'all income' of an individual, it is what reaches the individual as income which it is intended to charge. In the present case the decree of the court by charging the appellant's whole resources with a specific payment to his step-mother has to that extent diverted his income from him and has directed it to his stepmother; to that extent what he receives for her is not his income. It is not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands."

7. Another case of the Privy Council may well be seen in this connection. That case is reported in ***P.C. Mullick* v. *CIT*** [(1938) 6 ITR 206]. There, a testator appointed the appellants as executors and directed them to pay Rs 10,000 out of the income on the occasion of his *addya sradh*. The executors paid Rs 5537 for such expenses, and sought to deduct the amount from the assessable income. The Judicial Committee confirmed the decision of the Calcutta High Court disallowing the deduction, and observed that the payments were made out of the income of the estate coming to the hands of the executors and in pursuance of an obligation

imposed upon them by the testator. It observed that it was not a case in which a portion of the income had been diverted by an overriding title from the person who would have received it otherwise, and distinguished the case in ***Bejoy Singh Dudhuria*** case.

8. These cases have been diversely applied in India, but the facts of some of the cases bring out the distinction clearly. In ***Diwan Kishen Kishore* v. *CIT*** there was an impartible estate governed by the law of primogeniture, and under the custom applicable to the family, an allowance was payable to the junior member. Under an award given by the Deputy Commissioner acting as arbitrator and according to the will of the father of the holder of the estate and the junior member, a sum of Rs 7200 per year was payable to the junior member. This amount was sought to be deducted on the ground that it was a necessary and obligatory payment, and that the assessable income must, therefore, be taken to be pro tanto diminished. It was held that the income never became a part of the income of the family or of the eldest member but was a kind of a charge on the estate. The allowance given to the junior member, it was held, in the case of an impartible estate was the separate property of the younger member upon which he could be assessed and the rule that an allowance given by the head of a Hindu coparcenary to its members by way of maintenance was liable to be assessed as the income of the family, had no application. It was also observed that if the estate had been partible and partition could have taken place, the payment to the junior member out of the coparcenary funds would have stood on a different footing. In that case, the payment to the junior member was a kind of a charge which diverted a portion of the income from the assessee to the junior member in such a way that it could not be said that it became the income of the assessee.

9. In ***CIT* v. *Makanji Lalji*** [(1937) 5 ITR 539] it was stated that in computing the income of a Hindu undivided family monies paid to the widow of a deceased coparcener of the family as maintenance could not be deducted, even though the amount of maintenance had been decreed by the Court and had been made a charge on the properties belonging to the family. This case is open to serious doubt, because it falls within the rule stated in ***Bejoy Singh Dudhuria*** case; and though the High Court distinguished the case of the Judicial Committee, it appears that it was distinguished on a ground not truly relevant, namely, that in ***Bejoy Singh Dudhuria*** case the Advocate-General had abandoned the plea that the stepmother was still a member of the undivided Hindu family. It was also pointed out that this was a case of assessment as an individual and not an assessment of a Hindu undivided family.

10. In ***CIT* v. *D.R. Naik*** [(1939) 7 ITR 362] the assessee was the sole surviving member of a Hindu undivided family. There was a decree of Court by which the assessee was entitled to receive properties as a residuary legatee, subject, however, to certain payments of maintenance to widows. The widows continued to be members of the family. It was held that though Section 9 of the Income Tax Act did not apply, the assessee’s assessable income was only the balance left after payment of the maintenance charges. It appears from the facts of the case, however, that there was a charge for the maintenance upon the properties of the assessee. This case also brings out correctly the principles laid down by the Judicial Committee that if there be an overriding obligation which creates a charge and diverts the income to some one else, a deduction can be made of the amounts so paid.

11. The last case may be contrasted with the case reported in ***P.C. Mullick*** and ***D.C. Aich, In re*** [(1940) 8 ITR 236]. There, under a will certain payments had to be made to the beneficiaries. These payments were to be made gradually together with certain other annuities. It was held that the payments could only be made out of the income received by the executors and trustees from the property, and the sum was assessable to income tax in the hands of the executors. It was pointed out that under the will it was stated that the amounts were to be paid "out of the income of my property", and thus, what had been charged was the income of the assessees, the executors. The case is in line with the decision of the Privy Council in ***P.C. Mullick* v. *CIT***.

12. In ***Hira Lal, In re*** [(1945) 13 ITR 512] there was a joint Hindu family, and under two awards made by arbitrators which were made into a rule of the Court, certain maintenance allowances were payable to the widows. These payments were also made a charge upon the property. It was held that inasmuch as the payments were obligatory and subject to an overriding charge they must be excluded. Here too, the amount payable to the widows was diverted from the family to them by an overriding obligation in the nature of a charge, and the income could not be said to accrue to the joint Hindu family at all.

13. In ***Prince Khanderao Gaekwar* v. *CIT***, there was a family trust out of which two grandsons of the settler had to be paid a portion of the income. It was provided that if their mother lived separately, then the trustees were to pay her Rs 18,000 per year. The mother lived separately, and two deeds were executed by which the two grandsons agreed to pay Rs 15,000 per year to the mother, and created a charge on the property. The sons having paid Rs 6000 in excess of their obligations, sought to deduct the amount from their assessable income, and it was allowed by the Bombay High Court, observing that though the payment was a voluntary payment, it was subject to a valid and legal charge which could be enforced in a court of law and the amount was thus deductible under Section 9(1)(*iv*). There is no distinction between a charge created by a decree of Court and one created by agreement of parties, provided that by that charge the income from property can be said to be diverted so as to bring the matter within Section 9(1)(*iv*) of the Act. The case was one of application of the particular section of the Act and not one of an obligation created by a money decree, whether income accrued or not. The case is, therefore, distinguishable from the present, and we need not consider whether in the special circumstances of that case it was correctly decided.

14. In ***V.M. Raghavalu Naidu & Sons* v. *CIT*** [(1950) 18 ITR 787] the assessees were the executors and trustees of a will, who were required to pay maintenance allowances to the mother and widow of the testator. The amount of these allowances was sought to be deducted, but the claim was disallowed. Satyanarayana Rao and Viswanatha Sastri, JJ. Distinguished the case from that of the Privy Council in ***Bejoy Singh Dudhuria*** case. Viswanatha Sastri, J. observed that the testator was under a personal obligation under the Hindu law to maintain his wife and mother, and if he had spent a portion of his income on such maintenance, he could not have deducted the amount from his assessable income, and that the position of the executor was no better. Satyanarayana Rao, J. added that the amount was not an allowance which was charged upon the estate by a decree of Court or otherwise and which the testator himself had no right or title to receive. The income which was received by the executors

included the amount paid as maintenance, and a portion of it was thus applied in discharging the obligation.

15. The last cited case is again of the Bombay High Court, which seems to have influenced the decision in the instant case. That is reported in ***Seth Motilal Manekchand* v. *CIT***. In that case, there was a managing agency, which belonged to a Hindu joint family consisting of A, his son B and A's wife. A partition took place, and it was agreed that the managing agency should be divided, A and B taking a moiety each of the managing agency remuneration but each of them paying A's wife 2 as. 8 pies out of their respective 8 as. Share in the managing agency remuneration. Chagla, C.J. and Tendolkar, J. held that under the deed of partition A and B had really intended that they were to receive only a portion of the managing agency commission and that the amount paid to A's wife was diverted before it became the income of A and B and could be deducted. The learned Judge observed at p. 741 as follows:

> "We are inclined to accept the submission of Mr Kolah that it does constitute a charge, but in our opinion, it is unnecessary to decide this question because this question can only have relevance and significance if we were considering a claim made for deduction under Section 9(1)(*iv*) of the Income Tax Act where a claim is made in respect of immovable property where the immovable property is charged or mortgaged to pay a certain amount. It is sufficient for the purpose of this reference if we come to the conclusion that Bhagirathibai had a legal enforceable right against the partner in respect of her 2 annas and 8 pies share and that the partner was under a legal obligation to pay that amount."

16. These are the cases which have considered the problem from various angles. Some of them appear to have applied the principle correctly and some, not. But we do not propose to examine the correctness of the decisions in the light of the facts in them. In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable. In our opinion, the present case is one in which the wife and children of the assessee who continued to be members of the family received a portion of the income of the assessee, after the assessee had received the income as his own. The case is one of application of a portion of the income to discharge an obligation and not a case in which by an overriding charge the assessee became only a collector of another's income. The matter in the present case would have been different, if such an overriding charge had existed either upon the property or upon its income, which is not the

case. In our opinion, the case falls outside the rule in ***Bejoy Singh Dudhuria*** case and rather falls within the rule stated by the Judicial Committee in ***P.C. Mullick*** case.

17. For these reasons, we hold that the question referred to the High Court ought to have been answered in the negative. We, accordingly, discharge the answer given by the High Court, and the question will be answered in the negative. The appeal is thus allowed with costs here and in the High Court.

* * * * *

C.I.T.* v. *Sunil J. Kinariwala

(2003) 1 SCC 660

S.S.M. QUADRI, J. - At the instance of the Revenue, the Income Tax Appellate Tribunal referred the following questions, under Section 256(1) of the Income Tax Act, 1961 for the opinion of the High Court:

> (*1*) Whether, on the facts and in the circumstances of the case, 50 per cent out of the assessee's ten per cent, right, title and interest in the partnership firm of Messrs Kinariwala R.J.K. Industries belongs to Sunil Jivanlal Kinariwala Trust and the income arising therefrom belongs to the said Trust by overriding title?
>
> (*2*) Whether, on the facts and in the circumstances of the case, the sum of Rs 20,141 being the profits referable to 50 per cent, out of the assessee's right, title and interest of ten per cent, in the partnership firm of Messrs Kinariwala R.J.K. Industries is not the real income of the assessee, but of Sunil Jivanlal Kinariwala Trust and as such assessable only in the hands of the Trust?
>
> (*3*) Whether, on the facts and in the circumstances of the case, fifty per cent, out of the assessee's ten per cent, share in the firm of Messrs Kinariwala R.J.K. Industries has been validly assigned to Sunil Jivanlal Kinariwala Trust under the deed of trust dated 27-12-1973, and whether the income arising therefrom belongs to the said Trust by way of overriding title?

4. The assessee, a partner in the partnership firm, known as "M/s Kinariwala R.J.K. Industries", Ahmedabad, was having ten per cent share therein. On 27-12-1973, he created a trust named "Sunil Jivanlal Kinariwala Trust" by a deed of settlement assigning fifty per cent out of his ten per cent right, title and interest (excluding capital), as a partner in the firm, and a sum of rupees five thousand out of his capital in the firm in favour of the said Trust. There are three beneficiaries of the Trust - the assessee's brother's wife, assessee's niece and the assessee's mother. In Assessment Year 1974-75, he claimed that as fifty per cent of the income attributable to his share from the firm, stood transferred to the Trust resulting in diversion of income at source, the same could not be included in his total income for the purpose of his assessment. The Income Tax Officer rejected the claim on the view that it was a case of application of income and not diversion of income at source; he also found that Section 60 of the Act was attracted as only income without transfer of asset was settled. Against the order of assessment, the assessee appealed before the Appellate Assistant Commissioner of Income Tax who allowed the appeal directing that a sum of Rs 20,141 which stood transferred to the Trust under the settlement, be excluded from the total income of the assessee. However, on appeal by the Revenue, the Tribunal reversed the order of the Appellate Assistant Commissioner. Thus, the aforementioned questions of law came to be referred to the High Court by the Tribunal.

5. The High Court, relying on the judgments of this Court in ***CIT* v. *Bagyalakshmi & Co*.** [(1965) 55 ITR 660] and ***Murlidhar Himatsingka* v. *CIT*** [(1966) 62 ITR 323] held, *inter alia*, that on assignment of fifty per cent share of the assessee in the firm, it became the income of the Trust by overriding title and it could not be added in the total income of the

assessee. In that view of the matter, the aforementioned questions (1) to (3) were answered in the affirmative, in favour of the assessee and against the Revenue.

7. Mr Preetesh Kapur, learned counsel appearing for the Revenue, contended that having regard to the terms of the settlement, what was assigned was the right to receive profits to the extent of fifty per cent of the share of the assessee; there was, therefore, no overriding title in the Trust so as to divert the income at source and the High Court erred in treating the assignment as resulting in diversion of the income. The question of application of Section 60 of the Act was urged as an alternative contention and was not seriously pursued. Mr U.U. Lalit, learned counsel appearing for the respondent assessee, on the other hand, argued that under Section 29(1) of the Indian Partnership Act, 1932, the Trust became entitled to receive fifty per cent share of the assessee's income from the firm by assignment under the settlement deed and, therefore, the Trust was getting the income by virtue of the overriding title and the High Court had correctly answered the questions. Further, it was conceded by the learned counsel for the parties that Questions (*1*) and (*3*) overlap and they need to be reframed. By an order of this Court dated 3-12-2002, they were reframed as question (1). Now, we have to advert to the following two questions:

> (1) Whether, on the facts and in the circumstances of the case, assignment of 50 per cent out of the assessee's ten per cent share in right, title and interest (excluding capital) in M/s Kinariwala R.J.K. Industries in favour of Sunil Jivanlal Kinariwala Trust under a deed of trust dated 27-12-1973 creates an overriding title in favour of the Trust and whether the income accruing to the Trust can be treated as the income of the assessee?
>
> (2) Whether, on the facts and in the circumstances of the case, the sum of Rs 20,141 being the profits referable to 50 per cent, out of the assessee's right, title and interest of ten per cent, in the partnership firm of Messrs Kinariwala R.J.K. Industries is not the real income of the assessee, but of Sunil Jivanlal Kinariwala Trust and as such assessable only in the hands of the Trust?

8. It may be pointed out that under the scheme of the Act, it is the total income of an assessee, computed under the provisions of the Act, that is assessable to income tax. So much of the income which an assessee is not entitled to receive by virtue of an overriding title created in favour of a third party would get diverted at source and the same cannot be added in computing the total income of the assessee. The principle is simple enough but more often than not, as in the instant case, the question arises as to what is the criteria to determine, when does the income attributable to an assessee get diverted by overriding title? The determinative factor, in our view, is the nature and effect of the assessee's obligation in regard to the amount in question. When a third person becomes entitled to receive the amount under an obligation of an assessee even before he could lay a claim to receive it as his income, there would be diversion of income by an overriding title; but when after receipt of the income by the assessee, the same is passed on to a third person in discharge of the obligation of the assessee, it will be a case of application of income by the assessee and not of diversion of income by overriding title. The decisions of the Privy Council in ***Bejoy Singh Dudhuria* v. *CIT*** [(1933) 1 ITR 135(PC)] and ***P.C. Mullick* v. *CIT*** [(1938) 6 ITR 206(PC)] together are illustrative of the principle of diversion of income by overriding title.

9. In ***Bejoy Singh Dudhuria*** under a compromise decree of maintenance obtained by the stepmother of the assessee, a charge was created on the properties in his hand. The Law Lords of the Privy Council, reversing the judgment of the Calcutta High Court, held that the amount of maintenance recovered by the stepmother was not a case of application of the income of the assessee. In contrast, in ***P.C. Mullick*** under a will, certain payments had to be made to the beneficiaries by the executors and the trustees (assessees) from the property of the testator. It was held by the Privy Council that such payments could only be out of the income received by the assessees from the property, therefore, such payments were assessable to income tax in the hands of the assessees and there was no diversion of income at source. Whereas in the former case, the stepmother of the assessee acquired the right to get the maintenance by virtue of charge created by the decree of the court on the properties of the assessee even before he could lay his hands on the income from the properties, but in the latter case, the obligation of the assessee to pay amounts to the beneficiaries was required to be discharged after receipt of the income from the properties.

10. In ***CIT* v. *Sitaldas Tirathdas*** [(1961) 41 ITR 367] speaking for a Bench of three learned Judges of this Court, Hidayatullah, J. having considered, among others, the aforesaid two judgments of the Privy Council laid down the test as follows:

> In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable.

In that case, the respondent assessee derived his income from many sources. He sought to deduct certain sums of money on the ground that, under a consent decree, he was required to pay those sums as maintenance to his wife and children. Though no charge was created on the properties of the assessee by the compromise decree, the decreed sums were, in fact, paid by the assessee to his wife and children. The High Court took the view that notwithstanding absence of specific charge upon the properties of the assessee, the assessee was under an obligation to pay maintenance under the decree which could be enforced by a court of law and purporting to apply the principle of ***Bejoy Singh Dudhuria*** held that in view of the decree of the Court, the sums must be taken to have been diverted to the wife and children and never became income in the hands of the assessee. Setting aside the judgment of the High Court, this Court held: (ITR p. 375)

> In our opinion, the present case is one in which the wife and children of the assessee who continued to be members of the family received a portion of the income of the

> assessee, after the assessee had received the income as his own. The case is one of application of a portion of the income to discharge an obligation and not a case in which by an overriding charge the assessee became only a collector of another's income. The matter in the present case would have been different, if such an overriding charge had existed either upon the property or upon its income, which is not the case. In our opinion, the case falls outside the rule in ***Bejoy Singh Dudhuria*** case and rather falls within the rule stated by the Judicial Committee in ***P.C. Mullick*** case.

11. We may notice a few decisions as instances of application of the principle of diversion of income by overriding title.

13. In ***Moti Lal Chhadami Lal Jain* v. *CIT*** [(1991) 190 ITR 1] a company took over the business of the Hindu undivided family (referred to as "the landlord"). Under the agreement of lease with the landlord, the Company was required to pay rupees ten thousand to a college, run by a trust out of the annual rent of rupees twenty-one thousand. In a subsequent agreement entered into between the landlord, the Company, the Trust and the College, it was stipulated, *inter alia,* that in the event of failure to pay the amount to the College, it would have full right to recover the said amount by recourse to the court and that the College shall have the first charge on the property. The landlord claimed that the amount paid to the College was the income of the College as it got diverted by an overriding title and ceased to be the income of the landlord. That contention was rejected by the Tribunal as well as the High Court. On appeal to this Court, applying the principle in ***Sitaldas Tirathdas*** it was held by a Bench of three learned Judges that the stipulation in the agreement to pay rupees ten thousand out of the annual rent directly to the College was only a mode of application of the income of the landlord, which made no difference to its liability to pay tax on the entire rent of rupees twenty-one thousand which had accrued to the landlord. The fact that the College was given the right to sue and recover rupees ten thousand directly from the Company in case of default, it was observed, did not alter the position, nor would creation of charge in favour of the College make any difference.

15. In ***Bagyalakshmi*** two members of a Hindu undivided family together held ten annas' share in a firm. On partition in the family, the share of the said members was divided among various members of the family. Thereafter, a fresh partnership deed was executed in which the said two persons were, however, shown as having the same proportion of share in the firm. They claimed that they were liable to pay tax only on the respective shares shown in the partnership deed. That contention was upheld by the Tribunal. Thereafter, the Commissioner cancelled the registration of the partnership firm under the Act on the ground that it did not specify the correct shares of the said persons in the partnership. It was held by this Court that the firm was entitled to be registered and that the shares given to the said two persons in the partnership deed were correct according to the terms of the deed, although they would be answerable to the divided members of the family in respect of profits pertaining to their shares. This case does not deal with the principle of diversion of income by overriding title and is of no help to the respondent assessee to support his contention that there was diversion of income by an overriding title in his case.

16. In ***Murlidhar Himatsingka*** one of the partners of the firm constituted a sub-partnership firm with his two sons and a grandson. The deed of sub-partnership provided that the profits and losses of the partner in the main firm shall belong to the sub-partnership and shall be borne and divided in accordance with the shares specified therein. The question in that case was: whether the share of the partner in the main firm, who had become a partner in the sub-partnership, could be assessed in his individual assessment. It was held that there was an overriding obligation which converted the income of the partner in the main firm into the income of the sub-partnership and, therefore, the income attributable to the share of the partner had to be included in the assessment of the sub-partnership. That was on the principle that a partner in the sub-partnership had a definite enforceable right to claim a share in the profits accrued to or received by the other partner in the main partnership, as on entering into a sub-partnership, such a partner changes his character vis-à-vis the sub-partners and the Income Tax Authorities. Further, a sub-partnership creates a superior title and results in diversion of the income from the main firm to the sub-partnership before the same becomes the income of the partner concerned. In such a case, even if the partner receives the income from the main partnership, he does so not on his behalf but on behalf of the sub-partnership.

Distinguishing ***K.A. Ramachar,*** it was observed:

> In that case it was neither urged nor found that a sub-partnership came into existence between the assessee who was a partner in a firm and his wife, married daughter and minor daughter. It was a pure case of assignment of profits (and not losses) by the partner during the period of eight years. Further the fact that a sub-partner can have no direct claim to the profits vis-à-vis the other partners of the firm and that it is the partner alone who is entitled to profits vis-à-vis the other partners does not show that the changed character of the partner should not be taken into consideration for income tax purposes.

17. It is apt to notice that there is a clear distinction between a case where a partner of a firm assigns his share in favour of a third person and a case where a partner constitutes a sub-partnership with his share in the main partnership. Whereas in the former case, in view of Section 29(1) of the Indian Partnership Act, the assignee gets no right or interest in the main partnership, except, of course, to receive that part of the profits of the firm referable to the assignment and to the assets in the event of dissolution of the firm, but in the latter case, the sub-partnership acquires a special interest in the main partnership. The case on hand cannot be treated as one of a sub-partnership, though in view of Section 29(1) of the Indian Partnership Act, the Trust, as an assignee, becomes entitled to receive the assigned share in the profits from the firm not as a sub-partner because no sub-partnership came into existence but as an assignee of the share of income of the assigner-partner.

19. For the aforementioned reasons, we are of the view that the order under challenge cannot be sustained. It is, accordingly, set aside. Consequently, the share of the income of the assessee assigned in favour of the Trust has to be included in the total income of the assessee. The questions are, accordingly, answered in favour of the Revenue and against the assessee.

* * * * *

Bacha F. Guzdar v. *C.I.T., Bombay*

AIR 1955 SC 74

GULAM HASAN, J. - The question referred by the Tribunal to the High Court of Judicature at Bombay was stated thus:

> Whether 60% of the dividend amounting to Rs 2750 received by the assessee from the two Tea companies is agricultural income and as such exempt under Section 4(3)(*viii*) of the Act.

Chagla, C.J. and Tendolkar, J. who heard the reference, answered the Question 1n the negative by two separate but concurring judgments dated March 28, 1952.

3. The facts lie within a narrow compass. The appellant, Mrs Bacha F. Guzdar, was, in accounting year 1949-50, a shareholder in two Tea companies, Patrakola Tea Company Ltd., and Bishnauth Tea Company Ltd., and received from the aforesaid companies dividends aggregating to Rs 2750. The two companies carried on business of growing and manufacturing tea. By Rule 24 of the Indian Income Tax Rules, 1922, made in exercise of the powers conferred by Section 59 of the Indian Income Tax Act, it is provided that

> (I)ncome derived from the sale of tea grown and manufactured by the seller in the taxable territories shall be computed as if it were income derived from business and 40% of such income shall be deemed to be income, profits and gains, liable to tax.

It is common ground that 40% of the income of the Tea companies was taxed as income from the manufacture and sale of tea and 60% of such income was exempt from tax as agricultural income. According to the appellant, the dividend income received by her in respect of the shares held by her in the said Tea companies is to the extent of 60% agricultural income in her hands and therefore *pro tanto* exempt from tax while the Revenue contends that dividend income is not agricultural income and therefore the whole of the income is liable to tax. The Income Tax Officer and on appeal, the Appellate Assistant Commissioner both concurred in holding the whole of the said income to be liable to tax. The Income Tax Appellate Tribunal confirmed the view that the dividend income could not be treated as agricultural income in the hands of the shareholder and decided in favour of the Revenue, but agreed that its order gave rise to a question of law and formulated the same as set out above and referred it to the High Court. The High Court upheld the order of the Tribunal but granted leave to appeal to this Court.

4. The question, we comprehend, is capable of an easy solution and can best be answered by reference to the material provisions of the Income Tax Act. Under Section 2(1) agricultural income means:

> (*a*) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land- revenue in the taxable territories or subject to a, local rate assessed and collected by officers of the Government as such;

6. In order, however, that dividend may be held to be agricultural income it will be incumbent upon the appellant to show that, within the terms of the definition, it is rent or revenue derived from land which is used for agricultural purposes. Mr Kolah, for the appellant,

contends that it is revenue derived from land because 60% of the profits of the company out of which dividends are payable are referable to the pursuit of agricultural operations on the part of the company. It is true that the agricultural process renders 60% of the profits exempt from tax in the hands of the company from land which is used for agricultural purposes but can it be said that when such company decides to distribute its profits to the shareholders and declares the dividends to be allocated to them, such dividends in the hands of the shareholders also partake of the character of revenue derived from land which is used for agricultural purposes? Such a position - if accepted would extend the scope of the vital words "revenue derived from land" beyond its legitimate limits. Agricultural income as defined in the Act is obviously intended to refer to the revenue received by direct association with the land which is used for agricultural purposes and not by indirectly extending it to cases where that revenue or part thereof changes hands either by way of distribution of dividends or otherwise. In fact and truth dividend is derived from the investment made in the shares of the company and the foundation of it rests on the contractual relations between the company and the shareholder. Dividend is not derived by a shareholder by his direct relationship with the land. There can be no doubt that the initial source which has produced the revenue is land used for agricultural purposes but to give to the words "revenue derived from land" the unrestricted meaning, apart from its direct association or relation with the land, would be quite unwarranted. For example, the proposition that a creditor advancing money on interest to an agriculturist and receiving interest out of the produce of the lands in the hands of the agriculturist can claim exemption of tax upon the ground that it is agricultural income within the meaning of Section 4, sub-section (3)(viii) is hardly statable. The policy of the Act as gathered from the various sub-clauses of Section 2(1) appears to be to exempt agricultural income from the purview of Income Tax Act. The object appears to be not to subject to tax either the actual tiller of the soil or any other person getting land cultivated by others for deriving benefit therefrom, but to say that the benefit intended to be conferred upon this class of persons should extend to those into whosoever hands that revenue falls, however remote the receiver of such revenue may be is hardly warranted.

7. It was argued by Mr Kolah on the strength of an observation made by Lord Anderson in ***Commissioners of Inland Revenue* v. *Forrest*** [(1924) 8 Tax Cas. 704, 710] that an investor buys in the first place a share of the assets of the industrial concern proportionate to the number of shares he has purchased and also buys the right to participate in any profits which the company may make in the future. That a shareholder acquires a right to participate in the profits of the company may be readily conceded but it is not possible to accept the contention that the shareholder acquires any interest in the assets of the company. The use of the word 'assets' in the passage quoted above cannot be exploited to warrant the inference that a shareholder, on investing money in the purchase of shares, becomes entitled to the assets of the company and has any share in the property of the company. A shareholder has got no interest in the property of the company though he has undoubtedly a right to participate in the profits if and when the company decides to divide them. The interest of a shareholder vis-a-vis the company was explained in the ***Sholapur Mills*** case [(1950) SCR 869, 904]. That judgment negatives the position taken up on behalf of the appellant that a shareholder has got a right in the property of the company. It is true that the shareholders of the company have the, sole determining voice in administering the affairs of the company and are entitled, as provided by the Articles of Association to declare that dividends should be distributed out of the profits of the company to

the shareholders but the interest of the shareholder either individually or collectively does not amount to more than a right to participate in the profits of the company. The company is a juristic person and is distinct from the shareholders. It is the company which owns the property and not the shareholders. The dividend is a share of the profits declared by the company as liable to be distributed among the shareholders. Reliance is placed on behalf of the appellant on a passage in **Buckley's *Companies Act*** (12th Edn.), p. 894 where the etymological meaning of dividend is given as dividendum, the total divisible sum but in its ordinary sense it means the sum paid and received as the quotient forming the share of the divisible sum payable to the recipient. This statement does not justify the contention that shareholders are owners of a divisible sum or that they are owners of the property of the company. The proper approach to the solution of the Question 1s to concentrate on the plain words of the definition of agricultural income which connects in no uncertain language revenue with the land from which it directly springs and a stray observation in a case which has no bearing upon the present question does not advance the solution of the question. There is nothing in the Indian law to warrant the assumption that a shareholder who buys shares buys any interest in the property of the company which is a juristic person entirely distinct from the shareholders. The true position of a shareholder is that on buying shares an investor becomes entitled to participate in the profits of the company in which he holds the shares if and when the company declares, subject to the Articles of Association, that the profits or any portion thereof should be distributed by way of dividends among the shareholders. He has undoubtedly a further right to participate in *the assets of the company which would be left over after winding up* but not in the assets as a whole as Lord Anderson puts it.

8. The High Court expressed the view that until a dividend is declared there is no right in a shareholder to participate in the profits and according to them the declaration of dividend by the company is the effective source of the dividend which is subject to tax. This statement of the law we are unable to accept. Indeed the learned Attorney-General conceded that he was not prepared to subscribe to that proposition. The declaration of dividend is certainly not the source of the profit. The right to participation in the profits exists independently of any declaration by the company with the only difference that the enjoyment of profits is postponed until dividends are declared.

10. It was suggested that the dividend arises out of the profits accruing from land and is impressed with the same character as the profits and that it does not change its character merely because of the incident that it reaches the hands of the shareholder. This argument runs counter to the definition of agricultural income which emphasizes the necessity of the recipient of income having a direct and an immediate rather than an indirect and remote relation with land. To accept this argument will be tantamount to saying that the creditor recovering interest on money debt due from the agriculturist who pays out of the produce of the land is equally entitled to the exemption. In fairness to Mr Kolah it must, however, be stated that the contention was not so broadly put but there is no reason why one should stop at a particular stage and not pursue the analogy to its logical limits.

11. English decisions resting upon the peculiarities of the English Income Tax law can hardly be a safe guide, in determining upon the language of the Indian Income Tax Act the true meaning of the words "agricultural income". A few cases of the Privy Council decided with

reference to the provisions of the Indian Income Tax Act, however, deserve notice. The first case viz. ***CIT* v. *Raja Bahadur Kamakshya Narayan Singh*** [AIR 1949 PC 1] dealt with the question whether interest on arrears of rent payable in respect of land used for agricultural purposes is agricultural income and therefore exempt from Income Tax. It was held that it was neither rent nor revenue derived from land within the meaning of Section 2(1) of the Income Tax Act. Lord Uthwatt who delivered the judgment of the Privy Council used the following piquant language in coming to that conclusion:

> The word, derived' is not a term of Article Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent, which has suffered the accident of non-payment. And rent is not land within the meaning of the definition.

The second case viz. ***Premier Construction Co. Ltd*. v. *CIT*** [AIR 1949 PC 20] dealt, with the nature of the commission of a managing agent of the company a part of whose income was agricultural income. The assessee claimed exemption from tax on the ground that his remuneration at 10 per cent of the profits was calculated with reference to the income of the company part of which was agricultural income. It was held that the assessee received no agricultural income as defined by the Act but that he received a remuneration under a contract for personal service calculated on the amount of profits earned by the employer, payable not in specie out of any item of such profits, but out of any moneys of the employer available for the purpose, and that the remuneration therefore was not agricultural income and was not exempt from tax. Sir John Beaumont, in the above case observed:

> In Their Lordships' view the principle to be derived from a consideration of the terms of the Income Tax Act and the authorities referred to is that where an assessee receives income, not itself of a character to fall within the definition of agricultural income contained in the Act, such income does not assume the character of agricultural income by reason of the source from which it is derived, or the method by which it is calculated.

In the third case viz. ***Maharajkumar Gopal Saran Narain Singh* v. *CIT*** [AIR 1935 PC 143], an annual payment for life to the assessee was not held to be agricultural income and therefore not exempt from tax where the annuity arose out of a transfer made by the assessee of a portion of his estate for discharging his debts and for obtaining an adequate income for his life it being held that it was not rent or revenue derived from land but money paid under a contract imposing personal liability on the covenator the discharge of which was secured by a charge on land. But reliance was placed upon another judgment of the Privy Council in the same volume at p. 305 in ***CIT* v. *Sir Kameshwar Singh***. That was a case of a usufructuary mortgagee the profits received by whom were exempt from Income Tax on the ground that they were agricultural income in his hands. Lord Macmillan, after referring to certain sections of the Act, observed that "the result of those sections is to exclude agricultural income altogether from the scope of the Act howsoever or by whomsoever it may be received." These observations must be held to be confined to the facts of that particular case which was a case of usufructuary mortgagee who had received profits directly from the land. The obvious implication of the words used by Lord Macmillan was that whosoever receives profit from the land directly is entitled to the exemption. We accordingly dismiss the appeal with costs.

C.I.T. v. *Benoy Kumar Sahas Roy*

AIR 1957 SC 768

N.H. BHAGWATI, J. – This appeal with certificate of fitness under s. 66A(2) of the Indian Income-tax Act is directed against the Judgment and Order of the High Court of Judicature at Calcutta on a reference under s. 66(1) of the Act.

(2) The respondent owns an area of 6,000 acres of forest land assessed to land revenue and grown with *Sal* and *Piyasal* trees. The forest was originally of spontaneous growth, "not grown by the aid of human skill and labour" and it has been in existence for about 150 years. A considerable income is derived by the assessee from sales of trees from this forest.

The assessment year in which this forest income was last taxed under the Indian Income-tax Act was 1923-24 but thereafter and till 1944-45 which is the assessment year in question, it was always left out of account. The assessment for 1944-45 also was first made without including therein any forest income, but the assessment was subsequently re-opened under s. 34.

In response to a notice under s. 22(2) read with s. 34 of the Act, the respondent submitted a return showing the gross receipt of Rs. 51,798 from the said forest. A claim was, however, made that the said income was not assessable under the Act as it was agricultural income and was exempt under s. 4(3)(viii) of the Act. The Income Tax Officer rejected this claim and added a sum of Rs. 34,430 to the assessable income as income derived from the forest after allowing a sum of Rs. 17,548 as expenditure.

The Appellate Assistant Commissioner confirmed the assessment and the Income Tax Appellate Tribunal also was of opinion that the said income was not agricultural income but was income derived from the sale of jungle produce of spontaneous growth and as such was not covered by s. 2(1) of the Act. At the instance of the assessee the Tribunal referred to the High Court under s. 66(1) of the Act two questions of law arising out of its order, one of which was:

> Whether on the facts and in the circumstances of this case, the sum of Rs. 51,977 is 'agricultural income' and as such is exempt from payment of tax under S. 4(3)(viii) of the Indian Income-tax Act?

(3) The Tribunal submitted a statement of case from which the following facts appear as admitted or established:

> (i) The area covered by the forest is about 6,000 acres, trees growing being Sal and Piyasal;
>
> (ii) It is of spontaneous growth being about 150 years old. It is not a forest grown by the aid of human skill and labour;
>
> (iii) The forest is occasionally parcelled out for the purposes of sale and the space from which trees sold are cut away is guarded by forest guards to protect offshoots;
>
> (iv) It has been satisfactorily proved that considerable amount of human labour and care is being applied year after year for keeping the forest alive as also for reviving the portions that get denuded as a result of destruction by cattle and other causes;

(v) The staff is employed by the assessee to perform the following specific operations:

(a) Pruning
(b) Weeding
(c) Felling
(d) Clearing
(e) Cutting of channels to help the flow of rain water
(f) Guarding the trees against pests and other destructive elements.
(g) Sowing of seeds after digging of the soil in denuded areas.

(4) The Tribunal found that the employment of human labour and skill in items (a) to (f) was necessary for the maintenance and upkeep of any forest of spontaneous growth. Regarding item (g), however, it found that the said operation had been performed only occasionally and over a small fraction of the area where the original growth has been found to have been completely denuded. Such occasions were however few and far between, the normal process being that whenever a tree was cut, a stump of about 6" height was left intact which sent forth off-shoots all round bringing about fresh growth in course of time. This went on perpetually unless an area got otherwise completely denuded.

(5) The reference was heard by the High Court and the High Court held that actual cultivation of the land was not required and as human labour and skill were spent for the growth of the forest the income from the forest was agricultural income. It accordingly answered the above question in the affirmative. The Revenue obtained the requisite certificate of fitness for appeal to this Court and hence this appeal.

(6) The question that arises for consideration in this appeal is whether income derived from the sale of *Sal* and *Piyasal* trees in the forest owned by the assessee which was originally a forest of spontaneous growth "not grown by the aid of human skill and labour," but on which forestry operations described in the statement of case had been carried on by the assessee involving considerable amount of expenditure of human skill and labour is agricultural income within the meaning of s. 2(i) and as such exempt from payment of tax under s. 4(3)(viii) of the Indian Income Tax Act.

(8) Even though "agricultural income" which is exempted under S. 4(3)(viii) of the Act is defined in S. 2(1) , there is no definition of "agriculture" or "agricultural purpose" to be found in the Act and it therefore falls to be determined what is the connotation of these terms.

(9) An argument based on entries 14 and 19 of List II of the Seventh Schedule to the Constitution may be disposed of at once. It was urged that entry No. 14 referred to agriculture including agricultural education and research, protection against pests and prevention of plant diseases while entry No.19 referred to forests and there was therefore a clear line of demarcation between agriculture and forests with the result that forestry could not be comprised within agriculture.

If forestry was thus not comprised within agriculture, any income from forestry could not be agricultural income and the income derived by the assessee from the sale of the forest trees could not be agricultural income at all, as it was not derived from land by agriculture within the meaning of the definition of agricultural income given in the Indian Income-tax Act. This argument, however, does not take account of the fact that the entries in the lists of the Seventh Schedule to the Constitution are heads of legislation which are to be interpreted in a liberal manner comprising within their scope all matters incidental thereto.

They are not mutually exclusive. If the assessee plants on a vacant site trees with a view that they should grow into a forest, as for example, casuarina plantations and expends labour and skill for that purpose, the income from such trees would clearly be agricultural produce. It has to be remembered that even though this demarcation between agriculture and forestry was available in the Lists contained in the Seventh Schedule to the Government of India Act, 1935, no such demarcation existed in the Devolution Rules made under the Government of India Act, 1919, and in any event the definition of agricultural income with which we are concerned was incorporated in the Indian Income-tax Acts as early as 1886, if not earlier; vide S.5 of the Indian Income-tax Act, 1886.

It has also to be remembered that in spite of this demarcation between agriculture and forests in the Constitution, taxes on agricultural income are a separate head under entry 46 of List II of the Seventh Schedule and would comprise within their scope even income from forestry operations provided it falls within the definition of agricultural income which according to the definition given under Art. 366(1) means agricultural income as defined for the purposes of the enactments relating to Indian Income Tax.

(10) The terms “agriculture” and “agricultural purpose” not having been defined in the Indian Income-tax Act, we must necessarily fall back upon the general sense in which they have been understood in common parlance. “Agriculture” in its root sense means ager, a field and culture, cultivation, cultivation of field which of course implies expenditure of human skill and labour upon land. The term has, however, acquired a wider significance and that is to be found in the various dictionary meanings ascribed to it.

It may be permissible to look to the dictionary meaning of the term in the absence of any definition thereof in the relevant statutes.

(12) Turning therefore to the dictionary meaning of “agriculture” we find ***Webster’s New International Dictionary*** describing it as “the art or science of cultivating the ground, including rearing and management of livestock, husbandry, farming, etc. and also including in its broad sense farming, horticulture, forestry, butter and cheese-making etc.” Murray’s Oxford Dictionary describes it as “the science and art of cultivating the soil, including the allied pursuits of gathering in the crop and rearing livestock, tillage, husbandry, farming (in the widest sense).”

(13) In Corpus Juris the term “agriculture” has been understood to mean: “art or science of cultivating the ground, especially in fields or large quantities, including the preparation of the soil, the planting of seeds, the raising and harvesting of crops, and the rearing, feeding and management of livestock; tillage, husbandry and farming. In its general sense the word also includes gardening or horticulture.”

(16) These are the various meanings ascribed to the term “agriculture” in various dictionaries and it is significant to note that the term has been used both in the narrow sense of the cultivation of the field and the wider sense of comprising all activities in relation to land including horticulture, forestry, breeding and rearing of livestock, dairying, butter and cheese making, husbandry, etc.

(17) It was urged on behalf of the assessee that the Court should accept the wider significance of the term and include forestry operations also within its connotation even though they did not involve tilling of the land, sowing of seeds, planting, or similar work on the land. The argument was that tilling of the land, sowing of the seeds planting or similar work on the land were no doubt agricultural operations and if they were part of the forestry operations carried on by the assessee the subsequent operations would certainly be a continuation of the same and would therefore acquire the characteristic of agricultural operations.

But the absence of these basic operations would not necessarily make any difference to the character of the subsequent operations and would not divest them of their character of agricultural operations, so that if in a particular case one found that the forest was of spontaneous growth, even so if forestry operations were carried on in such forests for the purpose of furthering the growth of forest trees, these operations would also enjoy the character of agricultural operations.

If breeding and rearing of livestock, dairying, butter and cheese-making etc., could be comprised within the term "agriculture," it was asked, why should these also be not classed as agricultural operations.

(18) Considerable stress was laid on the fact that S. 4(3)(viii) of the Act enacted a provision in regard to the exemption of "agricultural income" from assessment and it was contended that exemptions should be liberally construed. Reliance was placed on the observations of Vishwanatha Sastri J., in ***Commissioner of Income-tax, Madras* v. *K.E. Sundara Mudaliar*** [1950-18 ITR 259, 271]:

> Exemption from tax granted by a Statute should be given full scope and amplitude and should not be whittled down by importing limitations not inserted by the Legislature.

(19) Mookerjee J. in ***Commissioner of Agricultural Income-tax, West Bengal* v. *Raja Jagadish Chandra Deo Dhabal Deb*** [1949-17 ITR 426, 438 (Cal)] also expressed himself similarly:

> (A)nd the present day view seems to be that where an exemption is conferred by statute, that clause has to be interpreted liberally and in favour of the assessee but must always be without any violence to the language used. The rule must be construed together with the exempting provisions, which must be regarded as paramount.

(21) It was also pointed out that "Taxes on agricultural income" formed a head of legislation specified in item 46 of List II of the Seventh Schedule to the Constitution and should be liberally construed, with the result that agriculture should be understood in the wider significance of the term and all agricultural income derived from agriculture or so understood should be included within the category.

(22) We have therefore got to look to the terms of the definition itself and construe the same regardless of any other consideration, though, in so far as the terms "agriculture" and "agricultural purpose" are concerned, we feel free in view of the same not having been defined in the Act itself, to consider the various meanings which have been ascribed to the same in the legal and other dictionaries.

(23) We may also note here the dictionary meanings of the terms "Forestry" and "Cultivation." The ***Shorter Oxford Dictionary***, Vol. I, page 735, gives the meaning of "forestry" as the "science and art of forming and cultivating forests, management of growing timber."

(24) **Webster's** ***New International Dictionary***, Vol. I, page 990, gives the following meaning of forestry:

> Science and art of farming, caring for, or cultivating forests; the management of growing timber.

(25) **Webster's** ***New International Dictionary***, Vol. I, page 643, while talking of cultivation says that:

> (T)o cultivate" means (1) to prepare, or to prepare and use, for the raising of crops; to till; as, to cultivate the soil, to loosen or break up the soil about (growing crop or plants) for the purpose of killing weeds, etc., especially with a cultivator, as to cultivate the corn;
>
> (2) to raise, or foster the growth of, by tillage or by labour and care; to produce by culture; as to cultivate roses; to cultivate oysters.

(26) Whether the narrower or the wider sense of the term "agriculture" should be adopted in a particular case depends not only upon the provisions of the various statutes in which the same occurs but also upon the facts and circumstances of each case. The definition of the term in one statute does not afford a guide to the construction of the same term in another statute and the sense in which the term has been understood in the several statutes does not necessarily throw any light on the manner in which the term should be understood generally.

The decided cases disclose a variety of opinions in regard to the connotation of the terms "agriculture" and "agricultural purposes." At one time "agriculture" was understood in its primary sense of cultivation of field and that too for production of food crops for human beings and beasts. This limited interpretation could not be adhered to even though tilling of the land, sowing of the seeds, planting or similar work on the land were the basic operations, the scope of the crops produced was enlarged and all crops raised on the land, whether they be food crops or not were included in the produce raised by agriculture.

There was however another school of thought which extended the term "agriculture" and included within its connotation not only the products raised by the cultivation of the land but also allied activities which had relation to the land and operations which had the effect of fostering the growth, preservation and maintenance as also the regeneration of the products of the land, thus bringing within its compass not only the basic agricultural operations but also the further operations performed on the products of the land even though they were not necessarily accompanied by these preliminary basic operations.

As against these cases which dealt with these preliminary basic operations and also the further operations either by themselves or in conjunction with the former which of course necessarily involved the expenditure of human skill and labour in carrying out those operations, there were instances of products of land which grew wild or were of spontaneous growth without the expenditure of human skill and labour and which it was agreed on all hands could not be comprised within "agriculture" and the income from which could not fall within the definition of "agricultural income."

(36) ***Emperor* v. *Probhat Chandra*** [ILR 51 Cal. 504] was a case under the Indian Income-tax Act and the classes of income derived from permanently settled estates were "(1) Income from fisheries, (2) Income from land used for stacking timber, (3) Income from pasturage." The income from the first two heads was certainly not agricultural income or income derived from "land which is used for agricultural purposes" within the meaning of Ss. 2 and 4 of the Act. But income derived from pasturage was held to be agricultural income which could not lawfully be charged with income-tax.

(38) ***Commissioner of Income-tax, Madras* v. *Manavedan Tirumalapad*** [AIR 1930 Mad. 764 (F.B.)] was also a decision under the Indian Income-tax Act and the assessee there was assessed by the Income-tax Officer for the year 1928-29 on the amount received by the sale of timber trees cut and removed from the forests. The question was whether these amounts were liable as such to income tax and the Court observed:

> (W)e are unable to distinguish between the income derived from the sale of paddy which is grown on land and the income derived from the sale of timber cut in a forest; but the profits earned from the sale of paddy would be assessable to income-tax but for the special exemption given to that income in the Income-tax Act, by reason of its being agricultural income. There is no such exemption in the case of income derived from the sale of timber.

(40) The later decision of the Madras High Court in ***Chandrasekhara Bharathi Swamigal* v. *Duraisami Naidu*** [ILR 54 Mad. 900], however, contains an elaborate discussion as to the connotation of the term "agriculture." The case arose under the Madras Estates Land Act, 1908 and the question which the Court had to consider was whether growing casuarina trees, i.e. trees for fuel, was an agricultural purpose so as to make the person who held the land for that purpose a "ryot" within the meaning of the Madras Estates Land Act.

The Court held that land held for growing casuarina trees was not land held for purposes of agriculture and the person holding the land for that purpose was not a "ryot" within the meaning of the Act. While delivering the judgment of the Court Reilly J., embarked upon a consideration of what the term "agriculture" meant and came to the conclusion that agriculture could not be defined by the nature of the product cultivated but should be defined rather by the circumstances in which the cultivation was carried on.

(41) It may be noticed that the learned Judge enlarged the connotation of the term "agriculture" by having regard to the circumstances in which the cultivation was carried on rather than the nature of the products cultivated and embraced within the scope of the term not merely the production of things useful as food for man or beast or other products fit for human consumption by way of luxury but also such useful products as cotton, jute, flax and hemp, though he stopped short at those products and hesitated to include therein growing of trees in plantation where the land was covered with trees which have to stand on it for a number of years.

(42) The last case to be referred in this series is that of ***Deen Mohammad Mian* v. *Hulas Narain Singh*** [23 Pat LT 143, 152], where it was held that an orchard is an agricultural land. It was observed:

> The case of an orchard is quite different. Orchard trees ordinarily are, and can be presumed to have been, planted by men after preparation of the ground which is cultivation and seasonal crops are gathered. Fruit trees also require seasonal attention such as pruning and digging of the soil around the roots and it cannot be said that this ceases to be cultivation merely because the whole tree is not replanted every year .... In my opinion the land in suit is agricultural land; it is land from which by preparing the soil and planting and cultivating trees the raiyat expects to enjoy periodical returns in the way of produce for food.

(44) A still further extension of the term is to be found in the following observations of Vishwanatha Sastri J., in 1950-18 ITR 259, 271), at p. 273 :

> It is a matter of ordinary experience, at least in this part of the country, that mango, cocoanut, palmyra, orange, jack, arecanut, tamarind and other trees are planted usually in an enclosed land, and that these trees do not yield any fruit or crop in the early years of their growth. They remain on the land for a long number of years yielding fruit only after their maturity. There is no reason why the planting, rearing, watering, fencing and protection of such trees and the gathering of their fruits during the annual seasons should not be held to be "agriculture." There is some kind of cultivation or prodding of the soil at the inception when the planting is done and subsequently also at intervals. In the case of coffee grown on hill slopes, there is no ploughing or tillage as in the case of wet and dry fields; but it cannot be maintained that growing coffee is not an agricultural operation. Coffee and tea plants stand on the soil for many years, and their produce is gathered periodically.

(45) It is interesting to note that all throughout these cases runs the central idea of either tillage of the land or sowing of seeds or planting or similar work on the land which invests the operation with the characteristic of agricultural operations and whenever that Central idea is fulfilled there is the user of land for agricultural purposes and the income derived therefrom becomes agricultural income.

(46) There were, on the other hand, decisions which interpreted the term "agriculture" in the wider sense as including all activities in relation to the land, even though they did not comprise these basic agricultural operations.

(51) In ***Commissioner of Income-tax, Burma* v. *Kokine Dairy, Rangoon*** [1938-6 ITR 502, 509], the question was whether income from a dairy farm and the milk derived from the farm is agricultural income and exempt as such from income-tax. Roberts C.J., who delivered the opinion of the Court observed:

> Where cattle are wholly stall-fed and not pastured upon the land at all, doubtless it is trade and no agricultural operation is being carried on: where cattle are being exclusively or mainly pastured and are nonetheless fed with small amounts of oil-cake or the like, it may well be that the income derived from the sale of their milk is agricultural income. But between the two extremes there must be a number of varying degrees, and the task of the

Income-tax Officer is to apply his mind to the two distinctions and to decide in any particular case on which side of the fence, if I may use the term, the matter falls.

(55) In ***Moolji Sicka & Co., In re*** [1939-7 ITR 493 (Cal.)] Derbyshire C.J., understood the term "agriculture" in a wider sense as including operations not only on the land itself but on the shrubs which grew on the soil and were according to him a part of the soil. The assessees were manufacturers of biri, a kind of cigarette consisting of tobacco wrapped in tendu leaves.

The tendu plant was of entirely wild growth and propagated itself without human agency in jungle and waste lands. The assessees had taken several villages on "lease" for plucking the leaves of such plants and the work done by the assessees consisted in pruning the trees and burning the dead branches and dried leaves lying on the ground.

The Court held that the profits accruing to the assessees by the sale of tendu leaves was not exempt as agricultural income but to the extent to which pruning of the tendu shrub occurred, there was in a technical and legal sense a cultivation of the soil in which the shrub grew and therefore so much of the income as was shown by the assessee to be profit derived from the collection and preparation, so as to take them fit to be taken to the market, of tendu leaves produced by the pruning of the tendu shrubs was exempt as agricultural income.

(56) The word cultivation was here understood by the learned Chief Justice not only in the sense of cultivation of the soil but in the sense of cultivation of the tendu shrubs which grew on the soil and were therefore a part of it. The operations which were performed on the shrubs were certainly not operations performed on the soil itself and the opinion expressed by the learned Chief Justice has certainly given an extended meaning to the term cultivation as used with reference to the soil.

It is significant however to observe that cultivation of the soil was considered an essential ingredient which rendered the income derived from the tendu leaves agricultural income within the meaning of its definition in S. 2(1)(a) of the Act.

(57) 1950-18 ITR 259 at p. 271 contains a further extension of this idea where Vishwanatha Sastri J., observed at p. 274:

> Pasture land used for the feeding and rearing of livestock is land used for agricultural purposes: ILR 25 Mad. 627 at pp. 629, 630. Rearing of livestock such as cows, buffaloes, sheep and poultry is included in "husbandry". These animals are considered to be the products of the soil, just like crops, roots, flowers and trees, for they live on the land and derive their sustenance from the soil and its produce: AIR 1938 Rang. 260 at p. 261)(FB). It is therefore not legitimate in my opinion, to confine the word "agriculture" to the cultivation of an open field with annual or periodical crops like wheat, rice, ragi, cotton, tobacco, jute, etc. Casuarina is usually raised on dry lands of poor quality, and it is usual to find the same land used alternatively for the cultivation of ordinary cereal crops like groundnut, gingelly, cholam, kambu, etc. and for the raising of Casuarina plantations. The land bears the dry assessment whatever be the nature of the crop raised.

(59) The cases above noted all of them involve some expenditure of human skill and labour either on the land or the produce of the land, for without such expenditure there would be no question of the income derived from such land being agricultural income. Where, however,

the products of the land are of wild, or spontaneous growth involving no expenditure of human labour and skill there is unanimity of opinion that no agricultural operations were at all involved and there is no agricultural income. In such cases, it would be the absence of any such operations rather than the performance thereof which would be the prime cause of growth of such products.

(60) The cases bearing on this aspect of the question may be noted. 91 Pun Re 1919, p. 237: AIR 1919 Lah 222 is the earliest case where a stretch of natural forest came in for consideration. It was a forest land and it was held to be agricultural land or land used for purposes subservient to agriculture or for pasture and therefore exempt from pre-emption under S. 4 of the Punjab Pre-emption Act, 1905.

(63) In ***Mustafa Ali Khan* v. *Commissioner of Income-tax, U.P. & C.P.*** [1945-13 ITR 98 (Oudh)], which went up to the Privy Council, the Oudh Chief Court held that income from the sale of forest trees growing on land naturally and without the intervention of human agency, even if the land was assessed to land revenue, was not agricultural income within the meaning of S. 2(1)(a) of the Income-tax Act.

(65) ***Benoy Ratan Banerji* v. *Commissioner of Income-tax, U.P., C.P. & Berar***, [1947– 15 ITR 98 (All)], was another case in which the assessee derived income from the sale of timber from his Zamindari on which there had been for many years, a number of forest trees, khar and wild plants. There was no evidence on the record to show that the growth of the trees in question was the result of any actual cultivation by the assessee at all.

The various trees which he sold were of spontaneous growth, not having grown as a result of actual cultivation. The Court held that in order to come within the definition of “agricultural income,” the income had not only to be derived from land which was used for “agricultural purposes” but such income had also to be derived by the process of “agriculture.”

The Court observed that being trees of spontaneous growth, to the production of which the assessee had made no contribution, by way of cultivation no question could arise either of the land on which they grew being “used for agricultural purposes” or of the trees themselves and the income they produced being the result of “agriculture.”

The Court accordingly held that the income from the sale of forest trees of spontaneous growth growing on land naturally and without the intervention of human agency, was not agricultural income within the meaning of S. 2(1)(a) of the Income-tax Act even if such land was subject to a local rate assessed and collected by officers of the Crown as such and such income was not exempt from income-tax under S. 4(3)(viii) of the Act.

(66) The Nagpur High Court in ***Beokar Singh* v. *Commissioner of Income Tax*** considered the dictionary meaning of the term “agriculture” which included forestry within its compass but observed that the essence of agriculture even when it was extended to include “forestry”, was the application of human skill and labour; without that it could neither be an art nor a science and that was according to them the determining factor in such class of cases.

(67) The Court came to the conclusion that it was essential that the income should be derived from some activity which necessitated the employment of human skill and labour and which was not merely a product of man’s neglect or inaction except for the gathering in of the

spoils. Not only must the assessee labour to reap the harvest, but he must also labour to produce it, and they accordingly held that the income in question was not agricultural income and was not exempt from taxation under S. 4(3)(viii) of the Indian Income-tax Act.

(68) We now come to the decision of the Privy Council in ***Mustafa Ali Khan* v. *Commissioner of Income-tax, U.P. Ajmer and Ajmer Merwara*** (1948) 16 ITR 330. It will be recalled that the Oudh Chief Court had in 1945 – 13 ITR 98 decided that income from the sale of forest trees growing on land naturally and without the intervention of human agency even if the land was assessed to land revenue was not agricultural income within the meaning of S. 2(1)(a) of the Indian Income-tax Act.

The appellant took an appeal to the Privy Council against this decision and the main question for consideration before their Lordships was whether the land was used for agricultural purposes and the income derived therefrom was agricultural income. Their Lordships of the Privy Council observed that the income in question

> (W)as derived from the sale of trees described as forest trees growing on land naturally and the case has throughout proceeded upon the footing that there was nothing to show that the assessee was carrying on any regular operations in forestry and that the jungle from which trees had been cut and sold was a spontaneous growth. Upon those facts the question is whether such income is (within S. 2(1)(a) of the Act) rent or revenue.... or alternatively .... whether such income was, within S. 2(1)(b), income derived from such land by agriculture.
>
> It appears to their Lordships that, whether exemption is sought under S. 2(1)(a) or S. 2(1)(b), the primary condition must be satisfied that the land in question is used for agricultural purposes; the expression “such land” in (b) refers back to the land mentioned in (a) and must have the same quality. It is not then necessary to consider any other difficulty which may stand in the way of the assessee. His case falls if he does not prove that the land is “used for agricultural purposes”. Upon this point their Lordships concur in the views which have been expressed not only in the Chief Court of Oudh but in the High Court of Madras (see 1946 – 14 ITR 92 at p. 99 and the High Court of Allahabad (see 1947 – 15 ITR 98 (All) and elsewhere in India. The question seems not yet to have been decided whether land can be said to be used for agricultural purposes within the section, if it has been planted with trees and cultivated in the regular course of arboriculture, and upon this question their Lordships express no opinion. It is sufficient for the purpose of the present appeal to say (1) that in their opinion no assistance is to be got from the meaning ascribed to the word “agriculture” in other statutes and (2) that, though it must always be difficult to draw the line, yet, unless there is some measure of cultivation of the land, some expenditure of skill and labour upon it, it cannot be said to be used for agricultural purposes within the meaning of the Indian Income-tax Act. In the present case their Lordships agree with the High Court in thinking that there is no evidence which would justify the conclusion that this condition is satisfied.

(69) It may be noted that the Privy Council also proceeded upon the footing that there was nothing to show that the assessee was carrying on any regular operations in forestry and these observations are patient of argument that if any regular operations in forestry had been carried on the land they might have made a difference to the result. Their Lordships also did not

express any opinion on the question whether land can be said to be used for agricultural purposes within the section if it has been planted with trees and cultivated in the regular course of arboriculture.

