The Anglo-French Textile Company Ltd.

Vs

Commissioner of Income-Tax, Madras

Civil Appeal No. 11 of 1952

(N. H. Bhagwati, M. C. Mahajan, S. R. Dass, Vivian Bose JJ)

08.12.1953

JUDGMENT

BHAGWATI, J. –

This is an appeal from the judgment and order of the High Court of judicature at Madras upon a reference made by the Income-tax Appellate Tribunal under Section 66(I) of the Indian Income-tax Act, 1922. The appellant company, the assessee, is incorporated in the United Kingdom under the English Companies Act and has its registered office in London. It own a spinning and weaving mill at Pondicherry in French India where it Manufactures yarn and cloth. Messrs. Best and Co., Ltd., Madras, have been appointed the agents of the assessee under an agreement dated the July 11, 1939, and have been invested with full powers in connection with the business of the assessee in the matter of purchasing stock, singing bills and other negotiable instruments and receipts and settling. compounding or compromising any claim by against the assessee. The yarn and cotton manufactured in Pondicherry were sold mostly in British India and partly outside British India. In the accounting years 1941 and 1942 all the contracts in respect of the sales in British India were entered into in British India and the deliveries were made payments received in British India. In regard to the sales outside British India also, payments in respect of such sales were received in Madras through the said agents.

The total sales of the goods in the assessment year 1942-43 were Rs. 69,69,145 and for the assessment year 1943-44 were Rs. 93,48,822. The value of the sales in British India amounted to Rs. 57,07,431 for the assessment year 1942-43 and to Rs. 67,98,356 for the assessment year 1943-44. The value of the total sales outside British India amounted to Rs. 12,61,714 for the year 1942-43 and Rs. 25,50,472 for the year 1943-44. Out of the said amounts received in respect of the foreign sales the amounts received in British India were Rs. 9,62,434 for 1942-43 and Rs. 75,230 for 1943-44 and the amounts received outside British India were Rs. 2,99,280 for 1942-43 and Rs. 24,75,242 for 1943-44.

On these facts the Income-tax Officer found that the assessee was resident in British India within the meaning of Section 4A(c)(b) of the Act reason of its income arising in British India in the year of account exceeding its income arising without British India and on that basis he assessed the company for the two assessment years 1942-43 and accrued to the company both within and without British India under Section 4(I)(b)(i) and (ii) of Act. The order of the Income-tax Officer was confirmed by the Appellate Assistant Commissioner and the order of the Appellate Assistant Commissioner was confirmed by the Appellate Tribunal on the May 15, 1946.

The assessee applied to the Appellate Tribunal under Section 66(I) of the Act for reference to the

High Court of certain question of law arising out of its order. The Commissioner of Income-tax in his reply suggested the following two questions for reference :-

> "(1) Whether, on the facts and in the circumstances of the case, the appellate Tribunal was right in holding that the Section 42(I) and (3) of the Income-tax Act has no application to income accruing or arising to the assessee company in British India or to income received by it in British India during the previous year ?
>
> (2) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the entire income of the assessee company during the accounting year ended December 31, 1941, was assessable under Section 4(1) of the Income-tax Act, and that no portion of such income was entitled to be exempted under Section 42(3) of the Act ?"

The Appellate Tribunal however referred the following questions to the High Court :-

> "(1) Whether on the facts and in the circumstances of the case, Section 42(1) and (3) of the Act alone and lot Section 4 of the Act have application to the income accruing or arising to the assessee company in British India and to the income attributable to the sale proceeds received by it in British India during the previous year ?
>
> (2) Whether on the facts and in the circumstances of this case the entire profits and gains arising to the assessee company in British India should be taken into account for the purpose of applying the test laid down under Section 4A(c)(b) or only that part of the profits which could be determined after the application of Section 42(3) of the Act as reasonably be attributable to that part of the operations carried on in British India ? and
>
> (3) Whether on the facts and in the circumstances of the case, the provisions of the Indian Income-tax Act contained in Section 4(1) with the sub-sections and section 4A(c)(b) are not ultra vires in so far as they seek to assess foreign income of the company registered outside British India ?"

The third question was concluded by the decision of their Lordships of the privy Council in the case of Wallace Bros. & Co., Ltd. and was therefore not argued before the High Court and the High Court answered it by stating that the provisions of Section 4(1) and Section 4A(c)(b) of the Act were not ultra virus the Indian Legislature. The question (1) was further amended by agreement between the learned counsel for the revenue authority and the assessee and it was reframed as under :-

> "(1) Whether on the facts and in the circumstances of the case Section 42(1) and (3) of the Act alone and not Section 4 of the Act have application to the income accruing or arising by reason of sales in British India of manufactured goods where the manufacturing process took place outside British India."

The question (2) was retained in the form in which it had been referred by the Appellate tribunal, both these questions were answered against the assessee by the High Court. The assessee obtained the necessary certificate from the High Court for leave to appeal to this Court and hence this appeal.

