

PRIVY COUNCIL

Pondicherry Railway Co. Ltd.

Vs.

Commissioner of Income-tax, Madras

Privy Council Appeal No.94 of 1930
(Lord Macmillan, J. Lord Salvesen and Sir George Lowndes JJ.)

26.03.1931

JUDGMENT

LORD MACMILLAN J.

1. For the years 1925-26 and 1926-27 assessment to income-tax and super-tax under the Income-tax Act, 1922 (11 of 1922) were made on "the Agent, Pondicherry Ry. Co. Ltd., Trichinopoly" in respect of the income derived by the company from its business. On appeal these assessments were confirmed by the Assistant Commissioner of Income-tax, Southern Range, Madura. The assessee thereupon under Section 66(2) of the Act required the Commissioner of Income-tax for the Province of Madras to refer to the High Court of Judicature at Madras certain questions of law arising with regard to the validity of the assessment. The Commissioner accordingly stated a case in which he referred for the decision of the Court four questions of law, three only of which it is necessary to set out here viz.:

"(b) Whether the Pondicherry Ry. Co. Ltd. which is resident without British India is liable to be assessed to income-tax on the income derived by it from the working of the Pondicherry Railway under section 4, Income-tax Act as income accruing or arising or received in British India?"

(c) Whether the Pondicherry Ry. Co. Ltd. carries on business in British India within the meaning of the Income-tax Act ? and

(d) Whether in any event the income of the said company that is liable to assessment to income-tax is only that portion which is payable to it under the concession between it and the French Colonial Government ?"

2. The Commissioner, as required by the Act, stated his opinion on the questions referred which was to the effect that Questions (b) and (c) fell to be answered in the

affirmative and Question (d) in the negative.

3. In the High Court the learned Chief Justice (Sir Murray Courts Trotter) was of opinion that Questions (b) and (c) should be answered in the negative, but the majority of the Court (Odgers and Beasley, JJ.) were of opinion that these questions should both be answered in the affirmative. This accordingly became the decision of the Court. As regards Question (d) the Court was unanimously of opinion in the negative.

4. The assessments having thus been upheld the Court under section 66-A (2) of the Act certified the case to be a fit one for appeal to His Majesty in Council and it has now been heard by their Lordships on the assessee's appeal.

5. It is necessary to set out in some detail the material facts. The Pondicherry Ry. Co. Ltd. was incorporated in the United Kingdom in 1869 under the British Joint Stock Companies Acts for the purpose of constructing a railway in the French Colony of Pondicherry. The registered office of the company has always been in London. In the year 1878 the company entered into a convention with the Minister of Marine and Colonies acting on behalf of the French Colony of India whereby a concession was granted to the company to construct and work a line of railway from the landing pier at Pondicherry to a junction with the S. I. Ry. at the frontier of the French territory. The duration of the convention was fixed at 99 years and the company thereby undertook to construct and work the proposed railway, or to cause the same to be constructed and worked, and assumed various obligations in regard to it. In consideration of the company's engagements the French Minister undertook to pay to the company in installments a subsidy of 1,251,375 francs and to provide the requisite land free of charge. The convention further provided as follows :

"The company undertakes on its part to make over to the Colonial Government during the whole duration of the concession one half of the net profits which shall be arrived at by deducting from the gross receipts the rates and taxes of every kind chargeable to the company as well as the amount expended in the purchase or hire of rolling stock, the expenditure relating to maintenance and repair of the lines, of fixed plant and rolling stock; expenses of working and administration; as well as such sums, if any, as with the consent of the Colonial Government may be placed to reserve to cover the costs of heavy repairs of the works of the railway and for the renewal of the "material." But this division shall not commence until after deduction by the company of a sum of one hundred and fifty-seven thousand five hundred francs (157,500 francs) from the

aggregate amount of the net profits during the first years of the working of the line; and this by way of reimbursement for the expenses of administration for which the company has made itself liable."

6. The company duly constructed the projected line of railway, which was entirely situated in French territory, and effected the junction at the frontier with the system of the South Indian Railway. As empowered in the convention with the French Minister the company entered into an agreement dated 25th March 1879, with the South Indian Railway Company Limited whereby the latter undertook to work, manage and maintain the Pondicherry Railway. The agreement in force between the two railway companies at the time of the assessments in question was dated 30th December 1890. Such agreements between an owning company and a working company are familiar in railway practice and may take various forms. Examples which have come before the Courts are discussed in their legal bearings in *Sevenoaks and Railway Co. v. London, Chatham and Dover Railway Co.* *South Behar Railway Co. v. Inland Revenue Commissioner* *Inland Revenue v. Edinburgh and Bathgate Railway Co.* and *Inland Revenue v. Dublin and Kingstown Railway Co.* [1926] 5 *Accountant's Tax Cases* 721. The working agreement in the present case is on simple lines. The South Indian Company undertakes to work the Pondicherry line "as if it were an integral part of their undertaking" and from time to time to pay the gross receipts of the line

"into such Government Treasury in India as the Secretary of State may prescribe."