They were, however, definite in their opinion that unless there is some measure of cultivation of the land, some expenditure of skill and labour upon it, the land cannot be said to be used for agricultural purposes within meaning of the Act. Agricultural operations are thus defined by them to be operations where there was some measure of cultivation of the land, some expenditure of skill and labour upon it.

If these conditions were satisfied in regard to any particular land, then such land can be said to be used for agricultural purposes and the income derived therefrom constitute agricultural income within the meaning of S. 2(i)(a) of the Act. The term "agriculture" for the purposes of the Indian Income-tax Act was thus in effect defined by their Lordships to mean some measure of cultivation of the land and some expenditure of skill and labour upon it and unless the operations, whether they be agricultural operations or forestry operations conformed within those definitions, they could not be styled agricultural operations so as to constitute land on which they were performed land used for agricultural purposes.

(79) In ***Pratap Singh* v. *Commissioner of Income Tax, U.P., C.P. and Berar*** [1952 – 22 ITR 1], however, the High Court of Allahabad struck a different note. The assessee there derived the income from the sale of forest trees growing on land naturally and spontaneously without the intervention of any human agency but carried on forestry operations working the forest for at least some time on scientific lines in accordance with a scheme of making profits. There was a regular working plan and the assessee was deriving regular income from the forest and spending money to increase the profit.

The Court held that the "agriculture" and "agricultural purposes" with reference to land clearly implied that some operations must be carried on the land itself; human skill and labour should be used for the purpose of ploughing the land, manuring it, planting the trees or some similar process, and that mere weeding care and preservation of forest trees which grew spontaneously were not operations on the land which were necessary to constitute the process, a process of agriculture. In the course of the judgment, the Court interpreted the above passage from the judgment of their Lordships of the Privy Council in 1949 – 16 ITR 330 as under:

> It is quite clear that their Lordships were of the view that, for income to be agricultural income, the essential element that must exist is that there should be "some measure of cultivation of the land," or "some expenditure of skill and labour upon it." The language used by their Lordships of the Privy Council shows that the expenditure of skill and labour must be upon the land and not merely on the trees which are already growing on it as a result of spontaneous growth.

(80) Mere regeneration and preservation of trees could not be said to be expenditure of human skill and labour upon the land itself and the land could not under the circumstances be held to be used for agricultural purposes nor could it be held that any process of agriculture was being carried on. The Court observed that planned and scientific exploitation of a forest of spontaneous growth, though it might yield regular income, would not be income from

agriculture as no operations were carried out and no human skill and labour was expended in such a case on the land itself.

(89) It appears from the above survey that there has been a divergence of opinion amongst the various Courts not only in regard to the connotation of the terms “agriculture” and “agricultural purposes” but also in regard to the nature of forestry operations performed in the forest which can be styled agricultural operations so as to constitute the “land used for agricultural purposes” within the definition of agricultural income as given both in the Indian Income-tax Act and in the several Agricultural Income-tax Acts passed by the various States.

(90) It may be noted at the outset that the definition of “agricultural income” given in S. 2(i) of the Indian Income-tax Act is in identical terms with the definitions of that term as given in the various Agricultural Income-tax Acts passed by the several States. It will be idle therefore to treat “Taxes on Agricultural Income” which fall within the legislative competence of the State Legislature as having no relation at all to the corresponding provisions of the Indian Income-tax Act.

Once it is determined that the income in question is derived from land used for agricultural purposes by agriculture, it would be agricultural income and as such exempt from tax under S. 4(3)(viii) of the Indian Income-tax Act and would fall within the purview of the relevant provisions of the several Agricultural Income-tax Acts passed by the various States.

The result of this determination would be that the assessee would not be liable to assessment under the Indian Income-tax Act but he would have to pay the Agricultural Income-tax which would be levied upon him under the relative Agricultural Income-tax Acts. The only enquiry which would therefore be relevant is whether the income in question is agricultural income within the terms of the definition thereof and that would have to be determined in each case by the Court having regard to the facts and circumstances of the particular case before it.

(91) In order that an income derived by the assessee should fall within the definition of agricultural income two conditions are necessary to be satisfied and they are: (i) that the land from which it is derived should be used for agricultural purposes and is either assessed for land revenue in the taxable territories or is subject to local rates assessed and collected by the officers of the Government as such; and (ii) that the income should be derived from such land by agriculture or by one or the other of the operations described in Cls. 2 and 3 of S. 2(b) of the Indian Income-tax Act.

(92) It was at one time thought that the assessment of the land to land revenue in the taxable territories was intended to exempt the income derived from that land from liability for payment of income-tax altogether and that theory was based on the assumption that an assessee who was subject to payment of land revenue should not further be subjected to the payment of income-tax, because if he was so subjected he would be liable to pay double taxation.

(95) We have, therefore, to consider when it can be said that the land is used for agricultural purposes or agricultural operations are performed on it. Agriculture is the basic idea underlying the expressions “agricultural purposes” and “agricultural operations” and it is pertinent, therefore, to enquire what is the connotation of the term “agriculture.”

As we have noted above, the primary sense in which the term agriculture is understood is agar-field and cultra- cultivation, i.e., the cultivation of the field and the term is understood only in that sense, agriculture would be restricted only to cultivation of the land in the strict sense of the term meaning thereby, tilling of the land, sowing of the seeds, planting and similar operations on the land.

They would be the basic operations and would require the expenditure of human skill and labour upon the land itself. There are however other operations which have got to be resorted to by the agriculturist and which are absolutely necessary for the purpose of effectively raising the produce from the land.

They are operations to be performed after the produce sprouts from the land, e.g., weeding, digging the soil around the growth, removal of undesirable under-growths and all operations which foster the growth and preserve the same not only from insects and pests but also from depradation from outside, tending, pruning, cutting, harvesting and rendering the produce fit for the market. The latter would all be agricultural operations when taken in conjunction with the basic operations above described, and it would be futile to urge that they are not agricultural operations at all.

But even though these subsequent operations may be assimilated to agricultural operations when they are in conjunction with these basic operations, could it be said that even though they are divorced from these basic operations they would nevertheless enjoy the characteristic of agricultural operations? Can one eliminate these basic operations altogether and say that even if these basic operations are not performed in a given case the mere performance of these subsequent operations would be tantamount to the performance of agricultural operations on the land so as to constitute the income derived by the assessee therefrom agricultural income within the definition of that term?

(96) We are of opinion that the mere performance of these subsequent operations on the products of the land where such products have not been raised on the land by the performance of the basic operations which we have described above would not be enough to characterise them as agricultural operations. In order to invest them with the character of agricultural operations, these subsequent operations must necessarily be in conjunction with and a continuation of the basic operations which are the effective cause of the products being raised from the land.

It is only if the products are raised from the land by the performance of these basic operations that the subsequent operations attach themselves to the products of the land and acquire the characteristic of agricultural operations. The cultivation of the land does not comprise merely of raising the products of the land in the narrower sense of the term like tilling of the land, sowing of the seeds, planting, and similar work done on the land but also includes the subsequent operations set out above all of which operations, basic as well as subsequent form, one integrated activity of the agriculturist and the term “agriculture” has got to be understood as connoting this integrated activity of the agriculturist.

One cannot dissociate the basic operations from the subsequent operations, and say that the subsequent operations, even though they are divorced from the basic operations can constitute agricultural operations by themselves. If this integrated activity which constitutes agriculture is undertaken and performed in regard to any land that land can be said to have been used for "agricultural purposes" and the income derived therefrom can be said to be "agricultural income" derived from the land by agriculture.

(97) In considering the connotation of the term "agriculture" we have so far thought of cultivation of land in the wider sense as comprising within its scope the basic as well as the subsequent operations described above, regardless of the nature of the products raised on the land. These products may be grain or vegetables or fruits which are necessary for the sustenance of human beings including plantations and groves, or grass or pasture for consumption of beasts or articles of luxury such as betel, coffee, tea, spices, tobacco, etc. or commercial crops like cotton, flax, jute, hemp, indigo, etc.

(101) If the term "agriculture" is thus understood as comprising within its scope the basic as well as subsequent operations in the process of agriculture and the raising on the land of products which have some utility either for consumption or for trade and commerce, it will be seen that the term "agriculture" receives a wider interpretation both in regard to its operations as well as the results of the same.

Nevertheless there is present all throughout the basic idea that there must be at the bottom of it cultivation of land in the sense of tilling of the land, sowing of the seeds, planting, and similar work done on the land itself. This basic conception is the essential *sine qua non* of any operation performed on the land constituting agricultural operation. If the basic operations are there, the rest of the operations found themselves upon the same.

But if these basic operations are wanting the subsequent operations do not acquire the characteristic of the agricultural operations.

(102) All these operations no doubt require the expenditure of human labour and skill but the human labour and skill spent in the performance of the basic operations only can be said to have been spent upon the land. The human labour and skill spent in the performance of subsequent operations cannot be said to have been spent on the land itself, though it may have the effect of preserving, fostering and regenerating the products of the land.

(103) This distinction is not so important in cases where the agriculturist performs these operations as a part of his integrated activity in cultivation of the land. Where, however, the products of the land are of spontaneous growth, unassisted by human skill and labour, and human skill and labour are spent merely in fostering the growth, preservation and regeneration of such products of land, the question falls to be considered whether these subsequent operations performed by the agriculturist are agricultural operations and enjoy the characteristic of agricultural operations.

(104) It is agreed on all hands that products which grow wild on the land or are of spontaneous growth not involving any human labour or skill upon the land are not products of agriculture and the income derived therefrom is not agricultural income. There is no process of agriculture involved in the raising of these products from the land. There are no agricultural operations performed by the assessee in respect of the same, and the only work which the assessee performs here is that of collecting the produce and consuming and marketing the same.

No agricultural operations have been performed and there is no question at all of the income derived therefrom being agricultural income within the definition given in S. 2(1) of the Indian Income-tax Act. Where, however, the assessee performs subsequent operations on these products of land which are of wild or spontaneous growth, the nature of those operations would have to be determined in the light of the principles enumerated above.

(105) Applying these principles to the facts of the present case, we no doubt start with the finding that the forest in question was of spontaneous growth. If there were no other facts found, that would entail the conclusion that the income is not agricultural income. But, then, it has also been found by the Tribunal that the forest is more than 150 years old, though portions of the forest have from time to time been denuded, that is to say, trees have completely fallen and the proprietors have planted fresh trees in those areas and they have performed operations for the purpose of nursing the trees planted by them.

It cannot be denied that so far as those trees are concerned, the income derived therefrom would be agricultural income. In view of the fact that the forest is more than 150 years old, the areas which had thus become denuded and re-planted cannot be considered to be negligible. The position therefore is that the whole of the income derived from the forest cannot be treated as non-agricultural income.

If the enquiry had been directed on proper lines, it would have been possible for the Income-tax authorities to ascertain how much of the income is attributable to forest of spontaneous growth and how much to trees planted by the proprietors. But no such enquiry had been directed, and in view of the long lapse of time, we do not consider it desirable to direct any such enquiry now. The expenditure shown by the assessee for the maintenance of the forest is about Rs. 17,000 as against a total income of about Rs. 51,000.

Having regard to the magnitude of this figure, we think that a substantial portion of the income must have been derived from trees planted by the proprietors themselves. As no attempt has been made by the Department to establish which portion of the income is attributable to forest of spontaneous growth, there are no materials on which we could say that the judgment of the court below is wrong.

(106) The appeal is accordingly dismissed with costs.

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C.I.T. v. *Maddi Venkatasubbayya*

(1951) XX ITR 151 (Mad.)

VISWANATHA SASTRI, J. – The question referred to us is as follows:

> Whether, in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 7,500 was 'agricultural income' within the meaning of Section 2(1)(b) of the Act and exempt from taxation under Section 4(3)(viii) of the Indian Income-tax Act?

The facts are briefly these. The assessee, a firm of merchants, purchased a standing crop of tobacco on an area of 93 acres 12 cents for Rs. 13,833 in January 1943, from the person who had raised the tobacco on the land. The tobacco was harvested, cured and sold in the market by the assessee before 21st March, 1943, for Rs. 33,498. The plucking of the ripe leaves, the pruning and flue-curing of the harvested tobacco were all done by the assessee firm. It is also stated that there was some sort of plouging on the land by the assessee. The curing of tobacco is said to be a process which is ordinarily employed by a cultivator of tobacco to render it fit for sale in the market.

The assessee was not a landholder or a ryot or a lessee of the land on which the tobacco crop stood. The tobacco plants had been raised on the land by its owner or lessee and they had reached such a degree of maturity as to render them saleable as standing crops to tobacco merchants in the locality. We may observe that it is not uncommon for merchants and traders in agricultural produce to purchase standing crops of tobacco, sugarcane, groundnut, etc., when the crop is ready or nearly ready for harvest. The purchaser in such a case may have to do some pruning work with reference to the crops as in this case and then cut the crops and market the produce. The operations said to have been performed by the purchaser in the present case were evidently performed with the consent of the person who raised the standing crop. They are incidental to reaping the fruits of the purchase. The Income-tax Officer and the Appellate Assistant Commissioner held that a part of the profit of the assessee realised by sale of the tobacco, namely Rs. 7,500, was derived from non-agricultural sources or operations and therefore liable to income-tax. The Appellate Tribunal held that the entire profits of the assessee from the tobacco dealer calculated in the sum of Rs. 12,000 was agricultural income and was exempt from income-tax under Section 4(3)(viii) of the Income-tax Act. The Commissioner of Income-tax disputes the correctness in law of the decision of the Appellate Tribunal. Hence this reference.

The burden is upon the assessee who claims exemption from tax under Section 4(3)(viii) of the Income-tax Act to prove that the income is "agricultural income" as defined in the Act: see ***Raja Mustafa Ali Khan* v. *Commissioner of Income-tax*** [(1948) 16 ITR 330 (PC)]. It is true, as pointed by the learned advocate for the assessee, that the exemption is conferred by the Act upon a particular kind of income and it does not depend on the character of the recipient. "Agricultural income" as defined in the Act is exempt from tax even though it can be brought under one or the other of the heads of income set out in Section 6 of the Act. Agricultural income has been held not to be assessable as business profits merely because the recipient of the income is a money-lender who has lent monies on a mortgage with possession and is receiving the rents and profits of agricultural land in lieu of interest on the loan. This is settled by the decision of the Judicial Committee in ***Commissioner of Income-tax* v. *Sir Kameswar Singh*** [(1935) 3 ITR 305 (PC)] and ***Raja Mustafa Ali Khan* v. *Commissioner of Income-tax*** [(1948) 16 ITR 330 (PC)]. But it has to be observed that the rent of the agricultural income received by a usufructuary mortgagee is agricultural income not because he is a usufructuary mortgagee but because being a usufructuary mortgagee he has gone into possession of the land and received rent as such. The mortgagee who receives rent receives it in the character of a person who has interest in the land and who is entitled to possession thereof. Therefore the income he receives in lieu of the interest on the loan is considered to be agricultural income. We, however, consider that this line of argument is not of assistance to the assessee in the present case.

It is agreed that the land on which the tobacco crop was raised was assessed to land revenue and was used for agricultural purposes. The income of the assessee was obviously not "rent" or "revenue" derived from such land within the meaning of Section 2(1)(a) of the Act. The only question is whether it is "income derived from such land by agriculture" within the meaning of Section 2(1)(b)(i) of the Act. The owner of the land, or of an interest therein, be he the landlord, ryot, lessee or usufructuary mortgagee, has an interest in the land and derives his income from the land. He may actually cultivate the land or he may receive the rent from cultivating tenants. In either case, the rent is the immediate and effective source of income and if the rent is derived from agriculture, the exemption from tax is attracted. Section 2(1)(a), (b)(ii) and (iii) and (c) of the Act clearly indicate that the person entitled to exemption are the persons falling within the following categories: The owner who lets agricultural land to cultivating tenants for a stipulated rent; the owner of agricultural land in which the tenant has a permanent right of occupancy with liability to pay a fixed rent or revenue; the owner of agricultural land who cultivates it himself; the lessee of such land; an occupancy tenant of such land having a permanent tenancy with liability for a fixed rent; a usufructuary mortgagee of the interest of the owner, landholder or tenant of such land as the case may be; a sub-lessee; and persons occupying a similar position.

The argument of the assessee's learned counsel is that Section 2(1)(b)(i) which alone falls to be considered in the present case is so wide in its scope as to be applicable to profits derived by a merchant who purchases a standing crop and sells the produce after harvesting it. It is said that such profits constitute an income "derived from land by agriculture." A cultivating owner or tenant of land who sells a standing crop or the produce after harvest, derives his income from his land by agriculture. The landholder or lessor who receives his rent either in kind or in cash from his tenant, derives income from his land by agriculture, though the person who actually ploughs and tills the land is the tenant. A merchant who purchases the standing crop derives profit from his contract on purchase at an advantageous price and resale of the produce at a higher price. The land is not the direct or immediate or effective source of his income. Agricultural income cannot be said to accrue to every person into whose hands the produce of the land passes. It is only the owner, landlord or ryot, or persons having a derivative interest in the land from these persons that can be said to "derive" income from the land by the performance of agricultural operations on it. A merchant who purchases the standing crop appears on the scene when the crop is ripe or very nearly ripe for harvest, and pays a price for the commodity in which he is trading. No doubt he has a right to enter upon the land to preserve the crop, to tend it and to harvest it but he has no right or interest of any kind in the land itself nor has he any right to the exclusive possession of the land for any period. Growing crops are movable property under Section 3 of the Transfer of Property Act and Section 2, clause (6), of the Registration Act. See also the definition of immovable property in the General Clauses Act. In English law a sale of growing crops is regarded as sale of chattels. The purchaser of a standing crop differs from the purchaser of harvested crops only in this, that the former has a right to enter upon the land to attend to the crop and cut it when it is ripe for harvesting. He is in the position of the holder of a "licence" within the definition of that term in Section 52 of the Indian Easements Act. The purchaser whether of standing crop or of the harvested produce derives his profits as a trader or merchant from the purchase and resale of the produce in the market and does not derive the profit from the land in which *ex concessi* he has no interest.

If the contention in the present case is to prevail, a trader in grains, cereals or other produce who purchases a standing crop ready to be harvested and sells the standing crop at a profit to another merchant, his profit is exempt from income-tax, even though he has no interest of any kind in the land on which the crops stand. Neither he nor his tenants or servants ever performed any agricultural operation on the land. The assessee earned a profit by the sale of the tobacco at a price over and above the cost price paid for the standing crop and the expenses incurred in harvesting and curing the tobacco. The pruning and ploughing operations were ancillary operations of an unsubstantial character and were conducted under an arrangement with the person who raised the crop. Once the standing crop passed from the ownership of the cultivating tenant to that of the trader who purchased it, it lost the quality of agricultural income at that point and any profit made by the trader thereafter by a sale of the produce at a higher price than his cost price would, in our opinion, be a business profit. The direct source of the assessee's income was the purchase and sale of the produce at an advantageous price. The mere fact that the thing purchased was standing crop rather than any other chattel would not make the profit derived from the operation of buying and selling anything else than a business profit. Rent, revenue or income derived from land by agriculture in Section 2 has reference to the rent, revenue or income derived by a person having some interest in land and by virtue of the fact that he is the owner of that interest. A profit accruing to a firm of merchants having no interest in land but having a mere licence to enter upon land and gather the produce as incidental to a transaction of purchase of standing crops, by a sale of the crops after harvest, differs radically in its character from income derived by way of rent or revenue or by the performance of agricultural operations by a person having an interest therein as owner, tenant or mortgagee with possession etc. The profit in this case is derived, as we have already stated, by entering into contracts for the purchase of a commodity and by the resale of that commodity for a higher price. The fact that the movable property now in question springs from, or is the product of agricultural operations carried out by the owner or tenant of agricultural land, does not lead to the conclusion that the profit of a trader who has no interest in the land but who buys and sells the movable property in the course of his trade is "agricultural income" as defined in the Act. A fruit merchant may purchase only the produce of an orchard belonging to another and a timber merchant may purchase only the trees planted by the owner of the grove. In these cases he gets the right to gather the fruits or the timber on the land but the profit realised by the merchant on a sale of the commodity is not agricultural income derived from land but is business profit.

In ***Yagappa Nadar* v. *Commissioner of Income-tax*** [(1927) I.L.R. 50 Mad. 923], this Court held that income earned by a person who had a licence to tap toddy from trees belonging to the licensors and who sold the toddy extracted by him at a profit was non-agricultural income, though if the same income was earned by the owner or the lessee of the land on which the trees grew, it would be agricultural income. The learned counsel for the Commissioner of Income-tax referred us to the decision of the Judicial Committee in ***Commissioner of Income-tax* v. *Kamakshya Narain Singh*** [(1948) 16 I.T.R. 325] which decided that interest on arrears of rent payable in respect of land used for agricultural purposes was not agricultural income within Section 2(1) of the Income-tax Act. It was held that the interest was neither rent nor revenue derived from the land. The relationship between the tenant who executed the bond for arrears of rent with interest and the landlord was held to be that of a debtor and creditor. There is however one observation of the Judicial Committee which might be helpful in connection with the present case. Their Lordships while holding that interest on rent was revenue derived by the landholder, went on to hold that it was not revenue "derived" from land. They observed:

> The word 'derived' is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest, land indeed appears in the second degree, but the immediate and effective source is rent, which has suffered the accident of non-payment.

Here also the land indeed appears in the history of the trading operations of the assessee but it cannot be said to be the immediate or the effective source of the income made by the assessee firm. The immediate and effective source was the trading operation of purchase of the standing crop and its resale in the market after harvesting the produce at an advantageous price.

For these reasons we hold that the sum of Rs. 7,500 was not exempt from liability to assessment to income-tax and that the answer to the question referred to must be in the negative and against the assessee. The assessee shall pay Rs. 250, the costs of the Commissioner of Income-tax on this reference.

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Sakarlal Naranlal v. *C.I.T.*

AIR 1965 Guj. 165

N.H. BHAGWATI, J. – Ordinarily we find cases where the assessee relies on section 4(3)(viii) and the revenue contests the claim of the assessee, but here in this reference the position is reversed and we find the revenue relying on section 4(3)(iii) and the assessee disputing that position. The reference relates to assessment year 1954-55, 1955-56 and 1956-57 the corresponding previous years being Samvat Years 2009, 2010 and 2011. The assessee is an individual and he holds certain agricultural lands. In or about 1952, a friend of the assessee suggested to him the idea of growing a vegetable product commonly called galka, the botanical name being luffa pentendra and the assessee accordingly obtained galka seeds from abroad and, after preparing the lands for cultivation, raised galka on the lands in 1952. Now the kind of galka prown by the assessee was not an indigenous kind but was a kind grown fairly widely in Formosa, Japan and other places. After the galkas were fully grown, they were removed from the plants and the assessee then subjected them to a process for preparing what are called loofahs. The process consisted of various steps taken in the following order: (1) tapping dry galkas for taking out the seeds; (2) deskinning them; (3) giving them an acetic acid bath; (4) holding them in salicylic acid; (5) drying them in the sun; (6) putting them in cold water for two days; and (7) lastly, pressing them for the purpose of packing. The final product which emerges as a result of subjecting galkas to this process is known as loofah. It is fibrous product in the nature of a pad and we are told that it is commonly used in the manufacture of shoes.

The foreign loofahs are about 16” in length and 4” in width. The loofahs prepared by the assessee were, however, only 5” in length and 2-1/2” in width. The assessee tried to market these loofahs abroad and sent them to England on consignment basis for sale, but it was found that it was not possible to sell them. The position was that even if they were sold at the lowest possible rate, the assessee would have been liable to pay purchase tax and that would have caused considerable loss to the assessee. The loofahs were, therefore, reshipped in India. The result was that loss was suffered by the assessee in this transaction. The assessee claimed a loss of Rs. 1,85,932-8-0 in the assessment for the assessment year 1954-55 and similar losses were also claimed in the assessment for the subsequent assessment years 1955-56 and 1956-57.

2. We may point out at this stage that the accounts in respect of the activities relating to the cultivation of galkas were entered by the assessee in the books of account of a business carried on by him in the name of Sakarlal Sons and Company. After the galkas were raised and removed from the plants, they were transferred by the assessee to the books of account of another business carried on by the assessee in the name of Minaxi Trading Company at a particular value determined by the assessee and it was Minaxi Trading Company which processed the galkas and exported loofahs prepared out of them. The losses set out above were, therefore, suffered by the business of Minaxi Trading Company and they were obviously arrived at on the basis of the cost of the galkas being taken at the value of which they were shown to have been taken over from Sakarlal Sons and Company. These losses were claimed by the assessee as business arising out of non-agricultural operations but the

revenue contended that they were agricultural losses and were, therefore, not liable to be taken into account in computing the income of the assessee from business. That is a question which we shall presently consider, but it is clear that even if the contention of the assessee is accepted and it is held that the operation of Minaxi Trading Company were non-agricultural operations, a question might well arise as to the correct amount of losses suffered by the assessee attributable to these non-agricultural operations. Both the business, namely, Sakarlal Sons and Company and Minaxi Trading Company being the proprietary business of the assessee, the revenue may in that event have to apportion the losses suffered by the assessee in the entire transaction between the agricultural operations carried on in the name of Sakarlal Sons and Company and the non-agricultural operations carried on in the name of Minaxi Trading Company by resort to rule 7 of the Rules made under section 59 of the Act. We are, however, not concerned with that question and we do not wish to express any opinion upon it. These facts have been set out by us namely because an argument was founded upon them on behalf of the assessee for showing the conduct of the assessee as a cultivator.

3. The losses claimed by the assessee were disallowed by the Income-tax Officer on the ground that they were agricultural losses. The Income-tax Officer took the view that the raising of galkas was ultimately an agricultural operation and so far as the processing of galkas resulting in the preparation of loofahs was concerned, it was a process ordinarily employed by a cultivator to render galkas produced by him fit to be taken to market and the losses resulting from these operations were, therefore, agricultural losses within the meaning of section 2(1) (b) (ii). The assessee carried the matter in appeal, but the Appellate Assistant Commissioner upheld the disallowance of these losses. The matter was then taken to the Tribunal. The Tribunal also came to the conclusion that the process employed by the assessee was a process which came within section 2(1)(b)(ii) and the losses suffered by the assessee were therefore, agricultural losses which were not liable to be dedicated in computing the income of the assessee. Much argument turned upon the question as to what findings of fact were actually reached by the Tribunal and it would, therefore, be desirable to set out the relevant portion of paragraph 5 and the whole of paragraph 6 of the order of the Tribunal which were in the following terms:

> "[I]t was submitted that this was a case where the product galka has a market by itself and that subsequent operations are in the nature of manufacturing operations which do not come within the scope of the definition of agricultural income in section 2(1) (b) (ii). Reliance for this purpose is placed on evidence in the shape of letters written by an entity called Messrs. M. Kawanishi of Kobe, Japan. This is a letter, which was written to the assessee on September 21, 1959, in which it is stated that looking to the quality of the stuff, texture and size, they would have been in a position to purchase the stuff on assorted basis in the year 1952, round about the 12s per dozen on C.I.F. Japanese port basis. Another letter written on October 8, 1959, by another party of Japan was also relief upon for showing that the price in 1952 would have been round about 15-1/2s, a dozen. It is stated that on the basis of these letters, even dried fruits had a market by themselves and that, therefore, the rest of the activity was not one which would be an agricultural operations.

> We are unable to agree with this submission. In order to find out whether there was a market for the produce as such or whether it had to be processed before it could be sold, what is necessary is to see whether there is a market at which it could be absorbed. The existence of a theoretical market in a place like Japan is not one that has to be taken into account for this purpose. The section postulates the performance of any process ordinarily employed by a cultivator so as to render the produce fit to be taken to market. The expression "ordinarily employed" would appear to postulate the existence of certain conditions at or about the locality in which the produce is grown. The item marketed by the assessee was a stranger to the Indian market. Therefore, there could have been no ready market in India. Indeed, this position was not disputed by the assessee. Therefore, merely because there was some possibility of a sale at its original stage, in a distant country, it does not follow that the fruit by itself had a market, which is relevant for our purpose. If a produce is grown, say in Kerala, and it does not have a ready market in its original stage there, then merely because there is some market, say in Punjab, for the produce in its original stage, it does not follow that the process ordinarily employed by cultivators in Kerala would cease to be agricultural process. In all these matters, what is liable to be looked into is the area in which the produce is grown and the customary process employed to render it fit for market, if it is not marketable in its original stage. That is why it is a question of fact of each case: see ***Brihan Maharashtra Sugar Syndicate Ltd.,* v. *Commissioner of Income-tax*** [(1946) 14 ITR 611]. In our opinion, therefore, in this case, there was no market it could be sold in its original stage.

The assessee thereupon made an application to the Tribunal for a reference and on the application the Tribunal made an order referring the following question for the opinion of this court:

> Whether on the facts here, where the galka produced does not have a market in India, the process employed on it for purposes of exporting and selling it abroad satisfies the requirements of section 2(1)(b)(ii) of the Act?

This was the form in which the question was framed, but an argument was addressed to us that this question did not bring out the real controversy between the parties inasmuch as it was based on a very limited postulate, namely, that the galkas did not have a market in India whereas the actual finding of the Tribunal was that there was no market at all for the galkas and that the question, should, therefore, be reframed so as to bring out the real controversy between the parties. We shall consider this argument at the appropriate stage.

4. It is evident that the question depends for its determination on the true construction of section 2(1)(b)(ii) of the Income-tax Act,1922. The question whether the process employed by the assessee for the purpose of preparing loofahs out of galkas with a view to exporting and selling loofahs abroad satisfies the requirements of section 2(1)(b)(ii) becomes material because if the process is covered by section 2(1)(b)(ii), the whole of the loss suffered by the assessee would be agricultural loss and would by reason of section 4(3)(viii) be liable to the excluded in computing the income of the assessee. Section 4(3)(viii) provides that agricultural income shall not be included in the total income of an assessee.

Section 2 refers to income derived from land which means arising from land and denotes income, the immediate and effective cause of which is land. It is divided into three clauses. Clause (i) in terms takes in income derived from agricultural land by agriculture which would include agricultural produce as held by the Supreme Court in ***Dooars Tea Co. Ltd*., v *Commissioner of Income-tax*** [(1962) 44 ITR 6]. Clause (ii) includes cases of income derived from the performance of any process ordinarily employed by a cultivator to render the produce fit to be taken to market. The reason behind this provision is not far to seek and it really provides a clue to its interpretation. A cultivator raises produce from the land with a view to selling it. If there is a market for the produce as grown, there is no difficulty; the cultivator can in such a case sell the produce without anything more and he need not perform any process on the produce. But if there is no market for the produce as grown and it can be sold only by performing some process on it, the cultivator would have to perform such process in order to be able to sell the produce; otherwise the produce would not be marketable and the raising of it would be futile. Where such is the case, the legislature says that, though strictly the agricultural operations ceases when the produce is raised and removed from the soil, the performance of the process should be regarded as a continuation of the agricultural operations since the process has to be performed by the cultivator for the purpose of enabling him to sell the produce which the otherwise cannot. It is because the performance of the process is essential in order to render the produce marketable, which it is otherwise not, that the law regards it as a part of the agricultural operations carried on by the cultivator. This reason also explains the other requirement of the section, namely, that the process must be such as is ordinarily employed by cultivators to make the produce saleable. The performance of the process is assimilated to agricultural operations and must, therefore, like agricultural operations *stricto sensu*, be an operation which is ordinarily done by cultivators. If some special or unusual process is employed by a cultivator, which is not ordinarily employed by cultivators to render the produce marketable, it cannot be regarded as part of the agricultural operations and the benefit of the income being treated as agricultural income would not be available to the cultivator. It will be clear from this discussion that there are two conditions which are required to be fulfilled before a process performed by the assessee can be said to be a process within the meaning of section 2(1)(b)(ii). The first condition is that the process must be necessary to render the produce fit to be taken to market and that involves the proposition that there must be no market for the produce in its raw state. If there is already a market for the produce in its raw state, then the process cannot be said to be a process employed to render the produce fit to be taken to market or, in other words, to make it marketable. That which is already marketable does not need any process to render it marketable. The second condition is that the process must be one which is ordinarily employed by a cultivator of the produce to render it marketable. But even if these two conditions are satisfied, it is not sufficient to attract the applicability of section 2(1) (b) (ii). There is an additional requirement which must be satisfied and that requirement springs directly from the language and the reason of the enactment. It follows as a necessary corollary from what is stated above that, even where the produce is subjected to a process ordinarily employed by cultivators to render it fit to be taken to market, the produce must not change its original character. The cultivator is permitted to subject the produce to a process in order to make it marketable and what is ultimately marketed must, therefore, be that produce. The character of the produce must not be altered as a result of the process. Of course when we say this we must make it clear that there may by changes brought about in the produce for the purpose of making the produce marketable but those changes must not amount to altering the original character of the produce: the vide ***Dooars Tea Company*** case.

5. Turning now to the authorities, the first decision to which our attention was invited was the decision of the Patna High Court in In ***re Bhikanpur Sugar Concern***. The question which arose in this case was whether income derived from sale of sugar manufactured from sugarcane grown by the assessee on its lands was agricultural income within the meaning of section 2(1)(b) of the Income-tax Act, 1918, which was in identical terms with section 2(1)(b) of the income-tax Act, 1922. The assessee contended that the income was agricultural income, but a Full Bench of the Patna High Court consisting of three judges held that it was not, on the ground that the process employed by the assessee for manufacturing sugar was not a process ordinarily employed by cultivators of sugarcane for rendering it fit for marketing. Dawson-Miller C.J. said that the market of the vast majority of cultivators of sugarcane was the sugar factory or the country mill and they did not manufacture sugar out of it in order to make it marketable and that the process employed by the assessee was, therefore, not a process ordinarily employed by cultivators so as to bring the case within the section 2(1)(b)(ii). The other learned judges also expressed the same view. This decision clearly proceeded on the basis that the process employed by the assessee not being a process ordinarily employed by cultivators to render the sugarcane produced by them marketable, one of the two conditions specified in section 2(1)(b)(ii) was not fulfilled.

6. We were then referred to a decision of the Calcutta High Court in ***Killing Valley Tea Company Ltd.* v. *Secretary of State*** [(AIR 1921 Cal. 40)]. The assessee in this case grew green leaf tea in a tea garden owned by it and manufactured tea by performing a process on green leaves plucked from the tea garden. In its assessment to income-tax, the assessee contended that the entire income from the sale of manufactured tea was agricultural income within the meaning of section 2(1)(b)(ii) of the Income-tax Act, 1918. The Calcutta High Court, however, held that though the green leaf from the tea plant was not a marketable commodity for immediate use as an article of food, it was certainly "a marketable commodity to be manufactured by people who possess the requisite machinery into tea fit for human consumption" and the manufacturing process could not, therefore, properly be said to be employed to render the tea leaves fit to be taken to market as required by the section. This decision, therefore proceeded on the basis that if there is a market for the produce grown by the assessee and despite that, some process is performed on it, such process cannot be said to be a process to render the produce fit to be taken to market so as to attract the applicability of section 2(1)(b)(ii).

7. The next decision which was cited before us was the decision of the Patna High Court in ***J.M. Casey* v. *Commissioner of Income-Tax*** [(AIR 1930 Pat 44)]. The facts in this case were that the assessee cultivated aloe plants and from them by means of machinery prepared sisal fibre which he sold in the market. The question arose whether the whole of the income derived by the assessee was exempt from tax as being agricultural income. The Patna High Court held that it was exempt and the ground on which the Patna High Court based its decision was that aloe leaves had no market and that the process performed on aloe leaved for

preparing sisal fibre was a process ordinarily employed to render aloe leaves fit to be taken to market. Courtney-Terrell C.J. who delivered the main judgment, observed that no cultivation of aloe plant appeared to have been practiced save in connection with the process of manufacture of sisal fibre and, moreover, there was no market for aloe leaves. Of course aloe leaves could be supplied to jails but the learned Chief Justice observed, that did not make any difference since the leaves so bought by the jail authorities were treated by the prisoners by means of the same laborious and uneconomic process which was employed by some villagers in treating the leaves of the wild and uncultivated plant and that the object of the manufacture in jails was not the conducting of an economic process which rendered profitable the cultivation of the aloe plant but merely to keep the prisoners employed on sufficiently laborious and punitive work. It was thus definitely found that the aloe leaves were not ordinarily marketable and they could normally be sold only by converting them into sisal fibre. The learned Chief Justice made it clear that the decision of the court was based on these conditions which existed at the time and observed:

> It may be that in the future the economic conditions may change. If the growth of the aloe leaf should become established as an agricultural industry by itself and if the manufacturers of sisal fibre should cease to cultivate the plant themselves and should purchase the leaves in an open market then and such circumstances may possibly require reconsideration in the light of the income-tax law.

An argument was also advanced on behalf of the revenue that the assessee being the only cultivator, the process employed by him could not be said to be a process ordinarily employed by a cultivator to render aloe leaves marketable, but this argument was met by the learned Chief Justice by saying that since there was no cultivation of the aloe plant save in connection with the economic process involving the use of machinery such as was employed by the assessee, the process ordinarily employed would in fact be that used by the assessee. This decision thus laid down two propositions: (1) that in order to attract the applicability of section 2(1) (3)(ii) the produce in its state must not have a ready and available market where goods of that kind are bought and sold; and (2) that even if the assessee is the only cultivator, a generalization can be made from the single instance of the assessee and the process employed by the assessee can be regarded as a process ordinarily employed by a cultivator in render the produce marketable. The second proposition laid down in this decision would meet the difficulty pointed out on behalf of the assessee, namely, that the assessee being the only cultivator of galkas in the present case, the process employed by him could not be appropriately described as a process ordinarily employed by a cultivator to render gankas fit to be taken to market.

8. Reference was also made to a decision of the Court of the Judicial Commissioner, Nagpur, in ***Sheolal* v. *Commissioner of Income-tax*** [AIR 1932 Nag. 6] where the question was whether the process of ginning applied by the assessee could be said to be a process within the meaning of section 2(1) (b) (ii). The court held that the process of ginning was not a process ordinarily employed by cultivators to render cotton grown by them fit to be taken to market since unginned cotton was sold by the cultivators and ginning was not essential in order to render the cotton fit to be taken to market. The fact that there was a market for cotton grown on the land was thus taken into account for the purpose of holding that the process of

ginning could not be said to be a process necessary to render the produce fit to be taken to market.

9. Then we were referred to a decision of the Bombay High Court in ***Brihan Maharashtra Sugar Syndicate Ltd*., v. *Commissioner of Income-tax***. The question which arose in this case was whether income realized as a sale of gul manufactured by the assessee out of sugarcane grown by it, was agricultural income within the meaning of section 2(1)(b)(ii). The Tribunal found that the requirements of the section were satisfied, but on a reference to the High Court a Division Bench of the High Court held that though there was evidence to support the finding of the Tribunal that the process employed by the assessee in the manufacture of gul was a process ordinarily employed by a cultivator, the finding that the process was one ordinarily employed by a cultivator to render the produce fit to be taken to market was erroneous inasmuch as there was a market for the sale of sugarcane before it was turned into gul. Kania J., as he then was, after referring to section 2(1) (b)(ii), said:

> Reading the words used in the definition section with their mutual meaning they must mean that the produce must retain its original character in spite of the process unless there is no market for selling it in that condition. If there is no market to sell the produce then any process which is ordinarily employed to render it fit to reach the market, where it can be sold, would be covered by the definition….

The learned judge agreed with the Patna High Court in ***J.M. Casey*** case that market must mean a ready and available market where produce of the kind grown by the assessee is bought and sold and observed that since the statement of the case itself showed that there was a market for sugarcane, the process employed by the assesses in converting it into gul could not be said to be a process ordinarily employed to render it fit to be taken to market where it can be sold. Now it must be conceded straightway that, in view of the decision of the Supreme Court in ***Dooars Tea Company Ltd.*** case, the statement contained in the passage quoted above can no longer be regarded as good law in so far as it says that if there is no market for selling the produce in its original character, the character of the produce may be altered by performing a process necessary to render it fit to be taken to market and such a process too would be covered by section 2(1)(b)(ii). It is now clear that the produce must retain its original character and if the effect of the process is to alter the character of the produce, the process would not be a process within the intendment of section 2(1)(b)(ii). But this much is certainly established by this decision, namely, if there is a market for the produce, no process performed on it can be said to be a process necessary for rendering it fit to be taken to market.

10. We were also referred to a decision of the Mysore High Court in ***A.T. Parthasarathiah & Bros*. v. *Commissioner of Income-tax*** [(1963) 48 ITR 830 (Mys.)]. That decision does not help us very much for it merely applies section 2(1)(b)(ii) as construed by us above to the facts of that case. The question there arose in regard to tamarind plucked by the assessee from trees owned by him and converted into “flower tamarind” by a process of cleaning which involved removal of fibre and seeds. The Mysore High Court held that inasmuch as the Tribunal had not addressed itself to the question as to what was the process ordinarily employed by cultivators in the locality where the assessee resides to render the tamarind grown by them fit to be taken to market, it was necessary to call for a further

statement of the case and the Tribunal was accordingly required to submit a further statement of the case in order to enable the court to dispose of the question.

11. The last decision to which we must refer is the decision of the Andhra Pradesh High Court in ***Boggavarapu Peda Ammaiah* v. *Commissioner of Income-tax*** [(1964) 1 ITJ 197 (A.P.)]. The assessee in this case carried on the business of export of tobacco grown on his lands and he claimed exemption in respect of income arising on the sale of tobacco as agricultural income. The revenue authorities treated the income derived from operations up to the stage of the "flue-curing" as agricultural income but regarded the subsequent activities which involved the performance of the process of re-drying, stripping and grading and sale of tobacco subjected to such process as non-agricultural operations and treated the income attributable to those operations as income from business subject to tax. The Andhra Pradesh High Court before whom the question came on a reference took the view that the tobacco after flue-curing had a large market in the country and the operations of re-drying, stripping and grading were, therefore, not quite essential to make the tobacco marketable. The High Court also took the view that these operations could not be regarded as a process ordinarily employed by cultivators in order to make the tobacco marketable. Since in the opinion of the High Court both the conditions of section 2(1)(b) (ii) were not satisfied, the High Court held that the income attributable to the operations of re-drying, stripping, and grading could not be described as agricultural income but should be treated as income liable to tax.

12. It would thus be seen that in all these decisions the various High Courts applied section 2(1) (b)(ii) to the facts of the case before them and examined the question whether the two conditions of the section were satisfied so as to make the income agricultural income. We will, therefore, now proceed to consider how far these two conditions could be said to be fulfilled in the present case in regard to the process employed by the assessee for the purpose of preparing loofahs out of galkas.

13. Before, however, we do so, it would be convenient to dispose of one short argument advanced by Mr. Kaji on behalf of the assessee and that argument was that galkas when subjected to the process for converting them into loofahs did not retain their original character but underwent a change in character, since loofahs were goods of a different character from galkas and section 2(1)(b)(ii) was, therefore, not attracted. Now it is undoubtedly true that if galkas did not retain their original character on being subjected to the process for converting them into loofahs, the process would not be a process within the meaning of section 2(1)(b)(ii). But unfortunately for the assessee it is not open to Mr. Kaji to urge this contention before us since the contention raises a question of fact and not having been advanced before the Tribunal and their being no finding of the Tribunal on the question and the question not being the subject-matter of reference before us, the assessee cannot be permitted to raise the contention before us.

14. Going back to the main question, Mr. Kaji contended that the Tribunal had misdirected itself in law in proceeding on the basis that for the purpose of determining whether there was no market for galkas in raw state which would make the performance of the process for converting them into loofahs necessary to render them marketable, the only market which the Tribunal was required to take into account was the market in India. He urged that even if there was no market for galkas in India, but there was a market abroad, say

for example, in Japan, as the contention of the assessee was, the performance of the process for converting them into loofahs could not be said to be necessary in order to render them fit to be taken to market and the Tribunal should have therefore considered whether there was no market for galkas outside India. This contention is, in our opinion, well-founded. We do not think it can be seriously disputed that if there was a market for galkas-and by galkas we mean the commodity of galkas in raw state-even outside India, the performance of the process for converting them into loofahs could not be said to be necessary in order to make them marketable. It is in this connection important to bear in mind that even loofahs had no market in India and the process of converting into loofahs was performed on the galkas with a view to exporting and selling them abroad. Both in the case of galkas and in the case of loofahs, therefore, there was no market in India and the market had to be found outside India. It is possible that if loofahs had a market in India, an argument could with some plausibility have been advanced that even if galkas had a market outside, a cultivator of galkas in India would ordinarily convert them into loofahs which would be saleable in India rather than sell galkas in their raw state outside India. But where, as in the present case, the markets, if any, could only be outside India, both for galkas and loofahs, it must be concluded that if galkas had a market outside India, the process employed for converting galkas into loofahs for a market which was also outside India could not be said to be employed in order to make galkas fit for being taken to market. In such a case both the markets being out of India and galkas being marketable, no process performed on them could be said to be a process essential to make them marketable. It was, therefore, not enough for the Tribunal to find that there was no market for galkas in India. The Tribunal should have also considered whether there was no market for galkas outside India and it was only if the Tribunal found that there was no market for galkas outside India, that the Tribunal could come to the conclusion that the process employed for the purpose of converting galkas into loofahs was a process covered by section 2(1)(b)(ii).

15. But the learned Advocate-General contended that even if that be the view which we are inclined to take, there was a finding of the Tribunal that there was no market for galkas and that in view of that finding the process employed by the assessee must be regarded as a process necessary to render galkas fit to be taken to market. This contention involves a consideration of the order of the Tribunal. But before we examine this contention, we say dispose of another argument advanced by Mr. Kaji, namely, that the process employed by the assessee could not be said to be process ordinarily employed by a cultivator to render galkas fit to be taken to market. There were two circumstances relied on by Mr. Kaji in this connection. The first was that the assessee was the only cultivator of galkas and there could not, therefore, be any standard with reference to which it could be said whether the process was a process ordinarily employed by a cultivator. But this argument is sufficiently met by the reasoning of the Patna High Court in ***J.M. Casey*** case to which we have already referred. As a matter of fact if galkas in their raw state had no market at all, a cultivator of galkas could not do otherwise than make loofahs out of them and the process of making loofahs would, therefore, be a process ordinarily employed by a cultivator of galkas. The second circumstance on which the reliance was placed was the fact that the accounts in respect of the cultivation of galkas were maintained by the assessee in one set of books while the accounts in respect of the processing of galkas and sale of loofahs made out of them were maintained

in other set of books. This, argued Mr. Kaji, showed that the intention of the assessee as a cultivator was not to make loofahs out of galkas but to sell galkas in their raw state and if the conduct of assessee be taken as a test, the process of making loofahs out of galkas could not be said to be a process which would be ordinarily employed by the cultivator. This argument is, in our opinion, totally devoid of force. It cannot be overlooked that both the concerns belonged to the assessee and it is not possible to infer from a mere bifurcation of the two activities of the assessee that an ordinary cultivator of galkas would sell galkas in their raw state and would not prepare loofahs out of them. The determining factor must be whether there was a market for galkas as a commodity. If there was a market for galkas as a commodity, it would be possible to take the view that a cultivator would ordinarily sell galkas in raw state for he would be interested merely in selling his produce and not in performing processes which are not necessary in order to render the produce marketable. But if there was no such market, then obviously the cultivator would have no choice but to make loofahs out of them for the purpose of sale. We must, therefore, come back to the question whether there was no market for galkas in the sense that there was no place in India or abroad where galkas as a commodity were bought or sold.

16. Now turning to the order of the Tribunal, the portion of the paragraph 5 of the order which we have reproduced above shows that before the Tribunal it was the contention of the assessee that galkas had a market by themselves and that the subsequent operations were in the nature of manufacturing operations. The assessee for the purpose of establishing this plea produced evidence in the shape of letters addressed by parties in Japan to the assessee and contended on the basis of these letters that there was a market for galkas. The Tribunal after setting out this contention of the assessee in paragraph 5 proceeded to deal with it in paragraph 6. The Tribunal started by saying that they were unable to agree with this contention of the assessee, namely, that galkas had a market. The Tribunal then proceeded to give its reasons for coming to this conclusion. The Tribunal first stated that in order to find out whether there was a market for the produce, what was necessary to be seen was whether there was a market at which it could be absorbed. This is no doubt a correct proposition, but in the way in which it is put, it is likely to be misunderstood and we would, therefore, like to clarify it by saying that what is required to be considered is not whether the particular produce grown by the assessee is saleable but whether there is a market where the produce ordinarily grown by a cultivator is bought or sold as a commodity so that a cultivator of the produce would ordinarily sell the produce as such and not perform any process on it. The Tribunal after setting out this proposition observed that the existence of "a theoretical market in a place like Japan is not one that has to be taken into account for this purpose." The learned Advocate-General relied strongly on this observation and contended that this observation showed that the Tribunal found as a fact there was no real market in Japan. Mr. Kaji, on the other hand, contended that all that the Tribunal meant to say in making this observation was that the existence of a theoretical market in a place like Japan was not relevant but what was relevant was the existence of a market in India. He urged that the word "theoretical" was used by the Tribunal to describe the market in Japan because the Tribunal considered that the real market to be considered was the market in India and all markets outside India were theoretical markets for the purpose of determination of the present question. We think Mr. Kaji is right in his reading of this observation of the Tribunal. The observations of the

Tribunal which immediately follow upon this observation clearly support the interpretation sought to be placed by Mr. Kaji. The Tribunal, after making this observations, proceeded to examine what is the market in reference to which the question whether it exists or does not exist is required to be considered. The Tribunal observed that the expression “ordinarily employed” would appear to postulate the existence of certain conditions at or about the locality in which the produce is grown, meaning thereby that whether there is a market for the produce must be judged in relation to the area in which the produce is grown. The Tribunal then stated that the item marketed by the assessee, namely galkas, was a stranger to the Indian market and, therefore, held that there could not be ready market for galkas in India. This position was as a matter of fact not disputed by the assessee. The Tribunal emphasized the necessity of the market in India by observing that merely because there was some possibility of a sale at its original stage in a distant country, it did not follow that galkas by themselves had a market. The Tribunal then gave an illustration to reinforce its point of view. The Tribunal observed that if a produce is grown, say in Kerala, and it does not have a ready market in its original stage there, then merely because there was some market, say in Punjab, for the produce in its original stage, it does not follow that the process ordinarily employed by cultivators in Kerala would cease to be agricultural process. The Tribunal then stated that what was required to be looked at was the area in which the produce is grown and the customary process employed to render it fit for market, if it is not marketable in its original stage. This process of reasoning of the Tribunal which we have set out above clearly shows that what the Tribunal considered to be the correct position in law was that the market to be taken into account must be the market in the area in which the produce is grown, that is, the Indian market, and since there was no ready market for galkas in India, it must be concluded that galkas had no market so as to attract the applicability of section 2(1)(b)(ii). And that conclusion was set out by the Tribunal in the last sentence of the paragraph. Reading the paragraph as a whole we think that though there are one or two observations in the paragraph which read in isolation appear to lend some support to the argument that the Tribunal found as a fact that there was no market for galkas in Japan and, therefore, no market at all in India or abroad since the market in Japan was the only market put forward on behalf of the assessee, if those observations are read in the context of the rest of the paragraph, it is clear that those observations were made not for recording a finding that there was no market for galkas as a commodity in Japan but merely for the purpose of emphasizing that what must be looked at is the market in India and not the market in a distant place like Japan. The word “theoretical” also appears to have been used in order to emphasize that the real market to be considered is the Indian market and that the rest of the markets would be mere theoretical markets. The word “theoretical” was not used in order to record a finding that there was no real market in Japan. It appears that in the view of the law which it took, the Tribunal did not concern itself to examine and find whether there was a market for galkas as a commodity in Japan and this becomes clear if we refer to the statement of the case and the question referred to us for our opinion. The statement of the case clearly shows that according to the Tribunal what it held was, to quote its own words:

> (T)hat what was liable to be looked into for the purpose of finding out whether there was a market is the area in which the produce is grown and the customary process employed to render it fit for market if it is not marketable in its original stage.

> The Tribunal found also that there was no market in India in which it could be sold in its original stage. Under these circumstances, it was held....

The question which has been referred to us also shows that according to the Tribunal the basis on which its decision was founded was that galkas did not have a market in India. Even if, therefore, there were any doubt as to what the Tribunal found in its order, such doubt is clearly laid at rest by the statement of the case and the question referred by the Tribunal. We, therefore, think that reading the order of the Tribunal as a whole along with the statement of the case and the question referred for our opinion, it must be held that the only finding reached by the Tribunal was that there was no market for galkas in raw stage in India and that there was no finding of the Tribunal that galkas as a commodity had no market even outside India.

17. Now the real controversy between the parties was whether the process employed by the assessee was a process within the meaning of section 2(1)(b)(ii) and in order to the proper determination of that controversy it was necessary for the Tribunal to give a finding on the question whether there was no market for galkas in India or outside India, for it is only if there was no market for galkas in India or abroad, that the process employed by the assessee could be said to be a process covered by section 2(1)(b)(ii) as contended by the revenue. The question as framed is however based on the postulate that it would be sufficient to attract the applicability of section 2(1)(b)(ii) if there was no market for galkas in India. It is, therefore, necessary to reframe the question in order to bring out the real controversy between the parties and the question as reframed will be as follows:

> Whether, on the facts and circumstances of the case, the process employed on galkas for purposes of exporting and selling them aboard satisfies the requirements of section 2(1)(b)(ii) of the Act?

In order to properly and effectively answer this question it is necessary to have the finding of the Tribunal on the question whether there was no market for galkas as a commodity in India or abroad. We, therefore, direct the Tribunal to give its finding on this question after hearing the parties and to submit a further statement of the case in relation to that finding. The Tribunal will of course confine itself to the record of the case in giving the finding. We, however, do not express any opinion on the question as to on whom would lie the burden of proof in regard to the question on which the Tribunal is directed to give the finding. That would be a matter for the Tribunal to consider. The reference will be placed on board for hearing after the supplementary statement of the case is received from the Tribunal.

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K. Lakshmanan & Co. v. *C.I.T.*

(1998) 9 SCC 537

B.N. KIRPAL AND S.P. KURDUKAR, JJ. - 1. The short question which arises for consideration in this batch of appeals is whether or not the income derived from business of rearing silkworms is "agricultural income" as defined under Section 2(1) of the Income Tax Act, 1961.

2. The appellant is a partnership firm constituted for the purpose of carrying out agricultural activities. During the course of its business it indulges in the activity of growing mulberry leaves and rearing silkworms. The assessee purchases silkworm eggs and when they are hatched the worms are principally fed on mulberry leaves. The mulberry leaves are plucked from the trees grown by the appellant and these leaves are cut into stripes which are fed to the silkworms. The worms wind around themselves the saliva which oozes from their mouth and the hardened saliva forms the protective cocoons. These cocoons are then sold in the market by the appellant.

3. Before the Income Tax Officer, the appellant claimed that the entire income which it derived from the growing of the mulberry leaves to the sale of the cocoons, was exempt from levy of income tax as it was "agricultural income" within the meaning of that expression used in Section 2(1) of the Act. The Income Tax Officer accepted the contention of the appellant only insofar as it related to the growing of the mulberry leaves but did not accept the appellant's contention that the rearing of the worms and the selling of the cocoons resulted in agricultural income. He accordingly concluded that that part of the income which was attributable to growing of mulberry leaves alone constituted agricultural income and was exempt from levy of income tax but the income derived from the rearing of silkworms on the leaves and selling of the cocoons was not agricultural income. Therefore, the Income Tax Officer estimated the income derived from the process of growing silkworms and rearing of cocoons at 25 per cent of the total income and subjected the same to tax in the assessment years involved. [In appeal, the Appellate Assistant Commissioner, accepted appellant's holding that income derived by it from growing mulberry leaves and from rearing of silkworms and cocoons was exempt from tax under the Act.]

5. The Revenue then filed an appeal before the Income Tax Appellate Tribunal which allowed the same and came to the conclusion that even though mulberry leaves did not have a market the case would still not fall within the purview of Section 2(1) of the Act inasmuch as the agricultural produce, viz., the mulberry leaves, was not what was sold in the market and what in fact was sold were cocoons which were not the agricultural produce of the appellant. At the instance of the appellant, the Tribunal then stated the case and referred the following question of law to the High Court:

> Whether, on the facts and in the circumstances of the case, the Tribunal is justified in holding that the income derived by the assessee from the process, i.e., the rearing of silkworms, is not entitled to exemption under Section 2(1)(*b*)(*ii*) of the Income Tax Act, 1961?

6. The High Court in the impugned judgment has answered the question of law in favour of the Revenue as it came to the conclusion that feeing of mulberry leaves to silkworms was not a

process employed by cultivator of mulberry leaves to make them marketable by way of producing silk cocoons.

7. On the basis of the facts found by the Tribunal, we do not find any infirmity in the conclusion of the High Court. Section 2(1) of the Act defines the expression "agricultural income".

8. Eliminating the unnecessary words from the said definition, "agricultural income" would mean an income derived from such land by the performance by a cultivator of any process ordinarily employed by him to render the produce raised by him fit to be taken to market. It is clear from the reading of the aforesaid statutory provision that what is taken to the market and sold must be the produce which is raised by the cultivator. Even though for the purpose of making it marketable or fit for sale, some process may have to be undertaken, the section does not contemplate the sale of an item or a commodity which is different from what is cultivated and processed. Had mulberry leaves been subjected to some process and sold in the market as such then certainly the income derived therefrom would be regarded as agricultural income but the case of the appellant before the authorities, and in this Court, has been that mulberry leaves cannot be sold in the market and they can only be fed to the silkworms. The agricultural produce of the cultivator will be mulberry leaves and by no stretch of imagination can the silkworms, and certainly not the silk cocoons, be regarded as the agricultural produce of the cultivator.