It may be observed that in replay to the notice under Section 22(2) and 38 of the Act for the

assessment year 1942-43 the agents of the assessee had on the June 1, 1943, submitted a return under protest and had claimed that the income shown in the return should be apportioned under Section 42(3) of the Act as between the operations carried on in British India and operations carried on outside British India. They had further declared that the company was non-resident in British India during the previous year for which the return was made. In the statement enclosed therewith the total world income for the year ended December 31, 1941, had been shown at Rs. 10,23,907. Profit at 10 per cent. on British Indian sales which aggregated to Rs. 57,07,431 was shown at Rs. 5,70,743 and after deduction of the proportionate expenses relating to sales in British India and sundry charges was put down at the net figure of Rs. 4,58,026 which was shown as the British India Income. It was, thus contended that the income arising in British India in the year of account did not exceed its income arising without British India and that therefore the assessee was non-resident in British India. This calculation of profits at the rate of 10 per cent. on British India sales did not make any allocation of profits and all the profits arising out of British Indian sales were shown in one lump sum. The Income-tax officer took it as settled law that the profits arose in the country in which the sales took place and as the bulk of the sales had taken place in British India the bulk of the profit accrued or arose in British India. He held that the provisions of Section 42(3) would apply only where the profits arose outside British India but which you virtue of Section 42(1) were deemed to accrue or arise in British India, and that it did not apply where the profits actually arose in British India by the sale of goods in British India. He therefore held that the entire profits on sale made in British India and were liable to tax under Section 4B(I)(c). On a calculation of the figures he came to the conclusion that the income of the assessee arising in British India in accounting year exceeded its income arising without British India and that the assessee was also held ordinarily resident in British India under Section 4A(c). The assessee was was also held ordinarily resident in British India under Section 4B(c) and he assessed the company accordingly on that basis. The Appellate Assistant Commissioner also proceeded on that basis and confirmed the order of the Income-tax Officer. He was however further of the opinion that the entire profits were received where the sale proceeds were received and the assessee was therefor liable to tax under Section 4(1)(a) also. This conclusion was arrived at by him relying upon two decisions of their Lordships of the Privy Council, Pondicherry Railway Company v. Commissioner of Income-tax, Madras, and Commissioner of Income-tax, Madras v. Diwan Bahadur Mathias, in the first of which at page 369 Lord Macmillan observed as follows : "Their Lordships accordingly are of opinion that the income derived by the Pondicherry Railway Company from the payments made to them by the South Indian Railway Company is, on the facts stated, received in British India within the meaning of the Act, by the agent of the Pondicherry Railway Company there on their behalf..... 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 business carried on by the assessee are received on British India and the place where the business is carried on is not material." The Appellate Tribunal adverted to the fact that the whole income of the company so far as 1942-43 is concerned was received in British India and so far as 1943-44 is concerned a major part of it in this way was received in British India, but did not base its decision on this aspect of the case. It held that the scope of Section 42(3) was circumscribed by confinement to those cases where profits were deemed to accrue or arise under Section 42 alone and there was no warrant for extending the principle of apportionment to other cases where the profits and gains were made taxable under other section of the Act. It also held that Section 42 dealt with "deemed" income whereas section 4A(c) deals with income that arose in British India. Therefore, it could not be said that for the purpose of Section 4A(c) a proportionate "deemed" income should be taken as income that arose in British India. When the application for reference was made to the Appellate Tribunal the Commissioner of income-tax in the question (I) which he suggested included within its ambit this aspect of income having been

received by the assessee in British India during the previous year. But when the Appellate Tribunal reframed the question (1) it merely confined it to income accruing and arising to the assessee in British India and to the income attributable to the sale proceeds received by it in British India during the previous year. The question (1) as finally framed by the High Court adverted to the income accruing or arising by reason of seas in British India on manufactured goods where manufacturing process took pace outside British India and the aspect of the income having been received by the assessee in British India was absolutely ignored.

When the questions were originally referred to the High Court the position in law as then understood was that profits arose in the country in which the sales took place. This position was however negatived, particularly in the case of manufacturing business, in a decision of this court in Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai & Co., Bombay.

After hearing at considerable length the arguments urged before us on behalf of the assessee as well as the Income-tax authorities we feel that in view of that decision the question framed by the Tribunal and the High Court do not bring out the real point in controversy between the parties and it is agreed that the following two questions truly represent and bring out the matter on which the parties are at issue. We therefore resettle the questions originally framed and reframe them as below :

> (1) Whether in view of the finding of fact in this case that the entire profits were received in India and the company is liable to tax under Section 4(I)(a) of the Act, the provision of Section 42(I) have any relevancy ?
>
> (2) Can the income received in India be said to arise in India within the meaning of Section 4A(c)(b) of the Act ? If not, should only those profits determined under Section 42(3) as attributable to the operations carried out in India be taken into account for applying the test laid down in Section 4A(c)(b) ?

The case is remanded to the High Court with the direction that it should give its opinion on these two questions and submit the case to this Court within three months.

In pursuance of the above order of remand the case came up for hearing before a Division Bench of the Madras High Court consisting of SATYANARAYANA RAO and BALAKRISHNA AYYAR, JJ., and the High Court delivered the following opinion on February 13, 1953.