7. It is then provided that

"out of the gross receipts of the Pondicherry line there shall be deducted and retained by the South Indian Company for working expenses the same percentage of gross receipts as the traffic of the South Indian Company, including therein the Pondicherry line, is from time to time worked at."

8. After deduction of this percentage for working expenses from gross receipts

"the balance shall be ascertained and shall be paid over every six months by the South Indian Company to the Pondicherry Company in India in rupees."

Provision is made for dividing between the two companies on a mileage basis the gross receipts from through traffic. The following paragraphs taken from the stated case indicate the matter in which the terms of the agreement are carried out in practice :

"10. The Agent of the South Indian Company who is managing its affairs in India keeps accounts at Trichinopoly to show the receipts and expenses of the

Pondicherry line and determines the net receipts payable to the Pondicherry Company according to the agreement with that company.

11. The petitioner, Mr. Percy Rothera, who is the agent of the South Indian Company, is also the agent of the Pondicherry Company and is addressed by the Secretary of the latter Company in London as such.

12. Mr. Rothera receives at Trichinopoly on behalf of the Pondicherry Company the profits due to it in accordance with the terms of the agreement with the South Indian Company. This will be seen from the correspondence annexed, Exs. C and D. Under instructions from the Board of Directors in London of the Pondicherry Company he remits the share of profits due under the convention to the Colonial Government at Pondicherry and remits the balance to the Pondicherry Company in London.

13. Mr. Rothera as the agent of the Pondicherry Company carries on correspondence with the Directors of the Company in London on matters connected with the working of the convention and the agreement, such as alterations in rates of fares, the preparation of the accounts of the company and the payment of the share of profits due to the French Colonial Government. He receives an honorarium of £21 a year from the Pondicherry Company for services rendered.

14. The Chief Engineer and the General Traffic Manager of the South Indian Company are also ex-officio officers of the Pondicherry Company and receive an honorarium of £10 10s. each. The revenue accounts of the Pondicherry Company are prepared by the Chief Auditor of the South Indian Company acting as Chief Auditor of the Pondicherry Company.

15. The Pondicherry Company has an office at Trichinopoly with a sign-board."

9. Exhibit C is a letter dated 5th April 1923, addressed from London by the Secretary of the Pondicherry Company to Mr. Scott (Mr. Rothera's predecessor. "Agent, Pondicherry Railway Co., Ltd., Trichinopoly," enclosing a statement of the expenses of administration of the company in England for the year. The letter proceeds :

"The figures now furnished will enable you to prepare the Revenue account for the year ending 31st March 1923, showing the amount of net profits divisible between the French Colonial Government and the company. When this has been done you will be good enough to pay over to the French authorities the moiety of the net profits in terms of Article 6 of the Convention and to remit by Demand Draft to the Board the balance due to the company."

10. Exhibit D is the reply of Mr. Scott, dated 30th May 1923. It is headed :

'Pondicherry Rly. Co., Ltd., (Incorporated in England), Agent's. Office, Trichinopoly," and Mr. Scott appends the word "Agent" to his signature. In the letter he reports that in conformity with the instructions received he has sent a cheque for Rs. 12,498-12 2 to the treasurer of the French establishments in India and he encloses as the share of the Pondicherry Railway Board a Demand Draft on the National Bank of India for £1,237 9s. 5d., the equivalent of Rs. 18,525. A specimen Demand Draft exhibited to their Lordships was drawn by the National Bank of India at Madras on their London office to the order of the Secretary of the Pondicherry Railway Company.

11. An affidavit by Mr. Rothera was filed in the Court of the Assistant Commissioner of Income-tax in which he stated inter alia that the letters from London addressed to him as agent of the Pondicherry Company related to instructions and orders of the London Board on questions of policy, increase or decrease of rates, the company's relationship with the French Government, or the preparation of accounts for the company in London, but had no relation to the actual working of the line. He further stated that he did not control the affairs of the Pondicherry Company but in all that he did on their behalf acted under the instructions of Board in London where the accounts of the company were maintained; everything that he did in the actual management and working of the line was done by him in his capacity as agent of the S. I. Ry. Co.

12. Turning now to the terms of the Income-Tax Act, their Lordships find there enacted in Section 4(1) that the statute is to " apply to all income, profits or gains as described or comprised in Section 6 from whatever source derived, accruing or arising or received in British India."