9. The aforesaid view finds support from the following observations of this Court in ***Dooars Tea Co. Ltd.* v. *CIT*** [(1962) 44 ITR 6 (p.12)]:

> Section 2(1)(*b*) consists of three clauses. Let us first construe clauses (*ii*) and (*iii*). Clause (*ii*) includes cases of income derived from the performance of any process therein specified. The process must be one which is usually employed by the cultivator or receiver of rent-in-kind; it may be simple manual process or it may involve the use and assistance of machinery. That is the first requirement of this proviso. The second requirement is that the said process must have been employed with the object of making the produce marketable. It is, however, clear that the employment of the process contemplated by the second clause must not alter the character of the produce. The produce must retain its original character and the only change that may have been brought about in the produce is to make it marketable. The said change in the condition of the produce is only intended to make the produce a saleable commodity in the market. Thus clause (*ii*) includes within the categories of income, income derived from the employment of the process falling under that clause. As we have just observed the object of employing the requisite process is to make the produce marketable but in terms the clause does not refer to sale and does not require that the income should be obtained from sale as such though in a sense it contemplates the sale of the produce.

10. We are in respectful agreement with the aforesaid observations. The High Court, as we have already observed, has rightly come to the conclusion that the income derived by the appellant from the sale of the cocoons could not in law be regarded as agricultural income. The question of law was, therefore, rightly answered in the affirmative and against the appellant.

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V.V.R.N.M. Subbayya Chettiar v. *C.I.T.*

AIR 1951 SC 101

FAZL ALI, J. - This is an appeal from a judgment of the High Court of Judicature at Madras on a reference made to it under Section 66(1) of the Indian Income Tax Act by the Income Tax Appellate Tribunal in connection with the assessment of the appellant to income tax for the year 1942-43. The question of law referred to the High Court was as follows:

> Whether in the circumstances of the case, the assessee (a Hindu undivided family) is 'resident' in British India under Section 4-A(*b*) of the Income Tax Act.

2. The circumstances of the case may be briefly stated as follows. The appellant is the *karta* of a joint Hindu family and has been living in Ceylon with his wife, son and three daughters, and they are stated to be domiciled in that country. He carries on business in Colombo under the name and style of the General Trading Corporation, and he owns a house, some immovable property and investments in British India. He has also shares in two firms situated at Vijayapuram and Nagapatnam in British India. In the year of account, 1941-42, which is the basis of the present assessment, the appellant is said to have visited British India on seven occasions and the total period of his stay in British India was 101 days. What he did during this period is summarized in the judgment of one of the learned Judges of the High Court in these words:

> During such stays, he personally attended to a litigation relating to the family lands both in the trial court and in the court of appeal. He was also attending the income tax proceedings relating to the assessment of the family income, appearing before the Income Tax Authorities at Karaikudi and Madras. On one of these occasions, he obtained an extension of time for payment of the tax after interviewing the authority concerned….

3. The other facts relied upon by the Income Tax Authorities were that he did not produce the file of correspondence with the business in Colombo so as to help them in determining whether the management and control of the business was situated in Colombo and he had started two partnership businesses in India on 25th February, 1942, and remained in India for some time after the commencement of those businesses.

4. Upon the facts so stated, the Income Tax Officer and the Assistant Commissioner of Income Tax held that the appellant was a resident within the meaning of Section 4-A(*b*) of the Income Tax Act, and was therefore liable to be assessed in respect of his foreign income. The Income Tax Appellate Tribunal however came to a different conclusion and held that in the circumstances of the case it could not be held that any act of management or control was exercised by the appellant during his stay in British India and therefore he was not liable to assessment in respect of his income outside British India. This view was not accepted by a Bench of the Madras High Court consisting of the learned Chief Justice and Patanjali Sastri, J. They held that the Tribunal had misdirected itself in determining the question of the "residence" of the appellant's family and that on the facts proved the control and management of the affairs of the family cannot be held to have been wholly situated outside British India, with the result that the family must be deemed to be resident in British India within the meaning of Section 4-

A(*b*) of the Income Tax Act. In this appeal, the appellant has questioned the correctness of the High Court's decision:

Section 4-A(*b*) runs thus:

For the purposes of this Act -

A Hindu undivided family, firm or other association of persons is resident in British India unless the control and management of its affairs is situated wholly without British India.

It will be noticed that Section 4-A deals with "residence" in the taxable territories, of (*a*) individuals, (*b*) a Hindu undivided family, firm or other association of persons, and (*c*) a company. In each of these cases, certain tests have been laid down, and the test with which we are concerned is that laid down in Section 4-A(*b*). This provision appears to be based very largely on the rule which has been applied in England to cases of corporations, in regard to which the law was stated thus by Lord Loreburn in ***De Beers* v. *Howe*** [5 Tax Cas 198]:

A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business.... The decision of Chief Baron Kelly and Baron Huddleston in ***Calcutta Jute Mills* v. *Nicholson*** and ***Cesena Sulphur Company* v. *Nicholson*** [(1876) 1 Ex D 428] now thirty years ago, involved the principle that a company resides for purposes of income tax where its real business is carried on. Those decisions have been acted upon ever since. I regard that as the true rule, and the real business is carried on where the central management and control actually abides.

5. It is clear that what is said in Section 4-A(*b*) of the Income Tax Act is what Lord Loreburn intended to convey by the words "where the central management and control actually abides".

6. The principles which are now well-established in England and which will be found to have been very clearly enunciated in ***Swedish Central Railway Company Limited* v. *Thompson*** [9 Tax Cas 373] which is one of the leading cases on the subject, are:

(*1*) that the conception of residence in the case of a fictitious 'person', such as a company, is as artificial as the company itself, and the locality of the residence can only be determined by analogy, by asking where is the head and seat and directing power of the affairs of the company. What these words mean have been explained by Patanjali Sastri, J. with very great clarity in the following passage where he deals with the meaning of Section 4-A(*b*) of the Income Tax Act:

'Control and management' signifies, in the present context, the controlling and directive power, 'the head and brain' as it is sometimes called, and 'situated' implies the functioning of such power at a particular place with some degree of permanence, while 'wholly' would seem to recognize the possibility of the seat of such power being divided between two distinct and separated places.

As a general rule, the control and management of a business remains in the hand of a person or a group of persons, and the question to be asked is wherefrom the person or group of persons controls or directs the business.

(*2*) Mere activity by the company in a place does not create residence, with the result that a company may be "residing" in one place and doing a great deal of business in another.

(*3*) The central management and control of a company may be divided, and it may keep house and do business in more than one place, and, if so, it may have more than one residence.

(*4*) In case of dual residence, it is necessary to show that the company performs some of the vital organic functions incidental to its existence as such in both the places, so that in fact there are two centres of management.

7. It appears to us that these principles have to be kept in view in properly construing Section 4-A(*b*) of the Act. The words used in this provision clearly show firstly, that, normally, a Hindu undivided family will be taken to be resident in the taxable territories, but such a presumption will not apply if the case can be brought under the second part of the provision. Secondly, we take it that the word "affairs" must mean affairs which are relevant for the purpose of the Income Tax Act and which have some relation to income. Thirdly, in order to bring the case under the exception, we have to ask whether the seat of the direction and control of the affairs of the family is inside or outside British India. Lastly, the word "wholly" suggests that a Hindu undivided family may have more than one "residence" in the same way as a corporation may have.

8. The question which now arises is what is the result of the application of these principles to this case, and whether it can be held that the central control and management of the affairs of the assessee's family has been shown to be divided in this case.

9. It seems to us that the mere fact that the assessee has a house at Kanadukathan, where his mother lives, cannot constitute that place the seat of control and management of the affairs of the family. Nor are we inclined in the circumstances of the present case to attach much importance to the fact that the assessee had to stay in British India for 101 days in a particular year. He was undoubtedly interested in the litigation with regard to his family property as well as in the income tax proceedings, and by merely coming out to India to take part in them, he cannot be said to have shifted the seat of management and control of the affairs of his family, or to have started a second centre for such control and management. The same remark must apply to the starting of two partnership businesses, as mere "activity" cannot be the test of residence. It seems to us that the learned Judges of the High Court have taken rather a narrow view of the meaning of Section 4-A(*b*), because they seem to have proceeded on the assumption that merely because the assessee attended to some of the affairs of his family during his visit to British India in the particular year, he brought himself within the ambit of the rule. On the other hand, it seems to us that the more correct approach to the case was made by the Appellate Assistant Commissioner of Income Tax in the following passage which occurs in his order dated 24th February, 1944:

> During a major portion of the accounting period (year ending 12th April, 1942) the appellant was controlling the businesses in Burma and Saigon and there is no evidence that such control was exercised only from Colombo. No correspondence or other evidence was produced which would show that any instructions were issued from Colombo as regards the management of the affairs in British India especially as it was an unauthorized clerk who

> was looking after such affairs. The presumption therefore is that whenever he came to British India the appellant was looking after these affairs himself and exercising control by issuing instructions.... It has been admitted that there are affairs of the family in British India. Has it been definitely established in this case that the control and management of such affairs has been only in Colombo? I have to hold it has not been established for the reasons already stated by me.

10. There can be no doubt that the onus of proving facts which would bring his case within the exception, which is provided by the latter part of Section 4-A(*b*), was on the assessee. The appellant was called upon to adduce evidence to show that the control and management of the affairs of the family was situated wholly outside the taxable territories, but the correspondence to which the Assistant Commissioner of Income Tax refers and other material evidence which might have shown that normally and as a matter of course the affairs in India were also being controlled from Colombo were not produced. The position therefore is this. On the one hand, we have the fact that the head and *karta* of the assessee's family who controls and manages its affairs permanently lives in Colombo and the family is domiciled in Ceylon. On the other hand, we have certain acts done by the *karta* himself in British India, which, though not conclusive by themselves to establish the existence of more than one centre of control for the affairs of the family, are by no means irrelevant to the matter in issue and therefore cannot be completely ruled out of consideration in determining it. In these circumstances, and in the absence of the material evidence to which reference has been made, the finding of the Assistant Commissioner, that the onus of proving such facts as would bring his case within the exception had not been discharged by the assessee and the normal presumption must be given effect to, appears to us to be a legitimate conclusion. In this view, the appeal must be dismissed with costs, but we should like to observe that as this case has to be decided mainly with reference to the question of onus of proof, the decision in this appeal must be confined to the year of assessment to which this case relates, and it would be open to the appellant to show in future years by proper evidence that the seat of control and management of the affairs of the family is wholly outside British India.

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Narottam and Parekh Ltd. v. *C.I.T., Bombay City*

AIR 1954 Bom. 67

CHAGLA, C.J. – The question that arises in this reference is whether the assessee company is a resident company. The assessment years are 1944-45 and 1945-46. The company is a subsidiary company of the Scindia Steam Navigation Co. Ltd. and its business is stevedoring in Ceylon. It is registered in Bombay and its registered office is also in Bombay. The meetings of the Board of Directors are held in Bombay and also the meetings of the shareholders.

(2) In order that a company should be resident it is necessary that the control and management of its affairs should be situated wholly in the taxable territories or its income earned in the taxable territories should exceed its income without the taxable territories in that year. In this case we are not concerned with the second part of the definition, because the income of this company in India was Rs. 3,791 whereas its total world income was Rs. 3,28,108, the bulk of which was earned in Ceylon by the business which it did. In order to construe S. 4A(c) of the Income-tax Act, it is important to bear in mind that this section deals with residence and it deals with residence of individuals, Hindu undivided family, firms and other association of persons and of a company, and therefore, the central idea underlying this section is the idea of residence, and what has got to be determined is where a particular company is resident.

Sub-clause (c) tells us what in the eye of the law is residence with regard to a company, and as far as the first part is concerned, in order that a company's income should be subjected to tax as a resident, it has got to be established that the control and management of its affairs is situated wholly in the taxable territories. As we shall presently point out, "control and management" is a compendious expression which has acquired a definite significance and connotation. It is also necessary that the control and management of the affairs of the company should be situated wholly in the taxable territories. Therefore, if any part of the control and management is outside the taxable territories, then the company would not be resident. In this connection, it is pertinent to look at the converse definition of a Hindu undivided family, firm or other association of persons.

In their case they are resident unless the control and management of its affairs is situated wholly without the taxable territories. Therefore, whereas in the case of a Hindu undivided family or firm or association of persons any measure of control and management within the taxable territories would make them resident, in the case of a company any measure of control and management of its affairs outside the taxable territories would make it non-resident. In construing the expression "control and management" it is necessary to bear in mind the distinction between doing of business and the control and management of business. Business and the whole of it may be done outside India and yet the control and management of that business may be wholly within India.

In this particular case considerable emphasis is placed upon the fact that the whole of the business of the company is done in Ceylon and the whole of the income which is liable to tax has been earned in Ceylon. But that is not a factor which the Legislature has emphasised. It is entirely irrelevant where the business is done and where the income has been earned. What is relevant and material is from which place has that business been controlled and managed. "Control and management" referred to in S. 4A(c) is, as we shall presently point out on the authorities, central control and management. The control and management contemplated by this sub-section is not the carrying on of day to day business by servants, employees or agents.

The real test to be applied is, where is the controlling and directing power, or rather, where does the controlling and directing power function, or to put it in a different language, there is always a seat of power or the head and brain, and what has got to be ascertained is, where is this seat of power, or the head and brain? A company or for the matter of that a firm or an undivided Hindu family has got to work through servants and agents, but it is not the servants and agents that constitute the seat of power of the controlling and directing power. It is that authority to which the servants, employees and agents are subject, it is that authority which controls and manages them, which is the central authority, and it is at the place where the central authority functions that the company resides.

It may be in some cases that, like an individual a company may have residence in more than one place. It may exercise control and management not only from one fixed abode, but it may have different places. That would again be a question dependent upon the circumstances of each case. But the contention which Mr. Kolah has most strongly pressed before us is entirely unacceptable that a company controls or manages at a particular place because its affairs are carried on at a particular place and they are carried on by people living there appointed by the company with large powers of management.

A company may have a dozen local branches at different places outside India, it may send out agents fully armed with authority to deal with and carry on business at these branches and yet it may retain the central management and controls in Bombay and manage and control all the affairs of these branches from Bombay and at Bombay. It would be impossible to contend that because there are authorised agents doing the business of the company at six different places outside India therefore the company is resident not only in Bombay but at all these six different places.

(3) When we turn to the facts of the case before us, what has been emphasised by Mr. Kolah is that two managers under two powers of attorney look after all the affairs of the assessee company in Ceylon and our attention has been drawn to these two powers-of-attorneys, and we agree with Mr. Kolah that the widest possible power and authority has been conferred upon these two managers under these power-of-attorney. But it is equally clear from the minutes of the meetings of the Board of Directors which are also before us that the central management and control has been kept in Bombay and has been exercised by the directors in Bombay.

The minutes deal with various matters which are delegated to these two managers and yet the directors from a proper sense of responsibility to the company have retained complete control over these matters and have from time to time given directions to the managers as to how things should be done and managed. The real fallacy underlying Mr. Kolah's argument is to confuse the doing of business with the central control and management of that business. It is perfectly true that these two managers do all the business of the company in Ceylon and in doing that business naturally a large amount of discretion is given to them and a considerable amount of authority. But the mere doing of business does not constitute these managers the controlling and directing power.

Their power-of-attorney can be cancelled at any moment, they must carry out any orders given to them from Bombay, they must submit to Bombay an explanation of what they have been doing, and throughout the time that they are working in Ceylon a vigilant eye is kept over their work from the directors' board room in Bombay. The correspondence which has also been referred upon between the company here and its office in Colombo also goes to show and emphasise the same state of affairs. Mr. Kolah is right again when he puts emphasis upon the fact that what we have to consider in this case is not the power or the capacity to manage and control, but the actual control and management, or in other words, not the '*de jure'* control and management but the 'de facto' control and management, and in order to hold that the company is resident during the years of account, it must be established that the company '*de facto'* controlled and managed its affairs in Bombay.

Mr. Kolah says that the two powers-of-attorney go to show that whatever legal or juridical control and management the company might have had, in fact the actual management was exercised by the two managers in Ceylon. In our opinion this is not a case where the company did nothing with regard to the actual management and control of its affairs and left it to some other agency. As we said before, the two managers were the employees of the company acting throughout the relevant period under the control and management of the company, and therefore in the case we are considering there was not only a 'de jure' control and management, but also a 'de facto' control and management.

(4) Turning to the authorities on which Mr. Kolah has relied, first there is a judgment of this Court in ***Bhimji Naik* v. *Commissioner of Income-tax, Bombay*** [AIR 1945 Bom. 271]. In that case Sir Leonard Stone, C.J. and Kania J. were really dealing with a question of construction of S. 4A(b), and the question that presented itself for decision before that Bench was whether the control and management contemplated by that sub-section was a 'de facto' or a 'de jure' control. In that case one Naik carried on business in South Africa. In 1912 he returned to India leaving his business in the hands of three managers. In 1937 he executed a partnership deed by which he admitted these three managers as partners. Under the partnership deed he retained to himself the full control of the business and even the right to dismiss any of the three partners.

The Income Tax Appellate Tribunal found that the firm was resident in British India as the legal right to control and manage vested in Naik and he was resident in British India and it was not shown that he had not exercised any control. The Court remanded the matter to the Tribunal taking the view that what they were concerned with was actual events which would go to show where the actual control and management of the affairs was 'de facto' situated and as the Tribunal had merely held that on the legal aspect of the partnership deed there were not sufficient facts on which they could express an opinion. It is rather important to note that Mr. Setalvad who appeared for the Commissioner attempted to argue that the position in the case was not materially different from that of a man owning a business and having employees, and the learned Chief Justice dealt with that argument as being

> [D]estructive of the whole reference, which proceeds on the basis that we are dealing with a partnership firm, as indeed is the case when the partnership deed is considered.

Therefore, the learned Chief Justice was at pains to draw a distinction between the case of a partner and the case of an agent or an employee, and inasmuch as in that case the business was being managed by the partners of Naik in South Africa, the question of 'de facto' management had to be considered. Kania, J. at p. 274 states that the question whether the assessee is resident within the meaning of S. 4-A is a question of fact, and he goes on to say:

> "As it is difficult to apply the test of physical residence to an association of persons or a firm, the test is held to be: where the central control and management actually abides.

Therefore, the learned Judge holds that the expression "control and management" means where the central control and management actually abides.

(5) The other case relied on is a Madras case – ***Talipatigala Estate* v. *Commr. of Income Tax*** [AIR 1950 Mad.781]. There the question that arose was whether the assessee firm had any part of the control and management within British India. There a rubber estate in Ceylon was managed by the assessee firm consisting of two partners, one of whom was resident in British India, and the estate was managed by an agent holding a power-of-attorney from the partners, and the Court held that not only the right to exercise control and management over the firm's affairs in Ceylon vested with the partner resident in British India but some amount of control and management of the firm's affairs was actually exercised in British India and the assessee firm was therefore resident in British India within the meaning of S. 4-A.

The Court was concerned to determine whether any part of the control and management was within British India and notwithstanding the fact that the rubber estate was managed by an agent holding a power-of-attorney, it was found that there was the exercise of control and management by the partners from British India.

(6) The third decision relied on is a decision of the Supreme Court in ***Subbayya Chettiar* v. *Commr. of Income Tax*** [AIR 1951 SC 101]. That was a case of an Hindu undivided family and the Supreme Court has laid down certain important tests for determining what is control and management within the meaning of S. 4-A of the Act. Fazl Ali J. in his judgment accepts the rule which has been applied in England to cases of corporations in order to determine their residence, and he quotes with approval Lord Loreburn's dictum in ***De Beers Consolidated Mines Ltd.* v. *Howe*** [(1906) 5 Tax Cas 198]:

> A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business.

He also lays down four principles which are enunciated in ***Swedish Central Railway Company Limited* v. *Thompson*** [(1925) 9 Tax Cas 342]. With regard to the first principle he accepts a passage of Patanjali Sastri J. (p. 102):

> Control and management signifies in the present context, the controlling and directive power, the head and brain as it is sometimes called, and situated implies the functioning of such power at a particular place with some degree of permanence, while wholly would seem to recognise the possibility of the seat of such power being divided between two distinct and separate places.

The second principle is that the mere activity by which the company in a place does not create residence. The third is that the central management and control of a company may be divided, and it may keep house and do business in more than one place. Finally, in case of dual residence, there may be two centres of management. But the important principle which applies to the present case is the one that has been first set out and which emphasises the fact that what we have to consider in order to determine the residence of a company is as to where its head and brain is, and the head and brain of the company will be where its controlling and directive power functions. Mr. Kolah has relied on what Fazl Ali J. says (p. 102):

> Secondly, we take it that the word 'affairs' must mean affairs which are relevant for the purpose of the Income-tax Act and which have some relation to income.

Mr. Kolah says that it is not any business that the company does which has got to be considered, but the affairs of the company in the sense in which Fazl Ali J. has explained that expression. With respect, that is perfectly correct. In order to determine the head and brain of the company we are not to concern ourselves with any other work that the company does except its business which yields profits, and in this particular case we have got to consider where the head and brain of the company is with regard to the stevedoring business in Ceylon which has yielded the income. But even applying that test, as already pointed out, we do come to the conclusion that the head and brain of the company with regard to this particular business or with regard to its affairs was in Bombay and not in Ceylon.

(7) The question, therefore, which has been submitted to us must be answered in the affirmative.

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Vodafone International Holdings B.V. v. *Union of India (UOI) and Anr*

(2012) 6 SCC 613

S. H. KAPADIA, C.J.I. - Vodafone International Holdings BV [for short "VIH"], a company resident for tax purposes in the Netherlands, acquired the entire share capital of CGP Investments (Holdings) Ltd. [for short "CGP"], a company resident for tax purposes in the Cayman Islands ["CI" for short] vide transaction dated 11.02.2007, whose stated aim, according to the Revenue, was "acquisition of 67% controlling interest in HEL", being a company resident for tax purposes in India which is disputed by the Appellant saying that VIH agreed to acquire companies which in turn controlled a 67% interest, but not controlling interest, in Hutchison Essar Limited ("HEL" for short). According to the Appellant, CGP held indirectly through other companies 52% shareholding interest in HEL as well as Options to acquire a further 15% shareholding interest in HEL, subject to relaxation of FDI Norms. In short, the Revenue seeks to tax the capital gains arising from the sale of the share capital of CGP on the basis that CGP, whilst not a tax resident in India, holds the underlying Indian assets.

2. It was contended on behalf of the Revenue that ***Union of India*** **v.** ***Azadi Bachao Andolan*** (2004) 10 SCC 1 needs to be overruled insofar as it departs from ***McDowell and Company Ltd.*** **v.** ***CTO*** (1985) 3 SCC 230 principle for the following: i) McDowell judgment has been missed which reads as under: "on this aspect Chinnappa Reddy, J. has proposed a separate opinion with which we agree".[i.e. Westminster principle is dead]. ii) That, Azadi Bachao failed to read McDowell in entirety. If so read, the only conclusion one could draw is that four learned judges speaking through Misra, J. agreed with the observations of Chinnappa Reddy, J. as to how in certain circumstances tax avoidance should be brought within the tax net. iii) That, subsequent to McDowell, another matter came before the Constitution Bench of five Judges in ***Mathuram Agrawal*** **v.** ***State of Madhya Pradesh***(1999) 8 SCC 667, in which Westminster principle was quoted which has not been noticed by ***Azadi Bachao***. Before coming to Indo-Mauritius Double Tax Avoidance Agreement (in Short, 'DTAA'), we need to clear the doubts raised on behalf of the Revenue regarding the correctness of ***Azadi Bachao*** (supra) for the simple reason that certain tests laid down in the judgments of the English Courts subsequent to ***The Commissioners of Inland Revenue*** **v.** ***His Grace the Duke of Westminster*** 1935All E.R.259 and ***W.T. Ramsay Ltd.*** **v.** ***Inland Revenue Commissioners*** (1981)1All E.R. 865 help us to understand the scope of Indo- Mauritius Double Tax Avoidance Agreement (herein after referred as DTAA). It needs to be clarified, that, ***McDowell*** dealt with two aspects. First, regarding validity of the Circular(s) issued by Central Board of Direct Taxes (herein after referred as, CBDT) concerning Indo-Mauritius DTAA. Second, on concept of tax avoidance/evasion. Before us, arguments were advanced on behalf of the Revenue only regarding the second aspect. The Westminster principle states that, "given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance". The said principle has been reiterated in subsequent English Courts Judgments as "the cardinal principle".

3. ***Ramsay*** was a case of sale-lease back transaction in which gain was sought to be counteracted, so as to avoid tax, by establishing an allowable loss. The method chosen was to buy from a company a readymade scheme, whose object was to create a neutral situation. The

decreasing asset was to be sold so as to create an artificial loss and the increasing asset was to yield a gain which would be exempt from tax. The Crown challenged the whole scheme saying that it was an artificial scheme and, therefore, fiscally in-effective. It was held that Westminster did not compel the court to look at a document or a transaction, isolated from the context to which it properly belonged. It is the task of the Court to ascertain the legal nature of the transaction and while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach. **In the present case, the Revenue has adopted a dissecting approach at the Department level.** ***Ramsay*** did not discard Westminster but read it in the proper context by which "device" which was colorable in nature had to be ignored as fiscal nullity.Thus, ***Ramsay*** lays down the principle of statutory interpretation rather than an over-arching anti-avoidance doctrine imposed upon tax laws. ***Furniss (Inspector of Taxes)*** **v.** ***Dawson*** **(1984) 1 All E.R. 530** dealt with the case of interpositioning of a company to evade tax. On facts, it was held that the inserted step had no business purpose, except deferment of tax although it had a business effect. **Dawson went beyond** ***Ramsay*****.** It reconstructed the transaction not on some fancied principle that *anything done to defer the tax be ignored but on the premise that the inserted transaction did not constitute "disposal" under the relevant Finance Act. Thus, Dawson is an extension of* ***Ramsay*** *principle.* After Dawson, which empowered the Revenue to restructure the transaction in certain circumstances, the Revenue started rejecting every case of strategic investment/tax planning undertaken years before the event saying that the insertion of the entity was effected with the sole intention of tax avoidance. In ***Craven (Inspector of Taxes)*** **v.** ***White (Stephen)*** **(1988) 3 All. E.R. 495** it was held that the Revenue cannot start with the question as to whether the transaction was a tax deferment/saving device but that the Revenue should apply the look at test to ascertain its true legal nature. It observed that genuine strategic planning had not been abandoned. The majority judgment in ***McDowell*** held that "*tax planning may be legitimate provided it is within the framework of law"*. Later, it further held that "*colorable device cannot be a part of tax planning and it is wrong to encourage the belief that it is honorable to avoid payment of tax by resorting to dubious methods*". It is the obligation of every citizen to pay the taxes without resorting to subterfuges. The above observations should be read with para 46 where the majority holds "on this aspect one of us, Chinnappa Reddy, J. has proposed a separate opinion with which we agree". The words "this aspect" express the majority's agreement with the judgment of Reddy, J. only in relation to tax evasion through the use of colorable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible. Moreover, Reddy, J. himself says that he agrees with the majority. In the judgment of Reddy, J. there are repeated references to schemes and devices in contradistinction to "legitimate avoidance of tax liability". In our view, although Chinnappa Reddy, J. makes a number of observations regarding the need to depart from the "Westminster" and tax avoidance - these are clearly only in the context of artificial and colorable devices. Reading McDowell, in the manner indicated hereinabove, in cases of treaty shopping and/or tax avoidance, there is no conflict between McDowell and Azadi Bachao or between McDowell and Mathuram Agrawal.

4. The Indian Income Tax Act, 1961, in the matter of corporate taxation, is founded on the principle of the independence of companies and other entities subject to income-tax. It is fairly well settled that for tax treaty purposes a subsidiary and its parent are also totally separate and distinct tax payers.

5. It is generally accepted that the group parent company is involved in giving principal guidance to group companies by providing general policy guidelines to group subsidiaries. However, the fact that a parent company exercises shareholder's influence on its subsidiaries does not generally imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. Further, if a company is a parent company, that company's executive director(s) should lead the group and the company's shareholder's influence will generally be employed to that end. This obviously implies a restriction on the autonomy of the subsidiary's executive directors. Such a restriction, which is the inevitable consequences of any group structure, is generally accepted, both in corporate and tax laws. However, where the subsidiary's executive directors' competences are transferred to other persons/bodies or where the subsidiary's executive directors' decision making has become fully subordinate to the Holding Company with the consequence that the subsidiary's executive directors are no more than puppets then the turning point in respect of the subsidiary's place of residence comes about. Similarly, if an actual controlling Non-Resident Enterprise (NRE) makes an indirect transfer through "abuse of organization form/legal form and without reasonable business purpose" which results in tax avoidance or avoidance of withholding tax, then the Revenue may disregard the form of the arrangement or the impugned action through use of Non-Resident Holding Company, re-characterize the equity transfer according to its economic substance and impose the tax on the actual controlling Non-Resident Enterprise. Thus, whether a transaction is used principally as a colorable device for the distribution of earnings, profits and gains, is determined by a review of all the facts and circumstances surrounding the transaction. It is in the above cases that the principle of lifting the corporate veil or the doctrine of substance over form or the concept of beneficial ownership or the concept of alter ego arises. There are many circumstances, apart from the one given above, where separate existence of different companies, that are part of the same group, will be totally or partly ignored as a device or a conduit (in the pejorative sense).

6. The common law jurisdictions do invariably impose taxation against a corporation based on the legal principle that the corporation is "a person" that is separate from its members. It is the decision of the House of Lords in ***Salomon* v. *Salomon* (1897) A.C. 22** that opened the door to the formation of a corporate group. If a "one man" corporation could be incorporated, then it would follow that one corporation could be a subsidiary of another. This legal principle is the basis of Holding Structures. It is a common practice in international law, which is the basis of international taxation, for foreign investors to invest in Indian companies through an interposed foreign holding or operating company, such as Cayman Islands or Mauritius based company for both tax and business purposes. In doing so, foreign investors are able to avoid the lengthy approval and registration processes required for a direct transfer (i.e., without a foreign holding or operating company) of an equity interest in a foreign invested Indian company. However, taxation of such Holding Structures very often gives rise to issues such as double taxation, tax deferrals and tax avoidance. In this case, we are concerned with the concept of GAAR. In this case, we are not concerned with treaty-shopping but with the anti-avoidance rules. The concept of GAAR is not new to India since India already has a judicial anti-avoidance rule, like some other jurisdictions. Lack of clarity and absence of appropriate provisions in the statute and/or in the treaty regarding the circumstances in which judicial anti-avoidance rules would apply has generated litigation in India. Holding Structures are recognized

in corporate as well as tax laws. **Special Purpose Vehicles (SPVs)** and Holding Companies have a place in legal structures in India, be it in company law, takeover code under SEBI or even under the income tax law. *When it comes to taxation of a Holding Structure, at the threshold, the burden is on the Revenue to allege and establish abuse, in the sense of tax avoidance in the creation and/or use of such structure(s). In the application of a judicial anti-avoidance rule, the Revenue may invoke the "**substance over form**" **principle** or "**piercing the corporate veil**" **test** only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidant.* To give an example, if a structure is used for circular trading or round tripping or to pay bribes then such transactions, though having a legal form, should be discarded by applying the test of fiscal nullity. Similarly, in a case where the Revenue finds that in a Holding Structure an entity which has no commercial/business substance has been interposed only to avoid tax then in such cases applying the test of fiscal nullity it would be open to the Revenue to discard such inter-positioning of that entity. However, this has to be done at the threshold. In this connection, we may reiterate the "**look at**" principle enunciated in ***Ramsay*** (supra) in which it was held that *the Revenue or the Court must look at a document or a transaction in a context to which it properly belongs to. It is the task of the Revenue/Court to ascertain the legal nature of the transaction and while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach. The Revenue cannot start with the question as to whether the impugned transaction is a tax deferment/saving device but that it should apply the "**look at**" **test** to ascertain its true legal nature* [***Craven* v. *White*** (supra) further observed that genuine strategic tax planning has not been abandoned by any decision of the English Courts till date].

7. Applying the above tests, we are of the view that *every strategic foreign direct investment coming to India, as an investment destination, should be seen in a holistic manner. While doing so, the Revenue/Courts should keep in mind the following factors: the concept of participation in investment, the duration of time during which the Holding Structure exists; the period of business operations in India; the generation of taxable revenues in India; the timing of the exit; the continuity of business on such exit. In short, the onus will be on the Revenue to identify the scheme and its dominant purpose. The corporate business purpose of a transaction is evidence of the fact that the impugned transaction is not undertaken as a colorable or artificial device. The stronger the evidence of a device, the stronger the corporate business purpose must exist to overcome the evidence of a device.*

8. Whether Section 9 is a "**look through**" provision as submitted on behalf of the Revenue? According to the Revenue, if its primary argument (namely, that HTIL has, under the SPA, directly extinguished its property rights in HEL and its subsidiaries) fails, even then in any event, income from the sale of CGP share would nonetheless fall within Section 9 of the Income Tax Act, 1961 as that Section provides for a "**look through**". In this connection, it was submitted that the word "**through**" in Section 9 inter alias means "**in consequence of**". It was, therefore, argued that *if transfer of a capital asset situate in India happens "in consequence of" something which has taken place overseas (including transfer of a capital asset), then all income derived even indirectly from such transfer, even though abroad, becomes taxable in India. That, even if control over HEL were to get transferred in consequence of transfer of the CGP Share outside India, it would yet be covered by Section 9.*

9. We find no merit in the above submission of the Revenue. At the outset, we quote herein below the following Sections of the Income Tax Act, 1961:

> **Scope of total income: Section 5 (2)** Subject to the provisions of this Act, the total income of any previous year of a person who is a non resident includes all income from whatever source derived which - (a)is received or is deemed to be received in India in such year by or on behalf of such person; or
>
> (b) accrues or arises or is deemed to accrue or arise to him in India during such year.
>
> **Income deemed to accrue or arise in India**: **Section 9 (1)** The following incomes shall be deemed to accrue or arise in India:-
>
> (i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

10. Section 9(1)(i) gathers in one place various types of income and directs that income falling under each of the sub-clauses shall be deemed to accrue or arise in India. Broadly there are four items of income. The income dealt with in each sub-clause is distinct and independent of the other and the requirements to bring income within each sub-clause, are separately noted. Hence, it is not necessary that income falling in one category under any one of the sub-clauses should also satisfy the requirements of the other sub-clauses to bring it within the expression "income deemed to accrue or arise in India" in Section 9(1)(i). In this case, we are concerned with the last sub-clause of Section 9(1)(i) which refers to income arising from "transfer of a capital asset situate in India". Thus, *charge on capital gains arises on transfer of a capital asset situate in India during the previous year. The said sub-clause consists of three elements, namely, transfer, existence of a capital asset, and situation of such asset in India. All three elements should exist in order to make the last sub-clause applicable. Therefore, if such a transfer does not exist in the previous year no charge is attracted. Further, Section 45 enacts that such income shall be deemed to be the income of the previous year in which transfer took place. Consequently, there is no room for doubt that such transfer should exist during the previous year in order to attract the said sub-clause. The fiction created by Section 9(1)(i) applies to the assessment of income of non-residents. In the case of a resident, it is immaterial whether the place of accrual of income is within India or outside India, since, in either event, he is liable to be charged to tax on such income. But, in the case of a non-resident, unless the place of accrual of income is within India, he cannot be subjected to tax. In other words, if any income accrues or arises to a non-resident, directly or indirectly, outside India is fictionally deemed to accrue or arise in India if such income accrues or arises as a sequel to the transfer of a capital asset situate in India.* Once the factum of such transfer is established by the Department, then the income of the non-resident arising or accruing from such transfer is made liable to be taxed by reason of Section 5(2)(b) of the Act. This fiction comes into play only when the income is not charged to tax on the basis of receipt in India, as receipt of income in India by itself attracts tax whether the recipient is a resident or non-resident. This fiction is brought in by the legislature to avoid any possible argument on the part of the non-resident vendor that profit accrued or arose outside India by reason of the contract to sell having been

executed outside India. Thus, income accruing or arising to a non-resident outside India on transfer of a capital asset situate in India is fictionally deemed to accrue or arise in India, which income is made liable to be taxed by reason of Section 5(2)(b) of the Act. This is the main purpose behind enactment of Section 9(1)(i) of the Act. We have to give effect to the language of the section when it is unambiguous and admits of no doubt regarding its interpretation, particularly when a legal fiction is embedded in that section. A legal fiction has a limited scope. A legal fiction cannot be expanded by giving purposive interpretation particularly if the result of such interpretation is to transform the concept of chargeability which is also there in Section 9(1)(i), particularly when one reads Section 9(1)(i) with Section 5(2)(b) of the Act. What is contended on behalf of the Revenue is that under Section 9(1)(i) it can "**look through**" the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that Section 9(1)(i) covers direct and indirect transfers of capital assets. For the above reasons, Section 9(1)(i)cannot by a process of interpretation be extended to cover indirect transfers of capital assets/property situate in India. To do so, would amount to changing the content and ambit of Section 9(1)(i). We cannot re-write Section 9(1)(i). The legislature has not used the words indirect transfer in Section 9(1)(i). If the word indirect is read into Section 9(1)(i), it would render the express statutory requirement of the 4th sub-clause in Section 9(1)(i) nugatory. This is because Section 9(1)(i) applies to transfers of a capital asset situate in India. This is one of the elements in the 4th sub-clause of Section 9(1)(i) and if indirect transfer of a capital asset is read into Section 9(1)(i) then the words capital asset situate in India would be rendered nugatory. Similarly, the words underlying asset do not find place in Section 9(1)(i). Further, "transfer" should be of an asset in respect of which it is possible to compute a capital gain in accordance with the provisions of the Act. Moreover, even Section 163(1)(c) is wide enough to cover the income whether received directly or indirectly. Thus, the words directly or indirectly in Section 9(1)(i) go with the income and not with the transfer of a capital asset (property). Lastly, it may be mentioned that the Direct Tax Code (DTC) Bill, 2010 proposes to tax income from transfer of shares of a foreign company by a non-resident, where at any time during 12 months preceding the transfer, the fair market value of the assets in India, owned directly or indirectly, by the company, represents at least 50% of the fair market value of all assets owned by the company. Thus, the Direct Tax Code Bill, 2010 (herein after referred as 'DTC, 2010') proposes taxation of offshore share transactions. This proposal indicates in a way that indirect transfers are not covered by the existing Section 9(1)(i) of the Act. In fact, the Direct Tax Coder Bill, 2009 expressly stated that income accruing even from indirect transfer of a capital asset situate in India would be deemed to accrue in India. These proposals, therefore, show that in the existing Section 9(1)(i) the word indirect cannot be read on the basis of purposive construction. The question of providing "**look through**" in the statute or in the treaty is a matter of policy. It is to be expressly provided for in the statute or in the treaty. Similarly, limitation of benefits has to be expressly provided for in the treaty. Such clauses cannot be read into the Section by interpretation. For the foregoing reasons, we hold that Section 9(1)(i) is not a "**look through**" provision.

11. At the outset, we need to reiterate that in this case **we are concerned with the sale of shares and not with the sale of assets, item-wise**. The facts of this case show sale of the entire investment made by HTIL, through a Top company, viz. CGP, in the Hutchison Structure.

In this case we need to apply the "**look at**" test. In the impugned judgment, the High Court has rightly observed that the arguments advanced on behalf of the Department vacillated. The reason for such vacillation was adoption of "**dissecting approach**" by the Department in the course of its arguments. ***Ramsay*** (supra) enunciated the look at test. *According to that test, the task of the Revenue is to ascertain the legal nature of the transaction and, while doing so, it has to look at the entire transaction holistically and not to adopt a dissecting approach. One more aspect needs to be reiterated. There is a conceptual difference between preordained transaction which is created for tax avoidance purposes, on the one hand, and a transaction which evidences investment to participate in India. In order to find out whether a given transaction evidences a preordained transaction in the sense indicated above or investment to participate, one has to take into account the factors enumerated hereinabove, namely, duration of time during which the holding structure existed, the period of business operations in India, generation of taxable revenue in India during the period of business operations in India, the timing of the exit, the continuity of business on such exit, etc.* Applying these tests to the facts of the present case, we find that the Hutchison structure has been in place since 1994. It operated during the period 1994 to 11.02.2007. It has paid income tax ranging from 3 crore to 250 crore per annum during the period 2002-03 to 2006-07. Even after 11.02.2007, taxes are being paid by VIH ranging from 394 crore to 962 crore per annum during the period 2007-08 to 2010-11 (these figures are apart from indirect taxes which also run in crores). Moreover, the SPA indicates "continuity" of the telecom business on the exit of its predecessor, namely, HTIL. Thus, it cannot be said that the structure was created or used as a sham or tax avoidant. It cannot be said that HTIL or VIH was a "fly by night" operator/ short time investor. If one applies the look at test discussed hereinabove, without invoking the dissecting approach, then, in our view, extinguishment took place because of the transfer of the CGP share and not by virtue of various clauses of SPA. In a case like the present one, where the structure has existed for a considerable length of time generating taxable revenues right from 1994 and where the court is satisfied that the transaction satisfies all the parameters of "participation in investment" then in such a case the court need not go into the questions such as **de facto control v. legal control**, **legal rights v. practical rights**, etc.

12. Be that as it may, did HTIL possess a legal right to appoint directors onto the board of HEL and as such had some "property right" in HEL? If not, the question of such a right getting "extinguished" will not arise. A legal right is an enforceable right. Enforceable by a legal process. The question is what is the nature of the "control" that a parent company has over its subsidiary? It is not suggested that a parent company never has control over the subsidiary. For example, in a proper case of "lifting of corporate veil", it would be proper to say that the parent company and the subsidiary form one entity. But barring such cases, the legal position of any company incorporated abroad is that its powers, functions and responsibilities are governed by the law of its incorporation. No multinational company can operate in a foreign jurisdiction save by operating independently as a "good local citizen". A company is a separate legal persona and the fact that all its shares are owned by one person or by the parent company has nothing to do with its separate legal existence. If the owned company is wound up, the liquidator, and not its parent company, would get hold of the assets of the subsidiary. In none of the authorities have the assets of the subsidiary been held to be those of the parent unless it is acting as an agent. Thus, even though a subsidiary may normally comply with the request of a parent company it is

not just a puppet of the parent company. The difference is between having power or having a persuasive position. Though it may be advantageous for parent and subsidiary companies to work as a group, each subsidiary will look to see whether there are separate commercial interests which should be guarded. When there is a parent company with subsidiaries, is it or is it not the law that the parent company has the "power" over the subsidiary. It depends on the facts of each case. For instance, take the case of a one-man company, where only one man is the shareholder perhaps holding 99% of the shares, his wife holding 1%. In those circumstances, his control over the company may be so complete that it is his alter ego. But, in case of multinationals it is important to realize that their subsidiaries have a great deal of autonomy in the country concerned except where subsidiaries are created or used as a sham. of course, in many cases the courts do lift up a corner of the veil but that does not mean that they alter the legal position between the companies. The directors of the subsidiary under their Articles are the managers of the companies. If new directors are appointed even at the request of the parent company and even if such directors were removable by the parent company, such directors of the subsidiary will owe their duty to their companies (subsidiaries). They are not to be dictated by the parent company if it is not in the interests of those companies (subsidiaries). The fact that the parent company exercises shareholder's influence on its subsidiaries cannot obliterate the decision-making power or authority of its (subsidiary's) directors. They cannot be has such steering interference with the subsidiary's core activities that subsidiary can no reduced to be puppets. The decisive criteria is whether the parent company's management longer be regarded to perform those activities on the authority of its own executive directors.

13. Before dealing with the submissions advanced on behalf of the Revenue, we need to appreciate the reason for execution of the Sale and Purchase of Share and Loans (in short 'SPA'). Exit is an important right of an investor in every strategic investment. The present case concerns transfer of investment in entirety. As stated above, exit coupled with continuity of business is one of the important tell-tale circumstance which indicates the commercial/business substance of the transaction. Thus, the need for SPA arose to re-adjust the outstanding loans between the companies; to provide for standstill arrangements in the interregnum between the date of signing of the SPA on 11.02.2007 and its completion on 8.05.2007; to provide for a seamless transfer and to provide for fundamental terms of price, indemnities, warranties etc. That, the entire investment was sold to the VIH through the investment vehicle (CGP). Consequently, there was no extinguishment of rights as alleged by the Revenue.

14. When a business gets big enough, it does two things. *First*, it reconfigures itself into a corporate group by dividing itself into a multitude of commonly owned subsidiaries. *Second*, it causes various entities in the said group to guarantee each other's debts. A typical large business corporation consists of sub-incorporates. Such division is legal. It is recognized by company law, laws of taxation, takeover codes etc. On top is a parent or a holding company. The parent is the public face of the business. The parent is the only group member that normally discloses financial results. Below the parent company are the subsidiaries which hold operational assets of the business and which often have their own subordinate entities that can extend layers. If large firms are not divided into subsidiaries, creditors would have to monitor the enterprise in its entirety. Subsidiaries reduce the amount of information that creditors need to gather. Subsidiaries also promote the benefits of specialization. Subsidiaries permit creditors

to lend against only specified divisions of the firm. These are the efficiencies inbuilt in a holding structure. Subsidiaries are often created for tax or regulatory reasons. They at times come into existence from mergers and acquisitions. As group members, subsidiaries work together to make the same or complementary goods and services and hence they are subject to the same market supply and demand conditions. They are financially inter-linked. One such linkage is the intra-group loans and guarantees. Parent entities own equity stakes in their subsidiaries. Consequently, on many occasions, the parent suffers a loss whenever the rest of the group experiences a downturn. Such grouping is based on the principle of internal correlation. Courts have evolved doctrines like piercing the corporate veil, substance over form etc. enabling taxation of underlying assets in cases of fraud, sham, tax avoidant, etc. However, genuine strategic tax planning is not ruled out.

15. CGP was incorporated in 1998 in Cayman Islands. It was in the Hutchison structure from 1998. The transaction in the present case was of divestment and, therefore, the transaction of sale was structured at an appropriate tier, so that the buyer really acquired the same degree of control as was hitherto exercised by Hutchison Telecommunications International Limited (CI) ["HTIL" for short]. VIH agreed to acquire companies and the companies it acquired controlled 67% interest in HEL. CGP was an investment vehicle. As stated above, it is through the acquisition of CGP that VIH proposed to indirectly acquire the rights and obligations of Global Services Private Limited [("GSPL" for short), a subsidiary of HTIL] in the Centrino and ND Callus Info Services Private Limited ["NDC" for short] Framework Agreements. The report of Ernst & Young dated 11.02.2007 inter alias states that when they were asked to conduct due diligence by VIH, it was in relation to Array and its subsidiaries. The said report evidences that at the negotiation stage, parties had in mind the transfer of an upstream company rather than the transfer of HEL directly. The transfer of Array had the advantage of transferring control over the entire shareholding held by downstream Mauritius companies (tier I companies), other than GSPL. On the other hand, the advantage of transferring the CGP share enabled VIH to indirectly acquire the rights and obligations of GSPL (Indian company) in the Centrino and NDC Framework agreements. This was the reason for VIH to go by the CGP route. One of the arguments of the Revenue before us was that the Mauritius route was not available to HTIL for the reason indicated above. In this connection, it was urged that the legal owner of HEL (Indian company) was not HTIL. Under the transaction, HTIL alone was the seller of the shares. VIH wanted to enter into an agreement only with HTIL so that if something goes wrong, VIH could look solely to HTIL being the group holding company (parent company). Further, funds were pumped into HEL by HTIL. These funds were to be received back in the shape of a capital gain which could then be used to declare a special dividend to the shareholders of HTIL. We find no merit in this argument. *Firstly*, the tier I (Mauritius companies) were the indirect subsidiaries of HTIL who could have influenced the former to sell the shares of Indian companies in which event the gains would have arisen to the Mauritius companies, who are not liable to pay capital gains tax under the Indo-Mauritius DTAA. That, nothing prevented the Mauritius companies from declaring dividend on gains made on the sale of shares. There is no tax on dividends in Mauritius. Thus, the Mauritius route was available but it was not opted for because that route would not have brought in the control over GSPL. *Secondly*, if the Mauritius companies had sold the shares of HEL, then the Mauritius companies would have continued to be the subsidiaries of HTIL, their accounts would have been consolidated in the hands of HTIL and

HTIL would have accounted for the gains in exactly the same way as it has accounted for the gains in the hands of HTIHL (CI) which was the nominated payee. Thus, in our view, two routes were available, namely, the CGP route and the Mauritius route. It was open to the parties to opt for any one of the two routes. *Thirdly*, as stated above, in the present case, the SPA was entered into inter alias for a smooth transition of business on divestment by HTIL. As stated, transfer of the CGP share enabled VIH to indirectly acquire the rights and obligations of GSPL in the Centrino and NDC Framework Agreements. Apart from the said rights and obligations under the Framework Agreements, GSPL also had a call centre business. VIH intended to take over from HTIL the telecom business. It had no intention to acquire the business of call centre. Moreover, the FDI norms applicable to the telecom business in India were different and distinct from the FDI norms applicable to the call centre business. Consequently, in order to avoid legal and regulatory objections from Government of India, the call centre business stood hived off. In our view, this step was an integral part of transition of business under SPA. The role of CGP in the transaction, was crucial and it cannot be said that the intervened entity (CGP) had no business or commercial purpose.

16. According to the Revenue, under the Companies Law of Cayman Islands, an exempted company was not entitled to conduct business in the Cayman Islands. CGP was an "exempted company". According to the Revenue, since CGP was a mere holding company and since it could not conduct business in Cayman Islands, the sites of the CGP share existed where the "underlying assets are situated", that is to say, India. That, since CGP as an exempted company conducts no business either in the Cayman Islands or elsewhere and since its sole purpose is to hold shares in a subsidiary company situated outside the Cayman Islands, the sites of the CGP share, in the present case, existed "where the underlying assets stood situated" (India). We find no merit in these arguments. At the outset, we do not wish to pronounce authoritatively on the Companies Law of Cayman Islands. Be that as it may, under the Indian Companies Act, 1956, the sites of the shares would be where the company is incorporated and where its shares can be transferred. In the present case, it has been asserted by VIH that the transfer of the CGP share was recorded in the Cayman Islands, where the register of members of the CGP is maintained. This assertion has neither been rebutted in the impugned order of the Department dated 31.05.2010 nor traversed in the pleadings filed by the Revenue nor controverted before us. In the circumstances, we are not inclined to accept the arguments of the Revenue that the sites of the CGP share was situated in the place (India) where the underlying assets stood situated.

17. As regards the question as to why VIH should pay consideration to HTIL based on an enterprise value of 67% of the share capital of HEL is concerned, it is important to note that valuation cannot be the basis of taxation. The basis of taxation is profits or income or receipt. In this case, we are not concerned with tax on income/ profit arising from business operations but with tax on transfer of rights (capital asset) and gains arising there from. In the latter case, we have to see the conditions on which the tax becomes payable under the Income Tax Act. Valuation may be a science, not law. In valuation, to arrive at the value one has to take into consideration the business realities, like the business model, the duration of its operations, concepts such as cash flow, the discounting factors, assets and liabilities, intangibles, etc. In the present case, the Revenue cannot invoke Section 9 of the Income Tax Act on the value of the

underlying asset or consequence of acquiring a share of CGP. In the present case, the Valuation done was on the basis of enterprise value. The price paid as a percentage of the enterprise value had to be 67% not because the figure of 67% was available in present to VIH, but on account of the fact that the competing Indian bidders would have had de facto access to the entire 67%, as they were not subject to the limitation of sectoral cap, and, therefore, would have immediately encashed the call options. The question still remains as to from where did this figure/ expression of 67% of equity interest come? The expression "equity interest" came from US Generally Accepted Accounting Principles (in short 'GAAP'). Thus, giving of the Letters of Credit and placing the shares of Plustech and Scorpios under Options were required to be disclosed to the US investors under the US GAAP, unlike Indian GAAP. Thus, the difference between the 52% figure (control) and 67% (equity interest) arose on account of the difference in computation under the Indian and US GAAP.

18. Applying the "**nature and character of the transaction**" test, the High Court came to the conclusion that the transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH. That, intrinsic to the transaction was a transfer of other "**rights and entitlements**" which rights and entitlements constituted in themselves "**capital assets**" within the meaning of Section 2(14) of the Income Tax Act, 1961. According to the High Court, VIH acquired the CGP share with other rights and entitlements whereas, according to the Appellant, whatever VIH obtained was through the CGP share (for short "**High Court Approach**"). At the outset, it needs to be mentioned that the Revenue has adopted the abovementioned High Court Approach as an alternative contention.

19. We have to view the subject matter of the transaction, in this case, from a **commercial and realistic perspective**. *The present case concerns an offshore transaction involving a structured investment. This case concerns "**a share sale**" and not "**an asset sale**". It concerns sale of an entire investment. A "sale" may take various forms. Accordingly, tax consequences will vary. The tax consequences of a share sale would be different from the tax consequences of an asset sale. A slump sale would involve tax consequences which could be different from the tax consequences of sale of assets on itemized basis. "Control" is a mixed question of law and fact. Ownership of shares may, in certain situations, result in the assumption of an interest which has the character of a controlling interest in the management of the company. A controlling interest is an incident of ownership of shares in a company, something which flows out of the holding of shares. A controlling interest is, therefore, not an identifiable or distinct capital asset independent of the holding of shares. The control of a company resides in the voting power of its shareholders and shares represent an interest of a shareholder which is made up of various rights contained in the contract embedded in the Articles of Association.* The right of a shareholder may assume the character of a controlling interest where the extent of the shareholding enables the shareholder to control the management. Shares, and the rights which emanate from them, flow together and cannot be dissected. In the felicitous phrase of Lord MacMillan in ***IRC* v. *Crossman* (1936) 1 All ER 762** , shares in a company consist of a "congeries of rights and liabilities" which are a creature of the Companies Acts and the Memorandum and Articles of Association of the company. Thus, control and management is a facet of the holding of shares. Applying the above principles governing shares and the rights of the shareholders to the facts of this case, we find that this case concerns a

straightforward share sale. VIH acquired Upstream shares with the intention that the congeries of rights, flowing from the CGP share, would give VIH an indirect control over the three genres of companies. This case deals with share sale and not asset sale. This case does not involve sale of assets on itemized basis. The High Court ought to have applied the look at test in which the entire Hutchison structure, as it existed, ought to have been looked at holistically. This case concerns investment into India by a holding company (parent company), HTIL through a maze of subsidiaries. When one applies the "nature and character of the transaction test", confusion arises if a dissecting approach of examining each individual asset is adopted. As stated, CGP was treated in the Hutchison structure as an investment vehicle. As a general rule, in a case where a transaction involves transfer of shares lock, stock and barrel, such a transaction cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licenses and so on as shares constitute a bundle of rights. **[*Charanjit Lal* v. *Union of India* AIR 1951 SC 41, *Venkatesh (minor)* v. *CIT* 243 ITR 367 (Mad) and *Smt. Maharani Ushadevi* v. *CIT* 131 ITR 445 (MP)]** Further, the High Court has failed to examine the nature of the following items, namely, non-compete agreement, control premium, call and put options, consultancy support, customer base, brand licenses etc. *On facts, we are of the view that the High Court, in the present case, ought to have examined the entire transaction holistically. VIH has rightly contended that the transaction in question should be looked at as an entire package. The items mentioned hereinabove, like, control premium, non-compete agreement, consultancy support, customer base, brand licenses, operating licenses etc. were all an integral part of the Holding Subsidiary Structure which existed for almost 13 years, generating huge revenues, as indicated above. Merely because at the time of exit capital gains tax becomes not payable or eligible to tax would not make the entire "share sale" (investment) a sham or a tax avoidant*. The High Court has failed to appreciate that the payment of US$ 11.08 bn was for purchase of the entire investment made by HTIL in India. The payment was for the entire package. The parties to the transaction have not agreed upon a separate price for the CGP share and for what the High Court calls as "other rights and entitlements" (including options, right to non-compete, control premium, customer base etc.). Thus, it was not open to the Revenue to split the payment and consider a part of such payments for each of the above items. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in installments or on the basis that the payment is related to a contingency ('options', in this case), particularly when the transaction does not contemplate such a split up. Where the parties have agreed for a lump sum consideration without placing separate values for each of the above items which go to make up the entire investment in participation, merely because certain values are indicated in the correspondence with FIPB which had raised the query, would not mean that the parties had agreed for the price payable for each of the above items. The transaction remained a contract of outright sale of the entire investment for a lump sum consideration. Thus, we need to "look at" the entire Ownership Structure set up by Hutchison as a single consolidated bargain and interpret the transactional documents, while examining the Offshore Transaction of the nature involved in this case, in that light.

20. Section 195 casts an obligation on the payer to deduct tax at source ("TAS" for short) from payments made to non-residents which payments are chargeable to tax. Such payment(s) must have an element of income embedded in it which is chargeable to tax in India.

If the sum paid or credited by the payer is not chargeable to tax then no obligation to deduct the tax would arise. Shareholding in companies incorporated outside India (CGP) is property located outside India. Where such shares become subject matter of offshore transfer between two non-residents, there is no liability for capital gains tax. In such a case, question of deduction of TAS would not arise. If in law the responsibility for payment is on a non-resident, the fact that the payment was made, under the instructions of the non-resident, to its Agent/Nominee in India or its PE/Branch Office will not absolve the payer of his liability under Section 195 to deduct TAS. Section 195(1) casts a duty upon the payer of any income specified therein to a non-resident to deduct there from the TAS unless such payer is himself liable to pay income-tax thereon as an Agent of the payee. Section 201 says that if such person fails to so deduct TAS he shall be deemed to be an Assessee-in-default in respect of the deductible amount of tax (Section 201). Liability to deduct tax is different from "assessment" under the Act. Thus, the person on whom the obligation to deduct TAS is cast is not the person who has earned the income. Assessment has to be done after liability to deduct TAS has arisen. The object of Section 195 is to ensure that tax due from non-resident persons is secured at the earliest point of time so that there is no difficulty in collection of tax subsequently at the time of regular assessment. The present case concerns the transaction of "outright sale" between two non-residents of a capital asset (share) outside India. Further, the said transaction was entered into on principal to principal basis. Therefore, no liability to deduct TAS arose. Further, in the case of transfer of the Structure in its entirety, one has to look at it holistically as one Single Consolidated Bargain which took place between two foreign companies outside India for which a lump sum price was paid of US$ 11.08 bn.