OPINION

Two question were referred to this Court for opinion by the Supreme Court by its order dated December 22, 1952. They are :-

> (1) Whether in view of the finding of fact in this case that the entire profits were received in India and the company is liable to tax under Section 4(1)(a) of the Act, the provisions of Section 42(1) have any relevancy ?
>
> (2) Can the income received in India be said to arise in India within the meaning of section 4A(c)(b) of the Act ? If not, should only those profits determined under Section 42(3) as attributable to the operations carried out in India be taken in to account for applying the test laid down in Section 4A(c)(b) ?

The relevant facts are not in dispute and are state in the order of remand of the Supreme Court and also in the judgment on this Court under appeal. It is, therefore, unnecessary to state them over again. It was found that the yarn and cotton manufactured in pondicherry were sold mostly in British India and partly outside British India. The contracts in respect of the sales in in British India during the accounting year were entered into in British India and the delivery of the goods in pursuance of the contracts was made and the sale price was received in British India. In regard to seas outside British India also, it was found that the payment of price in respect of such sales was also received in Madras. The remand was necessitated in view of the decision of the Supreme Court in Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai & Co., Bombay At the time this Court pronounced the judgment now under appeal, we had not the benefit of the judgment of the supreme Court. The view we took was that in the case of a composite business, which consists of manufacture and sale, where the operations are carried on at different places the profits accrued and arose in the place where the sales took place and the price was received. This view however was not accepted by the Supreme Court in the decision above referred to.

The first question raises the point whether in a case where the assessment proceeds on the basis of receipt of income. Profits and gains under Section 4(1)(a) of the Act, where there is an allocation between manufacturing profits and merchanting profits and where the two operations were carried on at different places, the former outside British India and the merchanting operations carried on inside British India. Section 4(1)(a) applies to both residents and non-residents. Under this clause, the total income of any previous year includes all income, profits and gains from whatever source derived which are either received in British India in the said year by or on behalf of the assessee or deemed to be received in British India during such period. As the basis of liability in the present case was actual receipt and not deemed receipt, Section 42 has no application as it applies only to profits, which are deemed under the section to accrue or arise either from any business connection or from any asset or source of income in British India. (We are omitting three other portions of Section 42(1) which are not relevant. If sub-section (1) of Section 42 does not apply to a case. The apportionment of profits under Section 42(3) does not arise. This view was taken by this Court in Burugu Nagayya and Rajanna v. Commissioner of Income-tax Madras by the Allahabad High Court in Hira Mills Ltd., v. Income-tax Officer, Cawnpore, and by the Calcutta High Court in Turner Morrison and Co., Ltd. v. Commissioner of Income-tax, West Bengal, Civil Appeal No. 41 of 1952. The view taken by the High Courts in the above decisions was accepted as laying down the law correctly and the Supreme Court affirmed the decision of the Calcutta High Court in Turner Morrison's case Das, J., who delivered the judgment of the Court summarised the position in the following paragraph :-

> "Mr. Mitra's second main points is that assuming that there was receipt of income, profits and gains within India, such income, profits and gains clearly arose through or from a business connection in India and, therefore, the provisions of Section 42 (1) would apply and such income, profits and gains should be dealt with as income, profits and gains should be deals with as income, profits and gains deemed to accrue or arise in India and consequently the inclusion of such income, profits and gains in the total income should be under Section 4(1)(c) for the Association is non-resident. Mr. Mitra urges that the charging under Section 3 is to be 'in accordance with and subject to the provisions of this Act.' Likewise, Section 4(1) is also 'subject to the provisions of this Act.' This, according to Mr. Mitra at once attracts Section 42 and such income, profits and gains being within Section 42 must be included in Section 4 (1)(c) and the other alternative, i.e., Section 4(1)(a), is no longer applicable. In other words, according to Mitra's contention, Section 4(1)(a) becomes a dead letter so far

> as income, profits and gains, arising or accruing to a non-resident are concerned. We are unable to accede to this connection. Section 42 only speaks of deemed income. The whole object of that section is to make certain income, profits and gains to be deemed to arise in India so as to bring them to the charge. The receipt of the income, profits and gains being one of the tests of liability, where the income, profits and gains are actually received in India, it is no longer necessary for the revenue authorities to have recourse to the fiction and this has been held quite clearly in Hira Mills Ltd. v. Income-tax Officer, Cawnpore and in Burugu Nagayya and Rajanna v. Commissioner of Income-tax, Madras. This is also implicit in the decision of the Privy Council in Pondicherry Railway Company Ltd. v. Commissioner of Income-tax, Madras, to which reference has already been made. Section 4(1)(a) in terms is, unlike Section 4(1)(b) or 4(1)(c), not confined in its application to any particular category of assessees. Section 4(1)(a) is general and applies to a resident or a non-resident person. The second proviso to Section 4(1) although it relates to the case of a person. The second proviso to Section 4(1) although it relates to the case of person not ordinarily resident, also indicates that income, profits and gains, which accrue or arise to such person without the taxable territories can be included in his total income if they are brought into or received in the taxable territories and become chargeable to tax under Section 3 read with Section 4(1)(a). For reasons herein before stated, this contention of Mr. Mitra must be rejected."