13. In Section 6 the heads of income, profits and gains chargeable to income-tax are set out in six categories, of which the fourth is " business." It is under this head that the appellant company has been assessed. section 10 enacts that :

" the tax shall be payable by an assessee under the head " business " in respect of the profits or gains of any business carried on by him " and prescribes that such profits or gains shall be computed after making allowance for inter alia (ix)any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains."

" Business " is defined in Section 2(4) as including " any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

14. In the Court below the question whether the assessed income of the Pondicherry

Company accrued or arose in British India within the meaning of the Act was much discussed, and the opinion of the majority of the Judges as embodied in the order of the Court of 26th March 1929, was that it did so accrue. Their Lordships do not find it necessary to pronounce upon this aspect of the case and have come to no conclusion with regard to it, for they are satisfied that the income in question was " received " in British India within the meaning of the statute, which is sufficient for the determination of the company's liability.

15. The argument presented by Mr. Micklethwaite for the appellants was to the effect that the facts when critically examined demonstrated that Mr. Rothera was not the agent of the company to receive payment on their behalf from the South Indian Company, but was merely their agent to transmit payment to the Board in London. He submitted that it was the company in London which received payment from the South Indian Company, not Mr. Rothera in Trichinopoly. The same sum could not be received twice and if it was truly received in London it could not be received also in Trichinopoly. The transmission of the Pondicherry Company's share of the gross receipts in the form of a draft on London, payable only in London, showed that Mr. Rothera's function was limited to that of a mere channel of communication, or in the phrase of the Chief Justice, to that of " a mere post office."

16. In their Lordships' view the facts do not support this contention. In the stated case it is found as a fact that:

" Mr. Rothera receives at Trichinopoly on behalf of the Pondicherry Company the profits due to it in accordance with the terms of the agreement with the S. I. Rly. Co."

17. This may no doubt be regarded as a mixed finding of fact and law, if the word " receives " is used in the statutory sense, but it is at least a finding of fact that payment is made to Mr. Rothera at Trichinopoly. Nothing is due to the Pondicherry Company under the agreement with the South Indian Company until the latter has ascertained the gross receipts which the traffic on the Pondicherry line has yielded and has deducted therefrom the prescribed percentage for working expenses. This calculation is effected at Trichinopoly in the office of the South Indian Company. The balance then becomes due and payable to the Pondicherry Company " in India in rupees." Mr. Rothera no doubt doubles the parts of agent of the Pondicherry Company and agent of the South Indian Company, which has led to some confusion of functions, but when his roles are disentangled it is clear that when as agent for the South Indian Company he has ascertained the sum due to the Pondicherry Company he transfers it to himself

as agent for the latter company for thereafter he proceeds to deal with it as instructed on behalf of that company. He does not merely transmit to London a sum of money payable to the Pondicherry Company by the South Indian Company.

18. He has to apportion the sum so payable between the Pondicherry Company and the French Government in terms of the convention and this is not a mere matter of dividing it by two for as appears from Ex. D, the share remitted to London is not the same as the share remitted to the French Government. It is one half of the net profits as ascertained in terms of the convention that the French Government receives and the computation of this half involves calculation on the part of Mr. Rothera as the agent of the Pondicherry Company. He is instructed from London to " pay over to the French authorities " their moiety. How he can obey this instruction and pay over what, on the appellants' submission, he has not received requires for its appreciation a metaphysical subtlety remote from the prosaic realm of income-tax law. How it may also be asked can he purchase a draft on London unless he has the wherewithal to pay for it ? The attempt to present Mr. Rothera as an animated post office fails when it is realized that his functions far transcend the mere mechanical act of transmitting a sum to its recipient. He is the paid agent at Trichinopoly of the Pondicherry Company carrying on their agency in an office bearing their name and he is entrusted with the important duties on their behalf which he himself describes in his affidavit and which are set out in the stated case, not the least important of which is to see to the carrying out of the financial arrangements between the Pondicherry Company on the one hand and the South Indian Company and the French Government on the other hand. If there is no receiving of money by the Pondicherry Company until it is received in London then the remarkable result follows that of the sum payable by the South Indian Company to the Pondicherry Company a substantial part is never received by the latter company at all, for the portion diverted by Mr. Rothera to the French Government is never received in London and if it is not received in Trichinopoly it is apparently nowhere received by the Pondicherry Company. It certainly is not paid by the South Indian Company to the French Government, for there is no privity between them, and if it is paid, as it is, by Mr. Rothera to the French Government it can only be so paid by him after he has received it. Moreover, the agreement with the South Indian Company requires that company to make payment to the Pondicherry Company "in India in rupees," It may be that this might be complied with by a payment made in French India, although their Lordships express no opinion on this point, but at least it is clear that it would not be complied with by a payment in London.

19. Their Lordships accordingly are of opinion that the income derived by the Pondicherry Company from the payments made to it by the South Indian Company is, on the facts stated, received in British India, within the meaning of the Act, by the agent of the Pondicherry Company there on their behalf.