21. Applying the look at test in order to ascertain the true nature and character of the transaction, we hold, that the Offshore Transaction herein is a bonafide structured FDI investment into India which fell outside India's territorial tax jurisdiction, hence not taxable. The said Offshore Transaction evidences participative investment and not a sham or tax avoidant preordained transaction. The said Offshore Transaction was between HTIL (a Cayman Islands company) and VIH (a company incorporated in Netherlands). The subject matter of the Transaction was the transfer of the CGP (a company incorporated in Cayman Islands). Consequently, the Indian Tax Authority had no territorial tax jurisdiction to tax the said Offshore Transaction.

22. FDI flows towards location with a strong governance infrastructure which includes enactment of laws and how well the legal system works. Certainty is integral to rule of law. Certainty and stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner. Legal doctrines like "Limitation of Benefits" and "look through" are matters of policy. It is for the Government of the day to have them incorporated in the Treaties and in the laws so as to avoid conflicting views. Investors should know where they stand. It also helps the tax administration in enforcing the provisions of the taxing laws. As stated above, the Hutchison structure has existed since 1994. According to the details submitted on behalf of the Appellant, we find that from 2002-03 to 2010-11 the Group has contributed an amount of `20,242 crores towards direct and indirect taxes on its business operations in India.

23. For the above reasons, we set aside the impugned judgment of the Bombay High Court dated 8.09.2010 in Writ Petition No. 1325 of 2010. Accordingly, the Civil Appeal stands allowed with no order as to costs. The Department is hereby directed to return the sum of `2,500 crores, which came to be deposited by the Appellant in terms of our interim order, with interest at the rate of 4% per annum within two months from today. The interest shall be calculated from the date of withdrawal by the Department from the Registry of the Supreme Court up to the date of payment. The Registry is directed to return the Bank Guarantee given by the Appellant within four weeks.

K.S. RADHAKRISHNAN, J. The question involved in this case is of considerable public importance, especially on Foreign Direct Investment (FDI), which is indispensable for a growing economy like India. Foreign investments in India are generally routed through Offshore Finance Centers (OFC) also through the countries with whom India has entered into treaties. Overseas investments in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognized as important avenues of global business in India. Potential users of off-shore finance are: international companies, individuals, investors and Ors. and capital flows through FDI, Portfolio Debt Investment and Foreign Portfolio Equity Investment and so on. Demand for off-shore facilities has considerably increased owing to high growth rates of cross-border investments and a number of rich global investors have come forward to use high technology and communication infrastructures. Removal of barriers to cross-border trade, the liberalization of financial markets and new communication technologies have had positive effects on global economic growth and India has also been greatly benefited. Merger, Amalgamation, Acquisition, Joint Venture, Takeovers and Slump-sale of assets are few methods of cross-border re-organizations. Under the FDI Scheme, investment can be made by availing the benefit of treaties, or through tax havens by non-residents in the share/convertible debentures/ preference shares of an Indian company but the question which looms large is whether our Company Law, Tax Laws and Regulatory Laws have been updated so that there can be greater scrutiny of non-resident enterprises, ranging from foreign contractors and service providers, to finance investors. Case in hand is an eye-opener of what we lack in our regulatory laws and what measures we have to take to meet the various unprecedented situations, that too without sacrificing national interest. Certainty in law in dealing with such cross-border investment issues is of prime importance, which has been felt by many countries around the world and some have taken adequate regulatory measures so that investors can arrange their affairs fruitfully and effectively. Steps taken by various countries to meet such situations may also guide us, a brief reference of which is being made in the later part of this judgment.

25. We are, in the present case, concerned with a matter relating to cross-border investment and the legal issues emanate from that. Facts have been elaborately dealt with by the High Court in the impugned judgment and also in the leading judgment of Lord Chief Justice, but reference to few facts is necessary to address and answer the core issues raised. On all major issues, I fully concur with the views expressed by the Lord Chief Justice in his erudite and scholarly judgment. Hutchison Whampoa is a multi-sectional, multi-jurisdictional entity which consolidates on a group basis telecom operations in various countries.

26. Shri Harish Salve, learned senior counsel appearing for Vodafone explained in detail how Hutchison Corporate Structure was built up and the purpose, object and relevance of such vertical Transnational Structures in the international context. Learned Senior counsel submitted that complex structures are designed not for avoiding tax but for good commercial reasons and Indian legal structure and foreign exchange laws recognize Overseas Corporate Bodies (OCB). Learned senior counsel also submitted that such Transnational Structures also contain exit option to the investors. Senior counsel also pointed out that where regulatory provisions mandate investment into corporate structure such structures cannot be disregarded for tax purposes by lifting the corporate veil especially when there is no motive to avoid tax. Shri Salve also submitted that Hutchison corporate structure was not designed to avoid tax and the transaction was not a colorable device to achieve that purpose. Senior counsel also submitted that source of income lies where the transaction is effected and not where the underlying asset is situated or economic interest lies. Reference was made to judgment in ***Seth Pushalal Mansinghka (P) Ltd.*** **v.** ***CIT*** **(1967) 66 ITR 159 (SC).** Learned Counsel also pointed out that without any express legislation, off-shore transaction cannot be taxed in India. Reference was made to two judgments of the Calcutta High Court ***Assam Consolidated Tea Estates*** **v.** ***Income Tax Officer 'A' Ward*** **(1971) 81 ITR 699 Cal.** and ***C.I.T. West Bengal*** **v.** ***National and Grindlays Bank Ltd.*** **(1969) 72 ITR 121 Cal.** Learned senior counsel also pointed out that when a transaction is between two foreign entities and not with an Indian entity, source of income cannot be traced back to India and nexus cannot be used to tax under Section 9 of Income Tax Act, 1961. Further, it was also pointed out that language in Section 9 does not contain "look through provisions" and even the words "indirectly" or "through" appearing in Section 9 would not make a transaction of a non-resident taxable in India unless there is a transfer of capital asset situated in India. Learned Senior counsel also submitted that the Income Tax Department has committed an error in proceeding on a "moving theory of nexus" on the basis that economic interest and underlying asset are situated in India. It was pointed out that there cannot be transfer of controlling interest in a Company independent from transfer of shares and under the provisions of the Company Law. Acquisition of shares in a Company entitles the Board a right of "control" over the Company. Learned Senior Counsel also pointed out the right to vote, right to appoint Board of Directors, and other management rights are incidental to the ownership of shares and there is no change of control in the eye of law but only in commercial terms. Mr. Salve emphasized that, in absence of the specific legislation, such transactions should not be taxed. On the sites of shares, learned senior counsel pointed out that the sites is determined depending upon the place where the asset is situated. Learned senior counsel also pointed out that on transfer of CGP, Vodafone got control over HEL and merely because Vodafone has presence or chargeable income in India, it cannot be inferred that it can be taxed in some other transactions. Learned senior counsel also submitted that the acquisition of "controlling interest" is a commercial concept and tax is levied on transaction and not its effect. Learned senior counsel pointed out that to lift the corporate veil of a legally recognized corporate structure time and the stage of the transaction are very important and not the motive to save the tax. Learned senior counsel point out that ***Azadi Bachao Andolan*** broadly reflects Indian jurisprudence and that generally Indian courts used to follow the principles laid down by English Courts on the issue of tax avoidance and tax evasion. Learned Senior counsel also submitted that Tax Residency Certificate (for short TRC) issued by the Mauritian authorities has

to be respected and in the absence of any Limitation on Benefit (LOB Clause), the benefit of the Indo-Mauritian Treaty is available to third parties who invest in India through Mauritius route.

27. Mr. R.F. Nariman, Learned Solicitor General appearing for the Income Tax Department submitted that the sale of CGP share was nothing but an artificial avoidance scheme and CGP was fished out of the HTIL legal structure as an artificial tax avoidance contrivance. Corporate structure created for genuine business purposes are those which are generally created or acquired: at the time when investment is being made; or further investments are being made; or the time when the Group is undergoing financial or other overall restructuring; or when operations, such as consolidation, are carried out, to clean-defused or over-diversified. Sound commercial reasons like hedging business risk, hedging political risk, mobility of investment, ability to raise loans from diverse investments, often underlie creation of such structures. In transnational investments, the use of a tax neutral and investor-friendly countries to establish SPV is motivated by the need to create a tax efficient structure to eliminate double taxation wherever possible and also plan their activities attracting no or lesser tax so as to give maximum benefit to the investors. Certain countries are exempted from capital gain, certain countries are partially exempted and, in certain countries, there is nil tax on capital gains. Such factors may go in creating a corporate structure and also restructuring. Corporate structure may also have an exit route, especially when investment is overseas. For purely commercial reasons, a foreign group may wind up its activities overseas for better returns, due to disputes between partners, unfavorable fiscal policies, uncertain political situations, strengthen fiscal loans and its application, threat to its investment, insecurity, weak and time consuming judicial system etc., all can be contributing factors that may drive its exit or restructuring. Clearly, there is a fundamental difference in transnational investment made overseas and domestic investment. Domestic investments are made in the home country and meant to stay as it were, but when the trans-national investment is made overseas away from the natural residence of the investing company, provisions are usually made for exit route to facilitate an exit as and when necessary for good business and commercial reasons, which is generally foreign to judicial review. Revenue/Courts can always examine whether those corporate structures are genuine and set up legally for a sound and veritable commercial purpose. Burden is entirely on the Revenue to show that the incorporation, consolidation, restructuring etc. has been effected to achieve a fraudulent, dishonest purpose, so as to defeat the law.

28. Overseas companies are companies incorporated outside India and neither the Companies Act nor the Income Tax Act enacted in India has any control over those companies established overseas and they are governed by the laws in the countries where they are established. From country to country laws governing incorporation, management, control, taxation etc. may change. Many developed and wealthy Nations may park their capital in such off-shore companies to carry on business operations in other countries in the world. Many countries give facilities for establishing companies in their jurisdiction with minimum control and maximum freedom. Competition is also there among various countries for setting up such offshore companies in their jurisdiction. Demand for offshore facilities has considerably increased, in recent times, owing to high growth rates of cross-border investments and to the increased number of rich investors who are prepared to use high technology and communication infrastructures to go offshore. Removal of barriers to cross- border trade, the liberalization of

communication technologies have had positive effects on the developing countries including India. Investment under foreign Direct Investment Scheme (FDI scheme), investment by Foreign Institutional Investors (FIIs) under the Portfolio Investment Scheme, investment by NRIs/OBCs under the Portfolio Investment Scheme and sale of shares by NRIs/OBCs on non-repatriation basis; Purchase and sale of securities other than shares and convertible debentures of an Indian company by a non-resident are common. Many of the offshore companies use the facilities of Offshore Financial Centers (in short 'OFC') situate in Mauritius, Cayman Islands etc. Many of these offshore holdings and arrangements are undertaken for sound commercial and legitimate tax planning reasons, without any intent to conceal income or assets from the home country tax jurisdiction and India has always encouraged such arrangements, unless it is fraudulent or fictitious.

29. Moving offshore or using an OFC does not necessarily lead to the conclusion that they involve in the activities of tax evasion or other criminal activities. The multi-national companies are attracted to offshore financial centers mainly due to the reason of providing attractive facilities for the investment. Many corporate conglomerates employ a large number of holding companies and often high-risk assets are parked in separate companies so as to avoid legal and technical risks to the main group. Instances are also there when individuals form offshore vehicles to engage in risky investments, through the use of derivatives trading etc. Many of such companies do, of course, involve in manipulation of the market, money laundering and also indulge in corrupt activities like round tripping, parking black money or offering, accepting etc., advantage or prospect thereof.

30. Lifting the corporate veil doctrine is readily applied in the cases coming within the Company Law, Law of Contract, Law of Taxation. Once the transaction is shown to be fraudulent, sham, circuitous or a device designed to defeat the interests of the shareholders, investors, parties to the contract and also for tax evasion, the Court can always lift the corporate veil and examine the substance of the transaction. Lifting the corporate veil doctrine can, therefore, be applied in tax matters even in the absence of any statutory authorization to that effect. Principle is also being applied in cases of holding company - subsidiary relationship- where in spite of being separate legal personalities, if the facts reveal that they indulge in dubious methods for tax evasion.

31. Tax avoidance and tax evasion are two expressions which find no definition either in the Indian Companies Act, 1956 or the Income Tax Act, 1961. But the expressions are being used in different contexts by our Courts as well as the Courts in England and various other countries, when a subject is sought to be taxed. One of the earliest decisions which came up before the House of Lords in England demanding tax on a transaction by the Crown is ***Duke of Westminster*** (supra). In that case, Duke of Westminster had made an arrangement that he would pay his gardener an annuity, in which case, a tax deduction could be claimed. Wages of household services were not deductible expenses in computing the taxable income, therefore, Duke of Westminster was advised by the tax experts that if such an agreement was employed, Duke would get tax exemption. Under the Tax Legislation then in force, if it was shown as gardener's wages, then the wages paid would not be deductible. Inland Revenue contended that the form of the transaction was not acceptable to it and the Duke was taxed on the substance of the transaction, which was that payment of annuity was treated as a payment of salary or wages.

Crown's claim of substance doctrine was, however, rejected by the House of Lords. Lord Tomlin's celebrated words are quoted below: "*Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable".*

32. The House of Lords, during 1980's, it seems, began to attach a "**purposive interpretation approach**" and gradually began to give emphasis on "**economic substance doctrine**" as a question of statutory interpretation. In a most celebrated case in ***Ramsay*** (supra), the House of Lords considered this question again. That was a case whereby the taxpayer entered into a circular series of transactions designed to produce a loss for tax purposes, but which together produced no commercial result. Viewed that transaction as a whole, the series of transactions was self-canceling, the taxpayer was in precisely the same commercial position at the end as at the beginning of the series of transactions. House of Lords ruled that, notwithstanding the rule in Duke of Westminster's case, the series of transactions should be disregarded for tax purposes and the manufactured loss, therefore, was not available to the taxpayer. **Lord Wilberforce** opined as follows:

> "*While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded; to do so in not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions intended to operate as such, it is that series or combination which may be regarded.*" (Emphasis supplied).

33. House of Lords, therefore, made the following important remarks concerning what action the Court should consider in cases that involve tax avoidance:

(a) A taxpayer was only to be taxed if the Legislation clearly indicated that this was the case;

(b) A taxpayer was entitled to manage his or her affairs so as to reduce tax;

(c) Even if the purpose or object of a transaction was to avoid tax this did not invalidate a transaction unless an anti-avoidance provision applied; and

(d) If a document or transaction was genuine and not a sham in the traditional sense, the Court had to adhere to the form of the transaction following the Duke Westminster concept.

34. In ***Ramsay*** (supra) it may be noted, the taxpayer produced a profit that was liable to capital gains tax, but a readymade claim was set up to create an allowable loss that was purchased by the taxpayer with the intention of avoiding the capital gains tax. Basically, the House of Lords, cautioned that the technique of tax avoidance might progress and technically

improve and Courts are not obliged to be at a standstill. In other words, the view expressed was that that a subject could be taxed only if there was a clear intendment and the intendment has to be ascertained on clear principles and the Courts would not approach the issue on a mere literal interpretation. ***Ramsay*** was, therefore, seen as a new approach to artificial tax avoidance scheme. ***Ramsay*** was followed by the House of Lords in another decision in ***IRC* v. *Burmah Oil Co Ltd.* (1982) 54 TC 200**. This case was also concerned with a self-canceling series of transactions. **Lord Diplock**, in that case, confirmed the judicial view that a development of the jurisprudence was taking place, stating that ***Ramsay*** case marked a significant change in the approach adopted by the House of Lords to a pre-ordained series of transactions. Ramay and Burmah cases, it may be noted, were against self-canceling artificial tax schemes which were widespread in England in 1970's. Rather than striking down the self-canceling transactions, of course, few of the speeches of Law Lords gave the impression that the tax effectiveness of a scheme should be judged by reference to its commercial substance rather than its legal form. On this, of course, there was some conflict with the principle laid down in Duke of Westminster. Duke of Westminster was concerned with the "single tax avoidance step". During 1970's, the Courts in England had to deal with several pre-planned avoidance schemes containing a number of steps. In fact, earlier in ***IRC* v. *Plummer* (1979) 3 All ER 775 , Lord Wilberforce** commented about a scheme stating that the same was carried out with "almost military precision" which required the court to look at the scheme as a whole. The scheme in question was a "circular annuity" plan, in which a charity made a capital payment to the taxpayer in consideration of his covenant to make annual payments of income over five years. The House of Lords held that the scheme was valid. Basically, the ***Ramsay*** was dealing with "readymade schemes". The High Court and the Court of Appeal ruled that ***Ramsay*** principle applied only where steps forming part of the scheme were self-canceling and they considered that it did not allow share exchange and sale agreements to be distributed as steps in the scheme, because they had an enduring legal effect. The House of Lords, however, held that steps inserted in a preordained series of transactions with no commercial purpose other than tax avoidance should be disregarded for tax purposes, notwithstanding that the inserted step (i.e. the introduction of Greenjacket) had a business effect. Lord Brightman stated that inserted step had no business purpose apart from the deferment of tax, although it had a business effect. Even though in ***Dawson***, the House of Lords seems to strike down the transaction by the taxpayer for the purpose of tax avoidance, House of Lords in ***Craven*** (supra) clarified the position further. In that case, the taxpayers exchanged their shares in a trading company (Q Ltd) for shares in an Isle of Man holding company (M Ltd), in anticipation of a potential sale or merger of the business. Taxpayers, in the meanwhile, had abandoned negotiations with one interested party, and later concluded a sale of Q Ltd's shares with another. M Ltd subsequently loaned the entire sale proceeds to the taxpayers, who appealed against assessments to capital gains tax. The House of Lords held in favor of the taxpayers, dismissing the crown's appeal by a majority of three to two. House of Lords noticed that when the share exchange took place, there was no certainty that the shares in Q Ltd would be sold. Lord Oliver, speaking for the majority, opined that ***Ramsay,* Burmah and Dawson** did not produce any legal principle that would nullify any transaction that has no intention besides tax avoidance and opined as follows:

> *"My Lords, for my part I find myself unable to accept that Dawson either established or can properly be used to support a general proposition that any transaction which is*

> *effected for avoiding tax on a contemplated subsequent transaction and is therefore planned, is for that reason, necessarily to be treated as one with that subsequent transaction and as having no independent effect".*

35. ***Craven*** made it clear that: (1) Strategic tax planning undertaken for months or possible years before the event (of-sale) in anticipation of which it was effected; (2) A series of transactions undertaken at the time of disposal/sale, including an intermediate transaction interposed into having no independent life, could under ***Ramsay*** principle be looked at and treated as a composite whole transaction to which the fiscal results of the single composite whole are to be applied, i.e. that an intermediate transfer which was, at the time when it was effected, so closely interconnected with the ultimate disposition, could properly be described as not, in itself, a real transaction at all, but merely an element in some different and larger whole without independent effect. In House of Lords in ***Ensign Tankers (Leasing) Ltd.* v. *Stokes* (1992) 1 AC 655** made a review of the various tax avoidance cases from ***Floor* v. *Davis* (1978) 2 All ER 1079**. In ***Ensign Tankers***, a company became a partner of a limited partnership that had acquired the right to produce the film "Escape to Victory". 75% of the cost of making the film was financed by way of a non-recourse loan from the production company, the company claimed the benefit of depreciation allowances based upon the full amount of the production cost. The House of Lords disallowed the claim, but allowed depreciation calculated on 25% of the cost for which the limited partnership was at risk. House of Lords examined the transaction as a whole and concluded that the limited partnership had only 'incurred capital expenditure on the provision of machinery or plant' of 25% and no more. **Lord Goff** explained the meaning of "**unacceptable tax avoidance**" in ***Ensign Tankers*** and held that unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed. This, of course, led to further debate as to what is "unacceptable tax avoidance" and "acceptable tax avoidance".

36. The Constitution Bench of this Court in ***McDowell*** (supra) examined at length the concept of tax evasion and tax avoidance in the light of the principles laid down by the House of Lords in several judgments like ***Duke of Westminster, Ramsay, Dawson*** etc. The scope of Indo-Mauritius DTAA, Circular No. 682 dated 30.3.1994 and Circular No. 789 dated 13.4.2000 issued by CBDT, later came up for consideration before a two Judges Bench of this Court in ***Azadi Bachao Andolan***. Learned Judges made some observations with regard to the opinion expressed by Justice Chinnappa Reddy in a Constitution Bench judgment of this Court in McDowell, which created some confusion with regard to the understanding of the Constitution Bench judgment, which needs clarification. The scope of the India-Mauritius Treaty was discussed elaborately above by the Chief Justice. Writ Petitions in public interest were filed before the Delhi High Court challenging the constitutional validity of the above mentioned circulars. Delhi High Court quashed Circular No. 789 stating that inasmuch as the circular directs the Income Tax authorities to accept as a certificate of residence issued by the authorities of Mauritius as sufficient evidence as regards the status of resident and beneficial ownership, was ultra vires the powers of CBDT. The Court also held that the Income Tax Office was entitled to lift the corporate veil in India to see whether a company was a resident of Mauritius or not and whether the company was paying income tax in Mauritius or not. The Court also held

that the "Treaty Shopping" by which the resident of a third country takes advantage of the provisions of the agreement was illegal and necessarily to be forbidden. Union of India preferred appeal against the judgment of the Delhi High Court, before this Court. This Court in **Azadi Bachao Andolan** allowed the appeal and Circular No. 789 was declared valid.

37. Mauritius, and India, it is known, has also signed a Memorandum of Understanding (MOU) whose object and purpose is to track down transactions tainted by fraud and financial crime, not to target the bona fide legitimate transactions. Mauritius has also enacted stringent "Know Your Clients" (KYC) Regulations and Anti-Money Laundering laws which seek to avoid abusive use of treaty. Viewed in the above perspective, we also find no reason to import the "abuse of rights doctrine" (abus de droit) to India.

38. ***McDowell*** has emphatically spoken on the principle of Tax Planning. Justice Ranganath Mishra, on his and on behalf of three other Judges, held *"Tax planning may be legitimate provided it is within the framework of law. Colorable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that is honorable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges."* A five Judges Bench judgment of this Court in ***Mathuram Agrawal*** **v.** ***State of Madhya Pradesh*** **(1999) 8 SCC 667**, *after referring to Lord Roskill on* ***Duke of Westminster*** *stated that the subject is not to be taxed by inference or analogy, but only by the plain words of a statute applicable to the facts and circumstances of each case.* Revenue cannot tax a subject without a statute to support and in the course we also acknowledge that every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury. Revenue's stand that the ratio laid down in McDowell is contrary to what has been laid down in Azadi Bachao Andolan, in our view, is unsustainable and, therefore, calls for no reconsideration by a larger branch.

39. Revenue argued that HTIL and Vodafone are offshore companies and since the sale took place outside India, applying the source test, the source is also outside India, unless legislation ropes in such transactions. Substantial territorial nexus between the income and the territory which seeks to tax that income, is of prime importance to levy tax. Expression used in Section 9(1)(i) is "source of income in India" which implies that income arises from that source and there is no question of income arising indirectly from a source in India. Expression used is "source of income in India" and not "from a source in India". Section 9 contains a "deeming provision" and in interpreting a provision creating a legal fiction, the Court is to ascertain for what purpose the fiction is created, but in construing the fiction it is not to be extended beyond the purpose for which it is created, or beyond the language of section by which it is created. For the above reasons, we set aside the impugned judgment of the Bombay High Court dated 8.09.2010 in Writ Petition No. 1325 of 2010.

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Ram Pershad v. *C.I.T.*

(1972) 2 SCC 696

JAGANMOHAN REDDY, J. - The assessee and his wife owned a large number of shares in a private limited company engaged in the business of running hotels. By virtue of Article 109 of the Articles of Association of the said company, the assessee became the first Managing Director on terms and conditions agreed to and embodied in an agreement, dated November 20, 1955, between himself and the company. Under the said agreement, the assessee was ,to receive Rs 2.000/- per month, fixed sum of Rs 500/-per month as car allowance, 10% of gross profits of the company and he and his wife were entitled to free board and lodging in the hotel. For the assessment year 1956-57 for which the accounting year is the year ending September 30, 1955, the assessee was assessed in respect of Rs.53,913/-payable to him as 10% of the gross profits of the company which he gave up soon after the accounts were finalised but before they were passed by the general meeting of the shareholders. The above amount was given up by him because the company would not be making net profits if the stipulated commission was paid to him. The assessee claimed that the amount given up by him was not liable to be included in his total income because the amount had not accrued to him at all, at any rate, in the accounting year ended March 31, 1956, and that even assuming that it had accrued in the accounting year ended March 31, 1956, it is not taxable under Section 7 or Section 10 of the Indian Income-tax Act, 1922. The Income-tax Officer, the Appellate Assistant Commissioner, the Tribunal and on a reference under Section 66(1) the High Court have all held that the 10% commission on gross profits amounting to Rs 53,913/- was taxable as 'salary' under Section 7 of the Act and that the income had accrued to the assessee during the previous year. Against the judgment of the High Court, this appeal is by special leave.

2. The questions of law which were referred to the High Court under Section 66(1) of the Act are as follows—

(1) Whether the sum of Rs 53,913/- was a revenue receipt of the assessee of the previous year?

(2) Whether the amount is chargeable under Section 7 or Section 10 of the Income-tax Act?

(3) If the amount is chargeable under Section 10, is the assessee entitled to a deduction of Rs 53,913/- under Section 10(1) or Section 10(2)?

The High Court answered the first question in the affirmative and in favour of the revenue, and on the second question it was of the view that the amount payable as commission was chargeable under Section 7 as salary and not under Section 10 of the Act. On this view, it did not think it necessary to answer the third question.

3. When the matter came up earlier, this court on November 9, 1971, considered it necessary to call for a further statement of the case from the Tribunal on the third question on the basis of the materials before it and having regard to the decision of ***Morvi Industries Ltd.* v. *Commissioner of Income-tax*** [AIR 1971 SC 2396]. The Tribunal in its supplementary statement of case has answered the question against the assessee and in favour of the

Department in holding that the assessee is not entitled to a deduction of the sum of Rs 53,913/- either under Section 10(1) or 10(2) of the Act.

4. It is not disputed that the commission payable to him would be a revenue receipt nor is it disputed that if it is chargeable under Section 7 no other question would arise having regard to the finding based on the decision in ***Morvi Industries*** case, that the amount of Rs. 53,913/- had accrued to the assessee in the year of account. It is therefore necessary for us to consider whether the 10% gross profits payable to the assessee under the terms of the agreement appointing him as the Managing Director is liable to be assessed as salary or under the head 'income from business'. It may be mentioned that 'salary' under Section 7 of the Act includes also commission, wages, perquisites, etc.

5. On behalf of the assessee, it was contended that in order to assess the income as salary it must be held that there was a relationship of master and servant between the company and the assessee. For such a relationship to exist, it must be shown that the employee must be subject to the supervision and control of the employer in respect of the work that the employee has to do. Where, however, there is no such supervision or control it will be a relationship of principal and agent or an independent contractor. Applying these tests, it is submitted that the appointment of the assessee as a Managing Director is not that of a servant but as an agent of the company and accordingly the commission payable to him is income from business and not salary.

6. There is no doubt that for ascertaining whether a person is a servant or an agent, a rough and ready test is, whether, under the terms of his employment, the employer exercises a supervisory control in respect of the work entrusted to him. A servant acts under the direct control and supervision of his master. An agent, on the other hand, in the exercise of his work is not subject to the direct control or supervision of the principal, though he is bound to exercise his authority in accordance with all lawful orders and instructions which may be given to him from time to time by his principal. But this test is not universal in its application and does not determine in every -*case,* having regard to the nature of employment, that he is a servant. A doctor may be employed as a medical officer and though no control is exercised over him in respect of the manner he should do the work nor in respect of the day to day work, he is required to do, he may nonetheless be a servant if his employment creates a relationship of master and servant. Similar is the case of a chauffeur who is employed to drive the car for his employer. If he is to take the employer or any other person at his request from place 'A' to place 'B' the employer does not supervise the manner in which he drives between those places. Such examples can be multiplied. A person who is engaged to manage a business may be a servant or an agent according to the nature of his service and the authority of his employment. Generally it may be possible to say that the greater the amount of direct control over the person employed, the stronger the conclusion in favour of his being a servant. Similarly the greater the degree of independence the greater the possibility of the services rendered being in the nature of principal and agent. It is not possible to lay down any precise rule of law to distinguish one kind of employment from the other. The nature of the particular business and the nature of the duties of the employee will require to be considered in each case in order to arrive at a conclusion as to whether the person employed is a servant or an agent. In each case the principle for ascertainment remains the same.

7. Though an agent as such is not a servant, a servant is generally for some purposes his master's implied agent, the extent of the agency depending upon the duties or position of the servant. It is again true that a director of a company is not a servant but an agent inasmuch as the company cannot act in its own person but has only to act through directors who qua the company have the relationship of an agent to its principal. A Managing Director may have a dual capacity. He may both be a Director as well as employee. It is therefore evident that in the capacity of a Managing Director he may be regarded as having not only the capacity as persona of a director but also has the persona of an employee, as an agent depending upon the nature of his work and the terms of his employment. Where he is so employed, the relationship between him as the Managing Director and the Company may be similar to a person who is employed as a servant or an agent for the term 'employed' is facile enough to cover any of these relationships. The nature of his employment may be determined by the articles of association of a company and/or the agreement if any, under which a contractual relationship between the Director and the company has been brought about, hereunder the Director is constituted an employee of the company, if such be the case, his remuneration will be assessable as salary under Section 7. In other words, whether or not a Managing Director is a servant of the company apart from his being a Director can only be determined by the article of association and the terms of his employment. A similar view has been expressed by the Scottish Court of Session in ***Anderson* v. *James Sutherland* (*Peterhead*) *Limited*** [AIR 1941 SC 203, 218] where Lord Normand at p. 218 said:

> (T)he managing director has two functions and two capacities. Qua Managing Director he is a party to a contract with the company, and this contract is a contract of employment; more specifically I am of opinion that it is a contract of service and not a contract for service.

8. A number of cases have been referred before us but the conclusion in each of the decisions turned on the particular nature of employment and the facts disclosed therein. In each of these decisions the "context played a vital part in the conclusions arrived at". In ***Piyare Lal Adishwar Lal* v. *Commissioner of Income-tax*** [40 ITR 17], Kapur, J. said (at p. 24) that:

> It is difficult to lay down any one test to distinguish the relationship of master and servant from that of an employer and independent contractor. In many cases the test laid down is that in the case of master and servant, the master can order or require what is to be done and how it is to be done but in the case of an independent contractor an employer can only say what is to be done but not how it shall be done. But this test also does not apply to all cases, e.g. in the case of ship's master, a chauffeur or a reporter of a newspaper .....In certain cases it has been laid down that the indicia of a contract of service are: (*a*) the master's power of selection of the servant; (*b*) the payment of wages or other remunerations; (*c*) the master's right to control the method of doing the work; and (*d*) the master's right to suspension or dismissal.

10. In ***Lakshminarayan Ram Gopal* v. *Government of Hyderabad***. [25 ITR 449 (SC)] Bhagwati, J., speaking for the Court held that the assessee under the managing agency agreement, having regard to certain indicia discernible from that agreement was an agency. At p. 458 the functions of the assessee which were inconsistant with his being a servant were specified. They were:

(1) The power to assign the agreement and the rights of the appellant thereunder;

(2) The right to continue in employment as the agents of the company for a period of 30 years until the appellants of their own will resign;

(3) The remuneration by way of commission of 2% of the amount of sale proceeds of the produce of the company; and

(4) The power of sub-delegation of functions given to the agent under Article 118.

All these circumstances went to establish that the appellants were the agents of the company and not merely the servants remunerated by wages or salary.

11. In ***Commissioner of Income-tax, Bombay* v. *Armstrong Smith*** [(1946) 14 ITR 606 (Bom)], Stone, C. J., and Kania, J., had held that under the terms of an agreement the Managing Director was a servant of the company. There they had to consider a case where the articles of association of the company provided that the assessee was to be the Chairman and Managing Director of the Company until he resigned office or died or ceased to hold at least one share in the capital of the company; that all the other directors were to be under his control and were bound to conform to his directions in regard to the company's business; that his remuneration was to be voted by the company at its annual general meeting and that the sum received by him for managing the company's business which arose from out of the contractual relationship with the company provided by the articles for performing the services of managing the company's business. In these circumstances it was held that the remuneration was taxable under Section 7 and not under Section 12 of the Act. It appears that a large number of English cases were cited but these were not referred to. Stone, G. J., observed (at pp. 609-610):

> We have been referred to quite a large number of English cases the effect of which, I think, be summarised by saying that a director of a company as such is not a servant of the company and that the fees he receives are by way of gratuity, but that does not prevent .a director or a managing director from entering into a contractual relationship with the company, so that, quite apart from his office of director as becomes entitled to remuneration as an employee of the company. Further that relationship may be created either by a service agreement or by the articles themselves. Now, in this case there is no question of any service agreement outside the articles and, therefore, the relationship between the company and the assessee, Mr Smith, depends upon the articles.

12. In ***Commissioner of Income-tax* v. *Negi Reddy***, [51 ITR 178 (Mad)], the Madras High Court was considering the case of a Managing Director of a film company who was also the Managing Director of another film company on similar terms and remuneration, namely, that he was to get a monthly remuneration of Rs 500/- and in addition a commission on net profits. The question there was, whether the remuneration received by him as Managing Director from these two companies was income from business assessable under Section 10 of the Act.

13. A detailed consideration of all the cases cited and the passages from text-books referred to before us do not assist us in coming to the conclusion that the test for determining whether the person employed by a company is a servant or agent is solely dependent on the extent of supervision and control exercised on him. The real question in this case is one of construction of the articles of association and the relevant agreement which was entered into between the company and the assessee. If the company is itself carrying on the business and the assessee is employed to manage its affairs in terms of its articles and the agreement, he could be dismissed or his employment can be terminated by the company if his work is not satisfactory, it could

hardly be said that he is not a servant of the company. Article 109 of the articles of association before its amendment and relevant for the period which we are considering provided that he' shall be the Managing Director of the company for 20 years on terms and conditions embodied in the agreement. Article 136 states that subject to the aforesaid agreement, the general management of the business of the company shall be in the hands of the Managing Director of the company who shall have power and authority on behalf of the company to do the several things specified therein which are usually necessary and desirable for the management of the affairs of the company. Article 137 provides that the receipts signed by the Managing Director or on his behalf for any moneys or goods or property received in the usual course of business of the company shall be effectual discharge on behalf of and against the company for moneys, funds, etc. It further provides that the Managing Director shall also have power to sign cheques on behalf of the company. Under Article 138 he is authorised to sub-delegate all or any of the powers. Article 139 enjoins that notwithstanding anything contained in those articles the Managing Director is expressly allowed generally to work for and contract with the company and specifically to do the work of agent to and Manager of and also to do any other work for the company upon such terms and conditions and on such remuneration as may from time to time be agreed upon between him and the Directors of the Company. Article 140 specifies powers in addition to the powers conferred on him as the Managing Director. Under Article 141 the Managing Director shall have charge and custody of all the property, books of account, papers, documents and effects belonging to the said company wheresoever situate. Article 142 provides that the Managing Director shall work for the executions of the decisions that may be arrived at by the Board from time to time and shall be empowered to do all that may be necessary in the execution of the decisions of the management of the company and shall do all things usual, necessary or desirable in the management of the affairs of the company or carrying out it objects. Clause (*k*) *of* the agreement, dated November 29, 1955, stipulates:

> That the said Ram Pershad said Managing Director is found to be acting otherwise than in the interests of the company '*or* is found to be not diligent to his duties as a Managing Director, the company in General Meeting may terminate his services before the expiry of the said period of 20 years.

The other terms of the agreement enumerate the powers and duties given to him under the articles of association.

14. A perusal of the articles and terms and conditions of the agreement definitely indicates that the assessee was appointed to manage the business of the company in terms of the articles of association and within the powers prescribed therein. Reference may particularly be made to Articles 139 and 142 to indicate the nature of the control imposed by the company upon the Managing Director. Under the former the additional work which he can do as an agent or manager of the company can be done on terms and conditions and on such remuneration as can be agreed upon between him and the Directors of the Company and under the latter he had to execute the decisions that may be arrived at by the Board from time to time. The very fact that apart from his being a Managing Director he is given the liberty to work for the company as an agent is indicative of his employment as a Managing Director not being that of an agent. Several of the clauses of Article 140 as pointed out by the High Court specifically empower the Board of Directors to exercise control over the Managing Director, such for instance to accept the title

of the property to be sold by the company, providing for the welfare of the employees, the power to appoint attorneys as the Directors think fit, etc. As pointed out earlier under the terms of' the agreement he can be removed within the period of 20 years for not discharging the work diligently or *if* he is found not to be acting in the interest of the company as Managing Director. These terms are inconsistent with the plea that he is an agent of the company and not a servant. The control which the company exercises over the assessee need not necessarily be one which tells him what to do from day to day. That would be a too narrow view of the test to determine the character of the employment. Nor does supervision imply that it should be a continuous exercise of the power to oversee or superintend the work to be done. The control and supervision is exercised and is exercisable in terms of the articles of association by the Board of Directors and the company in its general meeting. As a Managing Director he functions also as a member of the Board of Directors whose collective decisions he has to carry out in terms of the articles of association and he can do nothing which he is not permitted to do. Under Section 17 (2) of the Indian Companies Act, 1913, Regulation No. 71 of Table A which enjoins that the business of the company shall be managed by the directors is deemed to be contained in the articles of association of the company in identical terms or to the same effect. Since the Board of Directors are to manage the business of the Company they have every right to control and supervise the assessee's work whenever they deem it necessary. Every power which is given to the Managing Director therefore emanates from the articles of association which prescribes the limits of the exercise of that power. The powers of the assessee have to be exercised within the terms and limitations prescribed thereunder and subject to the control and supervision of the Directors which in our view is indicative of his being employed as a servant of the company.

15. We would therefore hold that the remuneration payable to him is salary. In this view, the other questions need not be considered and the appeal is dismissed with costs.

* * * * *

C.I.T. v. *L.W. Russel*

AIR 1965 SC 49

K. SUBBA RAO, J. - This appeal by special leave preferred against the judgment of the High Court of Kerala at Ernakulam raises the question of the interpretation of Section 7(1) of the Indian Income Tax Act, 1922.

2. The respondent, L.W. Russel, is an employee of the English and Scottish Joint Cooperative Wholesale Society Ltd., Kozhikode, hereinafter called "the Society", which was incorporated in England. The Society established a superannuation scheme for the benefit of the male European members of the Society's staff employed in India, Ceylon and Africa by means of deferred annuities. The terms of such benefits were incorporated in a trust deed dated July 27, 1934. Every European employee of the Society shall become a member of that scheme as a condition of employment. Under the terms of the scheme the trustee has to effect a policy of insurance for the purpose of ensuring an annuity to every member of the Society on his attaining the age of superannuation or on the happening of a specified contingency. The Society contributes 1/3 of the premium payable by such employee. During the year 1956-57 the Society contributed Rs 3333 towards the premium payable by the respondent. The Income Tax Officer, Kozhikode Circle, included the said amount in the taxable income of the respondent for the year 1956-57 under Section 7(1), Explanation 1 sub-clause (*v*) of the Act. The appeal preferred by the respondent against the said inclusion to the Appellate Assistant Commissioner of Income Tax, Kozhikode, was dismissed. The further appeal preferred to the Income Tax Appellate Tribunal received the same fate. The assessee thereupon filed an application under Section 66(1) of the Act to the Income Tax Appellate Tribunal for stating a case to the High Court. By its order dated December 1, 1958, the Tribunal submitted a statement of case referring the following three questions of law to the High Court of Kerala at Ernakulam:

(*1*) Whether the contributions paid by the employer to the assessee under the terms of a trust deed in respect of a contract for a deferred annuity on the life of the assessee is a 'perquisite' as contemplated by Section 7(1) of the Indian Income Tax Act?

(*2*) Whether the said contributions were allowed to or due to the applicant by or from the employer in the accounting year?

(*3*) Whether the deferred annuity aforesaid is an annuity hit by Section 7(1) and para of Explanation 1 thereto?

On the first question the High Court held that the employer's contribution under the terms of the trust deed was not a perquisite as contemplated by Section 7(1) of the Act. On the second question it came to the conclusion that the employer's contributions were not allowed to or due to the employee in the accounting year. On the third question it expressed the opinion that the legislature not having used the word "deferred" with annuity in Section 7(1) and the statute being a taxing one, the deferred annuity would not be hit by para (*v*) of Explanation 1 to Section 7(1) of the Act. The Commissioner of Income Tax has preferred the present appeal to this Court questioning the correctness of the said answers.

4. Mr Rajagopal Sastri, learned counsel for the appellant, contends that the amount contributed by the Society under the scheme towards the insurance premium payable by the

trustees for arranging a deferred annuity on the respondent's superannuation is a perquisite within the meaning of Section 7(1) of the Act and that the fact that the respondent may not have the benefit of the contributions on the happening of certain contingencies will not make the said contributions nonetheless a perquisite. The employer's share of the contributions to the fund earmarked for paying premiums of the insurance policy, the argument proceeds, vests in the respondent as soon as it is paid to the trustee and the happening of a contingency only operates as a defeasance of the vested right. The respondent is ex parte and, therefore, the Court has not the benefit of the exposition of the contrary view.

5. Before we attempt to construe the scope of Section 7(1) of the Act it will be convenient at the outset to notice the provisions of the scheme, for the scope of the respondent's right in the amounts representing the employer's contributions thereunder depends upon it. The trust deed and the rules dated July 27, 1934, embody the superannuation scheme. The scheme is described as the English and Scottish Joint Cooperative Wholesale Society Limited Overseas European Employees' Superannuation Scheme, hereinafter called "the Scheme". It is established for the benefit of the male European members of the Society's staff employed in India, Ceylon and Africa by means of deferred annuities. The Society itself is appointed thereunder as the first trustee. The trustees shall act as agents for and on behalf of the Society and the members respectively; they shall effect or cause to be effected such policy or policies as may be necessary to carry out the scheme and shall collect and arrange for the payment of the moneys payable under such policy or policies and shall hold such moneys as trustees for and on behalf of the person or persons entitled thereto under the rules of the Scheme. The object of the Scheme is to provide for pensions by means of deferred annuities for the members upon retirement from employment on attaining certain age under the conditions mentioned therein, namely, every European employee of the Society shall be required as a condition of employment to apply to become a member of the Scheme from the date of his engagement by the Society and no member shall be entitled to relinquish his membership except on the termination of his employment with the Society; the pension payable to a member shall be provided by means of a policy securing a deferred annuity upon the life of such member to be effected by the Trustees as agents for and on behalf of the Society and the members respectively with the Cooperative Insurance Society Limited securing the payment to the Trustees of an annuity equivalent to the pension to which such member shall be entitled under the Scheme and the Rules; the insurers shall agree that the Trustees shall be entitled to surrender such deferred annuity and that, on such deferred annuity being so surrendered, the insurers will pay to the Trustees the total amount of the premiums paid in respect thereof together with compound interest thereon; all moneys received by the Trustees from the insurers shall be held by them as Trustees for and on behalf of the person or persons entitled thereto under the Rules of the Scheme; any policy or policies issued by the insurers in connection with the Scheme shall be deposited with the Trustees; the Society shall contribute one-third of the premium from time to time payable in respect of the policy securing the deferred annuity in respect of each member as thereinbefore provided and the member shall contribute the remaining two-thirds; the age at which a member shall normally retire from the service of the Society shall be the age of 55 years and on retirement at such age a member shall be entitled to receive a pension of the amount specified in Rule 6; a member may also, after following the prescribed procedure, commute the pension to which he is entitled for a payment in cash in accordance with the fourth column of the Table in

the Appendix annexed to the Rules; if a member shall leave or be dismissed from the service of the Society for any reason whatsoever or shall die while in the service of the Society there shall be paid to him or his legal personal representatives the total amount of the portions of the premiums paid by such member and if he shall die whilst in the service of the Society there shall be paid to him or his legal personal representatives the total amount of the portions of the premiums paid by such member and if he shall die whilst in the service of the Society or shall leave or be dismissed from the service of the Society on account of permanent breakdown in health (as to the bona fides of which the Trustees shall be satisfied) such further proportion (if any) of the total amount of the portions of the premiums paid by the Society in respect of that member shall be payable in accordance with Table C in the Appendix to the Rules if the total amount of the portions of the premiums in respect of such member paid by the Society together with interest thereon as aforesaid shall not be paid by the Trustees to him or his legal personal representatives under sub-section (1) of Rule 15 then such proportion or the whole, as the case may be, of the Society's portion of such premiums and interest thereon as aforesaid as shall not be paid by the Trustees to such member or his legal personal representatives as aforesaid shall be paid by the Trustees to the Society; the rules may be altered, amended or rescinded and new rules may be made in accordance with the provisions of the Trust Deed but not otherwise.

6. We have given the relevant part of the Scheme and the Rules. The gist of the Scheme may be stated thus: The object of the Scheme is to provide for pensions to its employees. It is achieved by creating a trust. The Trustees appointed thereunder are the agents of the employer as well as of the employees and hold the moneys received from the employer, the employee and the insurer in trust for and on behalf of the person or persons entitled thereto under the rules of the Scheme. The Trustees are enjoined to take out policies of insurance securing a deferred annuity upon the life of each member, and funds are provided by contributions from the employer as well as from the employees. The Trustees realise the annuities and pay the pensions to the employees. Under certain contingencies mentioned above, an employee would be entitled to the pension only after superannuation. If the employee leaves the service of the Society or is dismissed from service or dies in the service of the Society, he will be entitled only to get back the total amount of the portion of the premium paid by him, though the trustees in their discretion under certain circumstances may give him a proportion of the premiums paid by the Society. The entire amount representing the contributions made by the Society or part thereof, as the case may be, will then have to be paid by the Trustees to the Society. Under the scheme the employee has not acquired any vested right in the contributions made by the Society. Such a right vests in him only when he attains the age of superannuation. Till that date that amount vests in the Trustees to be administered in accordance with the rules that is to say, in case the employee ceases to be a member of the Society by death or otherwise, the amounts contributed by the employer with interest thereon, subject to the discretionary power exercisable by the trustees, become payable to the Society. If he reaches the age of superannuation, the said contributions irrevocably become fixed as part of the funds yielding the pension. To put it in other words, till a member attains the age of superannuation the employer's share of the contributions towards the premiums does not vest in the employee. At best he has a contingent right therein. In one contingency the said amount becomes payable to the employer and in another contingency, to the employee.

7. Now let us look at the provisions of Section 7(1) of the Act in order to ascertain whether such a contingent right is hit by the said provisions. The material part of the section reads:

> 7. (1)The tax shall be payable by an assessee under the head 'salaries' in respect of any salary or wages, any annuity, pension or gratuity, and any fees, commissions, perquisites or profits in lieu of, or in addition to, any salary or wages, which are allowed to him by or are due to him, whether paid or not, from, or are paid by or on behalf of, ... a company....
>
> *Explanation 1*.- For the purpose of this section perquisite includes. * * * * *
>
> (*v*) any sum payable by the employer, whether directly or through a fund to which the provisions of Chapters IX-A and IX-B do not apply, to effect an assurance on the life of the assessee or in respect of a contract of annuity on the life of the assessee.

This section imposes a tax on the remuneration of an employee. It presupposes the existence of the relationship of employer and employee. The present case is sought to be brought under the head "perquisites in lieu of, or in addition to, any salary or wages, which are allowed to him by or are due to him, whether paid or not, from, or are paid by or on behalf of a company." The expression "perquisites" is defined in the *Oxford Dictionary* as "casual emolument, fee or profit attached to an office or position in addition to salary or wages". Explanation 1 to Section 7(1) of the Act gives an inclusive definition. Clause (*v*) thereof includes within the meaning of "perquisites" any sum payable by the employer, whether directly or through a fund to which the provisions of Chapters IX-A and IX-B do not apply, to effect an assurance on the life of the assessee or in respect of a contract for an annuity on the life of the assessee. A combined reading of the substantive part of Section 7(1) and clause (*v*) of Explanation 1 thereto makes it clear that if a sum of money is allowed to the employee by or is due to him from or is paid to enable the latter to effect an insurance on his life, the said sum would be a perquisite within the meaning of Section 7(1) of the Act and, therefore, would be exigible to tax. But before such sum becomes so exigible, it shall either be paid to the employee or allowed to him by or due to him from the employer. So far as the expression "paid" is concerned, there is no difficulty, for it takes in every receipt by the employee from the employer whether it was due to him or not. The expression "due" followed by the qualifying clause "whether paid or not" shows that there shall be an obligation on the part of the employer to pay that amount and a right on the employee to claim the same. The expression "allowed", it is said, is of a wider connotation and any credit made in the employer's account is covered thereby. The word "allowed" was introduced in the section by the Finance Act of 1955. The said expression in the legal terminology is equivalent to "fixed, taken into account, set apart, granted". It takes in perquisites given in cash or in kind or in money or money's worth and also amenities which are not convertible into money. It implies that a right is conferred on the employee in respect of those perquisites. One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payments to which the employee has no right till the contingency occurs. In short, the employee must have a vested right therein.

8. If that be the interpretation of Section 7(1) of the Act, it is not possible to hold that the amounts paid by the Society to the Trustees to be administered by them in accordance with the rules framed under the Scheme are perquisites allowed to the respondent or due to him. Till he reaches the age of superannuation, the amounts vest in the Trustees and the beneficiary under

the trust can be ascertained only on the happening of one or other of the contingencies provided for under the trust deed. On the happening of one contingency, the employer becomes the beneficiary, and on the happening of another contingency, the employee becomes the beneficiary.

The principle that unless a vested interest in the sum accrues to an employee it is not taxable, applies to the present case. As we have pointed out earlier, no interest in the sum contributed by the employer under the scheme vested in the employee as it was only a contingent interest depending upon his reaching the age of superannuation. It is not a perquisite allowed to him by the employer or an amount due to him from the employer within the meaning of Section 7(1) of the Act. We, therefore, hold that the High Court has given correct answers to the questions of law submitted to it by the Income Tax Appellate Tribunal.

9. In the result, the appeal fails and is dismissed.

* * * * *

C.I.T., West Bengal v. *Biman Behari Shaw Shebait*

(1968) 68 ITR 815

BANERJEE, J. – The assessment years with which we are concerned are years 1957-58 and 1958-59. One Banku Behari Saha executed a will on November 24, 1925, and thereby intended to found a debutter estate. He dedicated several properties to two deities installed by him, namely, Sri Sri Iswar Benode Behari Jew and Sri Sri Iswar Benodeswar Mahadev. In this reference we are concerned with two of the dedicated properties, namely, No. 12, Benode Behari Saha Lane and No. 122A, Manicktola Street, both in the town of Calcutta. It is necessary for us to consider the following clauses in the will, in order to understand the question referred to this court. The dedication opens with the following paragraph:

> According to the wishes of my revered father I have built the edifice of a temple, a Thakurbari at premises No. 12, Benode Behari Saha Lane, in close proximity to our said family dwelling house and have installed therein the deity of Sri Sri Iswar Benode Behari (an image of Sri Sri Iswar Radha Krishna) and Sri Sri Iswar Bendeswari Sina (possibly a misprint for Sri Sri Iswar Benodeswar Mahadev) and have been performing the Puja worship and seva, etc. of the same.
>
> The list of all the immovable properties included in this will is given in the schedules Ka, Kha and Ga written below. This property is my estate long enjoyed and possessed.
>
> Clause (11). By this instrument of Will I dedicate to the deity Sri Sri Iswar Benode Behari and Sri Sri Iswar Benodeswar Mahadev established by me the properties as included in the schedule (Ga) of this will and all such properties that will be included in the schedule (Ga) in future according to the provisions of this Will from and out of the schedule 'Ka' and 'Kha'. From the time of my death the aforesaid properties shall be used in the aforesaid Dev Seva and for pious acts as mentioned below and shall not at any time be transferred in any manner such as gift, sale, etc., save and except for reasons stated here below....
>
> Clause (17). Nobody save and except the Brahmin performing the Worship of the deity and servants shall ever be competent to reside in the Thakurbati at No. 12, Benode Behari Saha Lane and the said Thakurbati shall never be used as a place of agitation and meeting for the sake of interiors (sic – invitation) or for any public functions.

In schedule "Ga" premises No. 122, Manicktola Street is not descried either as a temple or a Thakurbati but the area of the land only, included in the premises, is given. Premises No. 12, Benode Behari Saha Lane, however, is described in the schedule as "Thakurbati and temple." There is no dispute that 122, Manicktola Street, later on was subdivided or renumbered as premises No. 122A, Manicktola Street and a temple was actually constructed on the site.

For the assessment years with which we are concerned, the Income-tax Officer computed the bona fide annual value of the premises No. 12, Benode Behari Saha Lane and 122A, Manicktola Street, at the amounts which they were likely to fetch if let out in the open market. The assessee objected to the assessment of an annual value of the two premises and appealed before the Appellate Assistant Commissioner. The reasons which appealed to the Appellate Assistant Commissioner were:

> As regards the second ground, No. 122A, Manicktola Street, Calcutta, and No. 12, Benode Behari Saha Lane, Calcutta are the temples of the two deities mentioned above. These premises have not been let out and no income accrues therefrom. The Income-tax Officer therefore was not justified in adding any income on account of these premises. In the earlier assessment no such addition has been made. The addition of Rs. 3,334 (Rs.4,000 less Rs. 666 for repairs) would be therefore deleted in each of the two assessments under appeal.

In the above view the Appellate Assistant Commissioner allowed the objection of the assessee.

Against the order of the Appellate Assistant Commissioner, the revenue appealed before the Appellate Tribunal. We are not concerned with the other grounds involved in the appeal. The Appellate Tribunal agreed with the order of the Appellate Assistant Commissioner deleting the bona fide income from two debutter premises mentioned above with the following observations:

> The Income-tax Officer computed the bona fide annual value of the house at the amount which they are likely to fetch if let out in the open market. The Appellate Assistant Commissioner has, however, found that these premises were not let out and no income accrued therefrom to the assessee. In fact, clause (17) of the Will aforesaid says that nobody save and except the priest performing the worship of the deity and its servants shall ever be competent to reside in the temple and it shall never be used as a place of agitation or meeting or for the sake of any public function. In view of the injunctions contained in the will against the residence of any body in the premises apart from the priest performing the worship of the deity and its servants, it is quite obvious that these premises have no letting value and the Appellate Assistant Commissioner was, therefore, justified in excluding from the assessment the annual value thereof.

Thereupon, the Commissioner of Income-tax, at first tried to induce the Appellate Tribunal to refer certain questions of law to this court and therein failing, induced this court to call for a statement of case from the Tribunal on the following point of law:

> Whether, on the facts and in the circumstances of the case, the Tribunal misdirected itself in law in holding that premises No. 12, Benode Behari Shaw Lane, Calcutta and No. 122A, Manicktola Street, Calcutta, had no bona fide annual value within the meaning of section 9(2) of the Income-tax Act, 1922?

In order to answer the question, it is necessary for us to remind ourselves of the provisions of sub-sections (1) and (2) of section 9 of the Income-tax Act, which are couched in the following language:

> 9. (1) The tax shall be payable by the assessee under the head 'income from property' in respect of the bona fide annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to tax, subject to the following allowances, namely, …
>
> (2) For the purpose of the section, the annual value of any property shall be deemed to be the sum for which the property might reasonably be expected to let from year to year.

It is apparent from the section quoted above that even where a property is not let and even where it does not produce any income, the Income-tax Officer is to proceed on the basis of a notional income, which the property might reasonably be expected to yield from year to year. Now, where a property is not actually let, even then there ought to be included in the annual income of the owner a notional income from the property. The letting value of a property, whether let or not, can be objectively ascertained on reasonable basis. If there be restrictions on the letting of the premises, that may merely reduce the letting value but it cannot be said, without more, that because of the existence of a restrictive clause there can be no notional annual income deemed to arise from the premises. For this proposition we find ample support from two decisions of the Bombay High Court, namely, ***D.M. Vakil* v. *Commissioner of Income-tax*** [(1946) 14 I.T.R. 298, 302] and ***Sir Currimbhoy Ebrahim Baronetcy Trust* v. *Commissioner of Income-tax*** [(1963) 48 I.T.R. 507]. In the first mentioned case Kania, C.J. observed:

> The legislature has therefore expressly provided that the tax shall be payable by the assessee in respect of the bona fide annual value irrespective of the question whether he receives the value or not. Section 9(2) provides that for the purposes of this section, the expression 'annual value' shall be deemed to mean the sum for which the property might reasonably be expected to let from year to year. It is again significant to note that the word used is 'might' and not 'can' or 'is.' Reading these two paragraphs of section 9 together, it is clear that the income from property is thus an artificially defined income and the liability arises from the fact that the assessee is the owner of the property. It is further provided in the section that if the owner occupies the property he has to pay tax calculated in the manner provided therein. Therefore, by reason of the fact that the property is not let out, the assessee does not escape taxation.
>
> On behalf of the trustees it was urged that in the present case the trustees are prevented from letting out the property to any one by virtue of clause 5 of the will itself. That, however, in my opinion, makes no difference. The liability to tax does not depend on the power of the owner to let the property as it also does not depend on the capacity of the owner to receive the bona fide annual value of the property. The law has laid down an artificial rule by which the amount is to be considered the income of the assessee from immovable property and provided that he should be taxed on that footing. In my opinion the argument of the Commissioner on this point is correct.

In that view of the law, we have to uphold the contention of Mr. Pal, appearing for the revenue, that the Tribunal was not correct in holding that, in view of the injunction contained in the will against the residence of any body in the premises (apart form the priest performing the worship of the deity and its servants), the premises have no letting value. That injunction will be of relevant consideration in finding out the bona fide value and the weight of the injunction may very much reduce the bona fide letting value of the house. But because of the existence of the injunction, the premises cannot be said to have no letting value, notional or otherwise. In the view that we take, we have to answer the question referred to us in the affirmative and in favour of the revenue. We, however, make one position clear. We are not sure that a temple, which is wholly and exclusively occupied by a deity or for use of the deity, comes within the mischief of section 9(2). We do not express any opinion on that point.