This view no doubt works hardship in the case of a non-resident, who has to be charged to income-tax under Section 4(1)(c) because in the light of the decision in Ahmedbhai Umarbhai's case where the business carried on by the assessee is of a composite character and part of the business operations are carried on outside British India and part with in British India, profits attributable to operations outside British India, would undoubtedly accrue or arise there, i.e., outside British India. Nevertheless if the profits are received in British India they cannot be charged under Section 4(I)(c) but must be charged under Section 4(I)(a). In such circumstances logic may require that there should be an allocation of profits and the tax should be restricted to merchanting profits. If the assessee did not in fact receive profits in British India though they had become receivable, he would be entitled under Section 4(c) to have an allocation made of the profits. But, if he did actually receive the profits in British India, he becomes liable to tax under Section 4 (a) on the basis of receipt and no question of apportionment of profits would arise. This hardship was not noticed by the Supreme Court for it is stated by Das. J., in that very paragraph, which was already quoted in part, in the concluding portion as follows :-

> "It may be that the construction we are adopting in agreement with the High Court may operate harshly against non-residents in that income, profits and gains attributable to business operations outside India may also be brought to charge as having been received in India and such consequence may deter non-resident merchants from doing business in India. These indeed are serious considerations but the courts have to construe the statute according to the plain language and tenor thereof and if any untoward consequences result therefrom, it is for authority, other than this court, to rectify or prevent the same."

In the light of the authoritative pronouncement of the Supreme Court, question No. 1 should be answered in the negative and against the assessee. In fact, both the learned counsel appearing in the case agree that the matter is concluded by the decision of the Supreme Court against the assessee, we answer the question accordingly.

The second question is important to fix the home ore residence of the assessee company for income-tax purposes. Under Section 4A (c) a company is considered to have its residence in British India in any year (a) either because the control and management of its affairs is situated wholly in British India in that year or (b) if its income arising in British India in that year exceeds its income arising without British India in the year (account not being taken in either case of income chargeable under the head "capital gain"). The first part of clause (c) has no application to the present case and is not relied on. The question is, therefore, restricted to Section 4A(c)(b). The principle behind the section as stated by Lord Uthwatt in Wallace Brothers & Co., Ltd. v. Commissioner of Income-tax, Bombay City and Bombay Suburban District at page 247 is :-

> "When a company in any particular year derives the major portion of its income from a country, it is a legitimate conclusion that the company has rooted itself there for that year. The connection that results is at least as solid as the connection given by the place if central control; and in a search for a home for income-tax purposes as respects that year, that connection might well be thought more pertinent than the connection, readily changeable and often changed, given by the place of central control. In such a search, the place where commercial activities yield the result is at least as relevant as the lace where they are conceived."

In view of the language of clause (b) of section 4A(c) regarding income arising in British India and income arising without British India. The application of Section 4(3) for the allocation of profits was not relied on before us as Section 4A (c)(b) does not speak of income deemed to accrue or arise either within or without British India and Section 42(3) cannot be invoked in a case where Section 42(I) does not apply. As in the present case we are concerned with actual arisal and not deemed arisal, the application of Section 42(3), it has been conceded before us, does not arise for consideration.

One has therefor to look to the language of Section 4A(c)(b) and find whether the income in the present case can be said to arise wholly in British India because it was received here or it arises partly in British India and partly outside notwithstanding its receipt in British India by reason of the fact that the business carried on by the company consisted of operations carried out of British India. The manufacturing process was undoubtedly carried outside British India. This takes us to a consideration of the question whether or not the principle of the decision in ahmedbhai Umarbhai's case which arose under the Excess profits Tax Act applies to the present case. It must be mentioned that the business carried on by the assessee consisted of purchase of raw material on a large scale through an agent, conversion of it into yarn and cloth, and their sale through an organization which booked orders carried them out, all of which operations resulted in a receipt of profits in British India. Some of these operations were out side British India and some were inside it. In the recent case relating to this very assessee, which went on appeal to the Supreme Court in Anglo-French Textile Co., v. Commissioner of Income- tax and was disposed of on December 22, 1953, and in which again the decision of Ahmedbhai Umarbhai's case was considered by the Supreme Court, it was pointed out that by the mere purchase of raw materials or goods in British India and sale of the goods, it cannot be said that the profits of such sale arose or accrued only at the place where the sales were effected. In such a case the simple operation of purchase, which was also part of the business activity does not entitle either the assessee or the revenue authorities to claim an allocation of the profits between the place of purchase and the place of sale treating these two as operations which could be considered as profit producing operations to which Section 42(3) would apply. But as pointed out by Mahajan, J., in the course of the judgment :-