20. That these payments constitute profits or gains of a "business" carried on by the Pondicherry Company was scarcely contested and their Lordships, following the decision in the South Behar Railway Company's case, have no hesitation in so finding. It is unnecessary to go on to consider whether the business is carried on in British India, which is the form which Question (c) takes, for it is enough if the profits of a business carried on by the assessee are received in British India and the place where the business is carried on is not material. The appellants expressed themselves as desirous that the question of where their business is carried on should be left open, in view of possible ulterior consequences, and their Lordships make no pronouncement on the point.

21. Question (d) relates to the quantum of the assessment. The statute permits the assessee in computing the profits or gains of any business carried on by him to deduct:

" any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains."

22. The Pondicherry Company is taken bound in the convention with the French Minister to "make over" to the Colonial Government "one half of the net profits" of the undertaking arrived at in the manner prescribed in the convention. It is claimed for the company that when it makes over to the Colonial Government their half of the net profits it is making an expenditure incurred solely for the purpose of earning its own profits. The Court below has unanimously negatived this contention and in their Lordships' opinion has rightly done so. A payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits. It assumes that profits have first come into existence. But profits on their coming into existence attract tax at that point and the revenue is not concerned with the subsequent application of the profits. It was persuasively argued that inasmuch as the Pondicherry Company as a condition of making any profits must pay over one half of them to the French authorities and could never itself receive the whole profits the payment so made was of the nature of a rent payable by the company or a charge on the undertaking. But the analogy in their Lordships' opinion is imperfect, and the form in which the parties have contracted that the French Government shall participate in the success of the undertaking precludes the deduction claimed. English authorities can

only be utilised with caution in the consideration of Indian income-tax cases owing to the differences in the relevant legislation, but the principle laid down by Lord Chancellor Halsbury in *Gresham Life Assurance Society v.*, at p. 315, is of general application unaffected by the specialties of the English tax system :

" The thing to be taxed," said his Lordship, is the amount of profits or gains. The word "profits" I think is to be understood in its natural and proper sense-in a sense which no commercial man would misunderstand. But when once an individual or a company has in that proper sense ascertained what are the profits of his business or his trade, the destination of those profits or the charge which has been made on those profits by previous agreement or otherwise is perfectly immaterial. The tax is payable upon the profits realised and the meaning to my mind is rendered plain by the words "payable out of profits."

23. Their Lordships thus find themselves in agreement with the result of the judgment of the High Court on all material points, but they are not prepared to follow the course adopted below of answering categorically the questions posed in the stated case, which have not been so framed as to enable their Lordships by affirmative or negative answers to express their opinion upon the topics to which they desire to confine their decision and on which alone it is necessary to pronounce for the purpose of determining the appellants' liability. Their Lordships will accordingly humbly advise His Majesty that the order of the High Court of 26th March 1929, be varied by deleting therefrom the following words:

" and this Court by a majority being of opinion that the profits and gains of the Pondicherry Railway Company accrued in British India and hence it is liable to be taxed and that the said Company carries on business in British India within the meaning of the Indian Income-tax Act doth answer Questions (b) and (c) in the affirmative." and substituting therefor the following :

" This Court doth declare in answer to Questions (b) and (c) that the Pondicherry Railway Company Limited is liable to be assessed to income-tax for the years 1925-26 and 1926-27; under Section 4(1), Income-tax Act on the income derived by it from the payments made to it by the S. I. Rly. Co. Ltd. in respect of the working of the Pondicherry Railway as being income received in British India by the Pondicherry Rly. Co. Ltd. from the carrying on of its business."

24. and that the order of the High Court of 1st May 1929, be varied by deleting there from the following words :

“and this Court being of opinion that the yearly payment made to the French Colonial Government is a distribution of profits and not an allowance deductible from those profits doth answer in the negative question (d), viz., "Whether in any event the income of the said Company that is liable to assessment to income-tax is only that portion which is payable to it under the concession between it and the French Colonial Government."

25. And substituting therefore the following :

" This Court doth declare in answer to Question (d) that in computing the profits or gains of the business carried on by the Pondicherry Ry. Co. Ltd. for the purpose of assessment to Indian Income-tax no allowance is deductible in respect of the half share of net profits payable by the Pondicherry Rly. Co. Ltd. to the French Colonial Government."

26. With these variations their Lordships will humbly advise His Majesty that the orders appealed from be affirmed and the appeal dismissed. The respondent will have his costs of the appeal.

Appeal dismissed.

Cases Referred.

[1879] 11 Ch D 625=48 LJ Ch 513=27 WR 672=40 LT 545,

[1925] AC 476,

[1926] SC 863

Styles [1892] AC 309=62 LJ QB 41=56 JP 709=41 WR 270=67 LT 479