East India Housing & Land Deveopment Trust Ltd. v. *C.I.T.*

(1961) 42 ITR 49

SHAH, J. - This is an appeal with special leave against the Judgment of the Income Tax Appellate Tribunal, Calcutta Bench, Calcutta. The appellant is a private company registered under the Indian Companies Act incorporated with the objects amongst others, (*1*) to buy and develop landed properties, and (*2*) to promote and develop markets. In 1946, the appellant purchased ten bighas of land in the town of Calcutta and set up a market therein. The appellant constructed shops, and stalls on platforms on that land. For Assessment Year 1953-54, the appellant received Rs 53,145 as income from the tenants of shops and Rs 29,721 from the tenants or occupants of stalls. The Income Tax Officer assessed the income derived from shops and stalls under Section 9 of the Income Tax Act. The order of assessment was confirmed in appeal by the Appellate Assistant Commissioner and by the Tribunal. The appellant has obtained special leave to appeal against the order of the Tribunal.

2. The appellant contends that because it is a company formed with the object of promoting and developing markets, its income derived from the shops and stalls is liable to be taxed under Section 10 of the Income Tax Act as “profits or gains of business” and that the income is not liable to be taxed as “income from property” under Section 9 of the Act. The appellant is undoubtedly under the provisions of the Calcutta Municipal Act, 1951, required to obtain a licence from the Corporation of Calcutta and to maintain sanitary and other services in conformity with the provisions of that Act and for that purpose has to maintain a staff and to incur expenditure. But on that account, the income derived from letting out property belonging to the appellant does not become “profits or gains” from business within the meaning of Sections 6 and 10 of the Income Tax Act. By Section 6 of the Income Tax Act, the following six different heads of income are made chargeable, (*1*) salaries, (*2*) interest on securities, (*3*) income from property, (*4*) profits and gains of business, profession or vocation, (*5*) income from other sources and (*6*) capital gains. This classification under distinct heads of income, profit and gain is made having regard to the sources from which income is derived. Income Tax is undoubtedly levied on the total taxable income of the tax payer and the tax levied is a single tax on the aggregate taxable receipts from all the sources: it is not a collection of taxes separately levied on distinct heads of income. But the distinct heads specified in Section 6 indicating the sources are mutually exclusive and income derived from different sources falling under specific heads has to be computed for the purpose of taxation in the manner provided by the appropriate section. If the income from a source falls within a specific head set out in Section 6, the fact that it may indirectly be covered by another head will not make the income taxable under the latter head.

3. The income derived by the company from shops and stalls is income received from property and falls under the specific head described in Section 9. The character of that income is not altered because it is received by a company formed with the object of developing and setting up markets. In the ***United Commercial Bank Ltd., Calcutta* v. *CIT*** [(1958) SCR 79] this Court explained after an exhaustive review of the authorities that under the scheme of the Income Tax Act, 1922, the heads of income, profits and gains enumerated in the different clauses of Section 6 are mutually exclusive, each specific head covering items of income arising from a particular source.

4. In ***Fry* v. *Salisbury House Estate Ltd.*** [LR (1930) AC 432] a company formed to acquire, manage and deal with a block of buildings having let out the rooms as unfurnished offices to tenants was held chargeable to tax under Schedule A to the Income Tax Act, 1918 and not Schedule D. The company provided a staff to operate the lifts and to act as porters and watch and protect the building and also provided certain services, such as heating and cleaning to the tenants at an additional charge. The taxing authorities sought to charge the income from letting out of the rooms as receipts of trade chargeable under Schedule D, but that claim was negatived by the House of Lords holding that the rents were profits arising from the ownership of land assessable under Schedule A and that the same could not be included in the assessment under Schedule D as trade receipts.

5. In ***Commercial Properties Ltd.* v. *CIT*** [(1928) 3 ITC 23] income derived from rents by a company whose sole object was to acquire lands, build houses and let them to tenants and whose sole business was management and collection of rents from the said properties, was held assessable under Section 9 and not under Section 10 of the Income Tax Act. It was observed in that case that merely because the owner of the property was a company incorporated with the object of owning property, the incidence of income derived from the property owned could not be regarded as altered; the income came more directly and specifically under the head property than income from business.

6. The income received by the appellant from shops is indisputably income from property: so is the income from stalls from occupants. The character of the income is not altered merely because some stalls remain occupied by the same occupants and the remaining stalls are occupied by a shifting class of occupants. The primary source of income from the stalls is occupation of the stalls, and it is a matter of little moment that the occupation which is the source of the income is temporary. The Income Tax Authorities were, in our judgment, right in holding that the income received by the appellant was assessable under Section 9 of the Income Tax Act.

7. The appeal therefore fails and is dismissed with costs.

* * * * *

R.B. Jodha Mal Kuthiala v. *C.I.T.*

(1971) 3 SCC 369

K.S. HEGDE, J. - In these appeals by certificate, the only question arising for decision is: "whether on the facts and in the circumstances of the case, the assessee continued to be the owner of the property for the purposes of computation of income under Section 9 of the Income-tax Act, 1922". A Full Bench of the Delhi High Court speaking through S. K. Kapur, J., answered that question in the negative. Being dissatisfied with that decision the assessee has brought these appeals.

2. Now turning to the facts of the case, the concerned assessment years are 1952-53, 1955-56 and 1956-57, the relevant accounting periods being financial years ending March 31, 1952, March 31, 1955 and March 31, 1956. The assessee is a registered firm deriving income from interest on securities, property, business and other sources. Sometime in the year 1946 it purchased the Nedous Hotel in Lahore for a sum of Rs 46 lakhs. For that purpose it raised a loan of Rs 30 lakhs from M/s Bharat Bank Ltd., Lahore and a loan of Rs 18 lakhs from the Raja of Jubbal. The loan taken from the bank was partly repaid but as regards the loan taken from the Raja, the assessee came to an agreement with the Raja under which the Raja accepted a half share in the said property in lieu of the loan advanced and also 1/3rd of the outstanding liability of the bank. This arrangement came into effect on November 1, 1951. After the creation of Pakistan, Lahore became a part of Pakistan. The Nedous Hotel was declared an evacuee property and consequently vested in the Custodian in the Pakistan.

3. In its return for the relevant assessment years, the assessee claimed losses of Rs 1,00,723, Rs. 1,16.599 and Rs 1,16,599 respectively but showed the gross annual letting value from the said property at Nil. The loss claimed was stated to be on account of interest payable to the bank. Since the property in question had vested in the Custodian of Evacuee Property, in Pakistan, the Income-tax Officer held that no income or loss from that property can be considered in the assessee's case. He accordingly disallowed the assessee's claim in respect of the interest paid to the bank. The Appellate Assistant Commissioner confirmed the order of the Income-tax Officer. In second appeal the Tribunal came to the conclusion that the assessee still continued to be the owner of the property for the purpose of computation of loss. The Tribunal held that the interest paid is a deductible allowance under Section 9(l)(iv) of the Act. In arriving at that conclusion, the Tribunal relied on its earlier decision in the case of the assessee in respect of the assessment year 1951-52. Thereafter at the instance of the assessee, the Tribunal submitted the question set out earlier. The High Court on an analysis of the various provisions of the Pakistan (Administration of Evacuee Property) Ordinance, 1949 came to the conclusion that for the purpose of Section 9 of the Act, the assessee cannot be considered as the owner of that property.

4. It was urged by Mr V. C. Mahajan, learned Counsel for the assessee that the High Court erred in opining that the assessee was not the owner of the property, for the purpose of Section 9 of the Act. According to him the property vested in the Custodian only for the purpose of administration and the assesse still continued to be its owner. He contended that the expression "owner" means the person having the ultimate right to the property. He further contended that so long as the assessee had a right to that property in whatever manner that right might have

been hedged in or restricted, he still continued to be the owner. On the other hand, it was contended on behalf of the Revenue that the income-tax is concerned with income, gains and profits. Therefore for the purpose of that Act, the owner is that person who is entitled to the income. According to the Revenue the word "owner" in Section 9 refers to the legal ownership and not to any beneficial interest in the property.

5. For deciding the question whether the assessee was the owner of the property for the purpose of Section 9 of the Act during the relevant accounting years, we have to look to the provisions of the Ordinance. Let us first take a survey of the relevant provisions of the Ordinance and thereafter analyse the effect of those provisions.

6. The long title of the Ordinance says that it is an Ordinance to provide for the administration of the evacuee property in Pakistan and for certain matters incidental thereto. The preamble says that "whereas an emergency has arisen which renders it necessary to provide for the administration of evacuee property in Pakistan and for certain matters incidental thereto". Section 6(1) provides that all evacuee property shall vest and shall be deemed always to have vested in the Custodian with effect from the 1st day of March, 1947. Section 9 gives power to the Custodian to take possession of the evacuee property. Section 11 provides that any amount due to an evacuee or payable in respect of any evacuee property shall be paid to the Custodian by the person liable to pay the same and the payment to the Custodian discharges the debtor's liability to the extent of the payment made. Section 12 prescribes that the property which has vested in or of which possession has been taken by the Custodian shall be exempt from all legal process, including seizure, distress, ejectment, attachment or sale by any officer of a Court or any other authority and no injunction or other order of whatever kind in respect of such property shall be granted or made by any Court or any other authority. Section 14(1) permits the Rehabilitation Authority to allot evacuee property to the refugees. Section 16(1) says that no creation or transfer of any right or interest in or encumbrance upon any property made in any manner whatsoever on or after the first day of March, 1947 by or on behalf of an evacuee or by or on behalf of a person who has or may become an evacuee after the date of such creation or transfer, shall be effective so as to confer any right of remedy on any party thereto or on any person claiming under any such party, unless it is confirmed by the Custodian. Section 19 empowers the Custodian to restore the evacuee property to the lawful owner subject to such conditions as he may, be pleased to impose. Section 20(1) stipulates that the Custodian may take such measures as he considers necessary or expedient for the purpose of administering, preserving and managing any evacuee property which has vested in him and may for any such purpose as aforesaid, do all acts and incur all expenses necessary or incidental thereto. Sub-section (2) of that section provides that "without prejudice to the generality of the provisions contained in sub-section (l), the Custodian may.. ..

> (m) sell any evacuee property, notwithstanding anything contained in any law or agreement to the contrary relating thereto:
>
> Provided that the Custodian shall not under this clause or the next succeeding clause sell any immovable evacuee property or any business or undertaking which is evacuee property, except with the previous approval of the Central Government".

7. Clause (n) of that sub-section empowers the Custodian to demolish or dismantle any evacuee property which in his opinion cannot be repaired, or sell the site of such property and

the materials thereof. The Custodian can recoup all the expenses incurred by him in the administration of the evacuee property from out of the receipts in his hand in respect of that property. Section 22(1) requires the Custodian to maintain separate account of the property of each evacuee of which he has taken possession and shall cause to be made therein entries of all receipts and expenditure in respect thereof.

8. The Ordinance starts by saying that it is an Ordinance to provide for the administration of evacuee property and not management of evacuee property. The expression “administration” in relation to an estate, in law means management and settling of that estate. It is a power to deal with the estate. The evacuee could not take possession of his property. He could not lease that property. He could not sell that property without the consent of the Custodian. He could not mortgage that property. He could not realise the income of the property. On the other hand, the Custodian could take possession of that property. He could realise its income. He could alienate the property and he could under certain circumstances demolish the property. All the rights that the evacuee had in the property he left in Pakistan were exercisable by the Custodian excepting that he could not appropriate the proceeds for his own use. The evacuee could not exercise any rights in that property except with the consent of the Custodian. He merely had some beneficial interest in that property. No doubt that residual interest in a sense is ownership. The property having vested in the Custodian, who had all the powers of the owner, he was the legal owner of the property. In the eye of the law, the Custodian was the owner of that property. The position of the Custodian was no less than that of a Trustee. Section 9(1) says:

> The tax shall be payable by an assessee under the head ‘Income From Property’ in respect of the bona fide annual value of property consisting of any buildings or lands apurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to tax subject to the following allowances namely: * * *

9. The question is who is the “owner” referred to in this .section? Is it the person in whom the property vests or is it he who is entitled to some beneficial interest in the property? It must be remembered that Section 9 brings to tax the ‘income from property and not the interest of a person in the property. A property cannot be owned by two persons, each one having independent and exclusive right over it. Hence for the purpose of Section 9, the owner must be that person who can exercise the rights of the owner, not on behalf of the owner but in his own right.

10. For a minute, let us look at things from the practical point of view. If the thousands of evacuees who left practically all their properties as well as businesses in Pakistan had been considered as the owners of those properties and businesses as long as the ‘Ordinance’ was in force then those unfortunate persons would have had to pay income-tax on the basis of the annual letting value of their properties and on the income, gains and profits of the businesses left by them in Pakistan though they did not get a paisa out of those properties and businesses. Fortunately no one in the past interpreted the law in the manner Mr. Mahajan wants us to interpret. It is true that equitable considerations are irrelevant in interpreting tax laws. But those laws, like all other laws have to be interpreted reasonably and in consonance with justice.

11. The question as to who is the owner of a house property under Section 9 of the Act in circumstances similar to those before us came up for consideration before the Calcutta High Court in the matter of ***The Official Assignee for Bengal* (*Estate of Jnanendra Nath Pramanik*)** [5 ITR 233 (HC)]. In that case on the adjudication of a person as insolvent under the Presidency Towns Insolvency Act, 1909, certain house property of the insolvent vested in the Official Assignee. The question arose whether the Official Assignee could be taxed in respect of the income of the property under Section 9. The High Court held that the property did not by reason of the adjudication of the debtor cease to be a subject fit for taxation and in view of the provisions of Section 17 of the Presidency Towns Insolvency Act, the Official Assignee was the "owner" of the property and he could rightly be assessed in respect of the income from that property under Section 9. Section 17 of the Presidency Towns Insolvency Act, reads:

> On the making of an order of adjudication, the property of the insolvent wherever situate shall vest in the official assignee and shall become divisible among his creditors, and thereafter, except as directed by this Act, no creditor to whom the insolvent is indebted in respect of any debt provable in insolvency shall, during the pendency of the insolvency proceedings, have any remedy against the property of the insolvent in respect of the debt or shall commence any suit or other legal proceedings except with the leave of the Court and on such terms as the Court may impose:
>
> Provided that this section shall not affect the power of any secured creditor to realize or otherwise deal with his security in the same manner as he would have been entitled to realize or deal with it if this section had not been passed.

12. We may note that the powers of the Custodian are no less than that of the Official Assignee under the Preridency Towns Insolvency Act, 1909. Delivering the judgment of the Court in the ***Official Assignee*** case, Costello, J., observed:

> With regard to the first point, Mr Page argued that although by Section 17 of the Presidency Towns Insolvency Act these properties vested in the Official Assignee he did not thereby or thereupon become the owner of those properties within the meaning properly ascribable to that word for the purposes of the applicability of Section 9. What Mr Page really invited us to do was to restrict the meaning of the word by putting before it the qualifying adjective "beneficial". That was argued by Mr Page was that the Official assignee had no legal interest in the properties themselves, they were merely vested in him for the purposes of the administration of them in the interest of the creditors of the insolvent. I am unable to accept Mr Page's contention. In this country there is no difference between "legal estate" and "equitable estate". In this connection the case of ***Sir Currimbhoy Ebrahim Baronetcy Trust* v. *Commissioner of Income-tax, Bombay*** [61 IA 209] is of assistance. At page 217 Sir Sydney Rowlatt when giving the judgment of the Privy Council made this observation: "In their Lordships' opinion the effect of the Act creating these trusts is not to give the baronet for the time being any right to any part of the interest or property specifically or any right which, even granting that the legal title is not the only thing that can ever be looked at, would make it true to say that any proportion of the interest is not 'receivable' or any proportion of the property is not 'owned' by the incorporated trustees.

13. The learned judges of the Calcutta High Court in reaching that conclusion relied on the decision in ***The Commissioner of Inland Revenue* v. *Fleming*** [14 TC 78]. That appeal related

to a claim for repayment of income-tax to which the respondent claimed to be entitled in respect of "personal allowance" introduced into the Income-tax system by Section 18 of the Finance Act, 1920. The claim arose in the following circumstances:

The respondent was declared insolvent in 1921. He was then the owner of heritable properties. His insolvency lasted till May 10, 1926. When he received his discharge on payment of composition and was reinvested in his estate. At that time his estate consisted of, (1) Two of the original heritable properties which had not been realised by the trustee in the insolvency and (2) a balance in cash of £53 odd. During the insolvency, the trustee paid income-tax on the full annual value of the two properties in question. The contention of the respondent was that the radical right to these properties was in him all the time, and that, in paying the tax, the trustee was really paying it on his behalf - that is on his income - and that consequently there arose in each of the years in which the payment was made a right to deduct his "personal allowance" from the annual value of the properties. The right to this abatement is said to have passed to the Respondent himself in virtue of the reinvestment in his estate which occurred upon his discharge on composition. Rejecting this contention Lord Presided observed:

> It is obvious that, unless during the years in question the annual value of the properties was income of the Respondent, he cannot have any claim to abatement of it for income-tax purposes; and accordingly everything depends upon the soundness of the proposition that the income consisting in the annual value of those properties was truly income of the Respondent. I do not see how it can possibly be so described. It was part of the income arising from the sequestrated estates vested in the trustee for the Respondent's creditors. Any income that did arise from those estates was income of the trustee as such, and he (and he alone) had the right to put it into his pocket as income. It was not income that went or could go into the pocket of the Respondent as income in any of the years in question. How then can it be said to have reached his pocket as income on his subsequent reinvestiture.

14. For determining the person liable to pay tax, the test laid down by the court was to find out the person entitled to that income. An attempt was made by Mr Mahajan to distinguish this case on the ground that under the corresponding English statute the liability to tax in respect of income from property is not laid on the owner of the property. It is true that Section 82 of the English Income-tax Act, 1952, is worded differently. But the principles underlying the two statutes are identical. This is clear from the various provisions in that Act.

15. The conclusion reached by Costello, J., in ***Official Assignee*** case receives support from the decision of the Privy Council in Trustees of ***Sir Currimbhqy Ibrahim Baronetcy Trust* v. *Commissioner of Income-tax, Bombay*** [2 ITR 148 (PC)]. The Counsel for the appellant was unable to point out to us any decision which has taken a view contrary to that taken in ***Official Assignee*** case.

16. The learned judges of the High Court in reaching their conclusion that the assessee was not the owner of the property in the relevant assessment years, took assistance from the decisions of English Courts dealing with the question of levy of income-tax on the income from enemy properties taken possession of by the Custodian, during war. In those cases the English judges have enunciated the theory, of suspended ownership. We do not think that we need call assistance' from those decisions. Mr Mahajan contended that despite the fact the evacuee

property was taken over by the Custodian and that he had been conferred with large powers to deal with it, an evacuee from Pakistan who owned that property before he migrated to India still continued to be the owner of the property. For this contention of his he placed reliance on some of the observations of this Court in ***Amur Singh* v. *Custodian, Evacuee Property, Punjab*** [AIR 1957 SC 599]. Therein, delivering judgment of the Court Jagannadhadas, J., observed (at p. 815 of the report):

> Stopping here it will be seen that the position, in its general aspect, is that all evacuee property is vested in the Custodian. But the evacuee has not lost his ownership in it. The law recognised his ultimate ownership subject to certain limitations. The evacuee may come back and obtain return of his property, as also an account of the management thereof by the Custodian.

17. Those observations have to be understood in the context in which they were made. Therein, their Lordships were considering whether the right of an evacuee in respect of the property left by him in the country from which he migrated was property right for the purpose of Article 19(1)(/) of the Constitution. No one denies that an evacuee from Pakistan has a residual right in the property that he left in Pakistan. But the real question is, can that right be considered as ownership within the meaning of Section 9 of the Act. As mentioned earlier that section seeks to bring to tax income of the property in the hands of the owner. Hence the focus of that section is on the receipt of the income. The word “owner” has different meanings in different contexts. Under certain circumstances a lessee may be considered as the owner of the property leased to him. In ***Stroud’s Judicial Dictionary*** (3rd Edn.), various meanings of the word “owner” are given. It is not .necessary for our present purpose to examine what the word “owner” means in different contexts. The meaning that we give to the word “owner” in Section 9 must not be such as to make that provision capable of being made an instrument of oppression. It must be in consonance with the principles underlying the Act.

18. Mr Mahajan next invited our attention to the observations in ***Pollock on Jurisprudence*** (6th Edn. 1929) 178-80: “Ownership may be described as the entirety of the powers of use and disposal allowed by law.... *The* owner of a thing is not necessarily the person who at a given time has the whole power of use and disposal; very often there is no such person. We must look for the person having the residue of all such power when we have accounted for every detached and limited portion of it; and he will be the owner even if the immediate power of control and use is elsewhere”.

20. Mr Mahajan in support of his contention next placed reliance on the decision of the Patna High Court in ***Raja P. C. Lal Choudhary* v. *Commissioner of Income-tax*** [16 ITR 123]. Therein the question was whether the receiver of a property appointed by court was the owner of the property for the purpose of Section 9 of the Act. The court came to the conclusion that he was not the owner as the property did not vest in him. In fact in the course of the judgment, the court made a distinction between a receiver and a trustee and an official assignee. In our opinion this decision instead of supporting the case of the appellant may lend some support to the contention of the Revenue.

21. Reliance was next placed on the decision of the Calcutta High Court in ***Nawab Bahadur of Murshidabad* v. *Commissioner of Income-tax, West Bengal*** [28 ITR 510]. The facts of that case were:

> Properties which belonged to the ancestors of the Nawab of Murshidabad as Rulers, were, some time after the territories had been conquered by the British, settled by the Secretary of State for India in the year 1891 on the then Nawab of Murshidabad under a deed of settlement which provided that such properties "shall henceforth and for ever be held and enjoyed by the said Nawab Bahadur and such one among his lineal male heirs as may be successively entitled to hold the said title in perpetuity, with and subject to the incidents, powers, limitations and conditions as to the inalienability and otherwise hereinafter contained". One of the conditions was that he was not entitled to sell or alienate the properties except with the approval of the Governor of Bengal. The Settlement deed was confirmed by Act XV of 1891. The question arose whether Nawab of Murshidabad was liable to pay tax in respect of the income of those properties under Section 9 of the Act. The Court held that whatever might have been the original nature of the "State properties", after the deed of settlement and the Act of 1891, as the dual status of the Nawab as the bolder of the state and as an individual ceased, it could not be said that the Nawab for the time being was not the "owner" of such properties for the purposes of Section 9 of the Act and the Nawab was therefore liable to be assessed to income-tax on the income of such properties. The Court further held that the word "owner" in Section £9 of the Act applies to owners of the whole income, even though they are under certain restrictions with regard to the alienation of the properties. We are unable to see how this decision gives any support to the contentions advanced on behalf of the assessee.

22. After giving our careful consideration to the question of law under consideration, we have come to the conclusion that the assessee was not the owner of Nedous Hotel during the relevant assessment years for the purpose of Section 9 of the Act. Hence these appeals fail and they are dismissed. In the circumstances of the case we make no order as to costs in these appeals.

* * * * *

B.D. Bharucha v. *C.I.T.*

(1967) 3 SCR 238

V. RAMASWAMI, J. - This appeal is brought, by special leave, from the judgment of the High Court of Bombay dated August 27, 1962 in Income Tax Reference No. 18 of 1961.

2. The appellant is an individual having income from House Property, Government Securities, Cinema Exhibition and financing film producers and distributors. During the period from March 3, 1952 to November 5, 1952 the appellant advanced a sum of Rs 40,000 to a Firm of film distributors known as Tarachand Pictures. The appellant thereafter entered into an agreement dated January 5, 1953 with Tarachand Pictures under which the appellant advanced a further sum of Rs 60,000 in respect of the distribution, exploitation and exhibition of a picture called "Shabab". According to clause 2 of the agreement the distributors were to pay a lumpsum of Rs 1750 by way of interest on the initial advance of Rs 40,000. Clause 3 of the agreement read as follows:

No interest will run henceforth on this sum of Rs 40,000 as also on the advances to be made as provided hereinabove but in lieu of interest it is agreed that the Distributors will share with the Financier profit and loss of the distribution, exploitation and exhibition of the picture SHABAB in the Bombay Circuit, two-third going to the Financier and one-third to the Distributors.

Clauses 4 and 5 were to the following effect:

> 4. The Distributors shall on or before the 15th of every month submit to the Financier a Statement of Account of the business done during the previous month in respect of the picture 'SHABAB' in the territories of Bombay Circuit.
>
> 5. The Distributors shall keep the proper accounts of the business of the picture 'SHABAB' and the same as well as all documents, reports and contracts will be available to the Financier or his agent for inspection.

Clause 7 read as follows:

> In case the picture is not released in Bombay within 15 months from the date hereof the Distributors shall be bound to immediately return all the moneys so far advanced to the Distributors by the Financier. In that event the Distributors shall be bound to return all the moneys together with interest thereon @ 9% per annum.

Clause 8 stated:

> In case of any breach being committed by the Distributors of any of the terms herein provided this agreement shall at once terminate and the moneys paid by the Financier shall be at once repaid by the Distributors to the Financier with interest @ 9% per annum.

It appears that the distributors were not in a position to exhibit the film in Bombay within the stipulated time. When the film was ultimately released for exhibition it proved to be unsuccessful. The matter was taken to the City Civil Court and ultimately a consent decree was obtained in Suit No. 2061 of 1954 in the Bombay City Civil Court. In the end the appellant found that there was a balance of Rs 80,759 which was irrecoverable and he accordingly wrote it off as a bad debt on December 31, 1955 in the ledger account. For the Assessment Year 1956-57, the corresponding previous year being the calendar year 1955, the appellant claimed a loss of Rs 80,759 which he had written off as bad debt, under Section 10(2)(*xi*) of the Income Tax Act. By his assessment order dated July 31, 1957, the Income Tax Officer disallowed the claim on the ground that the moneys advanced by the appellant under the agreement could not be regarded as a dealing in the course of his financing business, but the true nature of the transaction, as evidenced by the agreement, was a venture in the nature of a trade. The Income Tax Officer accordingly held that the loss was a capital loss and it could not be allowed as a bad debt under Section 10(2)(*xi*) of the Income Tax Act. The appellant took the matter in appeal to the Appellate Assistant Commissioner of Income Tax who dismissed the appeal. The appellant preferred a second appeal before the Income Tax Appellate Tribunal which by its order dated February 19, 1960 rejected the appeal, holding that the loss of Rs 80,759 was a capital loss and not a loss of stock-in-trade. The Tribunal took the view that the transaction was not a joint venture with the distributors or any partnership business and that it was also not a mere financing deal or a part of the moneylending activities of the appellant. According to the Appellate Tribunal, the true nature of the transaction was an investment of the capital for a return in the shape of share of profits, and the loss suffered by the appellant was therefore a capital loss and not a revenue loss. As required by the appellant, the Tribunal stated a case to the High Court under Section 66(1) of the Income Tax Act on the following question of law:

Whether the aforesaid loss of Rs 80,759 is deductible under any of the provisions of the Act?

By its judgment between the parties that the moneylender will share the loss of the business for which the money is lent. In other words, it was argued that no moneylending transaction can have the attribute of the moneylender sharing the risk of the loss of the business for which the money is lent, nor could it be a feature of any purely financial deal. We are unable to accept the argument of the respondent that the transaction between the parties under the agreement dated January 5, 1953 was not a moneylending transaction or a transaction in the nature of a financial deal in the course of the appellant's business. If clause 3 of the agreement is taken in isolation there may be some force in the contention of the respondent that the term under which the appellant undertook to share the loss took the transaction out of the category of a moneylending transaction and the loss suffered by the appellant was therefore a capital loss. In the present case, however, clause 3 of the agreement dated January 5, 1953 cannot be read in isolation but it must be construed in the context of clause 7 which provides that in case the picture was not released in Bombay within 15 months from the date of the agreement, the distributors will return all the moneys so far advanced to them by the appellant together with interest thereon at 9% per annum. It is the admitted position in the present case that the picture was not released by the distributors till the stipulated date, namely, April 4, 1954 but it was released on May 28, 1954 and clause 7 of the agreement therefore came into operation. The result therefore is that on and from April 4, 1954 there was a contract of loan between the parties in terms of clause 7 of the agreement and the principal amount became repayable from that date to the appellant with interest thereon at 9% per annum. It follows therefore that the appellant is entitled to claim the amount of Rs 80,759 as a bad debt under Section 10(2)(*xi*) of the Income Tax Act and the loss suffered by the appellant was not a loss of capital bat a revenue loss.

4. To find out whether an expenditure is on the capital account or on revenue account, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss of capital. But it is not true of all losses, because losses in the running of the business cannot be said to be of capital. The distinction is brought out for example, in ***Reid's Brewery Co. Ltd.* v. *Male*** [(1891) 3 Tax Cas 279]. In that case, the brewery company carried on, in addition to the business of a brewery, a business of bankers and moneylenders making loans and advances to their customers. This helped the customers in pushing sales of the product of the brewery company. Certain sums had to be written off and the amount was held to be deductible. In the course of his judgment Pollock B. said:

Of course, if it be capital invested, then it comes within the express provision of the Income Tax Act, that no deduction is to be made on that account.

but held that:

> [N]o person who is acquainted with the habits of business can doubt that this is not capital invested. What it is is this. It is capital used by the Appellants but used only in the sense that all money which is laid out by persons who are traders, whether it be in the purchase of goods be they traders alone, whether it be in the purchase of raw material be they manufacturers, or in the case of money-lenders, be they pawnbrokers or moneylenders, whether it be money lent in the course of their trade, it is used and it comes out of capital, but it is not an investment in the ordinary sense of the word.

In the present case, the conditions for the grant of the allowance under Section 10(2)(*xi*) of the Income Tax Act are satisfied. In the first place, the debt is in respect of the business which is carried on by the appellant in the relevant accounting year and accounts of the business are admittedly kept on mercantile basis. In the second place, the debt is in respect of and incidental to the business of the appellant. It has also been found that the debt had become irrecoverable in the relevant accounting year and the amount had been actually written off as irrecoverable in the books of the appellant.

5. For these reasons, we hold that the judgment of the Bombay High Court dated August 27, 1962 should be set aside and the question referred to the High Court must be answered in the affirmative and in favour of the appellant. We accordingly allow this appeal with costs here and in the High Court.

* * * * *

C.I.T. v. *Mysore Sugar Co. Ltd., Bangalore*

AIR 1967 SC 723

M. HIDAYATULLAH, J. – This appeal by the Commissioner of Income-tax, Mysore on a certificate granted under S. 66A of the Indian Income-tax Act, is directed against a judgment of the High Court of Mysore, dated September 7, 1959, by which the following question referred by the Income-tax Appellate Tribunal, Madras Bench, was answered in favour of the respondent:

> Whether there are materials for the tribunal to hold that the sum of Rs.2,87,422 aforesaid represents a loss of capital.

(2) The assessee Company purchases sugarcane from the sugarcane growers, and crushes them in its factory to prepare sugar. As a part of its business operations, it enters into agreements with the sugarcane growers, who are known locally as "Oppigedars," and advances them sugarcane seedlings, fertilizers and also cash. The Oppigedars enter into a written agreement called the "Oppige," by which they agree to sell sugarcane exclusively to the assessee Company at current market rates and to have the advances adjusted towards the price of sugarcane, agreeing to pay interest in the meantime. For this purpose, an account of each Oppigedar is opened by the assessee Company. A crop of sugarcane takes about 18 months to mature and these agreements take place at the harvest season each year, in preparation for the next crop.

(3) In the year 1948-49 due to drought, the assessee Company could not work its sugar mills and the Oppigedars could not grow or deliver the sugarcane. The advances made in 1948-49 thus remained unrecovered, because they could only be recovered by the supply of sugarcane to the assessee Company. The Mysore Government realising the hardship appointed a Committee to investigate the matter and to make a report and recommendations. This report was made by the Committee on July 27, 1950 and the whole of the report has been printed in the record of this case. The Oppige bond is not printed, perhaps because it was in Kannada; but the substance of the terms is given by the Committee and the above description fairly represents its nature. The Committee recommended that the assessee Company should ex-gratia forego some of its dues, and in the year of account ending June 30, 1952, the Company waived its rights in respect of Rs. 2,87,422. The Company claimed this as a deduction under Ss. 10(2)(xi) and 10(2)(xv) of the Indian Income-tax Act. The Income-tax Officer declined to make the deduction, because, in his opinion, this was neither a trade debt nor even a bad debt but an ex-gratia payment almost like a gift. An appeal to the Appellate Assistant Commissioner also failed. Before the Income-tax Appellate Tribunal, Madras Bench, these two arguments were again raised, but were rejected, the Tribunal holding that the payments were not with an eye to any commercial profit and could not thus be said to have been made out of commercial expediency, so as to attract Section 10(2)(xv) of the Act. The Tribunal also held that these were not bad debts, because they were "advances, pure and simple, not arising out of sales" and did not contribute to the profits of the businesses. From the order of reference, it appears that the Appellate Tribunal was also of the opinion that these advances were made to ensure a steady supply of quality sugarcane, and that the loss, if any, must be taken to represent a capital loss and not a trading loss.

(4) The Appellate Tribunal, however, referred the question for the opinion of the High Court and the High Court held that the expenditure was not in the nature of a capital expenditure, and was deductible as a revenue expenditure. It relied upon a passage from Sampath Ayyangar's Book on the Indian Income-tax Law and on the decision of this Court in ***Badridas Daga* v. *Commissioner of Income-tax*** [(1959) SCR 6 90 : AIR 1958 SC 783], to hold that this amount was deductible in computing the profits of the business for the year in question under S. 10(1) of the Income-tax Act.

(5) The case has been argued before us both under S. 10(1) and S. 10(2)(xv), though it appears that the case of the assessee Company has changed from S. 10(1) to S. 10(2)(xi) and S. 10(2)(xv) from time to time. The question, as propounded, seems to refer to Ss. 10(2)(xv) and 10(1) and not to S. 10(2)(xi). We, however, do not wish to emphasise the nature of the question posed, because, in our opinion, the central point to decide is whether the money which was given up, represented a loss of capital, or must be treated as a revenue expenditure.

(6) The tax under the head "Business" is payable under S. 10 of the Income-tax Act. That section provides by sub-s. (1) that the tax shall be payable by an assessee under the head "Profits and gains of business, etc." in respect of the profits or gains of any business etc. carried on by him. Under sub-s. (2), these profits or gains are computed after making certain allowances. Clause (xi) allows deduction of bad and doubtful business debts. It provides that when the assessee's accounts in respect of any part of his business are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of his business is deductible but not exceeding the amount actually written off as irrecoverable in the books of the assessee. Clause (xv) allows any expenditure not included in Cls. (i) to (xiv), which is not in the nature of capital expenditure or personal expenses of the assessee, to be deducted, if laid out or expended wholly and exclusively for the purpose of such business, etc. The clauses expressly provide what can be deducted; but the general scheme of the section is that profits or gains must be calculated after deducting outgoings reasonably attributable as business expenditure but so as not to deduct any portion of an expenditure of a capital nature. If an expenditure comes within any of the enumerated classes of allowances, the case can be considered under the appropriate class; but there may be an expenditure which, though not exactly covered by any of the enumerated classes, may have to be considered in finding out the true assessable profits or gains. This was laid down by the Privy Council in ***Commissioner of Income-tax C.P. and Berar* v. *S.M. Chitnavis*** [AIR 1932 PC 178], and has been accepted by this Court. In other words, S. 10(2) does not deal exhaustively with the deductions, which must be made to arrive at the true profits and gains.

(7) To find out whether an expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss of capital. But this is not true of all losses, because losses in the running of the business cannot be said to be of capital. The questions to consider in this connection are: for what was the money laid out? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an out-going in the doing of the business? If money be lost in the first circumstance, it is a loss of capital, but if lost in the second circumstance, it is a revenue loss. In the first, it bears the character of an

investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses.

(8) This distinction is admirably brought out in some English cases, which were cited at the Bar. We shall refer only to three of them. In ***English Crown Spelter Co., Ltd*. v. *Baker*** [(1908) 5 Tax Cas 327], the English Crown Spelter Co. carried on the business of zinc smelting for which it required large quantities of 'blende.' To get supplies of blende, a new Company called the Welsh Crown Spelter Company was formed, which received assistance from the English Company in the shape of advances on loan. Later, the English Company was required to write off £ 38,000 odd. The question arose whether the advance could be said to be an investment of capital, because if they were, the English Company would have no right to deduct the amount. If, on the other hand, it was money employed for the business, it could be deducted. Bray, J. who considered these questions, observed:

> If this were an ordinary business transaction of a contract by which the Welsh Company were to deliver certain blende, it may be at prices to be settled hereafter, and that this was really nothing more than an advance on account of the price of that blende, there would be a great deal to be said in favour of the Appellants.... It is impossible to look upon this as an ordinary business transaction of an advance against goods to be delivered ... I can come to no other conclusion but that this was an investment of capital in the Welsh Company and was not an ordinary trade transaction of an advance against goods.

(9) The second case, ***Charles Marsden and Sons Ltd.* v. *Commissioner of Inland Revenue*** [(1919) 12 Tax Cas 217], is under the Excess Profits Duty in England, and the question arose in the following circumstances: An English Company carried on the business of paper making. To arrange for supplies of wood pulp, it entered into an agreement with a Canadian Company for supply of 3,000 tons per year between 1917-1927. The English Company made an advance of £ 30,000 against future deliveries to be recouped at the rate of £ 1 per ton delivered. The Canadian Company was to pay interest in the meantime. Later, the importation of wood pulp was stopped, and the Canadian Company (appropriately called the Ha! Ha! Company) neither delivered the pulp nor returned the money. Rowlatt, J. held this to be a capital expenditure not admissible as a deduction. He was of opinion that the payment was not an advance payment for goods, observing that no one pays for goods ten years in advance, and that it was a venture to establish a source and money was adventured as capital.

(10) The last case, to which we need refer to illustrate the distinction made in such cases is ***Reid's Brewery Co. Ltd.* v. *Male*** [(1891) 3 Tax Cas 279]. The Brewery Company there carried on, in addition to the business of a brewery, a business of bankers and money-lenders making loans and advances to their customers. This helped the customers in pushing sales of the product of the Brewery Company. Certain sums had to be written off, and the amount was held to be deductible. Pollock, B. said:

> Of course, if it be capital invested then it comes within the express provision of the Income-tax Act, that no deduction is to be made on that account";
>
> but held that:
>
> [N]o person who is acquainted with the habits of business can doubt that this is not capital invested. What is this? It is capital used by the Appellants but used only in the

> sense that all money which is laid out by persons who are traders, whether it be in the purchase of goods be they traders alone, whether it be in the purchase of raw material be they manufacturers, or in the case of money lenders, be they pawn-brokers or money-lenders, whether it be money lent in the course of their trade, it is used and it comes out of capital, but it is not an investment in the ordinary sense of the word.

It was thus held to be a use of money in the course of the Company's business, and not an investment of capital at all.

(11) These cases illustrate the distinction between an expenditure by way of investment and an expenditure in the course of business, which we have described as current expenditure. The first may truly be regarded as on the capital side but not the second. Applying this test to this simple case, it is quite obvious which it is. The amount was an advance against price of one crop. The Oppigedars were to get the assistance not as an investment by the assessee Company in its agriculture, but only as an advance payment of price. The amount, so far as the assessee Company was concerned, represented the current expenditure towards the purchase of sugarcane, and it makes no difference that the sugarcane thus purchased was grown by the Oppigedars with the seedlings, fertilizer and money taken on account from the assessee Company. In so far as the assessee Company was concerned, it was doing no more than making a forward arrangement for the next year's crop and paying an amount in advance out of the price, so that the growing of the crop may not suffer due to want of funds in the hands of the growers. There was hardly any element of investment which contemplates more than payment of advance price. The resulting loss to the assessee Company was just as much a loss on the revenue side as would have been, if it had paid for the ready crop which was not delivered.

(12) In our judgment, the decision of the High Court is right. The appeal fails, and is dismissed with costs.

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Empire Jute Co. Ltd. v. *C.I.T.*

(1980) 4 SCC 25

P.N. BHAGWATI, J. - This appeal by special leave raises the vexed question whether a particular expenditure incurred by the assessee is of a capital or revenue nature.

2. The assessee is a limited company carrying on business of manufacture of jute. It has a factory with a certain number of looms situate in West Bengal. It is a member of the Indian Jute Mills Association. The Association consists of various jute manufacturing mills as its members and it has been formed with a view to protecting the interests of the members. The objects of the Association, inter alia, are (*i*) to protect, forward and defend the trade of members; (*ii*) to impose restrictive conditions on the conduct of the trade; and (*iii*) to adjust the production of the mills in the membership of the Association to the demand in the world market. It appears that right from 1939, the demand of jute in the world market was rather lean and with a view to adjusting the production of the mills to the demand in the world market, a working time agreement was entered into between the members of the Association restricting the number of working hours per week, for which the mills shall be entitled to work their looms. The first working time agreement was entered into on January 9, 19.39 and it was for a duration of five years and on its expiration, the second and thereafter the third working time agreements, each for a period of five years and in more or less similar terms, were entered into on June 12, 1944 and November 25, 1949 respectively. The third working time agreement was about to expire on December 11, 1954 and since it was felt that the necessity to restrict the number of working hours per week still continued, a fourth working time agreement was entered into between the members of the Association on December 9, 1954 and it was to remain in force for a period of five years from December 12, 1954. We are concerned in this appeal with the fourth working time agreement and since the decision of the controversy before us turns upon the interpretation of its true nature and effect, we shall refer to some of its relevant provisions.

3. The first clause of fourth working time agreement to which we must refer is Clause 4 which provided that, subject to the provisions of Clauses 11 and 12,

> [N]o signatory shall work more than forty-five hours of work per week and such restriction of hours of work per week shall continue in force until the number of working hours allowed shall be altered in accordance with the provisions of Clauses 7(1),(2) and (3).

Clause 5 then proceeded to explain that the number of working hours per week mentioned in the working time agreement represented the extent of hours to which signatories were in all entitled in each week to work their registered complement of looms as determined under Clause 13 on the basis that they used the full complement of their loomage as registered with and certified by the committee. This clause also contained a provision for increase of the number of working hours per week allowed to a signatory in the event of any reduction in his loomage. It was also stipulated in this clause that the hours of work allowed to be utilised in each week shall cease at the end of that week and shall not be allowed to be carried forward. The number of working hours per week prescribed by Clause 4 was, as indicated in the opening part of that clause, subject inter alia to the provision of Clause 10 and under that clause, a joint and several agreement could be made providing that throughout the duration of the working time agreement, members with registered complements of looms not exceeding 220 shall be entitled to work up to 72 hours per week. Clause 6(*a*) enabled members to be registered as a "Group of Mills" if they happened to. be under the control of the same managing agents or were combined by any arrangement or agreement and it was open to any member of the Group of Mills so registered to utilise the allotment of hours of work per week of other members in the same group who were not fully utilising the hours of work allowable to them under the working time agreement, provided that such transfer of hours of work was for a period of not less than six months Then followed Clause 6(b) which is very material and it provided, inter alia, as follows:

> Subject to the provisions of sub-clauses (*i*) to (*ii*) …signatories to this agreement shall be entitled to transfer in part or wholly their allotment of hours of work per week to any one or more of the other signatories; and upon such transfer being duly effected and registered and a certificate issued by the committee, the signatories to whom the allotment of working hours has been transferred shall be entitled to utilise the allotment of hours of work per week so transferred.

There were four conditions precedent subject to which the allotment of hours of work transferred by one member to another could be utilised by the latter and three of them were as under:

> (*i*) No hours of work shall be transferred unless the transfer covers hours of work per week for a period of not less than six months;
>
> (*ii*) All agreements to transfer shall, as a condition precedent to any rights being obtained by transferees, be submitted with an explanation to the committee and the committee's decision.... whether the transfer shall be allowed shall be final and conclusive.
>
> (*iii*) If the committee sanctions the transfer, it shall be a condition precedent to its utilisation that a certificate be issued and the transfer registered.

This transaction of transfer of allotment of hours of work per week was commonly referred to as sale of loom hours by one member to another. The consequence of such transfer was that the hours of work per week transferred by a member were liable to be deducted from the working hours per week allowed to such member under the working time agreement and the member in whose favour such transfer was made was entitled to utilise the number of working hours per week transferred to him in addition to the working hours per week allowed to him under the working time agreement. It was under this clause that the assessee purchased loom hours from four different jute manufacturing concerns which were signatories to the working time agreement, for the aggregate sum of Rs 2,03,255 during the year August 1, 1958 to July 31, 1959. In the course of assessment for the "assessment year 1960-61 for which the relevant accounting year was the previous year August 1, 1958 to July 31, 1959, the assessee claimed to deduct this amount of Rs 2,03,255 as revenue expenditure on the ground that it was part of the cost of operating the looms which constituted the profit-making apparatus of the assessee. The claim was disallowed by the Income Tax Officer but on appeal, the Appellate Assistant Commissioner accepted the claim and allowed the deduction on the view that the assessee did not acquire 'any capital asset when it purchased the loom hours and the amount spent by it was incurred for running the business or working it with a view to producing day-to-day profits and it was part of operating cost or revenue cost of production. The Revenue preferred an appeal to the Tribunal but the appeal was unsuccessful and the Tribunal taking the same view as the Appellate Assistant Commissioner, held that the expenditure incurred by the assessee was in the nature of revenue expenditure and hence deductible in computing the profits and gains of business of the assessee. This view taken by the Tribunal was challenged in a reference made to the High Court at the instance of the revenue. The High Court too was inclined to take the same view as the Tribunal, but it felt compelled by the decision of this Court in ***C. I. T.*** **v.** ***Maheshwari Devi Jute Mills Ltd***. [(1965) 57 ITR 36] to decide in favour of the revenue and on that view it overturned the decision of the tribunal and held that the amount paid by the assessee for purchase of the loom hours was in the nature of capital expenditure and was, therefore, not deductible under Section 10(2) (*xv*) of the Act. The assessee thereupon preferred the present appeal by special leave obtained from this Court.

4. Now an expenditure incurred by an assessee can qualify for deduction under Section 10 (2)(xv) only if it is incurred wholly and exclusively for the purpose of his business, but even if it fulfils this requirement, it is not enough; it must further be of revenue as distinguished from capital nature. Here in the present case it was not contended on behalf of the Revenue that the sum of Rs. 2,03,255 was not laid out wholly and exclusively for the purpose of the assessee's business but the only argument was and this argument found favour with the High Court, that it represented capital expenditure and was hence not deductible under Section 10(2) (*xv*). The sole question which therefore arises for determination in the appeal is whether the sum of Rs. 2,03,255 paid by the assessee represented capital expenditure or revenue expenditure. We shall have to examine this question on principle but before we do so, we must refer to the decision of this Court in ***Maheshwari Devi Juts Mills*** case since that is the decision which weighed heavily with the High Court, in fact, compelled it to negative the claim of the assessee and hold the expenditure to be on capital account. That was a converse case where the question was whether an amount received by the assessee for sale of loom hours was in the nature of capital receipt or revenue receipt. The view taken by this Court was that it was in the nature of capital receipt and hence not taxable. It was contended on behalf of the Revenue, relying on this decision, that just as the amount realised for sale of loom hours was held to be capital receipt, so also the amount paid for purchase of loom hours must be held to be of capital nature. But this argument suffers from a double fallacy.

5. In the first place it is not a universally true proposition that what may be capital receipt in the hands of the payee must necessarily be capital expenditure in relation to the payer. The fact that a certain payment constitutes income or capital receipt in the hands of the recipient is not material in determining whether the payment is revenue or capital disbursement qua the payer. It was felicitously pointed out by Macnaghten, J. in ***Racecourse Betting Control Board*** **v.** ***Wild*** (1938) 4 All ER 487 that a "payment may be a revenue payment from the point of view of the payer and a capital payment from the point of view of the receiver and vice versa". Therefore, the decision in ***Maheshwari Devi Jute Mills*** case cannot be regarded as an authority for the proposition that payment made by an assessee for purchase of loom hours would be capital expenditure. Whether it is capital expenditure or revenue expenditure would have to be determined having regard to the nature of the transaction and other relevant factors.

6. But, more importantly, it may be pointed out that ***Maheshwari Devi Jute Mills*** case proceeded on the basis that loom hours were a capital asset and the case was decided on that

basis. It was common ground between the parties throughout the proceedings, right from the stage of the Income Tax Officer up to the High Court, that the right to work the looms for the allotted hours of work was an asset capable of being transferred and this Court therefore did not allow counsel on behalf of the Revenue to raise a contention that loom hours were in the nature of a privilege and were not an asset at all. Since it was a commonly accepted basis that loom hours were an asset of the assessee, the only argument which could be advanced on behalf of the Revenue was that when the assessee transferred a part of its hours of work per week to another member, the transaction did not amount to sale of an asset belonging to the assessee, but it was merely the turning of an asset to account by permitting the transferee to use that asset and hence the amount received by the assessee was income from business. The Revenue submitted that:

> Where it is a part of the normal activity of the assessee's business to earn profit by making use of its asset by either employing it in its own manufacturing concern or by letting it out to others, consideration received for allowing the transferee to use that asset is income received from business and chargeable to income tax.

The principle invoked by the Revenue was that:

> Receipt by the exploitation of a commercial asset is the profit of the business, irrespective of the manner in which the asset is exploited by the owner m the business, for the owner is entitled to exploit it to his best advantage either by using it himself personally or by letting it out to somebody else.

This principle, supported as it was by numerous decisions, was accepted by the court as a valid principle, but it was pointed out that it had no application in the case before the court, because though loom hours were an asset, they could not from their very nature be let out while retaining property in them and there could be no grant of temporary right to use them. The court therefore concluded that this was really a case of sale of loom hours and not of exploitation of loom hours by permitting user while retaining ownership and, in the circumstances, the amount received by the assessee from sale of loom hours was liable to be regarded as capital receipt and not income. It will thus be seen that the entire case proceeded on the commonly accepted basis that loom hours were an asset and the only issue debated was whether the transaction in question constituted sale of this asset or it represented merely exploitation of the asset by permitting if user by another while retaining ownership. No question was raised before the court as to whether loom hours were an asset at all nor was any argument advanced as to what was the true nature of the transaction. It is quite possible that if the question had been examined fully on principle, unhampered by any predetermined hypothesis, the court might have come to a different conclusion. This decision cannot, therefore, be regarded as an authority compelling us to take the view that the amount paid for purchase of loom hours was capital and not revenue expenditure. The question is res Integra and we must proceed to examine it on first principle.

7. It is quite clear from the terms of the working time agreement that the allotment of loom hours to different mills constituted merely a contractual restriction on the right of every mill under the general law to work its looms to their full capacity. If there had been no working time agreement, each mill would have been entitled to work its looms uninterruptedly for twenty-four hours a day throughout the week, but that would have resulted in production of jute very much in excess of the demand in the world market, leading to unfair competition and precipitous fall

in jute price and in the process, prejudicially affecting all the mills and therefore with a view to protecting the interest of the mills who were members of the Association the working time agreement *was* entered into restricting the number of working hours per week for which each mill could work its looms. The allotment of working hours per week under the working time agreement was clearly not a right conferred on a mill, signatory to the working time agreement. It was rather a restriction voluntarily accepted by each mill with a view to adjusting the production to the demand in the world market and this restriction could not possibly be regarded as an asset of such mill. This restriction necessarily had the effect of limiting the production of the mill and consequentially also the profit which the mill could otherwise make by working full loom hours. But a provision was made in Clause 6(*i*) of the working time agreement that the whole or a part of the working hours per week could be transferred by one mill to another for a period of not less than six months and if such transfer was approved and registered by the Committee of the Association, the transferee mill would be entitled to utilise the number of working hours per week transferred to it in addition to the working hours per week allowed to it under the working time agreement, while the transferor mill could cease to be entitled to avail of the number of working hours per week so transferred and these would be liable to be deducted from the number of working hours per week otherwise allotted to it. The purchase of loom hours by a mill had therefore the effect of relaxing the restriction on the operation of looms to the extent of the number of working hours per week transferred to it, so that the transferee mill could work its looms for longer hours than permitted under the working time agreement and increase its profitability. The amount spent on purchase of loom hours thus represented consideration paid for being able to work the looms for a longer number of hours. It is difficult to see how such payment could possibly be regarded as expenditure on capital account.

8. The decided cases have, from time to time, evolved various tests for distinguishing between capital and revenue expenditure but no test is paramount or conclusive. There is no all embracing formula which can provide a ready solution to the problem; no touchstone has been devised. Every case has to be decided on its own facts keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. But a few tests formulated by the courts may be referred to as they might help to arrive at a correct decision of the controversy between the parties. One celebrated test is that laid down by Lord Gave, L. C., in ***Atherton* v. *British Insulated and Halsby Cables Ltd.*** [1926 AC 205] where the learned law Lord stated:

> When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

This test, as the parenthetical clause shows, must yield where there are special circumstances leading to a contrary conclusion and, as pointed out by Lord Radcliffe in ***Commissioner of Taxes* v. *Nchanga Consolidated Copper Mines Ltd***, [1964 AC 948], it would be misleading to suppose that in all cases, securing a benefit for the business would be prima facie capital expenditure "so long as the benefit is not so transitory as to have no endurance at all". There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may break down. It -is not every advantage of enduring nature, acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is therefore not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case. But even if this test were applied in the present case, it does not yield a conclusion in favour of the Revenue. Here, by purchase of loom hours no new asset has been created. There is no addition to or expansion of the profit-making apparatus of the assessee. The income-earning machine remains what it was prior to the purchase of loom hours. The assessee is merely enabled to operate the profit-making structure for a longer number of hours. And this advantage is clearly not of an enduring nature. It is limited in its duration to six months and, moreover, the additional working hours per week transferred to the assessee have to be utilised during the week and cannot be carried forward to the next week. It is, therefore, not possible to say that any advantage of enduring benefit in the capital field was acquired by the assessee in purchasing loom hours and the test of enduring benefit cannot help the Revenue.

9. Another test which is often applied is the one based on distinction between fixed and circulating capital. This test was applied by Lord Haldane in the leading case of ***John Smith & Son* v. *Moore*** [(1921) 2 AC 13] where the learned law Lord drew the distinction between fixed capital and circulating capital in words which have almost acquired the status of a definition. He said:

> Fixed capital (is) what the owner turns to profit by keeping it in his own possession; circulating capital (is) what he makes profit of by parting with it and letting it change masters.

Now so long as the expenditure in question can be clearly referred to the acquisition of an asset which falls within one or the other of these two categories, such a test would be a critical one. But this test also sometimes breake down because there are many forms of expenditure which do not fall easily within these two categories and not infrequently, as pointed out by Lord Radcliffe in ***Commissioner of Taxes* v. *Nchanga Consolidated Copper Mines Ltd***., the line of demarcation is difficult to draw and leads to subtle distinctions between profit that is made "out of" assets and profit that is made "upon" assets or "with" assets. Moreover, there may be cases where expenditure, though referable to or in connection with fixed capital, is nevertheless allowable as revenue expenditure. An illustrative example would be of expenditure incurred in preserving or maintaining capital assets. This test is therefore clearly not one of universal application. But even if we were to apply this test, it would not be possible to characterise the amount paid for purchase of loom hours as capital expenditure, because acquisition of additional loom hours does not add at all to the fixed capital of the assessee. The permanent structure of which the income is to be the produce or fruit remains the same; it is not enlarged. We are not sure whether loom hours can be regarded as part of circulating capital like labour, raw material, power etc., but it is clear beyond doubt that they are not part of fixed capital and hence even the application of this test does not compel the conclusion that the payment for purchase of loom hours was in the nature of capital expenditure.

10. The Revenue however contended that by purchase of loom hours the assessee acquired a right to produce more than what it otherwise would have been entitled to do and this right to produce additional quantity of goods constituted addition to or augmentation of its profit-making structure. The assessee acquired the right to produce a larger quantity of goods and to earn more income and this, according to the Revenue, amounted to acquisition of a source of profit or income which though intangible was nevertheless a source or 'spinner' of income and the amount spent on purchase of this source of profit or income therefore represented expenditure of capital nature. Now It 'is true that if disbursement is made for acquisition of a source of profit or Income, it would ordinarily, in the absence of any other countervailing circumstances, be in the nature of capital expenditure. But we fail to see how it can at all be said in the present case that the assessee acquired a source of profit or income when it purchased loom hours. The source of profit or income was the profit-making apparatus and this remained untouched and unaltered. There was no enlargement of the permanent structure of which the income would be the produce or fruit. What the assessee acquired was merely an advantage in the nature of relaxation of restriction on working hours imposed by the working time agreement, so that the assessee could operate its profit-earning structure for a longer number of hours. Undoubtedly, the profit-earning structure of the assessee was enabled to produce more goods, but that was not because of any addition or augmentation in the profit-making structure, but because the profit-making structure could be operated for longer working hours. The expenditure incurred for this purpose was primarily and essentially related to the operation or working of the looms which constituted the profit-making apparatus of the assessee. It was an expenditure for operating or working the looms for longer working hours with a view to producing a larger quantity of goods and earning more income and was therefore in the nature of revenue expenditure. We are conscious that in law as in life, and particularly in the field of taxation law, analogies are apt to be deceptive and misleading, but in the present context, the analogy of quota right may not be inappropriate. Take a case where acquisition of raw material is regulated by quota system and in order to obtain more raw material, the assessee purchases quota right of another. Now it is obvious that by purchase of such quota right, the assessee would be able to acquire more raw material and that would increase the profitability of his profit-making apparatus, but the amount paid for purchase of such quota right would indubitably be revenue expenditure, since it is incurred for acquiring raw material and is part of the operating cost. Similarly, if payment has to be made for securing additional power every week, such payment would also be part of the cost of operating the profit-making structure and hence in the nature of revenue expenditure, even though the effect of acquiring additional power would be to augment the productivity of the profit-making structure. On the same analogy payment made for purchase of loom hours which would enable the assessee to operate the profit-making structure for a longer number of hours than those permitted under the working time agreement would also be part of the cost of performing the income-earning operations and hence revenue in character.

11. When dealing with cases of this kind where the question is whether expenditure incurred by an assessee is capital or revenue expenditure, it is necessary to bear in mind what Dixon, J said in ***Hallstrom's Property Ltd.* v. *Federal Commissioner of Taxation***, [72 CLR 634]:

> What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted is the process.