> "While maintaining the view taken by the High Court in this case we wish to point out that it is not every business activity of a manufacturer that comes within the expression 'operation' to which the provisions of Section 42(3) are attracted. These provisions have no application unless according to the known and accepted business notions and usages the particular activity is regarded as a well defined business operation. Activities, which are not well defined or are of a casual or isolated character, would not ordinarily fall within the ambit of this rule. Distribution of profits on different business operations or activities ought only to be made for sufficient and cogent reasons and the observations made here are limited to the facts and circumstances of this case. In a case where all that may be known is that a few transactions of purchase of raw materials have taken place in British India, it could not ordinarily be said that the isolated acts were in their mature 'operations' within the meaning of that expression. In this case the raw materials were purchased systematically and habitually through an established agency having special skill and competency in selecting the goods to be purchased and fixing the time and place of purchase. Such activity appears to us to be well within the import of the term 'operation' as used in Section 42 (3) of at Act. It is not in the nature of an isolated transaction of purchase of raw materials."

In the present case, therefore, as found by the Supreme Court in the judgment from which we have just which we have just quoted, the operations connected with the purchase of raw materials were systematically and habitually made through the agency of Best and Co., and it is undoubtedly an operation which contributed to the profits of the business and this operation was in British India. The manufacturing operations were at Pondicherry, the sales were in British India and the receipt of the profits was also in British India. On the principle of the decision in Ahmedbhai Umarbhai's case, apart from Section 42 and independently of it, can it be said that the entire income had arisen in British India within the meaning of Section 4A(c) (b) as the sale proceeds were received in British India ? The answer undoubtedly must be in the negative. No doubt, the view this Court took in Commissioner of Income-tax, Madras v. The Little's Oriental Balm and Pharmaceuticals Ltd., and was followed in the judgment under appeal, was to the contrary. But in view of the decision of the Supreme Court in Ahmedbhai Umabhai's case that view no longer prevails.

Mr. Rama Rao Sahib, the learned counsel for the Commissioner of Income-tax adopted two lines of argument to induce us not to apply to the present circumstances the law as laid down in that decision. The first was that that case was concerned with the interpretation of the provisions of the provisions of the Excess Profits Tax Act particularly Section 5, Proviso 3, and Section 42 of the Income-tax Act which was made applicable to assessments under the Excess Profits Tax Act. It is true that one of the learned Judges, Patanjali Sastri, J., (as he then was) confined and restricted his decision to the provisions of the Excess Profits Tax Act read with the provisions of the Income-tax Act. His Lordship was not prepared to accept the contention that apart from statutory provisions, there was a principle of apportionment or allocation of profits between various operations of a composite business deducible from the decisions of the Privy Council in Kirk's case Chumilal Mehta's and International Harvester's case. His Lordship observed at page 486 referring to Kirk's case as follow :-

> "While it may well be a 'fallacy', while in applying a taxing statute which directs attention to the situation of the source of income as the test of chargeability, to ignore the initial stages in the production of the income and fasten attention on the last stage when it is realised in money, it may be open to question whether it is in consonance

> with business principles or practice in the absence of any statutory requirement to that effect to cut business operations arbitrarily into two or more portions and to apportion, as between them, the profits resulting from one continuous process ending in a sale. It appears however unnecessary in the present case to consider the applicability of the decision in Kirk's case to assessments arising under the Indian Act which makes the place at which the profits accrue or arise the test of liability or non-liability, as the case may be, as I am of opinion that Section 42 of the Income-tax Act which, as already stated, has been incorporated in the Excess Profits Tax Act, is applicable here and sanctions such apportionment."

The learned Judge's view, as one may gather from the judgment, is that apart from statutory provision the cutting up of business operations arbitrarily into manufacturing and merchanting operations and the allocation of profits between the two is not warranted by any principle of law and was not sanctioned by usage of the business. The decisions of the Judicial Committee were distinguished on the ground that in those cases the chargeability depended not on the income accruing or arising in the country but on the source of the income being in the country, for he observed in the concluding portion of the judgment :-

> "This was, presumably, because chargeability in both cases depended not on the income accruing or arising in the country, but on the source of the income being in the country. The decision was based on the language of the statute and the scheme of taxation disclosed thereby and what I have said about Kirk's case equally applies to it."

Though in the result his Lordship agreed with the conclusion reached by the High Court and agreed with the other learned Judges in dismissing the appeal, his decision was based upon the statutory provisions of the Excess Profits Tax Act which incorporated Section 42(3) of the Income-tax Act. But the majority of the Judges took a different view. Their Lordships not only rested their decision on the statutory provisions but dealt with the question apart from the provisions of the Act and reached the conclusion that the allocation of profits in a composite business between manufacturing operations carried on outside British India and merchanting operations inside British India were the sale proceeds were received in fact was justified both on principle and on authority. The authorities they relied on were the decisions of the Judicial Committee in Kirk's case International Harvester's case It may be pointed out that this later decision has since been followed and applied again by the Judicial Committee in the decision in Provincial Treasurer of Manitoba v. Wm. Wrigley Jr. Co., Limited. The decision cannot, therefore, be restricted to cases arising under the Excess Profits Tax Act.