The question must be viewed in the larger context of business necessity or expendiency. If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure. The same test was formulated by Lord Clyde in ***Robert Addie and Son's Collieries Ltd.* v. *I. R,*** [(1924) SC 231] in these words:

> Is it part of the company's working expenses, is it expenditure laid out as part of the process of profit-earning? - or, on-the other hand, is it a capital outlay, is it expenditure necessary for the acquisition of property or of rights of a permanent- character, the possession of which is a condition of carrying on its trade at all?

It is clear from the above discussion that the payment made by the assessee for purchase of loom hours was expenditure laid out as part of the process of profit-earning. It was, to use Lord Soumnar's words, an outlay of a business "in order to carry it on and to earn a profit out of this expense as an expense of carrying it on". It was part of the cost of operating the profit-earning apparatus and was clearly in the nature of revenue expenditure.

12. It was pointed out by Lord Radcliffe in ***Commissioner of Taxes* v. *Nchanga Consolidated Copper Mines Ltd.*** that "in 'considering allocation of expenditure between the capital and income accounts, it is almost unavoidable to argue from analogy". There are always cases falling indisputably on one or the other side of the line and it is a familiar argument in tax courts that the case under review bears close analogy to a case falling on the right side of the line and must therefore be decided in the same manner. If we apply this method, the case closest to the present one that we can find is ***Nchanga Consolidated Copper Mines*** case. The facts of this case were that three companies which were engaged in the business of copper mining formed a group and consequent on a steep fall in the price of copper in the world market, this group decided voluntarily to cut its production by 10 per cent which for the three companies together meant a cut of 27,000 tons for the year in question. It was agreed between the three companies that for the purpose of giving effect to this cut, company *B* should cease production for one year and that the assessee-company and company *B* should undertake between them the whole group programme for the year reduced by the overall cut of 27,000 tons and should pay compensation to company *B* for the abandonment of its production for the year. Pursuant to this agreement the assessee paid to company *B* £ 1,384,569 by way of its proportionate share of the compensation and the question arose whether this payment was in the nature of capital expenditure or revenue expenditure. The Privy Council, held that the compensation paid by the

assessee to company *B* in consideration of the latter agreeing to cease production for one year was in the nature of revenue expenditure and was allowable as a deduction in computing the taxable income of the assessee. Lord Radcliffe delivering the opinion of the Privy Council observed that the assessee's arrangement with companies *R* and *B* "out of which the expenditure arose, made it a cost incidental to the production and sale of the output of the mine and as such its true analogy was with an operating cost. The payment of compensation represented expenditure incurred by the assessee for enabling it to produce more goods despite the cut of 10 per cent and it was plainly part of the cost of performing the income-earning operation. This decision bears a very close analogy to the present case and if payment made by the assessee-company to company *B* for acquiring an advantage by way of entitlement to produce more goods notwithstanding the cut of 10 per cent was regarded by the Privy Council as revenue expenditure, a fortiorari, expenditure incurred by the assessee in the present case for purchase of loom hours so as to enable the assessee to work the profit-making apparatus for a longer number of hours and produce more goods than what the assessee would otherwise be entitled to do, must be held to be of revenue character.

13. The decision in ***Commissioner of Taxes* v. *Canon Company*** [45 TC 10] also bears comparison with the present case. There certain expenditure was incurred by the assessee-company for the purpose of obtaining a supplementary charter altering its constitution, so that the management of the company could be placed on a sound commercial footing and restrictions on the borrowing powers of the assessee-company could be removed. The old charter contained certain antiquated provisions and also restricted the borrowing powers of the assessee-company and these features severely handicapped the assessee-company in the development of its trading activities. The House of Lords held that the expenditure incurred for obtaining the revised charter eliminating these features which operated as impediments to the profitable development of the assessee-company's business was in the nature of revenue expenditure since it was incurred for facilitating the day-to-day trading operations of the assessee-company and enabling the management and conduct of the assessee-company's business to be carried on more efficiently. Lord Reid emphasised in the course of his speech that the expenditure was incurred by the assessee-company "to remove antiquated restrictions which were preventing profits from being earned" and on that account held the expenditure to be of revenue character. It must follow on an analogical reasoning that expenditure incurred by the assessee in the present case for the purpose of removing a restriction on the number of working hours for which it could operate the looms, with a view to increasing its profits, would also be in the nature of revenue expenditure.

14. We are therefore of the view that the payment of Rs 2,03,255 made by the assessee for purchase of loom hours represented revenue expenditure and was allowable as a deduction under Section 10(2) (xv) of the Act. We accordingly allow the appeal and answer the question referred by the Tribunal in favour of the assessee and against the Revenue.

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L.B. Sugar Factory & Oil Mills (P) Ltd., Pilibhit v. *C.I.T.*

AIR 1981 SC 395

P.N. BHAGWATI, J. - The dispute in this appeal by certificate relates to two items of expenditure incurred by the assessee during the assessment year 1956-57 for which the relevant accounting year was the year ending on 30th September, 1955. The assessee is a private limited company carrying on business of manufacture and sale of crystal sugar in a factory situated in Pilibhit in the State of Uttar Pradesh. In the year 1952-53, a dam was constructed by the State of Uttar Pradesh at a place called Deoni and a road Deoni Dam-Majhala was constructed connecting the Deoni Dam with Majhala. It seems that the Collector requested the assessee to make some contribution towards the construction of the Deoni Dam and the Deoni Dam-Majhala Road and pursuant to this request of the Collector, the assessee contributed a sum of Rs. 22,332/- during the accounting year ending 30th September, 1955. The assessee also contributed a sum of Rs. 50,000/- to the State of Uttar Pradesh during the same accounting year towards meeting the cost of construction of roads in the area around its factory under a Sugar-cane Development Scheme promoted by the Uttar Pradesh Government as part of the Second Five Year Plan. It was provided under the Sugar-cane Development Scheme that one third of the cost of construction of roads would be met by the Central Government, one third by the State Government and the remaining one third by Sugar factories and sugar-cane growers and it was under this scheme that the sum of Rs. 50,000/- was contributed by the assessee. In the course of its assessment to Income-tax for the assessment year 1956-57, the assessee claimed to deduct these two amounts of Rs. 22,332/- and Rs. 50,000/- as deductible expenditure under Section 10(2)(xv) of the Indian Income-tax Act, 1922. The Income-tax Officer disallowed the claim for deduction on the ground that the expenditure incurred was of capital nature and was not allowable as a deduction under Section 10(2)(xv). The assessee preferred an appeal to the Appellate Assistant Commissioner but the appeal failed and this led to the filing of a further appeal before the Tribunal. The appeal was heard by a Bench of two members of the Tribunal and there was a difference of opinion between them. The Judicial Member took the view that the expenditure of both the amounts of Rs. 22,332/- and Rs. 50,000/- was in the nature of revenue expenditure and was therefore allowable as a deduction while the Accountant Member held that this expenditure was on capital account and could not be allowed as revenue expenditure. Since there was a difference of opinion between the two members, the question which formed the subject matter of difference was referred for consideration to a third member. The third member did not go into the question whether the expenditure incurred by the assessee was in the nature of capital or revenue expenditure but took a totally different line and held that the contributions were made by the assessee as a good citizen just as any other person would and it could not be said that the expenditure was laid out wholly and exclusively for the purpose of the business of the assessee. The third member in this view agreed with the conclusion reached by the Accountant Member and held that both the amounts of Rs. 22,332/- and Rs. 50,000/- were not allowable as deductible expenditure under Section 10(2)(xv). The appeal of the assessee was accordingly rejected by the Tribunal so far as this point was concerned. The assessee thereupon sought a reference to the High Court and on the application of the assessee, the following question of law was referred for the opinion of the High Court:

Whether on the facts and circumstances of the case the sums of Rs. 22,332/- and Rs. 50,000/- were admissible deduction in computing the taxable profits and gains of the company's business.

The High Court observed that "On the finding recorded by the third member of the Tribunal and on the view expressed by the Accountant Member," the expenditure could not be said to have been incurred by the assessee in the ordinary course of its business and it could not be "classified as revenue expenditure on the ground of commercial expediency." The view taken by the High Court was that since "the expenditure was not related to the business activity of the assessee as such, the Tribunal was justified in concluding that it was not wholly and exclusively laid out for the business and that the deduction claimed by the assessee therefore did not come within the ambit of Section 10(2)(xv)." The High Court accordingly answered the question referred to it in favour of the revenue and against the assessee. The assessee thereupon preferred the present appeal in this Court after obtaining the necessary certificate from the High Court.

(2) Now an expenditure incurred by an assessee can qualify for deduction under Section 10(2)(xv) only if it is incurred wholly and exclusively for the purpose of his business, but even if it fulfils this requirement, it is not enough; it must further be of revenue as distinct from capital nature. Two questions therefore arise for consideration in the present appeal: one is whether the sums of Rs. 22,332/- and Rs. 50,000/- contributed by the assessee represented expenditure incurred wholly and exclusively for the purpose of the business of the assessee and the other is whether this expenditure was in the nature of capital or revenue expenditure. So far as the first item of expenditure of Rs. 22,332/- is concerned, the case does not present any difficulty at all, because it was common ground between the parties that this amount was contributed by the assessee long after the Deoni Dam and the Deoni Dam-Majhala Road were constructed and there is absolutely nothing to show that the contribution of this amount had anything to do with the business of the assessee or that the construction of the Deoni Dam or the Deoni Dam-Majhala Road was in any way advantageous to the assessee's business. The amount of Rs. 22,332/- was apparently contributed by the assessee without any legal obligation to do so, purely as an act of good citizenship, and it could not be said to have been laid out wholly and exclusively for the purpose of the business of the assessee. The expenditure of the amount of Rs. 22,332/- was therefore rightly disallowed as deductible expenditure under Section 10(2)(xv).

(3) But the position is different when we come to the second item of expenditure of Rs. 50,000/-. There the assessee is clearly on firmer ground. The amount of Rs. 50,000/- was contributed by the assessee under the Sugar-cane Development Scheme towards meeting the cost of construction of roads in the area around the factory. Now there can be no doubt that the construction of roads in the area around the factory was considerably advantageous to the business of the assessee, because it facilitated the running of its motor vehicles for transportation of sugarcane so necessary for its manufacturing activity. It is not as if the amount of Rs. 50,000/- was contributed by the assessee generally for the purpose of construction of roads in the State of Uttar Pradesh, but it was for the construction of roads in the area around the factory that the contribution was made and it cannot be disputed that if the roads are constructed around the factory area, they would facilitate the transport of sugar-cane to the factory and the flow of manufactured sugar out of the factory. The construction of roads was therefore clearly and indubitably connected with the business activity of the assessee and it is difficult to resist

the conclusion that the amount of Rs. 50,000/- contributed by the assessee towards meeting the cost of construction of the roads under the Sugar-cane Development Scheme was laid out wholly and exclusively for the purpose of the business of the assessee. This conclusion was indeed not seriously disputed on behalf of the Revenue but the principal contention urged on its behalf was that the expenditure of the amount of Rs. 50,000/- incurred by the assessee was in the nature of capital expenditure, since it was incurred for the purpose of bringing into existence an advantage for the enduring benefit of the assessee's business. The argument of the Revenue was that the newly constructed roads though not belonging to the assessee brought to the assessee an enduring advantage for the benefit of its business and the expenditure incurred by it was therefore in the nature of capital expenditure. The Revenue relied on the celebrated test laid down by Lord Cave, L.C. in ***British Insulated and Helsby Cables Ltd.*** **v.** ***Atherton*** [(1926) 10 Tax Cas 155] at p. 189 where the learned Law Lord stated:

> When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

This test enunciated by Lord Cave L.C. is undoubtedly a well known test for distinguishing between capital and revenue expenditure, but it must be remembered that this test is not of universal application and, as the parenthetical clause shows, it must yield where there are special circumstances leading to a contrary conclusion. The non-universality of this test was emphasised by Lord Radcliffe in ***Commissioner of Taxes*** **v.** ***Nchanga Consolidated Copper Mines Ltd.*** [(1965) 58 ITR 241 (PC)] where the learned Law Lord said in his highly felicitous language that it would be misleading to suppose that in all cases securing a benefit for the business would be prima facie capital expenditure "so long as the benefit is not so transitory as to have no endurance at all." It was also pointed out by this Court in ***Empire Jute Co. Ltd.*** **v.** ***C.I.T.*** [AIR 1980 SC 1946] that

> (T)here may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test.

If the advantage consists merely in facilitating the assessee's business operations or enabling management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched the expenditure would be on revenue account, even though the advantage may endure for an indefinite future.

(4) Now it is clear on the facts of the present case that by spending the amount of Rs.50,000/-, the assessee did not acquire any asset of an enduring nature. The roads which were constructed around the factory with the help of the amount of Rs. 50,000/- contributed by the assessee belonged to the Government of Uttar Pradesh and not to the assessee. Moreover, it was only a part of the cost of construction of these roads that was contributed by the assessee, since under the Sugar-cane Development Scheme one third of the cost of construction was to be borne by the Central Government, one third by the State Government and only the remaining one third

was to be divided between the sugar-cane factories and sugar-cane growers. These roads were undoubtedly advantageous to the business of the assessee as they facilitated the transport of sugar-cane to the factory and the outflow of manufactured sugar from the factory to the market centres. There can be no doubt that the construction of these roads facilitated the business operations of the assessee and enabled the management and conduct of the assessee's business to be carried on more efficiently and profitably. It is no doubt true that the advantage secured for the business of the assessee was of a long duration inasmuch as it would last so long as the roads continued to be in motorable condition, but it was not an advantage in the capital field, because no tangible or intangible asset was acquired by the assessee nor was there any addition to or expansion of the profit making apparatus of the assessee. The amount of Rs. 50,000/- was contributed by the assessee for the purpose of facilitating the conduct of the business of the assessee and making it more efficient and profitable and it was clearly an expenditure on revenue account.

(5) It was pointed out by Lord Radcliffe in ***Commissioner of Taxes* v. *Nchanga Consolidated Copper Mines Ltd.*** [(1965) 58 ITR 241 (PC)] that "in considering allocation of expenditure between the capital and income accounts, it is almost unavoidable to argue from analogy." There are always cases falling indisputably on one or the other side of the line and it is a familiar argument in tax courts that the case under review bears close analogy to a case falling in the right side of the line and must, therefore, be decided in the same manner. If we apply this method, the case closest to the present one is that in ***Lakshmiji Sugar Mills Co. P. Ltd.* v. *C.I.T.*** [AIR 1972 SC 159]. The facts of this case were very similar to the facts of the present case. The assessee in this case was also a limited company carrying on business of manufacture and sale of sugar in the State of Uttar Pradesh and it paid to the Cane Development Council certain amounts by way of contribution for the construction and development of roads between sugarcane producing centres and the sugar factory of the assessee and the question arose whether this expenditure was allowable as revenue expenditure under Section 10(2)(xv). No doubt, in this case, there was a statutory obligation under which the amount in question was contributed by the assessee, but this Court did not rest its decision on the circumstance that the expenditure was incurred under statutory obligation. This Court analysed the object and purpose of the expenditure and its true nature and held that it was a revenue and not capital nature. This Court observed:

> In the present case, apart from the element of compulsion, the roads which were constructed and developed were not the property of the assessee nor is it the case of the revenue that the entire cost of development of those roads was defrayed by the assessee. It only made certain contribution for road development between the various cane producing centres and the mills. The apparent object and purpose was to facilitate the running of its motor vehicles or other means employed for transportation of sugarcane to the factory. From the business point of view and on a fair appreciation of the whole situation the assessee considered that the development of the roads in question could greatly facilitate the transportation of sugarcane. This was essential for the benefit of its business which was of manufacturing sugar in which the main raw material admittedly consisted of sugarcane. These facts would bring it within the second part of the principle mentioned before, namely, that the expenditure was incurred for running the business or working it with a view to produce the profits without the assessee getting any advantage of an enduring benefit to itself.

These observations are directly applicable in the present case and we must hold on the analogy of this decision that the amount of Rs. 50,000 was contributed by the assessee "for running the business or working it with a view to produce the profits without the assessee getting any advantage of an enduring benefit to itself." This decision fully supports the view that the expenditure of the amount of Rs. 50,000 incurred by the assessee was on revenue account.

(6) We must also refer to the decision of this Court in ***Travancore-Cochin Chemicals Ltd.* v. *C.I.T***. [AIR 1977 SC 991] on which strong reliance was placed on behalf of the Revenue. The facts of this case are undoubtedly to some extent comparable with the facts of the present case. But ultimately in case of this kind, where the question is whether a particular expenditure incurred by an assessee is on capital account or revenue account, the decision must ultimately depend on the facts of each case. No two cases are alike and quite often emphasis on one aspect or the other may tilt the balance in favour of capital expenditure or revenue expenditure. This Court in fact in the course of its judgment in ***Travancore-Cochin Chemicals Ltd.*** case distinguished the decision in ***Lakshmiji Sugar Mills*** case on the ground that "on the facts of the case, this court was satisfied that the development of the roads was meant for facilitating the carrying on of the assessee's business. ***Lakshmiji Sugar Mills'*** case is quite different on facts from the one before us and must be confined to the peculiar facts of that case." We would make the same observation in regard to the decision in ***Travancore Cochin Chemicals'*** case and say that the decision must be confined to the peculiar facts of that case, because ***Lakshmiji Sugar Mills'*** case admittedly bears a closer analogy to the present case than the ***Travancore-Cochin Chemicals'*** case and if at all we apply the method of arguing by analogy, the decision in ***Lakshmiji Sugar Mills*** case must be regarded as affording us greater guidance in the decision in the present case than the decision in ***Travancore-Cochin Chemicals*** case. Moreover, we find that the parenthetical clause in the test formulated by Lord Cave L.C. in ***Atherton*** case [(1926) 10 Tax Cas 155] was not brought to the attention of this Court in ***Travancore-Cochin Chemical*** case with the result that this Court was persuaded to apply that test as if it were an absolute and universal test regardless of the question applicable in all cases irrespective whether the advantage secured for the business was in the capital field or not. We would therefore prefer to follow the decision in ***Lakshmiji Sugar Mills*** case and hold on the analogy of that decision that the amount of Rs. 50,000 contributed by the assessee represented expenditure on the revenue account.

(7) We accordingly dismiss the appeal in so far as the expenditure of the sum of Rs.22,332/- is concerned. But, so far as the expenditure of the sum of Rs. 50,000/- is concerned we hold that it was in the nature of revenue expenditure laid down wholly and exclusively for the purpose of the assessee's business and was, therefore, allowable as a deduction under Section 10(2)(xv) of the Act and allow the appeal to this limited extent.

Bikaner Gypsums Ltd. v. *C.I.T.*

(1991) 1 SCC 328

K.N. SINGH, J. - This appeal is directed against the judgment and order of the High Court of Rajasthan answering the question referred to it by the Income Tax Appellate Tribunal in the negative, in favour of the revenue and against the assessee. The question referred to the High Court was as under:

> Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the payment of Rs 3 lakhs to the Northern Railway was a revenue expenditure and was a deduction allowable under the Income Tax Act, 1961?

The circumstances leading to the reference and the appeal are necessary to be stated. The Natural Science (India) Ltd. predecessor-in-interest of the assessee acquired a lease from the Maharaja of the erstwhile Bikaner State on September 29, 1948 for mining of gypsum for a period of 20 years over an area of 4.27 square miles at Jamsar. The lease was liable to be renewed after expiring of 20 years. The Natural Science (India) Ltd. by a deed of assignment dated December 11, 1948 assigned the rights under the lease to the Bikaner Gypsums Ltd., a company wherein the State Government owned 45 per cent share. The Bikaner Gypsums Ltd. ('the assessee') carried on the business of mining gypsum in accordance with the terms and conditions stated in the lease. The assessee entered into an agreement with Sindri Fertilizers, a Government of India Public Undertaking for the supply of gypsum of minimum of 83.5 per cent quality. Under the lease, the assessee was conferred the liberties and powers to enter upon the entire leased land and to search for, win, work, get, raise, convert and carry away the gypsum for its own benefits in the most economic, convenient and beneficial manner and to treat the same by calcination and other processes. Clause 2 of Part II of the lease authorised the lessee to sink, dig, drive, quarry, make, erect, maintain and use in the said lands any borings, pits, shafts, inclines, drifts, tunnels, trenches, levels, waterways, airways and other works and to use, maintain, deepen or extend any existing works of the like nature in the demised land for the purposes of winning and mining of the mineral. Clause 3 granted liberty to erect, construct, maintain and use on or under the land any engines, machinery, plant, dressing, floors, furnaces, brick kilns, lime kilns, plaster kilns etc. Clause 4 conferred liberty on the lessee to make roads and ways and use existing roads and ways. Clause 7 granted liberty to the assessee to enter upon and use any part of parts of the surface of the said lands for the purpose of stacking, heaping or depositing thereon any produce of the mines or works carried on and any earth materials and substance dug or raised under the liberties and powers. Clause 8 conferred liberty on the lessee to enter upon and occupy any of the surface lands within the demised lands other than such as are occupied by dwelling houses or farms and the offices, gardens and yards. Clause 9 conferred power on the lessee to acquire, take up and occupy such surface lands in the demised lands as were then in the occupation of anybody other than the government on payment of compensation and rent to such occupiers, and if the lessee is unable to acquire such land from the tenants and occupiers, the government undertook to acquire such surface land for the lessee at the lessee's cost. Clause 15 of Part II conferred liberty and power on the lessee to do all things which may be necessary for winning, working, getting the said minerals and also for calcining, smelting, manufacturing, converting and making merchantable.

2**.** Part III of the lease contained restrictions and conditions to the exercise of the liberties and powers and privileges as contained in Part II of the lease. Clause 2 of Part III provided that the lessee shall not enter upon or occupy surface of any land in the occupation of any tenant or occupier without making reasonable compensation to such tenant or occupier. Clause 3 prescribed restriction on mining operation within 100 yards from any railway, reservoir, canal or other public works. It reads as under:

> 3. No mining operations or working shall be carried on or permitted to be carried on by the lessee in or under the said lands at or to any point within a distance of 100 yards from any railway, reservoir, canal or other public works or any buildings or inhabited site shown on the plan hereto annexed except with the previous permission in writing of the Minister, or some officer authorised by him in that behalf or otherwise than in accordance with such instructions, restrictions and conditions either general or special which may be attached to such permission. The said distance of 100 yards shall be measured in the case of a Railway Reservoir or canal horizontally from the outer of the bank or of outer edge of the cutting as the case may be and in the case of a building horizontally from the plinth thereof.

The above clause had been incorporated in the lease to protect the railway track and railway station which was situated within the area demised to the lessee. Clause 5 of Part VIII of the agreement stated as under:

> 5. If any underground or mineral rights in any lands or mines covered and leased to the lessee in accordance with the provisions of those presents be claimed by any ‘Jagirdar’, ‘Pattedar’, ‘Talukdar’, tenant or other person then and in all such cases the government shall upon notice from the lessee forthwith put the lessee in possession of all such lands and mines free of all costs and charges to the lessee and any compensation required to be paid to any such ‘Jagirdar’, ‘Pattedar’, ‘Talukdar’, tenant or other person claiming to have any underground or mineral rights shall be paid by the government.

3**.** The assessee company exclusively carried on the mining of gypsum in the entire area demised to it. The railway authorities extended the railway area by laying down fresh track, providing for railway siding. The railways further constructed quarters in the lease area without the permission of the assessee company. The assessee company filed a suit in civil court for ejecting the railways from the encroached area but it failed in the suit. The assessee company, thereupon, approached the Government of Rajasthan which had 45 per cent share of it and the Railway Board for negotiation to remove the railway station and track enabling the assessee to carry out the mining operation under the land occupied by the railways. Since, on research and survey the assessee company found that under the Railway Area a high quality of gypsum was available, which was required as raw material by the Sindri Fertilizers, all the four parties namely, Sindri Fertilizers, Government of Rajasthan, Railway Board and the assessee company negotiated the matter and ultimately the Railway Board agreed to shift the railway station, track and yards to another place or area offered by the assessee. Under the agreement the railway authorities agreed to shift the station and all its establishments to the alternative site offered by the assessee company and it was further agreed that all the four parties, namely, Sindri Fertilizers, Government of Rajasthan, Indian Railways and the assessee company shall equally bear the total expenses of Rs 12 lakhs incurred by the railways in shifting the railway station, yards and the quarters. Pursuant to the agreement, the assessee company paid a sum of Rs 3 lakhs as its share to the Northern Railway towards the cost of shifting of the railway station and other constructions. In addition to that the assessee company further paid a sum of Rs 7300 to the railways as compensation for the surface rights of the leased land. On the shifting of the railway track and station the assessee carried out mining in the erstwhile Railway Area and it raised gypsum to the extent of 6,30,390 tons and supplied the same to Sindri Fertilizers.

4**.** The assessee company claimed deduction of Rs 3 lakhs paid to the Northern Railway for the shifting of the railway station for the assessment year 1964-65. The Income Tax Officer rejected the assessee's claim on the ground that it was a capital expenditure. On appeal by the assessee, the Appellate Assistant Commissioner confirmed the order of the Income Tax Officer. On further appeal by the assessee the Income Tax Appellate Tribunal held that the payment of Rs 3 lakhs by the assessee company was not a capital expenditure, instead it was a revenue expenditure. On an application made by the revenue the Income Tax Appellate Tribunal referred the question as aforesaid to the High Court under Section 256 of the Income Tax Act, 1961. The High Court held that since on payment of Rs 3 lakhs to the railways the assessee acquired a new asset which was attributable to capital of enduring nature, the sum of Rs 3 lakhs was a capital expenditure and it could not be a revenue expenditure. On these findings the High Court answered the question in the negative in favour of the revenue against the assessee and it set aside the order of the Tribunal by the impugned order.

5**.** Learned counsel for the appellant contended that since the entire area had been leased out to the assessee for carrying out mining operations, the assessee had right to win the minerals which lay under the Railway Area as that land had also been demised to the assessee. Since the existence of railway station, building and yard obstructed the mining operations, the assessee paid the amount of Rs 3 lakhs for removal of the same with a view to carry on its business profitably. The assessee did not acquire any new asset, instead, it merely spent money in removing the obstruction to facilitate the mining in a profitable manner. On the other hand, learned counsel for the revenue urged that in view of the restriction imposed by clause 3 of Part III of the lease, the assessee had no right to the surface of the land occupied by the railways. The assessee acquired that right by paying Rs 3 lakhs which resulted into an enduring benefit to it. It was a capital expenditure. Both the counsel referred to a number of decisions in support of their submissions.

6**.** The question whether a particular expenditure incurred by the assessee is of capital or revenue nature is a vexed question which has always presented difficulty before the courts. There are a number of decisions of this Court and other courts formulating tests for distinguishing the capital from revenue expenditure. But the tests so laid down are not exhaustive and it is not possible to reconcile the reasons given in all of them, as each decision is founded on its own facts and circumstances. Since, in the instant case the facts are clear, it is not necessary to consider each and every case in detail or to analyse the tests laid down in various decisions. However, before we consider the facts and circumstances of the case, it is necessary to refer to some of the leading cases laying down guidelines for determining the question. In ***Assam Bengal Cement Co. Ltd.* v. *CIT*** [(1955) 1 SCR 972], this Court observed that in the great diversity of human affairs and the complicated nature of business operation, it is difficult to lay down a test which would apply to all situations. One has, therefore, to apply the criteria from the business point of view in order to determine whether on fair appreciation of the whole situation the expenditure incurred for a particular matter is of the nature of capital expenditure or a revenue expenditure. The court laid down a simple test for determining the nature of the expenditure. It observed : (SCR pp. 986-87)

> If the expenditure is made for acquiring or bringing into existence in asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure.

7**.** In ***K.T.M.T.M. Abdul Kayoom* v. *CIT*** [(1962) 44 ITR 589] this Court after considering a number of English and Indian authorities held that each case depends on its own facts, and a close similarity between one case and another is not enough, because even a single significant detail may alter the entire aspect. The court observed that what is decisive is the nature of the business, the nature of the expenditure, the nature of the right acquired, and their relation inter se, and this is the only key to resolve the issue in the light of the general principles, which are followed in such cases. In that case the assessee claimed deduction of Rs 6111 paid by it to the government as lease money for the grant of exclusive rights, liberty and authority to fish and carry away all chank shells in the sea off the coast line of a certain area specified in the lease for a period of three years. The court held that the amount of Rs 6111 was paid to obtain an enduring benefit in the shape of an exclusive right to fish; the payment was not related to the chanks, instead it was an amount spent in acquiring an asset from which it may collect its stock-in-trade. It was, therefore, an expenditure of a capital nature.

8**.** In ***Bombay Steam Navigation Co. Pvt. Ltd.* v. *CIT*** [(1965) 1 SCR 770] the assessee purchased the assets of another company for purposes of carrying on passenger and ferry services, it paid part of the consideration leaving the balance unpaid. Under the agreement of sale the assessee had to pay interest on the unpaid balance of money. The assessee claimed deduction of the amount of interest paid by it under the contract of purchase from its income. The court held that the claim for deduction of amount of interest as revenue expenditure was not admissible. The court observed that while considering the question the court should consider the nature and ordinary course of business and the object for which the expenditure is incurred. If the outgoing or expenditure is so related to the carrying on or conduct of the business, that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition for the carrying on of the business, the expenditure may be regarded as revenue expenditure. But, on the facts of the case, the court held that the assessee's claim was not admissible, as the expenditure was related to the acquisition of an asset or a right of a permanent character, the possession of which was a condition for carrying on the business.

9**.** The High Court has relied upon the decision of this Court in ***R.B. Seth Moolchand Suganchand* v. *CIT*** [(1972) 86 ITR 647] in rejecting the assessee's contention. In ***Suganchand*** case the assessee was carrying on a mining business, he had paid a sum of Rs 1,53,800 to acquire lease of certain areas of land bearing mica for a period of 20 years. Those areas had already been worked for 15 years by other lessees. The assessee had paid a sum of Rs 3200 as fee for a licence for prospecting for emerald for a period of one year. In addition to the fee, the assessee had to pay royalty on the emerald excavated and sold. The assessee claimed the expenditure of Rs 3200 paid by it as fee to the government for prospecting licence as revenue expenditure. The assessee further claimed that the appropriate part of Rs 1,53,800 paid by it as lease money was allowable as revenue expenditure. The court held that while considering the question in relation to the mining leases an empirical test is that where minerals have to be won, extracted and brought to surface by mining operations, the expenditure incurred for acquiring such a right would be of a capital nature. But, where the mineral has already been gotten and is on the surface, then the expenditure incurred for obtaining the right to acquire the raw material would be a revenue expenditure. The court held that since the payment of tender money was for acquisition of capital asset, the same could not be treated as a revenue expenditure. As regards the claim relating to the prospecting licence fee of Rs 3200 the court held that since the licence was for prospecting only and as the assessee had not started working a mine, the payment was made to the government with the object of initiating the business. The court held that even though the amount of prospecting licence fee was for a period of one year, it did not make any difference as the fee was paid to obtain a licence to investigate, search and find the mineral with the object of conducting the business, extracting ore from the earth necessary for initiating the business. The facts involved in that case are totally different from the instant case. The assessee in the instant case never claimed any deduction with regard to the licence fee or royalty paid by it, instead, the claim relates to the amount spent on the removal of a restriction which obstructed the carrying of the business of mining within a particular area in respect of which the assessee had already acquired mining rights. The payment of Rs 3 lakhs for shifting of the railway track and railway station was not made for initiating the business of mining operations or for acquiring any right, instead the payment was made to remove obstruction to facilitate the business of mining. The principles laid down in ***Suganchand*** case do not apply to the instant case.

10**.** In ***British Insulated and Helsby Cables Ltd.*** **v.** ***Atherton*** [1926 AC 205], Lord Cave laid down a test which has almost universally been accepted. Lord Cave observed:

> (W)hen an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

This dictum has been followed and approved by this Court in the cases of ***Assam Bengal Cement Co. Ltd., Abdul Kayoom*** and ***Seth Suganchand*** and several other decisions of this Court. But, the test laid down by Lord Cave has been explained in a number of cases which show that the tests for considering the expenditure for the purposes of bringing into existence, as an asset or an advantage for the enduring benefit of a trade is not always true and perhaps Lord Cave himself had in mind that the test of enduring benefit of a trade would be a good test in the absence of special circumstances leading to an opposite conclusion. Therefore, the test laid down by Lord Cave was not a conclusive one as Lord Cave himself did not regard his test as a conclusive one and he recognised that special circumstances might very well lead to an opposite conclusion.

11**.** In ***Gotan Lime Syndicate* v. *CIT*** [(1966) 59 ITR 718] the assessee which carried on the business of manufacturing lime from limestone, was granted the right to excavate limestone in certain areas under a lease. Under the lease the assessee had to pay royalty of Rs 96,000 per annum. The assessee claimed the payment of Rs 96,000 to the government as a revenue expenditure. This Court after considering its earlier decision in ***Abdul Kayoom*** case and also the decision of Lord Cave in ***British Insulated*** held that the royalty paid by the assessee has to be allowed as revenue expenditure as it had relation to the raw materials to be excavated and extracted. The court observed that the royalty payment including the dead rent had relation to the lime deposits. The court observed although the assessee did derive an advantage and further even though the advantage lasted at least for a period of five years there was no payment made once for all. No lump sum payment was ever settled, instead, only an annual royalty and dead rent was paid. The court held that the royalty was not a direct payment for securing an enduring benefit, instead it had relation to the raw materials to be obtained. In this decision expenditure for securing an advantage which was to last at least for a period of five years was not treated to have enduring benefit. In ***M.A. Jabbar* v. *CIT*** [(1968) 2 SCR 413], the assessee was carrying on the business of supplying lime and sand, and for the purposes of acquiring sand he had obtained a lease of a river bed from the State Government for a period of 11 months. Under the lease he had to pay large amount of lease money for the grant of an exclusive right to carry away sand within, under or upon the land. The assessee in proceedings for assessment of income tax claimed deduction with regard to the amount paid as lease money. The court held that the expenditure incurred by the assessee was not related to the acquisition of an asset or a right of permanent character instead the expenditure was for a specific object of enabling the assessee to remove the sand lying on the surface of the land which was stock-in-trade of the business, therefore, the expenditure was a revenue expenditure.

12**.** Whether payments made by an assessee for removal of any restriction or obstacle to its business would be in the nature of capital or revenue expenditure, has been considered by courts. In ***Commissioner of Inland Revenue* v. *Carron Company*** [(1966-69) 45 Tax Cas 18] the assessee carried on the business of iron founders which was incorporated by a Charter granted to it in 1773. By passage of time many of its features had become archaic and unsuited to modern conditions and the company's commercial performance was suffering a progressive decline. The Charter of the company placed restriction on the company's borrowing powers and it placed restriction on voting rights of certain members. The company decided to petition for a supplementary Charter providing for the vesting of the management in Board of Directors and for the removal of the limitation on company's borrowing powers and restrictions on the issue and transfer of shares. The company's petition was contested by dissenting shareholders in court. The company settled the litigation under which it had to pay the cost of legal action and buy out the holdings of the dissenting shareholders and in pursuance thereof a supplementary Charter was granted. In assessment proceedings, the company claimed deduction of payments made by it towards the cost of obtaining the Charter, the amounts paid to the dissenting shareholders and expenses in the action. The Special Commissioner held that the company was entitled to the deductions. On appeal the House of Lords held that since the object of the new

Charter was to remove obstacle to profitable trading, and the engagement of a competent Manager and the removal of restrictions on borrowing facilitated the day-to-day trading operation of the company, the expenditure was on income account. The House of Lords considered the test laid down by Lord Cave L.C. in ***British Insulated Company*** case and held that the payments made by the company, were for the purpose of removing of disability of the company's trading operation which prejudiced its operation. This was achieved without acquisition of any tangible or intangible asset or without creation of any new branch of trading activity. From a commercial and business point of view nothing in the nature of additional fixed capital was thereby achieved. The court pointed out that there is a sharp distinction between the removal of a disability on one hand payment for which is a revenue payment, and the bringing into existence of an advantage, payment for which may be a capital payment. Since, in the case before the court, the company had made payments for removal of disabilities which confined their business under the out of date Charter of 1773, the expenditure was on revenue account. In ***Empire Jute Company*** **v.** ***CIT*** [(1980) 124 ITR 1], this Court held that expenditure made by an assessee for the purpose of removing the restriction on the number of working hours with a view to increase its profits, was in the nature of revenue expenditure. The court observed that if the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account even though the advantage may endure for an indefinite future. We agree with the view taken in the aforesaid two decisions. In our opinion where the assessee has an existing right to carry on a business, any expenditure made by it during the course of business for the purpose of removal of any restriction or obstruction or disability would be on revenue account, provided the expenditure does not acquire any capital asset. Payments made for removal of restriction, obstruction or disability may result in acquiring benefits to the business, but that by itself would not acquire any capital asset.

13**.** In the instant case the assessee had been granted mining lease in respect of 4.27 square miles at Jamsar under which he had right to sink, dig, drive, quarry and extract mineral i.e. the gypsum and in that process he had right to dig the surface of the entire area leased out to him. Clause 3 of Part III of the lease, however, placed a restriction on his right to mining operations from the Railway Area, but that area could also be operated by it for mining purposes with the permission of the authorities. The assessee had under the lease acquired full right to carry on mining operations in the entire area including the Railway Area. Under clause 3 he could carry on mining operations only after obtaining the permission of the authorities which had been granted by the railway authorities. The payment of Rs 3 lakhs was not made by the assessee for the grant of permission to carry on mining operations within the Railway Area, instead the payment was made towards the cost of removing the construction which obstructed the mining operations. The presence of the railway station and railway track was operating as an obstacle to the assessee's business of mining, the assessee made the payment to remove that obstruction to facilitate the mining operations. On the payment made to the railway authorities the assessee did not acquire any fresh right to any mineral nor he acquired any capital asset instead the payment was made by it for shifting the railway station and track which operated as hindrance and obstruction to the business or mining in a profitable manner. The assessee had already paid tender money, licence fee and other charges for securing the right of mining in respect of the entire area of 4.27 square miles including the right to the minerals under the Railway Area. The High Court has held that on payment of Rs 3 lakhs, the assessee acquired capital asset of an enduring nature. The High Court failed to appreciate that clause 3 was only restrictive in nature, it did not destroy the assessee's right to the minerals found under the Railway Area. The restriction operated as an obstacle to the assessee's right to carry on business in a profitable manner. The assessee paid a sum of Rs 3 lakhs towards the cost of removal of the obstructions which enabled the assessee to carry on its business of mining in an area which had already been leased out to it for that purpose. There was, therefore, no acquisition of any capital asset. There is no dispute that the assessee completed mining operations on the released land (Railway Area) within a period of 2 years, in the circumstances the High Court's view that the benefit acquired by the assessee on the payment of the disputed amount was a benefit of an enduring nature is not sustainable in law. As already observed, there may be circumstances where expenditure, even if incurred for obtaining advantage of enduring benefit may not amount to acquisition of asset. The facts of each case have to be borne in mind in considering the question having regard to the nature of business its requirement and the nature of the advantage in commercial sense.

14**.** In considering the cases of mining business the nature of the lease the purpose for which expenditure is made, its relation to the carrying on of the business in a profitable manner should be considered. In the instant case existence of railway station, yard and buildings on the surface of the demised land operated as an obstruction to the assessee's business of mining. The railway authorities agreed to shift the railway establishment to facilitate the assessee to carry on his business in a profitable manner and for that purpose the assessee paid a sum of Rs 3 lakhs towards the cost of shifting the railway construction. The payment made by the assessee was for removal of disability and obstacle and it did not bring into existence any advantage of an enduring nature. The Tribunal rightly allowed the expenditure on revenue account. The High Court in our opinion failed to appreciate the true nature of the expenditure.

15**.** We are, therefore, of the opinion that the High Court committed error in interfering with the findings recorded by the Income Tax Appellate Tribunal. We, accordingly, allow the appeal, set aside the order of the High Court and restore the order of the Tribunal.

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C.I.T. v. *General Insurance Corporation*

2007 (1) SCJ 800

ASHOK BHAN, J. The question which arises for consideration in this appeal is, as to whether the expenditure incurred in connection with the issuance of bonus shares is a capital expenditure or revenue expenditure. The question of law framed in the High Court was:

> (*i*) Whether on the facts and in the circumstances of the case and in law the Tribunal was right in holding that the expenditure incurred on account of share issue is allowable expenditure?

2. The assessee is an Insurance Company which has four subsidiaries. For Assessment Year 1991-92 the assessee filed a return of income of Rs. 58,52,80,850 along with the audit report. The assessing officer disallowed a few expenses incurred as revenue expenditure, one of them being in the sum of Rs. 1,04,28,500 incurred towards the stamp duty and registration fees paid in connection with the increase in authorised share capital. The respondent assessee had during the accounting year, incurred expenditure separately for: (*i*) the increase of its authorised share capital, and (*ii*) the issue of bonus shares.

3. The assessing officer disallowed both the items of expenditure as revenue expenditure. According to him, the expenses incurred were towards a capital asset of a durable nature for the acquisition of a capital asset and, therefore, the expenses could only be attributable towards the capital expenditure.

4. The assessee being aggrieved filed an appeal under Section 143(3) before CIT (Appeals). Disallowance of Rs 1,04,28,500 in respect of stamp duty and registration fees incurred in connection with the increase in the authorised share capital were bifurcated by CIT (Appeals) into two categories, one relating to the increase in authorised share capital from Rs 75 crores to Rs 250 crores and second relating to issue of bonus shares. In respect of the first category of expenditure it was held that the same was not allowable in terms of the judgments of the Bombay High Court in ***Bombay Burmah Trading Corpn. Ltd.*** **v.** ***CIT*** [(1984) 145 ITR 793 (Bom)] and ***Richardson Hindustan Ltd.*** **v.** ***CIT*** [(1988) 169 ITR 516 (Bom)]. The expenditure falling under second category was allowed as revenue expenditure being directly covered by the decision in ***Bombay Burmah Trading Corpn***. case.

5. The Revenue being aggrieved challenged the order passed by CIT (Appeals) before the Income Tax Appellate Tribunal. The Tribunal upheld the decision of CIT (Appeals) treating the expenses incurred towards the issue of bonus shares as revenue expenditure by observing inter alia as under:

> "We have carefully considered the rival submissions. The basis for the judgment by the Hon'ble Supreme Court in ***Brooke Bond India Ltd.*** **v.** ***CIT*** [(1997) 10 SCC 362] has been that the expenditure was connected with the expansion of the capital base of the Company and therefore such expenditure was capital expenditure. However, in the case of issue of bonus shares there does not take place an expansion of the capital base of the Company but only reallocation of the existing funds. We, therefore, hold that the learned CIT (Appeals) rightly decided this issue in favour of the assessee. This ground of appeal is therefore rejected."

6. The Revenue thereafter filed an appeal under Section 260-A of the Income Tax Act before the High Court of Bombay, raising two questions of law. The High Court in its judgment has affirmed the Tribunal's judgment by following its earlier decision in ***Bombay Burmah Trading Corpn***. This Court granted leave qua the question of law as reproduced in para 1 of this judgment.

7. On the question, as to whether the expenses incurred in connection with the issue of bonus shares is a revenue expenditure or a capital expenditure, there is a conflict of opinion between the High Courts of Bombay and Calcutta on the one hand and Gujarat and Andhra Pradesh on the other. The Bombay and the Calcutta High Courts have taken the view that the expenses incurred in connection with the issue of bonus shares is a revenue expenditure whereas the Gujarat and the Andhra Pradesh High Courts have taken the view that the expenses incurred in connection with the bonus shares is in the nature of capital expenditure.

8. Learned counsel for the appellant relying upon the judgments of the Gujarat High Court in ***Ahmedabad Mfg. and Calico (P) Ltd.* v. *CIT*** [(1986) 162 ITR 800 (Guj)], ***CIT* v. *Mihir Textiles Ltd***. [(1994) 206 ITR 112 (Guj)], ***Gujarat Steel Tubes Ltd.* v. *CIT*** [(1994) 210 ITR 358 (Guj)], ***CIT* v. *Ajit Mills Ltd***. [(1994) 210 ITR 658 (Guj)] and the two judgments of the Andhra Pradesh High Court in ***Vazir Sultan Tobacco Co. Ltd.* v. *CIT*** [(1990) 184 ITR 70 (AP)] and ***Vazir Sultan Tobacco Co. Ltd.* v. *CIT*** [(1988) 174 ITR 689 (AP)] wherein it has been held that the issuance of bonus shares increases the issued and paid-up capital of the company and the bonus shares of the company are directly connected with the acquisition of capital and an advantage of enduring nature. CONTENDS that the expenses incurred towards issue of bonus shares confer an enduring benefit to the company which has a resultant impact on the capital structure of the company and, therefore, it should be regarded as the capital expenditure. Reliance has also been placed upon the judgments of this Court in ***Punjab State Industrial Development Corpn. Ltd.* v. *CIT*** [(1997) 10 SCC 184] and ***Brooke Bond India Ltd.* v. *CIT***. He also relied upon ***CIT* v. *Motor Industries Co. Ltd. (No. 2)*** [(1998) 229 ITR 137 (Kant)] of the Karnataka High Court and ***CIT* v. *Ajit Mills Ltd., Gujarat Steel Tubes Ltd.* v. *CIT*** of the Gujarat High Court and ***Union Carbide India Ltd.* v. *CIT*** [(1993) 203 ITR 584 (Cal)] of the Calcutta High Court.

9. As against this, learned Senior Counsel appearing for the respondent contends that undoubtedly increase in share capital *by the issue of fresh shares* leads to an inflow of fresh funds into the company which expands or adds to its capital employed resulting in expansion of its profit-making apparatus, but *the issue of bonus shares* by capitalisation of reserves is merely a reallocation of a company's funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same. The issue of bonus shares leaves the capital employed unchanged and, therefore, does not result in conferring an enduring benefit to the company and the same has to be regarded as revenue expenditure. He has relied upon the judgment of this Court in ***CIT* v. *Dalmia Investment Co. Ltd***. [AIR 1964 SC 1464], ***Bombay Burmah Trading Corpn. Ltd.* v. *CIT, Richardson Hindustan Ltd.* v. *CIT*** and the subsequent judgments of the same Court taking the same view and the judgment of the Calcutta High Court in ***Wood Craft Products Ltd.* v. *CIT*** [(1993) 204 ITR 545 (Cal)].

10. We may at the outset indicate that this Court has laid down the test for determining whether a particular expenditure is revenue or capital expenditure in ***Empire Jute Co. Ltd.* v. *CIT*** [(1980) 4 SCC 25].

11. In short, what has been held in this case is that if the expenditure is made once and for all with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade then there is a good reason for treating such an expenditure as properly attributable not to revenue but to capital. This is so, in the absence of special circumstances leading to an opposite conclusion.

12. Decisions of this Court in ***Punjab State Industrial Development Corpn. Ltd***. and ***Brooke Bond India Ltd***. and ***CIT* v. *Motor Industries Co. Ltd. (No. 2)*** of the Karnataka High Court, ***CIT* v. *Ajit Mills Ltd., Gujarat Steel Tubes Ltd.* v. *CIT*** and ***Union Carbide India Ltd.* v. *CIT*** of the Calcutta High Court are of not much assistance to us. All these cases relate to the issue of fresh shares which lead to an inflow of fresh funds into the company which expands or adds to its capital employed in the company resulting in the expansion of its profit-making apparatus. Expenditure incurred for the purpose of increasing company's share capital by the issue of fresh shares would certainly be a capital expenditure as has been held by this Court in the cases cited above.

13. Effect of issuance of bonus share has been explained by this Court in ***Dalmia Investment Co. Ltd***. where the question of valuation of bonus share was considered. After quoting the decision in ***Eisner* v. *Macomber***, [252 US 189 : 64 L Ed 521 (1920)] of the Supreme Court of United States of America, Hidayatullah, J. explained the consequences of issue of bonus shares by observing thus: (ITR p. 579)

> "In other words, by the issue of bonus shares pro rata, which ranked pari passu with the existing shares, the market price was exactly halved, and divided between the old and the bonus shares. This will ordinarily be the case but not when the shares do not rank pari passu and we shall deal with that case separately. When the shares rank pari passu the result may be stated by saying that what the shareholder held as a whole rupee coin is held by him, after the issue of bonus shares, in two 50 np. coins. The total value remains the same, but the evidence of that value is not in one certificate but in two."

14. It was further observed at ITR pp. 577-78:

> "It follows that though profits are profits in the hands of the company, when they are disposed of by converting them into capital instead of paying them over to the shareholders, no income can be said to accrue to the shareholder because the new shares confer a title to a larger proportion of the surplus assets at a general distribution. *The floating capital used in the company which formerly consisted of subscribed capital and the reserves now becomes the subscribed capital*."

15. The Gujarat High Court in ***Ahmedabad Mfg. and Calico (P) Ltd.* v. *CIT*** has held, that the expenses incurred towards the issuance of bonus shares is a capital expenditure. Bonus shares issued by the assessee company also constitute its capital. Bonus shares, as rights shares are an integral part of the permanent structure of the company and are not in any way connected with the working capital of the company which is utilised to carry on day-to-day operations of the business. Negativing the contention of the assessee that no benefit whatsoever is derived by

the assessee company when its profits and/or reserves are converted into paid-up shares, it was held that as a result of the increase in the paid-up share capital the creditworthiness of the assessee company would increase which would be a benefit or advantage of enduring nature. That the bonus shares are an integral part of the permanent structure of the assessee company. The bonus shares are not different from rights shares as, according to it, in the case of bonus shares a bonus is first paid to the shareholders who pay it back to the company to get their bonus shares. This reasoning of the Gujarat High Court was evident from the following extracts from its judgment at ITR p. 808:

> "It is clear that when bonus shares are issued, two things take place: (*i*) bonus is paid to the shareholders; and (*ii*) wholly or partly paid-up shares are issued against the bonus payable to the shareholders. The shareholders invest the bonus paid to them in the shares and that is how the bonus shares are issued to them.
>
> In our opinion, therefore, it would not make any difference whether paid-up share capital is augmented by issuance of right shares or bonus shares to the shareholders. … As already pointed out above, bonus shares are not different from rights shares."

16. The above observation is completely contrary to the observation of this Court in ***Dalmia Investment Co. Ltd***. which judgment had not been referred to by the Gujarat High Court. In ***Dalmia Investment Co. Ltd***. this Court has held that floating capital used in the company which formerly consisted of subscribed capital and the reserves now becomes the subscribed capital. The conversion of the reserves into capital did not involve the release of the profits to the shareholder; the money remains where it was, that is to say, employed in the business. In the face of these observations the reasoning given by the Gujarat High Court cannot be upheld.

17. We do not agree with the view taken by the Gujarat High Court that increase in the paid-up share capital by issuing bonus shares may increase the creditworthiness of the company but that does not mean that increase in the creditworthiness would be a benefit or advantage of enduring nature resulting in creating a capital asset.

18. The Andhra Pradesh High Court has in ***Vazir Sultan Tobacco Co. Ltd.* v. *CIT*** taken the view that the expenditure incurred on the issue of bonus shares was capital in nature because the issue of bonus shares led to an increase in the company's capital base.

19. The observations and conclusions are erroneous as they run contrary to the observation made by this Court in ***Dalmia Investment Co. Ltd***. The capital base of the company prior to or after the issuance of bonus shares remains unchanged.

20. Issuance of bonus shares does not result in any inflow of fresh funds or increase in the capital employed, the capital employed remains the same. Issuance of bonus shares by capitalisation of reserves is merely a reallocation of the company's fund. This is illustrated by the following hypothetical tabulation which establishes that bonus shares leaves the capital employed untouched, because in the hypothetical example, the capital employed remains the same (i.e. Rs. 600) both pre and post issuance of bonus shares:

S. No.	Particulars	Pre-Bonus Issue	On Bonus Issue	Post Bonus Shares

		Rs.	Rs.	Rs.
1.	Pre-paid share capital	100	100+100 = 200	200
2.	Reserve	500	500-100=400	400
	Total	600	600	600

21. As observed earlier, the issue of bonus shares by capitalisation of reserves is merely a reallocation of the company's funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same. If that be so, then it cannot be held that the company has acquired a benefit or advantage of enduring nature. The total funds available with the company will remain the same and the issue of bonus shares will not result in any change in the capital structure of the company. Issue of bonus shares does not result in the expansion of capital base of the company.

22. The case ***Wood Craft Products Ltd.*** of the Calcutta High Court is similar to the case of the respondent. In that case as well there was increase of authorised share capital by the issue of fresh shares and a separate issue of bonus shares. The Calcutta High Court drew a distinction between the raising of fresh capital and the issue of bonus shares and held that expenditure on the former was capital in nature as it changed the capital base. On the other hand, in the case of bonus shares, was held to be revenue expenditure following the decision of the Supreme Court in ***Dalmia Investment Co. Ltd***. on the ground that there was no change in the capital structure at all.

23. In our considered opinion, the view taken by the Bombay and the Calcutta High Courts is correct to the effect that the expenditure on issuance of bonus shares is revenue expenditure. The contrary judgments of the Gujarat and the Andhra Pradesh High Courts are erroneous and do not lay down the correct law.

24. For the reasons stated above, the question referred to us, is answered in the affirmative i.e. in favour of the assessee and against the Revenue.

* * * * *

N. Bagavathy Ammal v. *C.I.T.*

JT 2003(1) SC 363

RUMA PAL, J. - The question to be decided in these appeals is whether the word 'assets' in section 46(2) of the Income Tax Act, 1961 must be understood and construed according to the definition of the word 'capital assets' in section 2(14) of the Act.

2. The issue arises in respect of the assessment year 1970-71. The appellants in the two appeals which are disposed of by this judgment are sisters. They were share holders in M/s. Palkulam Estate (Private) Ltd., Nagercoil. The company went into liquidation in 1964. Pursuant to a compromise decree dated 22nd December 1969 in litigation between the assessees and their brother (who was also a share holder in the company), and the company represented by the liquidator, the assets of the company which included agricultural lands were distributed to the appellants and eight others. The compromise decree stated:

This Court further order and decree that as far as liabilities of Palkulam Estate Private Limited is concerned, the immovable properties be and hereby are distributed as indicated in schedule 'A' of the compromise. The respondents 1 to 5 and respondents 9 and 11 do get leased portions as shown in the plans, signed by liquidator Mr. K.M. Boothalingam Pillai and handed over to the appellant this day.

3. The appellants thereby received 479.89 acres of the agricultural lands prior to the end of the relevant accounting year that was 31.3.70. The assessment in respect of the year 1970-71 had been completed on 27.2.71. The Income Tax Officer reopened the assessments under section 148 of the Act. The appellants filed their returns in respect of the two notices under section 148. The contention of the appellants that in terms of the definition of 'assets' in section 2(14), agricultural lands were entitled to be excluded while computing capital gains on assets received by the shareholder from a company in liquidation under section 46(2) was not accepted. According to the assessing officer, section 46(2) refers only to money received on liquidation or the market value of the assets on the date of distribution and it was immaterial whether the asset was agricultural lands or otherwise. The value of the share of agricultural lands transferred to each appellant was, therefore, included as income subject to capital gains and subjected to tax. The assessees' appeals before the Commissioner of Income Tax (Appeals) were allowed by holding that the scope of section 46(2) would have to be read in the light of the definition of the word 'capital asset' in section 2(14) and that "having exempted agricultural lands from capital gains under the general provision, it was difficult to interpret section 46(2) as including agricultural land." The action of the Income Tax Officer in charging the income of the distribution of agricultural lands as capital gains under section 46(2) of the Act was accordingly set aside.

4. The revenue appealed before the tribunal. The tribunal dismissing the revenue's appeal held:

> On a combined reading of section 45, 46(2) and 48 it will be clear, according to our opinion, that assets mentioned in section 46(2) would mean capital assets. In as much as section 47(viii) exempts transfer of agricultural land from capital gain tax under section 45, we agree with the Commissioner of Income Tax (Appeals) in coming to the conclusion that

it is difficult to interpret section 46(2) as including agricultural lands which is outside the scope of the Income Tax.

5. Of the two questions referred to the High Court by the tribunal under section 256(1) at the instance of the revenue only one survives for our decision. The second question was not pressed before the High Court. The first question which was:

> Whether on the facts and in the circumstances of the case, the appellate tribunal is right in law in holding that the assets mentioned in section 46(2) would mean 'capital asset' as defined in section 2(14) and that consequently, the value of agricultural lands received by the assessee on the liquidation of Palkulam Estate (P) Ltd. cannot be charged to be tax under section 46(2) of the Income Tax Act, 1961?

was answered by the High Court against the assessees and in favour of the revenue. The High Court construed the provisions of section 46(2) and held, reversing the decision of the CIT(A) and the tribunal, that the definition of 'capital assets' under section 2(14) of the Act is not of any relevance for the purpose of construing section 46(2) of the Act, and the fact that agricultural lands to the extent provided in section 2(14)(c) of the Act are excluded from the definition did not have any impact on the taxability of the market value of the agricultural land received by the assessee on the distribution of the assets of a company in liquidation.

6. Before considering the correctness of the decision of the High Court the context in which section 46(2) came to be part of the Act needs to be considered.

7. Section 12-B of the Income Tax Act, 1922 provided for payment of tax under capital gains "in respect of any profits or gains whatsoever from the sale, exchange, relinquishment or transfer of a capital asset effected after 31st day of March 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place." Construing section 12-B of the Income Tax Act, 1922, this Court in ***Commissioner of Income Tax, Madras* v. *Madurai Mills Co. Ltd*.** [1973 (89) ITR 45] had held that when a shareholder receives money representing his share on distribution of the net assets of the company in liquidation, he receives that money in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to sale, exchange, relinquishment or transfer within the meaning of section 12-B of the Act.

8. Section 45(1) of the 1961 Act which substantially corresponds with section 12-B of the 1922 Act continues to provide that:

> Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as the otherwise provided in sections 54, 54B, 54D, 54EA, 54EB, 54F, 54G and 54H be chargeable to income tax under the head 'capital gains,' and shall be deemed to be the income of the previous year in which the transfer took place.

9. The words 'capital assets' has been defined in section 2(14) of the Act which as it stood at the relevant time, that is prior to its amendment in 1972, provided:

2. In this Act, unless the context otherwise requires * * * * *

(14) 'Capital assets' means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include

(iii) agricultural land in India.