The learned Chief Justice stated the principle at page 478 :-

> "On the sale of goods the assessee receives money. While the receipt of the price is thus in Bombay, it is an entirely different thing to say that therefore the whole profits of the manufacture and sale arose in Bombay. This argument overlooks the distinction between accruing or arising on the one hand and receipt on the other. Again, the question of profits has to be determined not on receipt of the price of each lot sold by the assessee but the result of all the operations in connection with the manufacture and sale of oil during the accounting year. An individual transaction may result in profits but that will not make the assessee liable if the result of his accounting year's activities is a loss. It is therefore improper in a case of this kind to

> consider the sale of oil as the deciding factor either to ascertain profits or to determine the place of the accrual of profits."

After reviewing the decisions cited, the learned Chief Justice was definitely of opinion that when the manufacturing activity of the assessee is at one place and the sale is at a different place, the whole of the profits do not necessarily arise at the place of sale although they might have been received at that place. If the profits therefore arose as a result of different sets of operations, like the manufacturing operations and trading operations, the profits must be treated as having accrued or arisen at the place or places where the different sets of operations were carried on and an apportionment of the profits has to be made, where the activities were carried on some inside and others outside British India. On this reasoning, if any portion of the activity which contributed to the profits is outside the taxable territory, the profits attributable to it cannot to the charge.

Fazl Ali, J., agreed with the judgment of his Lordship Mahajan, J., who considered the question more elaborately. In dealing with the question (at page 495) whether any profits of the manufacturing business of the assessee accrued and arose in the Hyderabad State, Mahajan, J., repelled the argument of the Commissioner that the place where the profits accrue or arise is not ordinarily the place where the source that produces the profits is situate, but the place of sale, in these words :-

> "It was said that profits in such a case only accrue at the place of sale and not at the place of manufacture. I am unable to accede to this contention. It is true that no profits are realized until the oil is sold but the act of sale merely fixes the time and place of receipt of profits. Profits are not wholly made by the act of sale and do not necessarily accrue at the place of sale. Act of sale is the culminating process in the earning of profits but it goes without saying that the act of sale could not be performed unless the goods were produced at Raichur and it would be wrong from a business point to say that all the profits resulted from that operation. It was the operation of manufacture at Raichur that enabled the assessee the assessee to sell oil and some portion of the profits must necessarily be attributable to the manufacturing process. To the extent that the profits are attributable to the manufacture of oil, it is not possible to say that they accrue or arise at any place different from the place where the manufactured articles came into existence."

The learned Judge was definite at page 499 when he stated : "My answer unhesitatingly is that the manufacturing profits arise at the place of manufacture. They could arise nowhere else. The sale profits arise at the place of sale and apportionment has to be made between the two, though the place of receipts and realisation of the profits is the place where the sales are made. The manufacturing profits could not be said to have accrued or arisen at that place because there was nothing done from which they could accrue or arise as natural or as an increase. The increase only took place at the place of manufacture and if there was any accrual over the production cost, that accrual was at the pace of the production itself."

The authorities cited were considered and his Lordship's conclusion is stated at page 501 in these words :-

> "It is true that the Indian Act does not lay down that profits necessarily arise or accrue at the place where the business is carried on or that they necessarily arise at the place where the source which produces the profit is situate but at the same time

> the Act does not lay down that the profits necessarily accrue or arise at the place where only one operation, namely of sale, is performed. Place of accrual of profits cannot necessarily be determined on the test of receivability. In certain cases, the place of origin of the profits may be the determining factor while in others the test of receivability may have application. Profits of a trade or business are what is gained by the business. The term implies a comparison between the state of business at two specific dates separated by an interval of an year and the fundamental meaning is the amount of gain made by the business during the year and can only be ascertained by a comparison of the assets of the business at the two dates, the increase shown at a later date compared to the earlier date represents the profits of the business. In this concept of the term, the place of business or the source from which they originate would in the case of certain businesses be the place where they can be said to accrue or arise. In this situation, the profits realised at sale have to be apportioned between the different business operations which have produced them and those apportioned to the part of business of manufacture at Raichur can only be said to arise at the place of manufacture as no other activity has produces those profits. No other place can be suggested where this increase can be said to have arisen."

Das, J., agreed with the judgment of Mukherjea, J. Mukherjea, J., dealt with this question from page 502 onwards. At page 515 after considering the decisions and the language of the statute. His Lordship stated his conclusion as follows :-

> "When a raw material is worked up into a new product by process of manufacture, it obviously increases in value; in other words, there is an accretion of profit to it and the increased value represents this income or profits which is the result of manufacture. As these profits accrue by reason of manufacture, the accrual, in my opinion, cannot but be located at the place where the manufacturing process is gone through. It is immaterial that the manufactured goods are sold later on at various places. If the manufacturer is himself the seller, it might be that he receives the entire profits including that of the manufacture only at the time of the sale; but in an inchoate shape, a portion of the profits does accrue at the place of manufacture, the exact amount of which is only ascertained after the sale takes place. For purpose of computation, the two parts of the business may be convinenced of as being carried on by two different sets of persons. As soon as the manufacture is complete, that part of the business is finished and the profits that accrue to that part certainly arises at the place where the manufacture is carried on and not where the sale ultimately takes place."

The quotations from the judgments clearly establish in our opinion, that the law was laid down not because of the statutory apportionment contemplated by the Excess Profits Tax Act and the Income-tax Act as Mr. Mama Rag Saheb argued, but irrespective of it.

The second line of argument addressed to us by Mr. Rama Rao Saheb was that the statute uses the word "arising" and does not add the word "accure" as in other portions such Section 4. He draws a distinction between the meaning of the words "accrue", "arise" and "received". The distinction between the meaning of the words "accure" or "arise" was noticed by Mahajan, J., at page 496 and by Justice Mukherjea, at pages 514 and 515 white referring to the earlier decision of the Calcutta High Court in Rogers Pyatt Shellac & Co., v. Secretary of State for India, where he brought out the distinction between the word "accure" and the word "arise". Fastening himself to the etymological

meaning of these words, Mr. Rama Rao Saheb argued that the use of the word "arise" connotes that the profits should not be merely at the stage of growth or increase but they must take tangible shapes so as to be receivable. In other words, according to his contention, the word "arise" means that short of receipt the profits have become receivable as all the processes have by that time been gone through, including the manufacturer and sale. The purchase price however remained unrealised. He contended that Section 4A(c)(b) does not contemplate exclusion of profits which accrue before the stage of receivability was reached. In other words, his contention is that under this section and for the purpose of fixing a home to the company, we must take into consideration all the profits that become receivable by reason of the manufacturing and trading operations of the assessee. The profits of the manufacturing activities could not be excluded. There is no doubt some force in this argument and the omission of the word "accruing" in the section seems to be deliberate. But the learned Judges in Ahmedbhai Umarbhai's case practically treated the two words "accrue" and "arise" as synonymous notwithstanding the difference in the shades of the meaning between the two word-Vide observations of Mahajan, J., at page 496, and Mukhejea, J., at page 515. The learned Chief Justice has not commented on the distinction between the two words. According to the Shorter Oxford English Dictionary edited by Onions the word "accrue" means to fall to any one as a natural growth or advantage to arise or spring from as a natural growth or increment, to come as an accession or advantage, to arise or spring from as a natural growth or result. "Arise" means to spring up, come into existence or notice, spring forth from its source. It is rather difficult to draw a distinction based upon the meaning of these two words and exclude the manufacturing profits in the income which is to be taken into consideration in fixing the habitation of the company. The words practically are synonymous and if one may use the analogy from another branch of the law "accrue" seems to connote more or less a lateral accretion while "arise" indicates a vertical accretion. But in both the idea is that the thing springs or grows so as to increase the value of the thing by adding an advantage. It is therefore difficult to accept the distinction and hold that the principle of the decision in Commissioner of Income-tax, Bombay v. Ahmedbhai Umerbhai and Co., Bombay should not be applied to the present case.

Our answer, therefore, to the second question is that the income received in British India cannot be said to wholly arise in India within the meaning of section 4A(c)(b) of the Act and that there should be allocation of the income between the various profit producing operations of the company in the light of the principles contained in the judgments in Ahmedbhai Umarbhai's case and in Anglo-French Textile Company v. Income-Tax Commissioner relating to the same assessee. The questions remitted to us are, therefore, answered accordingly

The case came up for final hearing in the Supreme Court before a Bench consisting of MEHR CHAND MAHAJAN, S. R. DAS, VIVIAN BOSE and N. H. BHAGWATI, JJ., and the Court delivered the following judgment on December 8, 1953 :-

The Judgment of the Court was delivered by

BHAGWATI, J. –

By our judgment dated the December 22, 1952, we reframed the questions as below :-

> (1) Whether in view of the following of fact in this case that the entire profits were received in India and the company is liable to tax under Section 4(1)(a) of the Act, the provisions of Section 42(1) have any relevancy ?

(2) Can the income received in India be said to arise in India within the meaning of Section 4A(c)(b) of the Act ? If not, should only those profits determined under Section 42(3) as attributable to the operations carried out in India be taken into account for applying the test laid down in Section 4A(c)(b),

and remanded the case to the High Court with the direction that it should give its opinion on these two questions. The High Court has accordingly considered these two questions which were referred to it for opinion and has answered Question No. 1 in the negative and against the assessee and Question. No 2 in the manner following, i.e., the income received in British India cannot be said to wholly arise in India within the meaning of Section 4A(c)(b) of the Act and that there should be allocation of the income between the various profit producing operations of the business of the company the light of the principle contained in the judgments in Ahmedbhai Umarbhai's case and in Anglo-French Textile Company v. Income-tax Commissioner relating to the same assessee.

When the matter came up for further arguments before us on this opinion of the High Court, Shri S. N. Mukherjee, the learned council for the appellant did not contest the correctness of the answer to Question No. 1 in view of the decision of this Court in Turner Morrison & Co. Ltd. v. Commissioner of Income-tax, West Bengal. It may be noted that even before the High Court the learned counsel appearing for both the parties agreed that the matter was concluded by this decision against the assessee and Question No. 1 was answered accordingly by the High Court.