10. It has been held by this Court that the principle of ***Madurai Mills*** that a distribution of assets of a company in liquidation does not amount to a transfer continues to apply to the 1961 Act.

11. The view in ***Madurai Mills Co. Ltd***. has also been statutorily affirmed in Section 46(1) which provides:

46.(1) Notwithstanding anything contained in section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45.

12. In other words a distinction is drawn between a "transfer" of assets and a distribution of assets of the company on liquidation. Where there is "transfer" of assets and not a "distribution" on liquidation then having regard to section 47(viii) which provides that:

"Nothing contained in section 45 shall apply to the following transfers:

(viii) any transfer of agricultural land in India effected before the 1st day of March 1970"

it may have been argued at least on behalf of the company that the 'transfer' having been concluded in 1969 was exempt from capital gains. This argument, however, is not available to the shareholders who receive assets from the company on distribution consequent upon liquidation because of section 46(2) which was introduced to make the receipts of assets from a company liquidation by its share holders a taxable event for the first time. Section 46(2) provides:

> 46(2). Where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income tax under the head 'capital gains' in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of sub-clause (c) of clause (22) of section 2 and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

13. The question is does the words 'assets' in section 46(2) mean 'capital assets' as defined in section 2(14) of the Act? If it does then, it is conceded by the revenue, there is no question of subjecting the agricultural lands received by the assessees from the company in liquidation to capital gains.

14. Indisputably, the object in introducing section 46(2) was to overcome the reasoning in ***Madurai Mills*** by broadening the base of the incidence of capital gains and expressly providing for receipt of assets of a company in liquidation by a shareholder as a taxable event.

15. Section 46(2) is in terms of an independent charging section. It also provides for a distinct method of calculation of capital gains. As said in ***C.I.T.* v. *R.M. Amin*:**

The aforesaid section, in our view, was enacted both with a view to make shareholders liable for payment of tax on capital gains as well as to prescribe the mode of calculating the capital gains to the shareholders on the distribution of assets by a company in liquidation. But for that sub-section as already mentioned, it would have been difficult to levy tax on capital gains to the shareholders on distribution of assets by a company in liquidation.

16. The section does not make any reference to capital assets either in connection with the imposition of capital gains tax nor its computation.

17. Having referred to 'capital asset' in section 45(1), 47 and 48, parliament appears to have deliberately chosen to use the word 'asset' in section 46(1) and (2), the ostensible intention being to bring assets of all kinds within the scope of the charge. It is not necessary to refer to a dictionary to hold that capital assets are a species of the genus 'assets.' If the words 'capital assets' and 'assets' as used in sections 45(1) and 46 respectively did not overlap then there was no need to provide for a non obstante clause in section 46(1) with reference to section 45. As correctly held by the High Court, agricultural land would have been a 'capital asset' but for the exclusion from the definition of 'capital asset' and what is not a capital asset may yet be an asset for the purposes of section 46(2).

18. Therefore, to the extent that a shareholder assessee receives assets whether capital or any other from the company in liquidation, the assessee is liable to pay tax on the market value of the assets as on the date of the distribution as provided under section 46(2). That appears to be the plain meaning of the section and we see no reason to construe it in any other fashion. The invocation of section 2(14) of the Act which defines "capital asset" is as such unnecessary for the purpose of construing section 46(2).

19. We accordingly dismiss the appeals without any order as to costs.

* * * * *

C.I.T. v. *Rajendra Prasad Moody*

(1978) 115 I.T.R. 519 (SC)

P.N. BHAGWATI, J. – These are two references made by the Tribunal to this court under s. 256 of the I.T. Act, 1961 in view of a conflict in the decisions of the High Courts on the question as to whether interest on moneys borrowed for investment in shares is allowable expenditure under s. 57(iii) when the shares have not yielded any return in the shape of dividend during the relevant assessment year. The preponderance of judicial opinion is in favour of the view that such interest is admissible, even though no dividend is received on the shares, but there are two High Courts which have taken a different view and hence it is necessary for this court to set the controversy at rest by finally deciding the question. It would be sufficient to state that the assessees in these two references are brothers and each of them had borrowed monies for the purpose of making investment in shares of certain companies and during the assessment year 1965-66 for which the relevant accounting year ended on 10th April 1965, each of the two assessees paid interest on the monies borrowed but did not receive any dividend on the shares purchased with those monies. Each of the two assessees made a claim for deduction of the amount of interest paid on the borrowed monies but this claim was negatived by the ITO and on appeal by the AAC on the ground that during the relevant assessment year the shares did not yield any dividend and, therefore, interest paid on the borrowed monies could not be regarded as expenditure laid out or expended wholly and exclusively for the purpose of making or earning income chargeable under the head "Income from other sources" so as to be allowable as a permissible deduction under s. 57(iii). The Tribunal, however, on further appeal, disagreed with the view taken by the taxing authorities and upheld the claim of each of the two assessees for deduction under s. 57(iii). The revenue being aggrieved by the decision of the Tribunal made an application in each case for reference of the following question of law, namely:

> Whether, on the facts and in the circumstances of the case, interest on money borrowed for investment in shares which had not yielded any dividend is admissible under s. 57(iii)?

And since there was divergence of judicial opinion on this question, the Tribunal referred it directly for the opinion of this court.

The determination of the question before us turns on the true interpretation of s. 57(iii) and it would, therefore, be convenient to refer to that section, but before we do so, we may point out that s. 57(iii) occurs in a fasciculus of sections under the heading, "F – Income from other sources." S. 56, which is the first in this group of sections, enacts in sub-s. (1) that income of every kind which is not chargeable to tax under any of the heads specified in s. 14, Item A to E, shall be chargeable to tax under the head "Income from other sources" and sub-s. (2) includes in such income various items, one of which is "dividends." Dividend on shares is thus income chargeable under the head "Income from other sources." S. 57 provides for certain deductions to be made in computing the income chargeable under the head "Income from other sources" and one of such deductions is that set out in cl. (iii), which reads as follows:

> Any other expenditure (not being in the nature of capital expenditure) laid out or expended, wholly and exclusively for the purpose of making or earning such income.

The expenditure to be deductible under s. 57(iii) must be laid out or expended wholly and exclusively for the purpose of making or earning such income. The argument of the revenue was that unless the expenditure sought to be deducted resulted in the making or earning of income, it could not be said to be laid out or expended for the purpose of making or earning such income. The making or earning of income, said the revenue, was a *sine qua non* to the admissibility of the expenditure under s. 57(iii) and, therefore, if in a particular assessment year there was no income, the expenditure would not be deductible under that section. The revenue relied strongly on the language of s. 37(1) and, contrasting the phraseology employed in s. 57(iii) with that in s. 37(1), pointed out that the legislature had deliberately used words of narrower import in granting the deduction under s. 57(iii). S. 37(1) provided for deduction of expenditure laid out or expended wholly and exclusively for the purpose of the business or profession in computing the income chargeable under the head “Profits or gains of business or profession.” The language used in s. 37(1) was “laid out or expended – for purpose of the business or profession” and not “laid out or expended – for the purpose of making or earning such income” as set out in s. 57(iii). The words in s. 57(iii) being narrower, contended the revenue, they cannot be given the same wide meaning as the words in s. 37(1) and hence no deduction of expenditure could be claimed under s. 57(iii) unless it was productive of income in the assessment year in question. This contention of the revenue undoubtedly found favour with the High Court but we do not think we can accept it. Our reasons for saying so are as follows:

What s. 57(iii) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. It is the purpose of the expenditure that is relevant in determining the applicability of s. 57(iii) and that purpose must be making or earning of income. S. 57(iii) does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction. It does not say that the expenditure shall be deductible only if any income is made or earned. There is in fact nothing in the language of s. 57(iii) to suggest that the purpose for which the expenditure is made should fructify into any benefit by way of return in the shape of income.The plain natural construction of the language of s. 57(iii) irresistibly leads to the conclusion that to bring a case within the section, it is not necessary that any income should in fact have been earned as a result of expenditure. It may be pointed out that an identical view was taken by this Court in ***Eastern Investments Ltd.* v. *CIT*** [(1951) 20 ITR 1, 4 (SC)], where interpreting the corresponding provision in s. 12(2) of the Indian I.T. Act, 1922, which was *ipsissima verba* in the same terms as s. 57(iii), Bose J., speaking on behalf of the court, observed:

> It is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned.

It is indeed difficult to see how, after this observation of the court, there can be any scope for controversy in regard to the interpretation of s. 57(iii).

It is also interesting to note that, according to the revenue, the expenditure would disqualify for deduction only if no income results from such expenditure in a particular assessment year, but if there is some income, howsoever small or meagre, the expenditure would be eligible for deduction. This means that in a case where the expenditure is Rs. 1000, if there is income of even Re. 1, the expenditure would be deductible and there would be resulting loss of Rs. 999 under the head “Income from other sources.” But if there is no income, then, on the argument of the revenue, the expenditure would have to be ignored as it would not be liable to be deducted. This would indeed be a strange and highly anomalous result and it is difficult to believe that the legislature could have ever intended to produce such illogicality. Moreover, it must be remembered that when a profit and loss account is cast in respect of any source of income, what is allowed by the statute as proper expenditure would be debited as an outgoing and income would be credited as a receipt and the resulting income or loss would be determined. It would make no difference to this process whether the expenditure is X or Y or nil; whatever is the proper expenditure allowed by the statute would be debited. Equally, it would make no difference whether there is any income and if so, what, since whatever it be, X or Y or nil, would be credited. And the ultimate income or loss would be found. We fail to appreciate how expenditure which is otherwise a proper expenditure can cease to be such merely because there is no receipt of income. Whatever is a proper outgoing by way of expenditure must be debited irrespective of whether there is receipt of income or not. That is the plain requirement of proper accounting and the interpretation of s. 57(iii) cannot be different. The deduction of the expenditure cannot, in the circumstances, be held to be conditional upon the making or earning of the income.

It is true that the language of s. 37(1) is a little wider than that of s. 57(iii), but we do not see how that can make any difference in the true interpretation of s. 57(iii). The language of s. 57(iii) is clear and unambiguous and it has to be construed according to its plain natural meaning and merely because a slightly wider phraseology is employed in another section which may take in something more, it does not mean that s. 57(iii) should be given a narrow and constricted meaning nor warranted by the language of the section and, in fact, contrary to such language.

This view which we are taking is clearly supported by the observations of Lord Thankerton in ***Hughes* v. *Bank of New Zealand*** [(1938) 6 ITR 636, 644 (HL)], where the learned Law Lord said:

> Expenditure in course of the trade which is unremunerative is none the less a proper deduction, if wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense.

This view is eminently correct as it is not only justified by the language of s. 57(iii) but it also accords with the principles of commercial accounting. The contrary view taken by the Patna High Court in ***Maharajadhiraj Sir Kameshwar Singh* v. *CIT*** [(1957) 32 ITR 377] and the Calcutta High Court in ***Sohanlal* v. *Madanlal CIT*** [(1963) 47 ITR 1] must in the circumstances be held to be incorrect. We accordingly answer the question referred to us for our opinion in each of these two references in favour of the assessee and against the revenue.

Philip John Plasket Thomas v. *C.I.T.*

(1964) 2 SCR 480

S.K. DAS, J. - These are four appeals on certificates granted by the High Court of Calcutta under Section 66-A(2) of the Indian Income Tax Act, 1922. The appeals are from the decision of the High Court dated February 28,1961 in Income Tax Reference No. 49 of 1956.

2. We may first state the relevant facts. One P.J.P. Thomas is the appellant before us. He was the assessee before the taxing authorities. He held 750 ‘A’ shares in J. Thomas & Co. Ltd., of 8 Mission Row, Calcutta. The assessee entered into an engagement to marry one Mrs Judith Knight, stated to be a divorcee, and the engagement was announced in certain newspapers on September 3, 1947. On December 10, 1947 the assessee and Mrs Knight presented to the Company an application to transfer the said 750 ‘A’ shares to Mrs Judith Knight. A transfer deed of that date stated:

> I, Philip John Plasket Thomas of 8, Mission Row, Calcutta, in consideration of my forthcoming marriage with Judith Knight of 35, Ridgeway, Kingsbury, London (hereinafter called the said transferee) do hereby transfer to the said transferee the 750 ‘A’ shares numbered 1-750 standing in my name in the books of J. Thomas & Co. Ltd. to hold to the said transferee.… Executors, administrators and assigns, subject to the several conditions on which I hold the name at the time of the execution thereof. And I the said transferee do hereby agree to take the said shares subject to the same conditions.

On December 15, 1947 the Company transferred the shares to Mrs Judith Knight and registered her as the owner of the shares. On December 18, 1947 the marriage was solemnised. On January 26, 1948 the fact of marriage was communicated to the Company and the name of the shareholder was changed in the books of the Company to Mrs Judith Thomas. It is undisputed that during the relevant periods the shares stood registered in the name of the assessee’s wife and when the income in question arose to her she was the wife of the assesee. The four accounting years with which the assessments were concerned were those ending respectively on April 30, 1948, April 30, 1949, April 30, 1950 and April 30, 1951. The four assessment years were 1949-50, 1950-51, 1951-52 and 1952-53. It appears that for the years 1949-50 and 1950-51 assessments of P.J.P. Thomas which had by then been already completed were reopened under Section 34 of the Indian Income Tax Act, 1922 and the dividends of Rs 97,091 and Rs 78,272 as grossed up and paid to Mrs Judith Thomas during the accounting years ending April 30, 1948 and April 30, 1949 were reassessed in the hands of P.J.P. Thomas. For Assessment Years 1951-52 and 1952-53, the dividends paid by the Company to Mrs Judith Thomas during the accounting periods ending April 30, 1950 and April 30, 1951 were held by the Income Tax Officer to be includible in the total income of P.J.P. Thomas under Section l6(3)(b) of the Act and accordingly orders were passed including the sums of Rs 1,00,000 and Rs 16,385 being the grossed up dividends for the two years respectively in the total income of P.J.P. Thomas.

3. Against the said assessment orders the assessee preferred appeals to the Appellate Assistant Commissioner. By a common order dated May 11, 1955 the Appellate Assistant Commissioner confirmed the orders of the Income Tax Officer holding that not only the provisions of Section 16(3)(b) but also the provisions of Section l6(3)(a)(iii) of the Act applied

in these cases. Against the order of the Appellate Assistant Commissioner the assessee preferred four appeals to the Appellate Tribunal and contended (1) that he transferred the shares to Mrs Judith Knight when she was not his wife, (2) that the transfer of shares was absolute at the time when it was made and no condition was attached to the transfer, and (3) that the transfer was for adequate consideration. On these grounds the assessee contended that the provisions of Section l6(3) of the Act were not attracted to the cases in question. The Appellate Tribunal by a consolidated order dated April 4, 1956 disagreed with the view of the Income Tax Officer and the Appellate Assistant Commissioner that the provisions of Section l6(3)(b) applied, but it held that the cases fell within Section l6(3)(a)(iii) of the Act, because the transfer became effective only after the marriage. It further held that the transfer could also be construed as a revokable transfer within the meaning of Section 16(1)(c) of the Act. Therefore the Appellate Tribunal dismissed the four appeals.

4. The assessee then made four applications for referring two questions of law arising out of the Tribunal's order to the High Court. These questions were:

> 1. In the facts and circumstances of these cases, whether the dividends paid by J. Thomas & Co. Ltd, to Mrs Judith Thomas, grossed upto the sums of Rs 97,091, Rs 78,272, Rs 1,00,000 and Rs 16,385 respectively for the four years in question could be included in the income of Mr P.J.P. Thomas and be taxed in his hands under the provisions of Section 16(3)(a)(iii) of the Indian Income Tax Act?
>
> 2. In the facts and circumstances of these cases, whether the dividends referred to above could be included in the total income of Mr P.J.P. Thomas under the provisions of Section 16(1)(c) of the Indian Income Tax Act?

The Tribunal accepted these applications and referred the aforesaid two questions to this High Court. By its decision dated February 28, 1961 the High Court answered the first question against the assessee and the second question in his favour. The assessee then moved the High Court for a certificate of fitness under Section 66-A(2) of the Act and having obtained such certificate has preferred the present appeals to this Court. The appeals relate only to the correctness or otherwise of the answer given by the High Court to the first question. As the Department has filed no appeal as to the answer given by the High Court to the second question, it is unnecessary for us to consider the correctness or otherwise of that answer.

5. The answer to the first question depends on the determination of two points: (1) what on its proper interpretation is the true scope and effect of Section l6(3)(a)(iii) of the Act, and (2) whether the transfer made by the assesses in favour of Mrs Knight took effect only from the date of the marriage between the assessee and Mrs Knight. A third point as to adequate consideration for the transfer was also gone into by the High Court, but in the view which we have taken of the first two points involved in the question it is unnecessary to decide the point of adequate consideration.

> **16.** ***Exemptions and exclusions in determining the total income*.-**
>
> (3) In computing the total income of any individual for this purpose of assessment, there shall be included.
>
> (*a*) so much of the income of a wife or minor child of such individual as arises directly or indirectly….

(*i*) from the membership of the wife in a firm of which her husband is a partner;

(*ii*) from the admission of the minor to the benefits of partnership in a firm of which such individual is a partner;

(*iii*) from assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration or in connection with an agreement, to live apart; or

(*iv*) from assets transferred directly or indirectly to the minor child, not being a married daughter, by such individual (otherwise than for adequate consideration).”

7. Sub-section (3) of Section 16 of the Act was introduced in 1937. For the purpose of its application it is immaterial whether the partnership was formed before or after 1937 and whether the transfer was effected before or after that date. However, the sub-section deals only with income arising after its introduction. It clearly aims at foiling an individual’s attempt to avoid or reduce the incidence of tax by transferring his assets to his wife or minor child, or admitting his wife as a partner or admitting his minor child to the benefits of partnership, in a firm in which such individual is a partner. It creates an artificial income and must be strictly construed [see ***Bhogilal Laherchand* v. *CIT,*** 25 ITR 523]. Clauses (a)(i) and (a)(ii) of the sub-section provide that in computing the total income of an individual there should be included the income arising directly or indirectly to his wife from her share as a partner or to his minor child from the admission to the benefits of partnership, in a firm of which such individual is a partner. We are not directly concerned with clauses (a)(i) and (a)(ii). We are concerned with clause (a)(iii). Under that clause the income arising from assets transferred by an individual to his wife has to be included in the transferor’s total income. There are two exceptions to this Rule, viz. (1) where the transfer is for adequate consideration, or (2) where it is in connection with an agreement to live apart. The second exception has no bearing on the cases before us.

8. The first and principal point which has been urged before us on behalf of the appellant is this. It is pointed out that at the time the transfer of shares was made by the assessee to Mrs Judith Knight the latter was not the wife of the former and therefore clause (a)(iii) which talks of “assets transferred directly or indirectly to the wife by the husband” has no application, apart altogether from any question of adequate consideration. This argument on behalf of the appellant was advanced before the High Court also. The High Court sought to meet it in the following way. Mukharji, J., who gave the leading judgment said that in order to determine whether particular case came under clause (a)(iii) or not, the relevant point of time was the time of computation of the total income of the individual for the purpose of assessment and the section did not limit any particular time as to when the transfer of assets should take place. He then observed:

> It appears to me that as the addition of the wife’s income to the husband’s income under this sub-section is made, the relevant time of the relationship between husband and wife which has to be considered by the taxing authorities is the time of computing of the total income of the individual for the purpose of assessment. That is how I read the opening words of Section 16(3) of the Act: ‘In computing the total income of any individual for the purpose of assessment’.”

Bose, J. expressed a slightly different view. He said that the material consideration under Section l6(3)(a)(iii) was whether the transferee was actually the wife of the assessee during the relevant accounting period when the income from the assets transferred to her accrued. In effect both the learned Judges held that for the application of clause (a)(iii) it was not necessary that the relationship of husband and wife must subsist at the time when the transfer of the assets is made; according to Mukharji, J., the crucial date to determine the relationship is the date when the taxing authorities are computing the total income of the husband and according to Bose, J., the crucial time is the time when the income accrues to the wife. It must also be stated in fairness to Mukharji, J., that he did not accept the view that the words “husband” and “wife” in clause (a)(iii) included prospective husband and prospective wife. He accepted the view that the words “husband” and “wife” must mean legal husband and legal wife. Even so, he expressed the view that on a true construction of Section l6(3)(a)(iii) the time when the relationship has to be construed is the time when the computation of the total income of the husband is made.

9. Learned counsel for the appellant has very strongly contended before us that the view expressed by the learned Judges of the High Court as to the proper interpretation of clause (a)(iii) is not correct. On a plain reading of sub-section (3) of Section l6 it seems clear to us that at the time when the income accrues, it must be the income of the wife of that individual whose total income is to be computed for the purpose of assessment: this seems to follow clearly from clause (a) of sub-section (3). Therefore in a sense it is right to say that the relationship of husband and wife must subsist at the time of the accural of the income; otherwise the income will not be the income of the wife, for the word “wife” predicates a marital relationship. The matter does not however end there. When we go to sub-clause (iii) we find that only so much of the income of the wife as arises directly or indirectly from assets transferred directly or indirectly to the wife by the husband shall be included in the total income of the husband. Therefore, sub-clause (iii) predicates a further condition, the condition being that the income must be from such assets as have been transferred directly or indirectly to the wife by the husband. This condition must be fulfilled before sub-clause (iii) is attracted to a case. It is clear that all income of the wife from all her assets is not includible in the income of the husband. Thus on a proper reading of Section 16(3)(a)(iii) it seems clear enough that the relationship of husband and wife must also subsist when the transfer of assets is made in order to fulfil the condition that the transfer is “directly or indirectly to the wife by the husband”.

10. Learned counsel for the respondent has contended before us that the transfer mentioned in Section l6(3)(a)(iii) need not necessarily be post-nuptial and he has argued that the main object of the provision is the principle of aggregation, that is, the inclusion of the income of the wife in the income of the husband, because of the influence which the husband exercises over the wife. He has also pointed out that sub-clause (i) which refers to the membership of the wife in a firm of which her husband is a partner is indicative of the object of the provision because it does not talk of any assets being brought into the firm by the wife. He has further argued than in sub-clause (i) the word “wife” is merely descriptive and means the woman referred to in clause (a) and the word “husband” has reference merely to the individual whose total income is to be computed for the purpose of assessment. In support of this argument he has relied on the expression “such individual” occurring in sub-section (3)(a). We are unable to accept these arguments as correct. It is indeed true that all the four sub-clauses of clause(a) must be harmoniously read as this court observed in ***CIT* v. *Sodra Dev*** [32 ITR 615, 623]; but we see no disharmony between sub-clause (i) and sub-clause (iii) on the interpretation which we are putting. Sub-clause (i) talks only of the membership of the wife in a firm of which her husband is a partner; it has no reference to assets at all. Sub-clause (iii) however talks of assets and

qualifies the word “assets” by the adjectival clause “transferred directly or indirectly to the wife by the husband”. We fail to see how any disharmony results from giving full effect to the adjectival clause in sub-clause (iii). Nor do we see why the words “husband” and “wife” should be taken in the archaic sense contended for by the learned counsel for the respondent.

We are dealing here with a statute and the statute must be construed in a manner which carries out the intention of the legislature. The intention of the legislature must be gathered from the words of the statute itself. If the words are unambiguous or plain, they will indicate the intention with which the statute was passed and the object to be obtained by it. There is nothing in sub-section (3) of Section 16 which would indicate that the word “wife” or the word “husband” must not be taken in their primary sense which is clearly indicative of a marital relationship. Nor are we satisfied that the object of the legislature is just the principle of aggregation. We have said earlier that sub-section (3) of Section 16 clearly aims at foiling an individual’s attempt to avoid or reduce the incidence of tax by transferring his assets to the wife or minor child or admitting his wife as a partner or admitting his minor child to the benefits of partnership, in a firm in which such individual is a partner. This object does not require that the word “wife” or the word “husband” should be interpreted in an archaic or secondary sense.

11. Learned counsel for the respondent has drawn our attention to certain English decisions, particularly the decision of the House of Lords in ***Lord Vestey’s Executors and Vestey* v. *Commissioners of Inland Revenue*** [31 Tax Cases 1]. One of the questions which was considered in that decision was whether for the purpose of either Section l8 of the Finance Act, 1936 (in England) or Section 38 of the Finance Act, 1938 (in England) “wife” included a “widow”. Their Lordships had to consider the earlier decision of the court of appeal in ***Commissioners of Inland Revenue* v. *Gaunt*** [24 Tax Cases 69] which held that the one word included the other. Their Lordships ultimately held, overruling the decision in *Gaunt case* that the word “wife” did not include a “widow”. The English decisions proceeded on the footing that in England it is a principle of income tax law, embodied in Rule 16 of the General Rules, that for income tax purposes husband and wife living together are one. Lord Morton said:

> I think that the treatment of husband and wife by the legislature for income tax purposes rests on the view that any income enjoyed by one spouse is a benefit to the other spouse. It is not surprising, therefore, that in the sections now under consideration a benefit to the wife of the settlor is treated as being a benefit to the settlor, but it seems to me unlikely that this principle is being extended by these sections to the widow of the settlor.

Now, it is quite clear to us that the treatment of husband and wife in the Indian Income Tax Act, 1922 does not rest on the view that any income enjoyed by one spouse is a benefit to the other spouse; for sub-section (3) of Section l6 makes it quite clear that all income enjoyed by the wife is not to be included in the income of the husband and only such of the wife’s income as comes within the sub-section is to be included in the income of the husband. We therefore think that the English decisions are not in point and there are no reasons why the word “wife” or the word “husband” should not be given its true natural meaning.

12. This brings us to the second question, namely, whether the transfer of shares made by the assessee in favour of Mrs Judith Knight on December 10, 1947 was to take effect only from the date of their marriage. It is admitted that on December 10, 1947 the assessee and Mrs Knight

were not married. It is also admitted that they were engaged to be married and the engagement was announced on September 3, 1947. The transfer deed which we have earlier quoted contained no words of postponement. On the contrary, it contained words which indicated that the transfer took effect immediately. Learned counsel for the respondent has rightly pointed out that the expression in the transfer deed "in consideration of my forthcoming marriage" can have very little meaning as a real consideration, because on September 3, 1947 the parties had mutually promised to marry each other; therefore the promise to marry had been made earlier than December 10, 1947. Learned counsel for the respondent has argued before us that the transfer of shares was really a gift made to Mrs Knight in contemplation of the forthcoming marriage and the gift was subject to a condition subsequent, namely, that of marriage which if not performed would put an end to the gift. This does not however advance the case of the respondent in any way. A gift may be made subject to conditions, either precedent or subsequent. A condition precedent is one to be performed before the gift takes effect; a condition subsequent is one to be performed after the gift had taken effect, and, if the condition is unfulfilled will put an end to the gift. But if the gift had already taken effect on December 10, 1947 and the condition subsequent has been later fulfilled, then the gift is effective as from December 10, 1947 when the assessee and Mrs Knight were not husband and wife. That being the position, sub-clause (iii) of Section 16(3)(a) will not be attracted to the case as the transfer of the shares was not made by the husband to his wife.

13. We were also addressed on the question as to the circumstances in which a gift to an intended wife or husband may be recovered when the marriage does not take place through the fault of either of the two parties. We do not think that that question falls for decision in the present case. From whatever point of view we look at the transfer of shares in the present case, whether it be in consideration of a promise to marry or be a gift subject to the subsequent condition of marriage, the transfer takes effect immediately and is not postponed to the date of marriage. If that be the true position, as we hold it to be, then sub-clause (*iii*) of Section l6(3)(a) is not attracted to these cases, apart altogether from any question as to whether there was adequate consideration for the transfer within the meaning of that sub-clause. For the reasons given above we allow the appeals and answer the question referred to the High Court in favour of the assessee.

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Batta Kalyani v. *Commissioner of Income Tax*

(1985)154 ITR 59

<u>ANJANEYULU, J</u>. - The following question of law has been referred this court by the Income-tax Appellate Tribunal under s. 256(1) of the I.T. Act, 1961:

> Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is justified in holding that the income of the assessee's husband is includible in the assessment of the assessee under s. 64(1)(ii) of the Act ?

2. This reference relates to the income-tax assessment year 1976-77. The assessee, Smt. Batta Kalyani, runs a hardware and paint shops. She employed her husband, B. Venkataramaiah, to manage the business and paid him salary for services rendered. There is no dispute that the business is carried on by the assessee as a sole proprietrix. The ITO included in the total income of the assessee, the salary paid by the assessee to her husband by applying the provisions of s. 64(1)(ii) of the Act.

3. The ITO held that the assessee's husband who was employed to manage the business did not possess any technical or professional qualification and the income delivered by the assessee's husband was not solely attributable to the application of the technical or professional knowledge and experience of the assessee's husband. In that view, ITO came to the conclusion that the proviso to s. 64(1)(ii) has no application to the facts of the present case. The assessee appealed to the AAC, who allowed the assessee's appeal, holding that the sum paid by way of salary to the assessee's husband is governed by the proviso to s. 64(i)(ii) of the Act and, consequently, the salary paid to the assessee's husband was not liable to be included in the total income of the assessee. The ITO appealed to the Appellate Tribunal against the order of the AAC. The Tribunal allowed the ITO's appeal. In allowing the appeal, the Tribunal came to two conclusions:

> (a) that the proviso to s. 64(1)(ii) of the Act can have no application unless 'the technical or professional qualifications' relate to the qualification awarded by a recognised body; (b) there was also no evidence in the present case to show that the income earned by the assessee's husband was solely attributable to the application of technical or professional knowledge and experience. In the above view, the Income-tax Appellate Tribunal reversed the order of the AAC and upheld the ITO's inclusion in the assessee's income under s. 64(1)(ii) of the salary paid to her husband. The assessee asked for and obtained this reference under s. 256(1) of the Act.

4. Sri. M. J. Swamy, learned counsel for the assessee, has raised a two fold plea before us. Firstly, he urged that the Tribunal was in error in considering that the technical or professional qualification for purposes of the proviso above referred to should necessarily relate to a degree, diploma or other certificate issued by a recognised body. Learned counsel submitted that the proviso did not contain any requirement that the technical or professional qualification is referable to the conferment of such qualification by a recognised body. It is submitted that if a peron possesses technical or professional konwledge, that itself is an attribute of qualification. Learned counsel reinforced the submission by reference to the latter part of the proviso which referred to the professional knowledge and experience. According to the learned counsel, if

qualification is the requirement, the latter part of the proviso could surely have proceeded to state that the income should be solely attributable to the application of his or her technical or professional qualifications. Instead of using the word "qualification", the Legislature had used the words "knowledge and experience". Learned counsel, therefore, submitted that the word "qualification" according in the first part of the proviso must be read taking into due consideration the words "knowledge and experience" used in the latter part of the proviso. Learned counsel further pointed out that in the present case, the assessee's husband had rich experience in paint business and he used his skill and knowledge in the paint business and helped the assessee to manage the business who was otherwise incapable of carrying on the business. According to the learned counsel, the requirements of the proviso are satisfied and the salary paid to the assessee's husband should not have been included in the total income of the assessee.

5. Sri. M. S. N. Murthy, learned standing counsel for the Revenue, urged that the word "qualification" occurring in the first part of the proviso should necessarily refer to the certificate, diploma or a degree conferred by recognised body and the technical or professional knowledge and experience referred to in the latter part of the proviso must be also originate from the qualification referred to in the first part. According to the learned counsel for the Revenue, technical or professional knowledge and experience simpliciter without a qualification does not satisfy the requirement of the second part. Therefore, in a case where there is no recognised technical or professional qualification as such, mere possession of technical knowledge and experience does not bring into application the proviso above referred to. In this view, learned standing counsel for the Revenue submitted that the view taken by the Income-tax Appellate Tribunal is proper.

6. We find considerable force in the submission of the learned counsel for the assessee that the words "technical or professional qualification" occurring in the first part of the proviso do not necessarily relate to the technical or professional qualifications acquired by obtaining a certificate, diploma or a degree or in any other form from a recognised body like university or an institute. That this was not the intention of the Legislature is clear from the use of the expression "knowledge and experience" in the latter part of the proviso, as otherwise it would have been perfectly permissible for the Legislature to use the same expression as occurring in the first part. The harmonious construction of the two parts of the proviso, in our opinion, would be that if a person possesses technical or professional knowledge and the income is solely attributable to the application of such technical or professional knowledge and experience, the requirement for the application of the proviso is satisfied, although the person concerned may not possess any qualification issued by a recognised body. In our opinion, the Tribunal erred in coming to the conclusion that unless a recognised body conferred a qualification, it should not be considered that a person possessed technical or professional qualification. It is enough, in our opinion, for the purpose of the proviso, if the recipient of the salary possesses the attributes of technical or professional qualification, in the sense that he has got expertise in such profession or technique. If by the use of that expertise in the profession or technique, the person concerned earns salary, then the part of the proviso is also satisfied.

7. Coming, however, to the facts of the present case, we are not satisfied that the second part of the proviso is complied with. The finding of the Tribunal is that there was no evidence to

prove that the income earned by the assessee's husband was solely attributable to the application of technical or professional knowledge and experience.

8. This is essentially a finding of fact and it is not challenged before the lower authorities. We are, therefore, unable to accept the submission of the learned counsel for the assessee that in the present case both the requirement of the proviso are satisfied. In that view of the matter, we consider that the Tribunal was justified in coming to the conclusion that the salary paid by the assessee's wife to her husband is includible in her total income under s. 64(1)(ii) of the Act. We, accordingly, answer the question in the affirmative, that is, in favour of the Revenue and against the assessee.

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J.M. Mokashi v. *Commissioner of Income-Tax*

(1994) 207 ITR 252 (Bom)

B.P. SARAF, J. - By this reference under section 256(1) of the Income-tax Act, 1961, the Income-tax Appellate Tribunal has referred the following question of law to this court for opinion:

> "Whether, on facts and in the circumstances of the case, the Income-tax Appellate Tribunal has rightly held that the income of the assessee's wife is includible in the income of the assessee under section 64(1)(ii) of the Income-tax Act, 1961 ?"

2. The assessee is a practising physician and cardiologist. His wife, Smt. Jayashree J. Mokashi, had passed first year Arts of the Bombay University and was employed by him as a receptionist-cum-accountant. During the accounting period, relevant to the assessment year 1978-79, the assessee paid a sum of Rs. 8,100 to her by way of salary. This amount was included by the Income-tax Officer in the income of the assessee by applying the provisions of section 64(1)(ii) of the Act. The assessee preferred an appeal to the Appellate Assistant Commissioner of Income-tax. The appeal was rejected and the order of the Income-tax Officer was affirmed by the Appellate Assistant Commissioner. The assessee filed a second appeal before the Tribunal. As there were some conflicting decisions of the various Benches of the Tribunal on the point of issue, the Tribunal, by its order dated October 15, 1980, referred the matter to a Special Bench for hearing and decision.

3. Before the Special Bench of the Income-tax Appellate Tribunal, the orders of the Income-tax Officer and the Appellate Assistant Commissioner were challenged on various grounds. The first contention of the assessee was that the word "concern" appearing in section 64(1)(ii) did not include "profession", as distinguished from "business" and, as such, the provisions of the above section were not applicable. The second contention was that the expression "substantial interest" appearing in section 64(1)(ii) read with Explanation 2(ii) referred only to a proportion of the whole interest and not the "whole interest", and as such, section 64(1)(ii) had no application to a proprietary concern in which the assessee has 100 per cent interest. The third contention of the assessee was that possession of "technical or professional qualifications" by the spouse of the assessee does not mean that she must hold a degree of a competent authority or university in a particular technical or professional subject. According to the assessee, it is sufficient if the spouse concerned possesses necessary technical or professional knowledge and experience which might enable her to perform her duties. Another argument of the assessee was that the word "and" appearing twice in the proviso to section 64(1)(ii) should be interpreted as "or" and, consequently, the proviso should be held applicable if any of the two requirements, viz., the spouse possesses technical or professional qualifications or the income as attributable to her technical or professional knowledge exists.

4. The Tribunal rejected all the above contentions of the assessee and held as follows:

"(i) Section 64(1)(ii) applies, inter alia, to individual assessees,

who are proprietors;

(ii) "concern" means business as well as a professional concern;

(iii) a concern in which the individual has a substantial interest would include a concern in which the individual has a cent per cent interest;

(iv) "professional qualifications" means fitness to do a job or undertake an occupation or vocation requiring intellectual skill or requiring manual skill as controlled by intellectual skill and which is such that a person should be able to eke out a living therefrom independently though the salary does not cease to be the product of professional skill merely because a particular employment is accepted;

(v) the term "technical" implies specialised knowledge generally of a mechanical or scientific subject or any particular subject;

(vi) the word "and" appearing twice in the proviso to section 64(1)(ii) means "and" and not "or"; and

(vii) "experience" as appearing in the proviso to section 64(1)(ii) includes experience acquired in the course of acquiring technical or professional qualifications."

5. The Tribunal, on a consideration of the facts of the assessee's case in the light of the aforesaid interpretation of section 64(1)(ii) of the Act, observed that there was no material on record to show that Mrs. Mokashi had any technical or professional qualification or that the salary paid to her was attributable to any technical or professional knowledge and experience of hers. In view of the aforesaid findings, the Tribunal confirmed the order of the Appellate Assistant Commissioner and the Income-tax Officer.

6. Aggrieved by the order of the Tribunal, the assessee applied to the Tribunal for reference of the question of law arising out of its opinion. The Tribunal, on being satisfied that a question of law did arise, referred the question set out above to this court for opinion.

7. We have heard Mr. V. Patil, learned counsel for the assessee, and Mr. G. S. Jetly, learned counsel for the assessee reiterated all the submissions made on behalf of the assessee before the Tribunal. In support of the same, reliance was placed on the decision of the Andhra Pradesh High Court in ***Batta Kalyani* v. *CIT*** [(1985) 154 ITR 59]; of the Kerala High Court in ***CIT* v. *Sorabji Dorabji*** [(1987) 168 ITR 598] and ***Dr. K. Thomas Varghese* v. *CIT*** [(1986) 161 ITR 21]; of the Gujarat High Court in ***CIT* v. *Dr. K. K. Shah*** [(1982) 135 ITR 146] and of the Madhya Pradesh High Court in ***CIT* v. *Madhubala Shrenik Kumar*** [(1990) 181 ITR 180]. Learned counsel for the Revenue supports the decision of the Tribunal. According to him, neither the expression "concern" can be equated to "business establishment" nor the words "technical or professional qualifications" be equated to educational qualifications. These words have their special meaning and they have to be interpreted accordingly. Counsel further submits that the use of the word "experience" with technical and professional qualification in the latter part of the proviso is intended to restrict the scope and ambit thereof and not to enlarge it.

8. Counsel also submits that the definition of "substantial interest" is intended to specify the lowest limit of the interest of the assessee in the concern which will attract the provisions of section 64(1)(ii). It cannot be interpreted to mean that interest higher than the lowest limit specified in the definition will not amount to "substantial interest". Such an interpretation will be most unnatural and will go counter to the very object and scheme of section 64(1)(ii).

10. From a plain reading of section 64(1)(ii) of the Act, it is clear that this section lays down various circumstances under which income of certain family members specified therein, namely, spouse, minor child, son's wife and son's minor child is clubbed with the income of the assessee.

11. Clause (ii) provides that the income derived by the spouse of an individual by way of remuneration, etc., from a concern in which the individual has substantial interest shall be included in the income of the said individual. The only exception is contained in the proviso to clause (ii) which provides that the said clause shall not apply where the spouse possesses technical or professional qualifications and the remuneration can be solely attributed to the application of such technical or professional knowledge and experience of the spouse.

12. The assessee has raised a number of controversies in regard to the interpretation of the above provisions and the true meaning of some of the expressions used therein. We shall deal with them one by one. First, we may deal with the controversy in regard to the scope and ambit of the expression "concern". According to the assessee, the expression "concern" refers only to business establishments as contrasted with professional organisations which depend on the personal skill and knowledge of the person concerned. Establishments of professionals like doctors, according to counsel for the assessee, do not fall within the ambit of the expression "concern", and as such, section 64(1)(ii) has no application to payments made by an individual, who is a professional, to the spouse of such individual. We have carefully considered the above submission. We, however, find it difficult to accept the same and give such a narrow and constricted meaning to the word "concern" which is neither natural nor borne out from the setting and context in which it appears. The word "concern" is a word of wide import. It has various shades of meanings. According to the dictionaries, it means "something which pertains to a person; business affairs;". It also means "a matter that engages a person's attention, interest or care or that affects his welfare or happiness". In ***Black's Law Dictionary*** (Sixth edition), it has been defined thus:

> "Concern. To pertain, relate or belong to; be of interest or importance to; have connection with; to have reference to; to involve; to affect the interest of."

13. From the above definitions, it is evident that the word "concern" is a word of wide import and it conveys different ideas and meanings depending upon the context and setting in which it appears. In the context of section 64(1)(ii) of the Act read with Explanation 2 thereto, it is clear that "concern" includes any company, firm, individual or any other entity carrying on business or professional activity. It cannot be given any restricted meaning to take out of its ambit professional organisations or organisations run as proprietary establishments. It covers all establishments or organisations - whether engaged in business activities or professional activities. This is so also because the word "business" itself is a word of wide import and has been broadly interpreted to include "professions, vocations and callings". It is in this context that in ***Barendra Prasad Ray* v. *ITO*** [(1981) 129 ITR 295], the Supreme Court, while interpreting the expression "business connection" appearing in section 9(1) of the Act, held as follows (at page 306) :

> "The word 'business' is one of wide import and it means an activity carried on continuously and systematically by a person by the application of his labour or skill with a

view to earning an income. We are of the view that in the context in which the expression 'business connection' is used in section 9(1) of the Act, there is no warrant for giving a restricted meaning to it excluding 'professional connections' from its scope."

14. We are, therefore, of the clear opinion that the expression "concern" appearing in section 64(1)(ii) of the Act is a word of wide import and takes within its sweep and ambit all organisations or establishments engaged in business or profession, whether owned by a company, partnership or individual or any other entity.

15. We now turn to the next contention of the assessee that section 64(1)(ii) being applicable to concerns in which the assessee has a substantial interest within the meaning of Explanation 2 thereto, a proprietary concern in which the individual has cent per cent interest does not fall within the purview thereof. We have considered the above submission. We, however, do not find any force in the same. Explanation 2 is a deeming provision which provides that in a case where the concern is a company, the assessee shall be deemed to have substantial interest therein if he holds not less than twenty per cent of its shares and in other cases, if he is entitled to not less than twenty per cent of the profits of such concern. The object of this Explanation is to create a legal fiction to extend the application of section 64(1)(ii) to concerns in which the interest of individual concerned exceeds the limits specified therein. It sets out the lowest limit of interest of the individual in the concern for the purpose of applicability of section 64(1)(ii). Its object is to widen the net of the section - not to restrict it. No outer limit of interest of the individual has, therefore, been specified. It will be a most unreasonable and unnatural interpretation of Explanation 2 to hold that though persons having "not less than twenty per cent of the profits of the concern" shall be deemed to have substantial interest in the concern, persons having cent per cent interest will not be deemed so. We, therefore, reject the above contention of the assessee in regard to the interpretation of Explanation 2 and hold that an individual entitled to cent per cent of the profits of a concern is a person having substantial interest within the ordinary meaning of the expression itself. No resort to the deeming provision contained in Explanation 2 is necessary in such a case, though even on application thereof, the same result will be achieved.

16. We are now left with the objections of the assessee based on the interpretation of the proviso to section 64(1)(ii). As earlier indicated, section 64(1)(ii) provides for clubbing with the income of an individual, the income of the spouse of such individual by way of salary, commission, remuneration, etc., derived from a concern in which the individual has substantial interest. The only exception is contained in the proviso thereto. If the spouse possesses technical or professional qualification, any income derived by such spouse even from a concern falling in section 64(1)(ii) read with Explanation 2 thereto will not be liable to be clubbed with the income of the spouse provided the "income" too fulfils the requirement of the second part of the proviso. We may, for a better understanding, dissect the requirements of the proviso to section 64(1)(ii) as follows :

"(i) The spouse possesses 'technical or professional qualifications'; and

(ii) the income is solely attributable to the application of his or her technical or professional knowledge and experience."

17. A serious controversy has been raised by learned counsel for the assessee in regard to the interpretation of these conditions. According to counsel, the "qualification" mentioned in the above clause should be liberally interpreted to mean and include any qualification which makes a person suitable for a job. It should not be given any narrow or restrictive meaning. Secondly, according to counsel, the two conditions set out above should be read harmoniously. The two conditions are not cumulative but alternative, and the use of the words "knowledge and experience" in the second part goes to show that the proviso will be applicable even in cases where the spouse does not possess technical or professional qualification but has the requisite technical or professional knowledge or experience - submits counsel for the assessee.

18. We have carefully considered the above submissions of counsel for the assessee. We are not impressed by the same. Accordingly to us, these submissions are based on a totally erroneous interpretation of the proviso, which, to our mind, is very clear and unambiguous.

19. In order to claim the benefit of the proviso to avoid clubbing of income under section 64(1)(ii) of the Act, both the conditions specified in the proviso must be satisfied. The first condition relates to the spouse of the individual who must possess "technical or professional qualifications". If this condition is not satisfied, the proviso will not apply and reference to the second requirement will be unnecessary. If the first condition in regard to the qualification of the spouse is satisfied, it will be necessary to refer to the second condition which pertains to the income that will not be clubbed. It may be pertinent to mention that even in the case of a spouse possessing technical or professional qualification, only the income arising to such spouse which is solely attributable to the application of his or her technical or professional knowledge and experience will be out of the purview of section 64(1)(ii) and not the whole of the income of such spouse. It is in this context that the words "technical or professional knowledge and experience" have been used in the latter part of the proviso in contradistinction to "technical or professional qualifications" used in the earlier part. Thus, two different expressions have been used by Parliament in the very same proviso, not inadvertently, but with a deliberate purpose. We shall revert back to this aspect a little later, after discussing the true meaning and import of the first condition, viz., possession of technical or professional qualification.

20. The word "qualification" simpliciter is a word of very wide import and, in the absence of any qualifying words or expression, conveys the idea of any quality which makes a man fit for any job or any activity in life. The word "qualification" has been defined in the Random House Dictionary of English Language to mean "a quality, accomplishments, etc." ***Black's Law Dictionary*** (sixth edition) contains the following definition of “qualification”:

> "Qualification. - The possession by an individual of the qualities, properties, or circumstances, natural or adventitious, which are inherently or legally necessary to render him eligible to fill an office or to perform public duty or office. . . ."

21. But, the word "qualification" in the proviso to section 64(1)(ii) if qualified by the words "technical or professional". In that view of the matter, its broad meaning will not be relevant for the present purpose. We have, in fact, to ascertain the true meaning of "technical qualifications" or "professional qualifications".

> “Technical” according to ***Black's Law Dictionary***, means “belonging or peculiar to an art or profession”.

22. According to ***Random House Dictionary*** of the English Language, “technical”, inter alia, means: “1. Pertaining to or suitable for an art....”

23. Similarly, “profession” means a vocation or occupation requiring special, usually advanced education, knowledge, and skill, e.g., law or medical profession. (See ***Black's Law Dictionary***, sixth edition). ***Halsbury's Laws of England*** (fourth edition, Vol. 23), describes “profession” as follows:

> “....A profession involves an idea of an occupation requiring either purely intellectual skill, or if any manual skill is involved, as in painting, sculpture, or surgery, skill controlled by the operator's intellectual skill, as distinguished from an occupation which is substantially a production or sale or arrangement for the production or sale of commodities. The word 'profession' is certainly wider than the old definition of the learned professions - the church, medicine and law. A company cannot carry on a profession.”

24. Though the word profession now has a broader and more comprehensive meaning than formerly was accorded to it and its signification now extends far beyond the well-known classical professions of earlier days and as the applications of science and learning are extended to other departments or affairs other vocations also receive the same treatment, persons engaged in executive and clerical aspects of business organisations, brokers, insurance agents, etc., are not held to be engaged in the practice of a profession. (See Corpus Juris Secundum, Vol. 72). The word "profession" still retains its distinct character and does not take within its ambit any and every activity or employment undertaken by a person for his livelihood.

25. If we read the expression "technical or professional qualification" used in the proviso to section 64(1)(ii) in the light of the above definitions of "technical" and "professional", it becomes clear that the "qualification" mentioned therein must be such which makes a person eligible for technical or professional work. A person can, therefore, be said to be in possession of requisite technical qualification when by virtue thereof, he is eligible to perform that function. Similarly, professional qualification must mean qualification which is necessary for carrying on the particular profession. Take, for example, the legal profession. The requisite qualifications for carrying on the legal profession have been laid down by the statute. In such a case, a person possessing such qualification alone can be said to be in possession of professional qualification, because such qualification is a must for carrying on the profession. Knowledge of law or experience is not relevant for that purpose. Similarly, a person cannot carry on medical profession unless he possesses the requisite degree. Similarly, there are technical jobs which require degrees and diplomas - whereas, there are a few others where university degree or diploma is not necessary. Adequate training and evidence thereof might be sufficient. Thus, the nature of professional qualification will vary from profession to profession. Similarly, the nature of technical qualification will also vary depending on the nature of the technical job. What is technical or professional qualification, therefore, will have to be decided in each case depending upon the nature of the profession or the technical work. But one thing is certain that it is not any and every qualification, academic or otherwise, which can bring a spouse within the scope and ambit of the proviso to take the income out of the clubbing provision. It is the possession of only technical or professional qualification necessary for undertaking the particular technical job or carrying on the profession to which the income is attributed that will meet the requirement of the first part of the proviso "knowledge and experience" will not be relevant for

that purpose. A spouse, well-versed in law and experienced in the working of the legal profession, cannot be said to be in possession of professional qualification for carrying on the legal profession if he or she does not possess the requisite degree or diploma. Payments made to the spouse in such a case for any legal services cannot be brought within the purview of the proviso by reference to the words "knowledge and experience" occurring in the latter part thereof.

26. The second requirement of the proviso, in fact, refers to the income of the spouse from a concern falling under section 64(1)(ii) and restricts the benefit of the proviso even in the case of an eligible spouse only to that part of the income which can be "solely attributed to the application of his or her technical or professional knowledge and experience". This provision makes it clear that the possession of technical or professional qualification is a condition precedent on fulfillment of which that part of the income which falls in the second part of the proviso is excluded from the operation of the clubbing provision. Take, for example, the case of the wife of an individual who is a qualified legal practitioner. Her professional services are utilized by the assessee and remuneration paid to her by way of salary, fees, etc. In such a case, she fulfils the first requirement of the proviso and she is, therefore, entitled to the benefit of the proviso. But, the benefit is again hedged in with certain conditions and is limited to the extent indicated in the proviso. In that context, her "knowledge and experience" will assume significance. Take for example, the case of the wife of the individual who has just passed the LL. B. examination and enrolled herself as an advocate or having passed the LL.B. examination, did not practice law for long but has started doing so just a year or two back. Her professional services as a lawyer are utilized in the concern of her husband and she is paid remuneration therefor. In such a case, when the assessee claims the benefit of the proviso to avoid clubbing of such income of his wife with his own income, he will be required to satisfy that the remuneration so paid to her for her legal services was "solely attributable to the application of her professional knowledge and experience" as a lawyer. If the taxing authorities find that the remuneration paid for the legal services was excessive or high having regard to her limited professional knowledge and experience, he may determine the amount of remuneration which can be solely attributed to the application of her professional knowledge and experience and exclude only that part of her income from the clubbing provision contained in section 64(1)(ii). Thus, the object of the second part of the proviso is to restrict the benefit of the proviso only to reasonable payments for professional services and to put a check on diversion of income to the spouses possessing technical or professional qualifications in the guise of salary, fees, etc., for professional or technical services with a view to reduce the incidence of tax.

27. The forgoing discussion clearly goes to show that the two conditions mentioned in the proviso are cumulative and not alternative. They deal with two different aspects - one pertains to the eligibility of the spouse to claim benefit of the proviso, the other to the income which would qualify for exclusion from clubbing. Both are relevant and equally important. There is no scope for mixing up the two and diluting the first condition relating to qualification of the spouse by reference to the expression "knowledge and experience" in the second condition. Any attempt to do so will go counter to the clear language, scheme and object of the proviso and the well-accepted rule of interpretation that one part of a section or clause should not be construed in such a manner as to render the other part redundant. It is a cardinal rule of interpretation of

statutes that a construction which would leave without effect any part of the statute should normally be rejected. We are, therefore, clear in our mind that there is no conflict between the two requirements of the proviso, each deals with a different aspect and both of them must be satisfied, though the second comes into operation only on fulfillment of the first condition, not otherwise.

28. The above view of ours gets full support from the decision of the Karnataka High Court in ***CIT* v. *D. Rajagopal*** [(1985) 154 ITR 375], where it was held that both the conditions of the proviso must be satisfied for excluding the income of the spouse from the operation of section 64(1)(ii) of the Act.

29. In ***Kamlabai Gujri (Smt.)* v. *CIT*** [(1986) ITR 33], the Madhya Pradesh High Court also held that it was solely for the assessee to show that the salary received by her was solely attributable to the application of her professional knowledge and experience. This decision does not, in any way, help the assessee as it cannot be construed to have held that the first condition regarding "possession of professional or technical qualification" need not be satisfied. On the other hand, this decision presupposes that the first condition if fulfilled. Reliance was placed by the assessee on another decision of the Madhya Pradesh High Court in ***CIT* v. *Madhubala Shrenik Kumar*** [(1990) 181 ITR 180], where it was held that the words "technical or professional qualifications" occurring in the proviso cannot be construed to mean obtaining a degree or diploma from a recognised body. This part of the controversy, we have dealt with at length in the foregoing discussion. We have already held that the nature of qualification will vary from case to case. We have, however, made it clear that for the interpretation of the word “qualification” in the first part, reference to the expression “knowledge and experience” in the latter part is not correct. We, therefore, find it difficult to agree with the above decision if it is interpreted to have held so. Reliance was also placed on the decision of the Andhra Pradesh High Court in ***Batta Kalyani* v. *CIT*** [(1985) 154 ITR 59], where it was held that the harmonious construction of the two parts of the proviso would be that if a person possesses technical or professional knowledge and the income is solely attributable to the application of such technical or professional knowledge and experience, the requirements for the application of the proviso are satisfied, although the person concerned may not possess any qualification issued by a recognised body. It was further held that it is enough for the purposes of the proviso if the recipient of the salary possesses the attributes of technical or professional qualification, in the sense that he has got expertise in such profession or technique. If by the use of that expertise in the profession or technique, the person concerned earns a salary, then the latter part of the proviso is also satisfied. We have carefully considered the above decision. In our opinion for the reasons set out by us in this decision, the interpretation of the proviso by the Andhra Pradesh High Court is not correct. It goes counter to the express language of the proviso. We, therefore, express our inability to agree with the same.

30. In the instant case, the spouse of the assessee neither possessed any technical or professional qualification nor was she paid for any technical or professional services rendered by her. Admittedly, she had passed first year Arts of the Bombay University and that was her only qualification. She was employed by her husband, the assessee in this case, as receptionist-cum-accountant and paid a salary for that employment. In such a case, it is not only difficult but impossible to hold that she possessed any “technical or professional qualification” which is

necessary to bring her within the proviso. That being so, the proviso to section 64(1)(ii) is not applicable to her and, as such, the assessee is not entitled to get the benefit thereof to bring her income out of the purview of the clubbing provision contained in section 64(1)(ii).

31. In view of the foregoing discussion, we answer the question referred to us in the affirmative, i.e., in favour of the Revenue and against the assessee.

* * * * *

Mohini Thapar (Dead) by L.RS. v. *C.I.T. (Central) Calcutta*

(1972) 4 SCC 493

HEGDE, J. - All these appeals by certificate are filed by the legal representatives of Late Karam' Chand Thapar who was the assessee in this case. He died after the assessments were made. The assessment years with which we are concerned in these appeals are 1949-50, 1950-51, 1951-52, 1952-53 and 1953-54. The facts of the case lie within a narrow compass. Late Karam Chand Thapar made certain cash gifts to his wife Smt Mohini Thapar. From out of those gifts, she purchased certain shares and the balance amount she invested. The shares earned dividends and the investments yielded interest. The interest realised and the dividends earned were included in the income of Karam Chand Thapar for the purpose of assessment in the assessment years mentioned earlier. The assessee objected to the inclusion of that amount in his income. The question is whether the department was entitled to include the dividends and interest in question in computing the taxable income of the assessee. The Income-tax Officer held that they were liable to be included in the income of the assessee. That decision was upheld by the Appellate Assistant Commissioner. On a further appeal, taken by the assessee to the Tribunal the Tribunal upheld the order of the Assistant Commissioner. Thereafter at the instance of the assessee, the question set out below was submitted to the High Court under Section 66(1) of the Indian Income Tax Act, 1922, in respect of the assessment year 1949-50:

> (1) Whether on the facts and in the circumstances of the case, the income of Rs 21,225/- derived from deposits and shares held by the assessee's wife, Smt Mohini Devi Thapar, was income from assets directly or indirectly transferred by the assesses to his wife within the meaning of Section 16(3) of the Income-tax Act.

Similar questions were referred in respect of other assessment year. The High Court answered these questions in favour of the revenue. Hence these appeals.

2. Section 16(3)(*a*)(*iii*) of the Act - the provision relevant for the purpose of these appeals reads thus:

> (3) In computing the. total income of any individual for the purpose of assessment, there shall be included –
>
> (*a*) so much of the income of a wife or minor child of such individual as arises directly or indirectly -
>
> (*iii*) from assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration or in connection with-an agreement to live apart,

3. The assets transferred in this case is the gift of cash amounts made by the assessee to his wife. The transfers in question are direct transfers. But those assets, as mentioned earlier, were invested either in shares or otherwise. Hence it was urged on behalf of the revenue-that the incomes realised either as dividends from shares or as interest from deposits are income indirectly received in respect of the transfer of cash directly made. This contention of the revenue appears to be sound. That position clearly emerges from the plain language of the section.

4. It was urged by Dr Pal, learned Counsel for the assessee that there is no nexus between the income earned and the transfer of the assets. According to him before an income can come

within Section 16(3)(*a*)(*iii*) it must be an income directly arising from the assets transferred. In other words, he urged that only such income which can be said to have directly sprung from the assets transferred can come within the scope of Section 16(3)(*a*)(*iii*). We are unable to accept-this contention as sound. Otherwise the expression 'as arises directly or indirectly' in Section 16(3)(*a*) would become redundant. The net cast by Section 16(3)(*a*)(*iii*) includes not merely the income that arises directly from the assets transferred but also that arises indirectly from the assets transferred. We are in agreement with the contention of Dr Pal that the income that can be brought to tax under Section 16(3)(*a*)(*iii*) must have a nexus with the assets transferred directly or indirectly. But in this case the income with which we are concerned has a nexus with the assets transferred.

5. In support of his contention Dr Pal relied on the decision of this Court in ***C.I.T.* v. *Prem Bhat Parakh*** [(1970) 1 SCC 784]. The facts of that case are as follows: The assessee, who was a partner in a firm having 7 annas share therein, retired from the firm on July 1, 1954. Thereafter, he gifted Rs 75,000 to each of his four sons, three of whom were minors. There was a reconstitution of the firm with effect from July 2, 1954, whereby the major son became a partner and the minor sons were admitted to the benefits of partnership in the firm. The question was whether the income arising to the minors by virtue of their admission to the benefits of partnership in the firm could be included in the total income of the assessee under Section 16(3)(*a*)(*iii*) - a provision similar to Section 16(3)(*a*)(*iii*). The Tribunal found that the capital invested by the minors in the firm came from the gift made in their favour by their father, the assessee. This Court overruling the contention of the revenue came to the conclusion that the connection between the gifts made by the assessee and the income of the minors from the firm was a remote one and it could not be said that the income arose directly or indirectly from assets transferred. Hence the income arising to the three minor sons of the assessee by virtue of their admission to the benefits of partnership in the firm could not be included in the total income of the assessee. The *ratio* of the decision is found at page 30 of the report. This is what the Court observed in that case:

> The connection between the gifts mentioned earlier and the income in question is a remote one. The income of the minors arose as a result of their admission to the benefits of the partnership. It is true that they were admitted to the benefits of the partnership because of the contribution made by them. But there is no nexus between the transfer of the assets and the income in question. It cannot be said that that income arose directly or indirectly from the transfer of the assets referred to earlier. Section 16(3) of the Act created an artificial income. That section must receive strict construction as observed by this Court in ***C.I.T.* v. *Keshavlal Lallubhai Patt*** [(1965) 55 ITR 637]. In our judgment before an income can be held to come within the ambit of Section 16(3), it must be proved to have arisen - directly or indirectly - from a transfer of assets made by the assessee in favour of his wife or minor children. The connection between the transfer of assets and the income must be proximate. The income in question must arise as a result of the transfer and not in some manner connected with it.

The ratio of that decision is inapplicable to the facts of the present case. In the result, these appeals fail and they are dismissed.

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State of Kerala v. *C. Velukutty*

(1966) LX ITR 239 (SC)

K. SUBBA RAO J. – These two appeals by special leave are preferred against the order of the High Court of Kerala in Tax Revision Cases Nos. 52 and 53 of 1960 relating to sales tax assessments made on the respondent for the year 1955-56 and 1956-57 respectively.

The following facts relate to Civil Appeal No. 986 of 1964 in respect of the assessment year 1955-56: The respondent has two offices, the head office is at Court Road and the branch office, at Big Bazar. Both the offices are in Kozhikode. The branch office does wholesale business and the head office does retail business and they maintain separate accounts. The goods sent from the branch office to the head office are entered in the accounts as transfers. The head office maintains accounts disclosing the goods so transferred by the branch office and also the goods purchased by it locally. The branch office has also transactions with other customers. On April 6, 1957, the Deputy Commercial Tax Officer, Kozhikode, assessed the respondent on the net turnover of his business of Rs. 9,30,565-10-5 for the assessment year 1955-56. But later on, on a surprise inspection of the head office by the Intelligence Officer, North Zone, Kozhikode, some books of accounts and records were recovered. On October 27, 1958, on the basis of the said books and records, the Sales Tax Officer issued a notice to the respondent proposing to determine to the best of his judgment the turnover which had escaped assessment. The respondent agreed to the Sales Tax Officer assessing the turnover of the head office on the basis of the aforesaid secret books recovered from the shop, but objected to a fresh assessment being made in respect of the branch office at Big Bazaar. That objection was rejected and the Sales Tax Officer reassessed the turnover of the business of the respondent in the following manner: (1) He found that in regard to the head office the transactions disclosed in the secret books were 135% of the turnover recorded in the regular accounts and on that basis added 135% to the turnover disclosed in the regular book of the said office. He then applied the same percentage in regard to the assessment of the turnover of the branch office. He added 135% to the turnover found in the regular accounts of the branch office. He assessed the total turnover of the two offices at Rs. 19,71,805-13-5. On the basis of the said total turnover the respondent was assessed to sales tax amounting to Rs. 16,269.37. The respondent preferred an appeal against the said order of the Sales Tax Officer to the Appellate Assistant Commissioner without any success. The further appeal preferred by him to the Sales Tax Appellate Tribunal was also dismissed. The said order was taken in revision to the High Court of Kerala in T.R.C. No. 52 of 1960.

The facts of the Civil Appeal No. 987 of 1964 relating to the assessment for the year 1956-57 are as follows: (1) On the basis of the secret accounts discovered in the surprise inspection of the head office, the Sales Tax Office issued a notice to the respondent proposing to determine to the best of his judgment the turnover which had escaped assessment. The respondent had no objection for a reassessment being made in respect of the turnover of the head office on the basis of the secret accounts discovered, but objected to the reassessment of the turnover of his branch office. (2) The Sales Tax Officer applied the same principle in regard to the assessments of both the shops as he had adopted in the case of the turnover for the assessment year 1955-56.

Taking the head office he found in regard to the general goods that the escaped assessment was 200% of the turnover assessed; and in regard to sugar, 500% of the assessed turnover. He, therefore, added 200% and 500% to the turnover of the general goods and turnover of sugar respectively. In the same manner, in regard to the turnover of the branch office, though no secret books were discovered in respect of that office, he added to the turnover already assessed 200% of the turnover of the general goods and 500% of the turnover of sugar. With the result he fixed the total turnover of the two offices at Rs. 39,66,377-2-6 made up of the turnover of the head office at Rs. 2,21,251-14-5 and of the branch office at Rs. 37,45,125-4-1. The respondent pursued the matter up to the High Court. T.R.C. No. 53 of 1960 was the revision filed by him in the High Court.

The High Court set aside the orders of the Sales Tax Tribunal in respect of both the assessment years on the ground that the finding of the escaped assessment so far as the branch office was concerned amounted to an error of law, because it was based on conjecture. Rejecting the plea of the State that the matter should be remanded for a fresh assessment, the High Court dismissed the revisions. Hence the present appeals.

Mr. Govinda Menon, learned counsel for the State, argued that the High Court was wrong in holding that the best judgment assessment was capricious. He pressed on us to hold that the branch office must have maintained secret accounts corresponding to the secret accounts discovered in respect of the head office, that the respondent had suppressed the said accounts and that, therefore, the Sales Tax Officer acted reasonably in ascertaining the escaped assessment on the basis of the percentage of escaped assessment found in respect of the head office. He further contended that the High Court had no jurisdiction to interfere with the finding of the fact arrived at by the Tribunal.

Mr. Sreedharan Nambiar, appearing for the respondent, contended that there was no basis for the Sales Tax Officer to hold that the respondent maintained separate accounts in respect of the branch office business, that there was absolutely no material before the Sales Tax Officer to sustain his best judgment assessment, and that, therefore, the said assessment made by the Sales Tax Officer was capricious and arbitrary and was rightly set aside by the High Court.

At the outset the relevant provisions of the Travancore-Cochi General Sales Tax Act; 1125 M.E. (XI of 1125), may be noticed:

> ***"Section 12*** – (1) Every dealer whose turnover is ten thousand Indian rupees or more in a year shall submit such return or returns relating to his turnover, in such manner and within such periods as may be prescribed.
> (2) (a) If the assessing authority is satisfied that any return submitted under sub-section (1) is correct and complete, he shall assess the dealer on the basis thereof.
>
> (b) If no return is submitted by the dealer under sub-section 1) before the date prescribed or specified in that behalf or if the return submitted by him appears to the assessing authority to be incorrect or incomplete, the assessing authority shall assess the dealer to the best of his judgment.
>
> Provided that before taking action under this clause the dealer shall be given a reasonable opportunity of proving the correctness and completeness of any return submitted by him.

Section 15B – Within sixty days from the date on which an order under section 15A, sub-section (4) or sub-section (6) was communicated to him, the assessee or the Deputy Commissioner may prefer a petition to the High Court against the order on the ground that the Appellate Tribunal has either decided erroneously or failed to decide any question of law."

It is manifest that the jurisdiction of the High Court under section 15B is confined only to the question whether the Tribunal has either decided erroneously or failed to decide any question of law. As we will point out immediately, the Sales Tax Officer acted capriciously and arbitrarily in assessing the respondent, which he could not do under section 12(2)(b) of the Act and the Tribunal confirmed that order. It is a clear case where the Tribunal decided erroneously on a question of law.

What is the scope of section 12(2)(b) of the Act? The expression "to the best of his judgment" in the said clause is presumably borrowed from section 23(4) of the Income-tax Act. The said expression in the Income-tax Act was the subject of judicial scrutiny. The Privy Council in ***Commissioner of Income Tax* v. *Laxminarayan Badridas*** [(1937) 5 I.T.R. 170 at 180], has considered those words. Therein it observed:

"He (the assessing authority) must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee, and all other maters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the mater, it must be honest guess-work. In that sense, too, the assessment must be to some extent arbitrary."

The Privy Council, while recognizing that an assessment made by am officer to the best of his judgment involved some guess-work, emphasized that he must exercise his judgment after taking into consideration the relevant material. The view expressed by the Privy Council in the context of the Income-tax Act was followed when a similar question arose under the Sales Tax Act. A Division Bench of the Calcutta High Court in ***Jagadish Prosad Pannalal* v. *Member, Board of Revenue, West Bengal*** [(1951) 2 S.T.C. 21], confirmed the assessment made by the sales tax authorities, as in making the best judgment assessment the said authorities considered all the available materials and applied their mind and tried their best to come to a correct conclusion. So too, a Division Bench of the Patna High Court in ***Doma Sahu Kishun Lal Sao* v. *State of Bihar*** [(1951) 2 S.T.C. 37], refused to interfere with the best judgment assessment of a Sales Tax Officer as he took every relevant material into consideration, namely, the situation of the shop, the rush of the customers and the stock in the shop and also the estimate made by the Assistant Commissioner in the previous quarters.

Under section 12(2)(b) of the Act, power is conferred on the assessing authority in the circumstances mentioned thereunder to assess the dealer to the best of his judgment. The limits of the power are implicit in the expression "best of his judgment." Judgment is a faculty to decide matters with wisdom truly and legally. Judgment does not depend upon the arbitrary caprice of a judge, but on settled and invariable principles of justice. Though there is an element of guess-work in a "best judgment assessment," it shall not be a wild one, but shall have a reasonable nexus to the available material and circumstances of each case. Though sub-section (2) of section 12 of the Act provides for a summary method because of the default of the assessee, it does not enable the assessing authority to function capriciously without regard for the available material.

Can it be said that in the instant case the impugned assessment satisfied the said tests? From the discovery of secret accounts in the head office, it does not necessarily follow that a corresponding set of secret accounts were maintained in the branch office, though it is possible that such accounts were maintained. But, as the accounts were secret, it is also not improbable that the branch office might not have kept parallel accounts, as duplication of false accounts would facilitate discovery of fraud and it would have been thought advisable to maintain only one set of false accounts in the head office. Be that as it may, the maintenance of secret accounts in the branch office cannot be assumed in the circumstances of the case. That apart, the maintenance of secret accounts in the branch office might lead to an inference that the accounts disclosed did not comprehend all the transactions of the branch office. But that does not establish or even probabilize the finding that 135% or 200% or 500% of the discovered turnover was suppressed. That could have been ascertained from other materials. The branch office had dealings with other customers. Their names disclosed in the accounts. The accounts of those customers or their statements could have afforded a basis for the best judgment assessment. There must also have been other surrounding circumstances, such as those mentioned in the Privy Council's decision cited supra. But in this case there was no material before the assessing authority relevant to the assessment and the impugned assessments were arbitrarily made by applying a ratio between disclosed and concealed turnover in one shop to another shop of the assessee. It was only a capricious surmise unsupported by any relevant material. The High Court, therefore, rightly set aside the orders of the Tribunal.

Nor can we accede to the request of the learned counsel for the State to remand the matter to the Tribunal for fresh disposal. The sales tax authority had every opportunity to base its judgment on relevant material; but it did not do so. The department persisted all through the hierarchy of tribunals to sustain the impugned assessment. The High Court, having regard to the circumstances of the case, refused to give the department another opportunity. We do not think we are justified to take a different view.

In the result, the appeals fail and are dismissed.

* * * * *

Commissioner of Income-Tax v. *Burlop Dealers Ltd.*

(1971) 79 ITR 609 (SC)

J.C. SHAH, CJI – Burlop Dealers Ltd., hereinafter referred to as "the assessee", is a limited company. For the assessment year 1949-50, the assessee submitted a profit and loss account disclosing in the relevant year of account Rs. 1,75,875 as profit in a joint venture from H. Manory Ltd. and claimed that Rs. 87,937 being half the profit earned from H. Manory Ltd. was paid to Ratiram Tansukhrai under a partnership agreement. The assessee stated that on June 5, 1948, it had entered into an agreement with H. Manory Ltd. to do business in plywood chests and in consideration of financing the business the assessee was to receive 50% of the profits of the business. The assessee also claimed that it had entered into an agrement on October 7, 1948, with Ratiram Tansukhrai for financing the transactions of H. Manory Ltd. in the joint venture, and had agreed to pay to Ratiram Tansukhrai 50% of the profit earned by it from the business with H. Manory Ltd.

The Income-Tax Officer accepted the return filed by the assessee and included in computing the total income for the assessment year 1949-50, Rs. 87,937 only as the profit earned on the joint venture with H. Manory Ltd. In the assessment year 1950-51 the assessee filed a return also accompanied by a profit and loss account disclosing a total profit of Rs. 1,62,155 in the relevant account year received from H. Manory Ltd., and claimed that it had transferred Rs. 81,077 to the account of Ratiram Tansukhrai as his share. The Income-tax Officer, on examination of the transactions, brought the entire amount of Rs. 1,62,155 to tax holding that the alleged agreement of October 1948, between the assessee and Ratiram Tansukhrai had merely been "got up as a device to reduce the profits, received from H. Manory Ltd." This order was confirmed by the Appellate Assistant Commissioner and by the Income-Tax Appellate Tribunal. The Tribunal then stated a case under section 66(1) of the Income-tax Act, to the High Court of Calcutta. The High Court agreed with the view of the Tribunal and answered the question against the assessee.

In the meanwhile on May 13, 1955, the Income-tax Officer issued a notice under section 34 to the assessee for the assessment year 1949-50 to reopen the assessment and to assess the amount of Rs. 87,937 allowed in the assessment of income-tax as paid to Ratiram Tansukhrai. The assessee filed a return which did not include the amount paid to Ratiram Tansukhrai. The Income-tax Officer reassessed the income under section 34(1)(a) and added Rs. 87,937 to the income returned by the assessee in the assessment year 1949-50. The Appellate Assistant Commissioner held that the Income-tax Officer was entitled to take action under section 34(1)(a) of the Income-tax Act, 1922, after the amendment in 1948, and to reopen the assessment if income had been under-assessed owing to the failure of the assessee to disclose fully and truly all material facts necessary for the assessment. He confirmed the order observing that the assessee had misled the Income-tax Officer into believing that there was a genuine arrangement with Ratiram Tansukhrai and had stated in the profit and loss account that the amount paid to Ratiram Tansukhrai was the share of the latter in the partnership, whereas no such share was payable to Ratiram Tansukhrai.

In appeal against the order of the Appellate Assistant Commissioner the Income-tax Appellate Tribunal held that the assessee had produced all the relevant accounts and documents necessary for completing the assessment, and the assessee was under no obligation to inform the Income-tax Officer about the true nature of the transactions. The Tribunal on that view reversed the order of the Appellate Assistant Commissioner and directed that the amount of Rs. 87,939 be excluded from the total income of the assessee for the year 1949-50.

An application under section 66(1) of the Indian Income-tax Act for stating a case to the High Court was rejected by the Tribunal. A petition to the High Court of Calcutta under section 66(2) for directing the Tribunal to submit a statement of the case was also rejected. The Commissioner has appealed to this court.

Section 34(1) of the Indian Income-tax Act, 1922; as it stood in the assessment year 1949-50 provided:

> "If –
>
> (a) the Income-tax Officer has reason to believe that by reason of the omission or failure on the part of an assessee to make a return of his income under section 22 for any year or to disclose fully and truly all material facts necessary for his assessment for that year, income, profits or gains chargeable to income-tax have escaped assessment for that year, or have been under-assessed... or
>
> (b) notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the assessee, the Income-tax Officer has in consequence of information in his possession reason to believe that income, profits or gains chargeable to income-tax have escaped assessment for any year, or have been under-assessed, ...
>
> he may in cases falling under clause (a) at any time within eight years and in cases falling under clause (b) at any time within four years of the end of that year, serve on the assessee, ... a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of section 22 and may proceed to assess or reassess such income, profits or gains ..."

The Income-tax Officer had, in consequence of information in his possession that the agreement with Ratiram Tansukhrai was a share transaction, reason to believe that income chargeable to tax had escaped assessment. Such a case would appropriately fall under section 34(1)(b). But the period prescribed for serving a notice under section 34(1)(b) had elapsed. Under section 34(1)(a) the Income-tax Officer had authority to serve a notice when he had reason to believe that by reason of omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for the year, income chargeable to tax had escaped assessment. As observed by this court in ***Calcutta Discount Co. Ltd.* v. *Income-tax Officer, Companies District I, Calcutta*** [(1061) 41 I.T.R. 191, 200(SC)]:

> "The words used are 'omission or failure to disclose fully and truly all material facts necessary for his assessment for that year.' It postulates a duty on every assessee to disclose fully and truly all material facts necessary for his assessment. What facts are material and necessary for assessment will differ from case to case. In every assessment proceeding, the assessing authority will, for the purpose of computing or determining the proper tax due from an assessee, require to know all the facts which help him in coming to the correct conclusion. From the primary facts in his possession, whether on disclosure by the assessee, or discovered by him on the basis of the facts disclosed, or otherwise, the

> assessing authority has to draw inferences as regards certain other facts; and ultimately, from the primary facts and the further facts inferred from them, the authority has to draw the proper legal inferences, and ascertain on a correct interpretation of the taxing enactment, the proper tax leviable."

We are of the view that under section 34(1)(a) if the assessee has disclosed primary facts relevant to the assessment, he is under no obligation to instruct the Income-tax Officer about the interference which the Income-tax Officer may raise from those facts. The terms of the *Explanation* to section 34(1) also do not impose a more onerous obligation. Mere production of the books of account or other evidence from which material facts could with due diligence have been discovered does not necessarily amount to disclosure within the meaning of section 34(1), but where on the evidence and the materials produced the Income-tax Officer could have reached a conclusion other than the one which he has reached, a proceeding under section 34(1)(a) will not lie merely on the ground that the Income-tax Officer has raised an inference which he may later regard as erroneous.

The assessee had disclosed his books of account and evidence from which material facts could be discovered; it was under no obligation to inform the Income-tax Officer about the possible inferences which may be raised against him. It was for the Income-tax Officer to raise such an inference and if he did not do so the income which has escaped assessment cannot be brought to tax under section 34(1)(a). The appeal fails and is dismissed with costs.

* * * * *

Gemini Leather Stores v. *The Income-Tax Officer, 'B' Ward Agra*

AIR 1975 SC 1268

A.C. GUPTA, J. – The appellant a partnership firm, was assessed to income-tax for the assessment year 1956-57 on a turnover of Rupees fifteen lacs by the Income-tax Officer by his order dated January 22, 1958. The Income-tax Officer did not accept the return filed by the assessee and the books of account produced by it and made a best judgment assessment. The turnover so assessed was reduced by the Appellate Assistant Commissioner and further reduced by the Appellate Tribunal. On March 31, 1965 the Income-tax Officer issued a notice under Sec. 148 of the Income-tax Act, 1961 stating that he had reasons to believe that income chargeable in respect of the assessment year 1956-57 had escaped assessment within the meaning of Section 147 of the Act and directing the assessee to file a return as he proposed to reassess the income for the said assessment year. The assessee filed a writ petition before the High Court at Allahabad challenging the validity of the notice dated March 31, 1965 on the ground that the Income-tax Officer had no jurisdiction to issue the notice. A learned single Judge of the High Court dismissed the writ petition and his order was affirmed in appeal by a Division Bench. The appeal to this Court is by the assessee on certificate granted by the High Court.

2. The justification for taking action under Sections 147 and 148 of the Income-tax Act, 1961 as stated by the Division Bench of the High Court is:

> "The firm utilised certain drafts for making purchases at Madras and Calcutta. These drafts represented undisclosed income of the firm. This aspect of the matter was not considered at the time of the original assessment. It is proposed to take this income into consideration for purposes of reassessment. The amounts, for which drafts were purchased by the firm, were not recorded in the disclosed account of the firm. It is, therefore, proposed to tackle that income for purposes of reassessment."

The learned single Judge took the view that the Income-tax Officer did not apply his mind to the question as to whether the amounts invested in the purchase of the drafts could be treated as part of the total income of the assessee, and as the assessee did not disclose the source of these amounts which were not recorded in the account books produced by the assessee, all the conditions for invoking the jurisdiction under Section 147(a) were present. This was also the view taken by the Division Bench.

3. It appears that the Income-tax Officer had written a detailed order in making his best judgment assessment. Having found out all about the drafts which were not mentioned in the assessee's books of account, the Income-tax Officer gave the partners of the firm opportunity to explain the drafts. Referring to the statement of one of the partners, Shri Om Prakash, the Income-tax Officer observed in his order:

> "He has said that the drafts which were sent by him relating to Messrs Gemini Leather Stores were entered in the books of the firm while other drafts which he has made would be of others whose name he does not remember. As he is unable to tell to whom other drafts sent by him relate in spite of specific opportunities given to him, the obvious inference is that moneys of the drafts are that of the firm with which he is connected."

Referring to the circumstances in which these drafts had been sent or received, the Income-tax Officer further observed:

> "Since these drafts have been sent or received in such circumstances and by such persons connected with the firm the conclusion is obvious that these drafts relate to the firm."

4. It is not disputed that the case falls under clause (a) of Section 147. The question is whether the Income-tax Officer had reason to believe that income chargeable to tax had escaped assessment for the assessment year in question by reason of the omission or failure on the part of the assessee to disclose fully and truly all material facts. The decision in ***Calcutta Discount Company*** case [AIR 1961 SC 372]. is based on Section 34 of the Income-tax Act, 1922, the provisions of which correspond to those of Sections 147 and 148 of the Income-tax Act, 1961; the points of departure from the old law are not material for the purpose of this case. The position is stated in ***Calcutta Discount Company*** case as follows:

> "In every assessment proceeding the assessing authority will, for the purpose of computing or determining the proper tax due from an assessee, require to know all the facts which help him in coming to the correct conclusion. From the primary facts in his possession, whether on disclosure by the assessee, or discovered by him on the basis of the facts disclosed, or otherwise, the assessing authority has to draw inferences as regards certain other facts; and ultimately from the primary facts and the further facts inferred from them, the authority has to draw the proper legal inferences... Once all the primary facts are before the assessing authority, he requires no further assistance by way of disclosure. It is for him to decide what inferences of facts can be reasonably drawn and what legal inferences have ultimately to be drawn. It is not for somebody else - far less the assessee - to tell the assessing authority what inferences, whether of facts of law, should be drawn."

In the case before us the assessee did not disclose the transactions evidenced by the drafts which the Income-tax Officer discovered. After this discovery the Income-tax Officer had in his possession all the primary facts, and it was for him to make necessary enquiries and draw proper inferences as to whether the amounts invested in the purchase of the drafts could be treated as part of the total income of the assessee during the relevant year. This the Income-tax Officer did not do. It was plainly a case of oversight, and it cannot be said that the income chargeable to tax for the relevant assessment year had escaped assessment by reason of the omission or failure on the part of the assessee to disclose fully and truly all material facts. The Income-tax Officer had all the material facts before him when he made the original assessment. He cannot now take recourse to Section 147(a) to remedy the error resulting from his own oversight. For these reasons we allow the appeal and quash the impugned notice dated March 31, 1965 and the proceedings in consequence thereof.

* * * * *

Income-Tax Officer v. *Lakhmani Mewal Das*

(1976) 3 SCC 757

H.R. KHANNA, J. – The respondent was assessed for the assessment year 1958-59 under Section 23(3) of the Indian Income-tax Act, 1922 on June 14, 1960. His total income was assessed to be Rs. 37,872. While making the assessment the Income-tax Officer allowed deduction of a sum of Rs. 15,991 by way of expenses claimed by the respondent. The expenses included Rs. 10,494 by way of interest. According to the respondent, he produced through his authorised representative all books of accounts, bank statements and other necessary documents in connection with the return. On March 14, 1967 the respondent received notice dated March 8, 1967 issued by the appellant under Section 148 of the Act stating that the appellant had reason to believe that the respondent's income which was chargeable to tax for the assessment year 1958-59 had escaped assessment within the meaning of Section 147 of the Act and that the notice was being issued after obtaining the necessary satisfaction of the Commissioner of Income-tax. The respondent was called upon to submit within 30 days from the date of the service of the notice a return in the prescribed form of his income for the assessment year 1958-59. On May 2, 1967 the respondent through his lawyer stated that there was no material on which the appellant had reason to believe that the respondent's income had escaped assessment and, therefore, the condition precedent for the assumption of jurisdiction by the appellant had not been satisfied. The appellant was said to have no competence or jurisdiction to reopen the assessment under Section 147 of the Act on a mere change of opinion. The appellant was also called upon to furnish all the materials on which he had reason to believe that income had escaped assessment. As, according to the respondent, there was no satisfactory response from the appellant, he filed petition under Article 226 of the Constitution for quashing the impugned notice.

It was denied in the affidavit on behalf of the appellant that all materials relevant and necessary for the assessment of the respondent's income for the assessment year 1958-59 had been produced before the Income-tax Officer at the time of the original assessment. It was further stated:

> "Subsequent to the assessment for the assessment year 1958-59, it was discovered, *inter alia*, that some of the loans shown to have been taken and interests alleged to have been paid thereon by the petitioner during the relevant assessment year were not genuine. The Income-tax Officer had reason to believe that *bona fide* thereon are not genuine. If necessary, I crave leave to produce the hon'ble Judge hearing the application the relevant records on the basis of which the said Income-tax Officer had reason to believe that the income of the petitioner escaped assessment as aforesaid at the hearing of the application."

During the pendency of the proceedings, the High Court directed that a copy of the report made by the appellant to the Commissioner of Income-tax for obtaining latter's sanction under Section 147 be produced. The report was accordingly produced, and the same reads as under:

> "There are hundi loan credits in the name of Narayansingh Nandalal, D.K. Naraindas, Bhagwandas Srichand, etc., who are known name lenders, and also hundi loan credit in the name, Mohansingh Kanayalal, who has since confessed he was doing only name-lending.

> In the original assessment these credits were not investigated in detail. As the information regarding the bogus nature of thee credits is since known, action under Section 147(a) is called for to reopen the assessment and assess these credits as the undisclosed income of the assessee. The assessee is still claiming that the credits are genuine in the assessment proceedings for 1962-63. Commissioner's sanction is solicited to reopen the assessment for 1958-59, under Section 147(a)."

All the three Judges who constituted the Full Bench found that the assessee was not being charged with omission to disclose all facts: he was charged for having made an untrue disclosure because the assessee had stated that he had received certain sums of money from certain persons as loans when, in fact, he had not received any sum at all from those persons. It was also stated by the assessee at the time of the original assessment that he had paid interest to certain persons when, in fact, he had not, if the information received later was true. The duty of the assessee, it was held, was not only to make a full disclosure of all material facts, his duty was also to make a true disclosure of facts and not to mislead the assessing officer by disclosing certain things which did represent facts. The High Court accordingly held that once an assessee infringes this rule, any subsequent discovery of fact by the assessing officer which would raise a reasonable belief in his mind that the assessee had not made a true and correct disclosure of the facts and had thereby been responsible for escapement of his income from assessment would attract Section 147 of the Act. Two of the learned Judges, A.K. Mukherjea and S.K. Mukherjea, JJ., however, took the view that the conditions precedent for the exercise of jurisdiction by the Income-tax Officer under Section 147 of the Income-tax Act were not fulfilled in the case as the report submitted by the Income-tax Officer to the Commissioner for sanction under Section 147(a) was defective. The defects in the report, in the opinion of the High Court, were the same as had been pointed out by this Court in the case of ***Chhugamal Rajpal* v. *S.P. Chaliha*** [(1971) 1 SCC 453]. The Commissioner while according permission for taking action under Section 147, it was observed, acted mechanically because the Commissioner had not expressly stated that he was satisfied that this was a fit case for the issue of notice under Section 148. As against the majority, Sabyasachi Mukherji, J. held that notice under Section 148 of the Act was valid and did not suffer from any infirmity. It was also observed that the Commissioner of Income-tax had not acted improperly in giving sanction.

In the result, by majority the High Court quashed the notice issued by the appellant to the respondent.

In appeal before us Mr. Sharma on behalf of the appellants has assailed the judgment of the majority of the learned Judges in so far as they have held that the report submitted by the Income-tax Officer to the Commissioner of Income-tax for sanction was defective. As against that, Dr. Pal on behalf of the assessee-respondent has canvassed for the correctness of the view taken by the majority regarding the defective nature of the report. Dr. Pal has in his own turn assailed the finding of all the three learned Judges of the High Court in so far as they have held that the assessee was being charged with omission to disclose true facts. Contention has also been advanced by Dr. Pal that the material on the basis of which the Income-tax Officer initiated these proceedings for reopening the assessment did not have a rational connection with the formation of the belief that the assessee had not made a true disclosure of the facts at the time of the original assessment.

Before dealing with the points of controversy, it would be useful to reproduce the relevant provisions of the Act. Sections 147 and 148 deal with income escaping assessment and issue of notice where income has escaped assessment.

The provisions of Sections 147 to 153 of the Act correspond to those of Section 34 of the Indian Income-tax Act, 1922. There have been some points of departure from the old law, but it is not necessary for the purpose of the present case to refer to them.

It would appear from the perusal of the provisions reproduced above that two conditions have to be satisfied before an Income-tax Officer acquires jurisdiction to issue notice under Section 148 in respect of an assessment beyond the period of four years but within a period of eight years from the end of the relevant year, viz. (1) the Income-tax Officer must have reason to believe that income chargeable to tax has escaped assessment, and (2) he must have reason to believe that such income has escaped assessment by reason of the omission or failure on the part of the assess (a) to make a return under Section 139 for the assessment year to the Income-tax Officer, or (b) to disclose fully and truly material facts necessary for his assessment for that year. Both these conditions must coexist in order to confer jurisdiction on the Income-tax Officer. It is also imperative for the Income-tax Officer to record his reasons before initiating proceedings as required by Section 148(2). Another requirement is that before notice is issued after the expiry of four years from the end of the relevant assessment years, the Commissioner should be satisfied on the reasons recorded by the Income-tax Officer that it is a fit case for the issue of such notice. We may add that the duty which is cast upon the assessee is to make a true and full disclosure of the primary facts at the time of the original assessment. Production before the Income-tax Officer of the accounts books or other evidence from which material evidence could with due diligence have been discovered by the Income-tax Officer will not necessarily amount to disclosure contemplated by law. The duty of the assessee in any case does not extend beyond making a true and full disclosure of primary facts. Once he has done that his duty ends. It is for the Income-tax Officer to draw the correct inference from the primary facts. It is no responsibility of the assessee to advise the Income-tax Officer with regard to the inference which he should draw from the primary facts. If an Income-tax Officer draws an inference which appears subsequently to be erroneous, mere change of opinion with regard to that inference would not justify initiation of action for reopening assessment.

The grounds or reasons which lead to the formation of the belief contemplated by Section 147(a) of the Act must have a material bearing on the question of escapement of income of the assessee from assessment because of his failure or omission to disclose fully and truly all material facts. Once there exist reasonable grounds for the Income-tax Officer to form the above belief, that would be sufficient to clothe him with jurisdiction to issue notice. Whether the grounds are adequate or not is not a mater for the court to investigate. The sufficiency of grounds which induce the Income-tax Officer to act is, therefore, not a justiciable issue. It is, of course, open to the assessee to contend that the Income-tax Officer did not hold the belief that there had been such non-disclosure. The existence of the belief can be challenged by the assessee but not the sufficiency of reasons for the belief. The expression “reason to believe” does not mean a purely subjective satisfaction on the part of the Income-tax Officer. The reason must be held in good faith. It cannot be merely a pretence. It is open to the court to examine whether the reasons for the formation of the belief have a rational connection with or a relevant bearing on the formation of the belief and are not extraneous or irrelevant for the purpose of the section. To this limited extent, the action of the Income-tax Officer in starting proceedings in respect of income escaping assessment is open to challenge in a court of law.

Keeping the above principles in view, we may now turn our attention to the facts of the present case. Two grounds were mentioned in the report made by the Income-tax Officer for reopening of the assessee respondent with a view to show that his income had been underassessed because of his failure to disclose fully and truly material facts necessary for the assessment. One was that Mohansingh Kanayalal, who was shown to be one of the creditors of the assessee, had since confessed that he was doing only name-lending. The other ground was that Narayansingh Nandalal, D.K. Naraindas, Bhagwandas Srichand, etc., whose names too were mentioned in the list of the creditors of the assessee, were known name-lenders. So far as the second ground is concerned, neither the majority of the Judges of the High Court nor the learned Judge who was in the minority relied upon that ground. Regarding that ground, the learned Judge who was in the minority observed that no basis had been indicated as to how it became known that those creditors were known name-lenders and when it was known. The majority while not relying upon that ground placed reliance upon the case of ***Chhugamal Rajpal***. In that case the Income-tax Officer while submitting a report to the Commissioner of Income-tax for obtaining his sanction with a view to issue notice under Section 148 of the Act stated:

"During the year the assessee has shown to have taken loans from various parties of Calcutta. From D.I.'s Inv. No. A/P/Misc.(5) D.I/63-64/5623 dated August 13, 1965 forwarded to this office under C.I.T. Bihar and Orissa, Patna's letter No. Inv.(Inv.) 15/65-66/1953-2017 dated Patna September 24, 1965, it appears that these persons are name-lenders and the transactions are bogus. Hence, proper investigation regarding these loans is necessary. The names of some of the persons from whom money is alleged to have been taken on loan on hundis are: Seth Bhagwan Singh Sricharan; 2. Lakha Singh Lal Singh; 3. Radhakissen Shyam Sunder. The amount of escapement involved amounts to Rs. 1,00,000.

In dealing with that report this Court observed:

> From the report submitted by the Income-tax Officer to the Commissioner, it is clear that he could not have had reasons to believe that by reasons of the assessee's omission to disclose fully and truly all material facts necessary for his assessment for the accounting year in question, income chargeable to tax has escaped assessment for that year; nor could it be said that he, as a consequence of information in his possession, had reasons to believe that the income chargeable to tax has escaped assessment for that year. We are not satisfied that the Income-tax Officer had any material before him which could satisfy the requirements of either clause (a) or clause (b) of Section 147. Therefore, he could not have issued a notice under Section 148.

Reference to the names of Narayansingh Nandalal, D.K. Naraindas, Bhagwandas Srichand, etc. in the report of the Income-tax Officer to the Commissioner of Income-tax in the instant case does not stand on a better footing than the reference to the three names in the report made by the Income-tax Office in the case of Chhugamal Rajpal. We would, therefore, hold the second ground mentioned by the Income-tax Officer, i.e., reference to the names of

Narayansingh Nandalal, D.K. Naraindas, Bhagwandas Srichand, etc., could not have led to the formation of the belief that the income of the respondent assessee chargeable to tax had escaped assessment for that year because of the failure or omission of the assessee to disclose fully and truly all material facts. All the three learned Judges of the High Court, in our opinion, were justified in excluding the second ground from consideration.

We may now deal with the first ground mentioned in the report of the Income-tax Officer to the Commissioner of Income-tax. This ground relates to Mohansingh Kanayalal, against whose name there was an entry about the payment of Rs. 74 annas 3 as interest in the books of the assessee, having made a confession that he was doing only name-lending. There is nothing to show that the above confession related to a loan to the assessee and not to someone else, much less to the loan of Rs. 2,500 which was shown to have been advanced by that person to the assessee-respondent. There is also no indication as to when that confession was made and whether it relates to the period from April 1, 1957 to March 31, 1958 which is the subject-matter of the assessment sought to be reopened. The report was made on February 13, 1967. In the absence of the date of the alleged confession, it would not be unreasonable to assume that the confession was made a few weeks or months before the report. To infer from that confession that it relates to the period from April 1, 1957 to March 31, 1958 and that it pertains to the loan shown to have been advanced to the assessee, in our opinion, would be rather farfetched.

As stated earlier, the reasons for the formation of the belief must have a rational connection with or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income-tax Officer and the formation of his belief that there has been escapement of the income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts. It is no doubt true that the court cannot go into the sufficiency or adequacy of the material and substitute its own opinion for that of the Income-tax Officer on the point as to whether action should be initiated for reopening assessment. At the same time we have to bear in mind that it is not any and every material, howsoever vague and indefinite or distant, remote and farfetched, which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment. The fact that the words “definite information” which were there in Section 34 of the Act of 1922 at one time before its amendment in 1948 are not there in Section 147 of the Act of 1961 would not lead to the conclusion that action can now be taken for reopening assessment even if the information is wholly vague, indefinite, farfetched and remote. The reason for the formation of the belief must be held in good faith and should not be a mere pretence.

The powers of the Income-tax Officer to reopen assessment though wide are not plenary. The words of the statute are “reason to believe” and not “reason to suspect”. The reopening of the assessment after the lapse of many years is a serious matter. The Act, no doubt, contemplates the reopening of the assessment if grounds exist for believing that income of the assessee has escaped income or other income escaping assessment in a large number of cases come to the notice of the income-tax authorities after the assessment has been completed. The provisions of the Act in this respect depart from the normal rule that there should be, subject to right of appeal and revision, finality about orders in judicial and quasi-judicial proceeding. It is, therefore, essential that before such action is taken the requirements of the law should be satisfied. The live link or close nexus which should be there between the material before the Income-tax Officer in the present case and the belief which he was to form regarding the escapement of the income of the assessee from assessment because of the latter's failure or omission to disclose fully and truly all material facts was missing in the case. In any event, the link was too tenuous to provide a legally sound basis for reopening the assessment. The majority of the learned Judges in the High Court, in our opinion, were not in error in holding that the said material could not have led to the formation of the belief that the income of the assessee respondent had escaped assessment because of his failure or omission to disclose fully and truly all material facts. We would, therefore, uphold the view of the majority and dismiss the appeal with costs.

* * * * *

Srikrishna (P) Ltd. v. *I.T.O.*

(1996) 9 SCC 534

B.P. JEEVAN REDDY, J. - 1. This is an appeal preferred by the assessee against the judgment and order of a Division Bench of the Calcutta High Court allowing the writ appeal preferred by the Revenue against the judgment of a learned Single Judge. The learned Single Judge had allowed the writ petition filed by the assessee questioning the validity of a notice issued under Section 148 read with Section 147 of the Income Tax Act.

2. In the return filed for the Assessment Year 1959-60, the assessee had shown certain hundi loans totalling Rs 8,53,298 said to have been taken from a number of persons. The Income Tax Officer accepted the averment and made the assessment. During the assessment proceedings for the succeeding year, 1960-61, the assessee again showed hundi loans in a sum of more than rupees seventeen lakhs. The Income Tax Officer enquired into the truth of the averment and found that many of them were bogus claims while some of the alleged lenders were found to be near relations of directors or principal shareholders of the assessee. The Income Tax Officer held that out of the hundi loans of more than rupees seventeen lakhs claimed by the assessee, loans totalling Rs 11,15,275 were not established to be genuine loans and accordingly added that amount as income from undisclosed sources. Having regard to the similarity of the claims and the persons who are said to have advanced the said unsecured hundi loans during the accounting year relevant to the Assessment Year 1959-60, the Income Tax Officer issued a notice under Section 148 calling upon the assessee to file a revised return for the Assessment Year 1959-60. Immediately, upon receiving the said notice, the assessee approached the Calcutta High Court by way of a writ petition questioning the validity of the notice on the grounds that the Income Tax Officer had no reasonable ground to believe that income chargeable to tax has escaped assessment for the said year on account of any omission or failure on his part to make a full and true disclosure of all material facts. The writ petition was allowed by a learned Single Judge, as stated above, whose decision has been reversed in appeal by the Division Bench. This Court entertained the special leave petition filed by the assessee and granted leave on 26-7-1977. This Court, however, did not stay the proceedings pursuant to the impugned notice. It directed that the Income Tax Officer may proceed to complete the assessment proceedings but will not issue a demand notice. The Income Tax Officer has accordingly completed the reassessment.

4. Section 139 places an obligation upon every person to furnish voluntarily a return of his total income if such income during the previous year exceeded the maximum amount which is not chargeable to income tax. The obligation so placed involves the further obligation to disclose all material facts necessary for his assessment for that year *fully and truly*. If at any subsequent point of time, it is found that either on account of an omission or failure of the assessee to file the return or on account of his omission or failure to disclose fully and truly all material facts necessary for his assessment for that year, income chargeable to tax has escaped assessment for that year, the Income Tax Officer is entitled to reopen the assessment in accordance with the procedure prescribed by the Act. To be more precise, he can issue the notice under Section 148 proposing to reopen the assessment only where he has reason to believe that on account of either the omission or failure on the part of the assessee to file the

return or on account of the omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for that year, income has escaped assessment. The existence of the reason(s) to believe is supposed to be the check, a limitation, upon his power to reopen the assessment.

Section 148(2) imposes a further check upon the said power, viz., the requirement of recording of reasons for such reopening by the Income Tax Officer. Section 151 imposed yet another check upon the said power, viz., the Commissioner or the Board, as the case may be, has to be satisfied, on the basis of the reasons recorded by the Income Tax Officer, that it is a fit case for issuance of such a notice. The power conferred upon the Income Tax Officer by Sections 147 and 148 is thus not an unbridled one. It is hedged in with several safeguards conceived in the interest of eliminating room for abuse of this power by the assessing officers. The idea was to save the assessees from harassment resulting from mechanical reopening of assessment but this protection avails only those assessees who disclose all material facts truly and fully.

5. Coming to the facts of this case, the reasons recorded by the Income Tax Officer for reopening the assessment for the year 1959-60 are to the following effect:

> "In the course of the assessment proceeding for the Assessment Year 1960-61 investigations were made into the unsecured loans of Rs 17,32,298 which was the position of the last day of the accounting year relevant to the Assessment Year 1960-61. These investigations disclosed that a large number of them were bogus hundi loans or loans from near relations of the Directors or principal shareholders. Hence, the amounts credited to some of these accounts have been assessed as income from undisclosed sources to the extent of Rs 11,51,275.00.
>
> Similar loans are noticed for the Assessment Year 1959-60 and they stand at Rs 8,53,298 as per Balance-Sheet as on 16-4-1959.
>
> I have, therefore reasons to believe that by reason of omission or failure on the part of the assessee company to disclose fully and truly all material facts necessary for its assessment of 1959-60 in regard to these accounts, income chargeable to tax has escaped assessment.
>
> I, therefore, propose action under Section 147(*a*) of I.T. Act, 1961."

6. We may also mention that after hearing this appeal for some time, we found it appropriate to look into the relevant record and accordingly made the following order on 10-10-1995:

> "After hearing the appeals for some time, we find it necessary to look into the record to satisfy ourselves with respect to the following fact:
>
> Whether, at the time of issuing of notice under Section 148, the ITO had material before him showing the persons who have lent the sum of Rs 8,53,298 during the accounting year relevant to Assessment Year 1959-60, were the very same persons who are said to have lent Rs 11,51,275 (bogus loans) during the accounting year relevant to Assessment Year 1960-61, and disallowed by the ITO in that assessment year?
>
> Adjourned for eight weeks."

7. Accordingly, the Income Tax Officer has submitted a chart showing that out of the unsecured hundi loans of Rs 8,53,298 claimed by the assessee, ten persons who are said to have lent a total amount of Rs 3,80,000 were common to both the Assessment Years 1959-60 and 1960-61. In other words, these very ten persons are said to have advanced loans again during the next year and all the ten were found to be bogus lenders as recorded in the assessment proceedings relating to Assessment Year 1960-61. Now, the question is can it be said in the above facts that the issuance of the notice under Section 148 was not warranted? Can it be said in the face of the above facts that the Income Tax Officer had no reason to believe that on account of the assessee's omission/failure to disclose fully and truly all material facts necessary for his assessment for that year, income chargeable to tax has escaped assessment for that year. In the reasons recorded by the Income Tax Officer [as required by Section 148(2)], he had stated clearly that in the course of assessment proceedings for the succeeding assessment year, it was found that out of the unsecured hundi loans put forward by the assessee, a large number were found to be bogus and that many of the so-called lenders were found to be near relations of the Directors or the principal shareholders. He stated that similar loans are also noticed for the Assessment Year 1959-60 and, therefore, he has reason to believe that there has been no true and full disclosure of all material facts by the assessee for the Assessment Year 1959-60 leading to escapement of income. It is not alleged by the assessee that the Income Tax Officer had not checked up or tallied the names of the alleged lenders for both the assessment years and that he merely went by the fact that there were unsecured hundi loans for both the assessment years. In the absence of any such allegation — which allegation, if made, could have afforded an opportunity to the Income Tax Officer to answer the said averment — we must presume that the Income Tax Officer did find that a large number of alleged lenders who were found to be bogus during the Assessment Year 1960-61 were also put forward as lenders during the Assessment Year 1959-60 as well. Evidently, this is what he meant in the context, when he spoke of "similar loans" being noticed for the year in question as well. In such a situation, it is impossible to say that the Income Tax Officer had no reasonable ground to believe that there has been no full and true disclosure of all material facts by the assessee during the relevant assessment year and that on that account, income chargeable to tax had escaped assessment. As we shall emphasise hereinafter, every disclosure is not and cannot be treated to be a true and full disclosure. A disclosure may be a false one or true one. It may be a full disclosure or it may not be. A partial disclosure may very often be a misleading one. What is required is a *full and true disclosure of all material facts necessary for making assessment for that year*. This calls for an examination of the decisions of this Court analysing and elucidating Sections 147 and 148 of the Act.

8. The first and foremost is the decision of the Constitution Bench in ***Calcutta Discount Co. Ltd.* v. *ITO, Companies Distt.-I*** [AIR 1961 SC 372]. The case arose under Section 34 of the Income Tax Act (as amended in 1951). In material particulars, the provisions in Section 34 were similar to those in Section 147. Having regard to the fact that it is the only Constitution Bench decision on the point, it is necessary to examine it in some detail. The Constitution Bench explained the purport of Section 34 in the following words:

> "To confer jurisdiction under this section to issue notice in respect of assessments beyond the period of four years, but within a period of eight years, from the end of the relevant year two conditions have therefore to be satisfied. The first is that the Income Tax Officer must

have reason to believe that income, profits or gains chargeable to income tax have been under-assessed. The second is that he must have also reason to believe that such 'under-assessment' has occurred by reason of either (*i*) omission or failure on the part of an assessee to make a return of his income under Section 22, or (*ii*) omission or failure on the part of an assessee to disclose fully and truly all material facts necessary for his assessment for that year. *Both these conditions are conditions precedent to be satisfied before the Income Tax Officer could have jurisdiction to issue a notice for the assessment or reassessment* beyond the period of four years, but within the period of eight years, from the end of the year in question.

The words used are 'omission or failure to disclose fully and truly all material facts necessary for his assessment for that year'. *It postulates a duty on every assessee to disclose fully and truly all material facts necessary for his assessment*. What facts are material and necessary for assessment will differ from case to case. In every assessment proceeding, the assessing authority will, for the purpose of computing or determining the proper tax due from an assessee, require to know all the facts which help him in coming to the correct conclusion. From the primary facts in his possession, whether on disclosure by the assessee, or discovered by him on the basis of the facts disclosed, or otherwise - the assessing authority has to draw inferences as regards certain other facts; and ultimately, from the primary facts and the further facts inferred from them, the authority has to draw the proper legal inferences, and ascertain on a correct interpretation of the taxing enactment, the proper tax leviable. Thus, when a question arises whether certain income received by an assessee is capital receipt, or revenue receipt, the assessing authority has to find out what primary facts have been proved, what other facts can be inferred from them, and, taking all these together, to decide what the legal inference should be.

We have, therefore, come to the conclusion that while the duty of the assessee is to disclose fully and truly all primary relevant facts, it does not extend beyond this."

9. In that case, the alleged non-disclosure of material facts fully and truly — to put it in the words of the court — was the failure of the assessee to disclose "the true intention behind the sale of the shares". The assessee had stated during the assessment proceedings that the sale of shares during the relevant assessment years was a casual transaction in the nature of mere change of investment. The Income Tax Officer found later that those sales were really in the nature of trading transactions. The case of the Revenue was that the assessee ought to have stated that they were trading transactions and that his assertion that they were casual transactions, in the nature of change of investment, amounted to "omission or failure to disclose fully and truly all material facts necessary for his assessment for that year" within the meaning of Section 34. This contention of the Revenue was rejected holding that the *true nature of transaction*, being a matter capable of different opinions, is not a material or primary fact but a matter of inference and hence, it cannot be said that there was an omission or failure of the nature contemplated by Section 34 on the part of the assessee. Now, what needs to be emphasised is that the obligation on the assessee to disclose the material facts — or what are called, primary facts - is not a mere disclosure but a disclosure which is *full and true*. A false disclosure is not a true disclosure. The disclosure must not only be true but must be full - "fully and truly". A false assertion, or statement, of material fact, therefore, attracts the jurisdiction of the Income Tax Officer under Sections 34/147. Take this very case: the Income Tax Officer

says that on the basis of investigations and enquiries made during the assessment proceedings relating to the subsequent assessment year, he has come into possession of material, on the basis of which, he has reasons to believe that the assessee had put forward certain bogus and false unsecured hundi loans said to have been taken by him from non-existent persons or his dummies, as the case may be, and that on that account income chargeable to tax has escaped assessment. According to him, this was a false assertion to the knowledge of the assessee. The Income Tax Officer says that during the assessment relating to subsequent assessment year, similar loans (from some of these very persons) were found to be bogus. On that basis, he seeks to reopen the assessment. It is necessary to remember that we are at the stage of reopening only. The question is whether, in the above circumstances, the assessee can say, with any justification, that he had *fully and truly* disclosed the material facts necessary for his assessment for that year. Having created and recorded bogus entries of loans, with what face can the assessee say that he had truly and fully disclosed all material facts necessary for his assessment for that year? True it is that Income Tax Officer could have investigated the truth of the said assertion - which he actually did in the subsequent assessment year - but that does not relieve the assessee of his obligation, placed upon him by the statute, to disclose fully and truly all material facts. Indubitably, whether a loan, alleged to have been taken by the assessee, is true or false, is a material fact - and not an inference, factual or legal, to be drawn from given facts. In this case, it is shown to us that ten persons (who are alleged to have advanced loans to the assessee in a total sum of Rs 3,80,000 out of the total hundi loans of Rs 8,53,298) were established to be bogus persons or mere name-lenders in the assessment proceedings relating to the subsequent assessment year. Does it not furnish a reasonable ground for the Income Tax Officer to believe that on account of the failure - indeed not a mere failure but a positive design to mislead - of the assessee to disclose all material facts, fully and truly, necessary for his assessment for that year, income has escaped assessment? We are of the firm opinion that it does. It is necessary to reiterate that we are now at the stage of the validity of the notice under sections 148/147. The enquiry at this stage is only to see whether there are reasonable grounds for the Income Tax Officer to believe and not whether the omission/failure and the escapement of income is established. It is necessary to keep this distinction in mind.

10. A recent decision of this Court in ***Phool Chand Bajrang Lal* v. *ITO*** [(1993) 4 SCC 77], we are gratified to note, adopts an identical view of law and we are in respectful agreement with it. The decision rightly emphasises the obligation of the assessee to disclose all material facts necessary for making his assessment *fully and truly*. A false disclosure, it is held, does not satisfy the said requirement. We are also in respectful agreement with the following holding in the said decision:

> “Since the belief is that of the Income Tax Officer, the sufficiency of reasons for forming the belief, is not for the Court to judge but it is open to an assessee to establish that there in fact existed no belief or that the belief was not at all a bona fide one or was based on vague, irrelevant and non-specific information. To that limited extent, the Court may look into the conclusion arrived at by the Income Tax Officer and examine whether there was any material available on the record from which the requisite belief could be formed by the Income Tax Officer and further whether that material had any rational connection or a live link for the formation of the requisite belief.”

11. Learned counsel for the assessee, Shri Gupta placed strong reliance upon the decisions of this Court in ***Chhugamal Rajpal* v. *S.P. Chaliha*** [(1971) 1 SCC 453]; ***ITO* v. *Lakhmani Mewal Das*** [(1976) 3 SCC 757] and ***CIT* v. *Burlop Dealers Ltd*.** [(1971) 1 SCC 462] as laying down propositions contrary to those laid down in ***Phool Chand Bajrang Lal***. We cannot agree. The principle is well settled by *Calcutta Discount* and it is not reasonable to suggest that any different proposition was sought to be enunciated in the said decisions. ***Calcutta Discount*** emphasises repeatedly the assessee's obligation to disclose all material facts necessary for his assessment *fully and truly* in the context of the two requirements — called conditions precedent which must be satisfied before the Income Tax Officer gets the jurisdiction to reopen the assessment under Sections 147/148. This obligation can neither be ignored nor watered down. Nor can anyone suggest that a false disclosure satisfies the requirement of full and true disclosure. All the requirements stipulated by Section 147 must be given due and equal weight. Finality of proceedings is certainly a consideration but that avails one who has fully and truly disclosed all material facts necessary for his assessment for that year - and not to others. All the decisions relied upon by Shri Gupta have been elaborately discussed and distinguished in ***Phool Chand Bajrang Lal*** and we fully agree with the same. We think it unnecessary to repeat those reasons. In particular, we agree with the reasons given in ***Phool Chand Bajrang Lal*** for holding that the decision of this Court in ***Burlop Dealers*** must be confined to the particular fact-situation of that case and that it cannot be construed to be of universal application irrespective of the facts and circumstances of the case before the Court.

12. It is brought to our notice that certain other decisions of this Court have rightly emphasised the requirement of full and true disclosure and have held that failure or omission to do so, legitimately attracts the power under Section 147. In ***Inspecting Asstt. CIT* v. *V.I.P. Industries Ltd.*** [(1991) 191 ITR 661 (SC)] a three-Judge Bench had this to say:

> "After hearing learned counsel for both the parties, we are unable to uphold the order of the High Court. It appears that, subsequently, facts have come to the notice of the Income Tax Department that the facts disclosed in the return are not a true and correct declaration of facts. In that view of the matter, we set aside the order of the High Court passed in Writ Petition No. 1634 of 1988 with Writ Petition No. 2919 of 1988 [***V.I.P. Industries* v. *Inspecting Asstt. Commr.*** (1991) 187 ITR 639 (Bom)], and send the case back on remand to the Income Tax Officer for a decision in accordance with law after giving an opportunity of hearing to the parties concerned.
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> The special leave petitions are disposed of."

13. In ***Central Provinces Manganese Ore Co. Ltd.* v. *ITO*** [(1991) 4 SCC 166] again this Court observed:

> "The only question which arises for our consideration is as to whether the two conditions required to confer jurisdiction on the Income Tax Officer under Section 147(*a*) of the Act have been satisfied in this case. The first is that the Income Tax Officer must have reason to believe that the income chargeable to income tax had been under-assessed and the second that such under-assessment has occurred by reason of omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for its assessment for the year 1953-54.

So far as the first condition is concerned, the Income Tax Officer, in his recorded reasons, has relied upon the fact as found by the Customs Authorities that the appellant had under-invoiced the goods he exported. It is no doubt correct that the said finding may not be binding upon the income tax authorities but it can be a valid reason to believe that the chargeable income has been under-assessed. The final outcome of the proceedings is not relevant. What is relevant is the existence of reasons to make the Income Tax Officer believe that there has been under-assessment of the assessee's income for a particular year. We are satisfied that the first condition to invoke the jurisdiction of the Income Tax Officer under Section 147(*a*) of the Act was satisfied.

As regards the second condition, the appellant did not produce the books of accounts kept by them at their head office in London nor the original contracts of sale which were entered into at London with the buyers. The appellant did not produce before the Income Tax Officer any of the accounts which related to the foreign buyers. No reasons were given for the supply of manganese ore at a rate lower than the market rate. It is for the assessee to disclose all the primary facts before the Income Tax Officer to enable him to account for the true income of the assessee. The proven charge of under-invoicing per se satisfied the second condition. The appellant's assessable income has to be determined on the basis of the price received by it for the goods exported. If the true price has not been disclosed and there was under-invoicing, the logical conclusion prima facie is that there has been failure on the part of the appellant to disclose fully and truly all material facts before the Income Tax Officer. We are, therefore, satisfied that both the conditions required to attract the provisions of Section 147(*a*) have been complied with in this case."

14. In ***ITO* v. *Mewalal Dwarka Prasad*** [(1989) 176 ITR 529] this Court held that if the notice issued under Section 148 is good in respect of one item, it cannot be quashed under Article 226 on the ground that it may not be valid in respect of some other items. We need not, however, dilate on this aspect for the reason that no argument has been urged before us to the effect that since the notice under Section 148 is found to be justifiable in respect of some loans disclosed and not with respect to other loans, it is invalid.

15. For the above reasons, the appeal fails.