In regard to Question No. 2 however Shri Porus A. Mehta, learned counsel for the respondent contended before us that the matter was not concluded by the judgment of the majority in Commissioner of Income- tax, Bombay v. Ahmedbhai Umerbhai & Co., Bombay, and that the High Court was wrong in the answer which it gave to this question. He contended that the decision in the case of Commissioner of Income-tax, Bombay v. Ahmedbhai Umerbhai & Co., Bombay, turned on the statutory provision of the Excess Profits Tax Act read with Section 42(3) of the India Income-Tax Act which was expressly incorporated therein by virtue of Section 21 of the Act and not on any general principles of apportionment of the income, profits or gains enunciated therein. He took us in extension over the portions of the majority judgments and tried to demonstrate that the decision there was based purely on the applicability of Section 42(3) of the Indian Income-tax Act, but for the applicability of which, according to his submission, there was no room for the apportionment of the income, profits or gains of the business in the manner contended by the appellant. We do not accept this contention of the respondent. Section 4A(c)(b) is concerned with the income arising in the taxable territories in a particular year exceeding the income arising without the taxable territories in that year and the very words of the section are capable of being construed as also contemplating a state of affairs where there may have to be a division or apportionment between the income arising in the taxable territories and the income arising without the taxable territories in a particular year. The whole of the argument urged before us on behalf of the respondent was aimed at establishing that the scheme of the Indian Income-tax Act was not to tax the source of income but the income, profit or gains from whatever source derived which were received or were deemed to be received in the taxable territories or which accrued or arose or were deemed to accrue or arise in the taxable territories during the particular year and that it was immaterial whether the income, profits or gains were derived from business operations carried on in the taxable territories or without the taxable territories. This argument was possible when the decisions which held that income, profits or gains arose or accrued at the places where the sales took place were good law, because then there was no question of apportionment of income, profits or gains arising from the business operations carried on in the taxable territories and income, profits or gains arising from business operations carried on without the taxable territories. The moment however it was held, as it was done Commissioner of

Income-tax, Bombay v. Ahmedbhai Umarbhai & Co., Bombay, that though profits may not be realised until a manufactured article was sold, profits were not wholly made by the act of sale and did not necessarily accrue at the place of sale and to the extent profits were attributable to the manufacturing operations profits accrued at the place where business operations were carried on, these decisions went by the board. The question whether a particular part of the income, profits or gains arose or accrued within the taxable territories or without the taxable territories would have to be decided having regard to the general principles as to where the income, profits or gains could be said to arise or accrue. Section 42 of the Indian Income-tax Act has no relevance to the determination of this question because it is mainly concerned with income which is deemed to have arisen or accrued and not with income which actually arises or accrues within the taxable territories. Section 42(3) also is a part of the scheme which is enacted in Section 42 and cannot help in the determination of the question before us. As a matter of fact the use of the words "under Section 42(3)" in Question No 2 as reframed by us was not appropriate and the only question which should have been sent to the High Court was "If not, should only those profits determined as attributable to the operations carried out in India be taken into account for applying the test laid down in Section 4A(c)(b) ?"

If therefore Section 42(3) has nothing to do with the determination of the income arising the taxable territories as distinguished from the income arising without the taxable territories as understood in Section 4A(c)(b) of the Act what we have got to consider is whether there is anything in the Act which prevents the application of the general principle of apportionment of income, profits or gains between those which are derived from business operations carried on within the taxable territories and those which are derived from business operations carried on without the taxable territories. The contention which was advanced by Shri Porus A. Mehta on behalf of the respondents in this behalf, viz., that the word "arise" was the only word used in Section 4A(c)(b) and the word "accrue" did not find any place therein, that there was a distinction between the conception of arising and the conception of accrual and that the apportionment of the income was appropriate only in cases where the income accrued and was inappropriate in cases where the income arose, was sufficiently repelled in the judgment in Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai & Co., Bombay was observed :-

> "Whether the words 'derive' and 'produce' are or are not synonymous with the words 'accrue' or 'arise', it can be said without hesitation that the words 'accrue' or 'arise' though not defined in the Act are certainly synonymous and are used in the sense of 'bringing in as a natural result'. Strictly speaking, the word 'accrue' is not synonymous with 'arise', the former connoting the idea of growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable. There is a distinction in the dictionary meaning of these words, but throughout the Act they seem to denote the same idea or ideas very similar and the difference only lies in this that one is more appropriate when applied to a particular case. In the case of a composite business, i.e., in the case of a person who is carrying on a number of businesses, it is a always difficult to decide as to the place of the accrual of profits and their apportionment inter se. For instance, where a person carries on manufacture, sale, export and import, it is not possible to say that the place where the profits accrue to him is the place of sale. The profits received relate firstly to his business as a manufacturer, secondly to his trading operations, and thirdly to his business of import and export. Profit or loss has to be apportioned between these businesses in a businesslike manner and according to well established principles of accountancy. In such cases it will be doing no violence to the meaning of the words

> "accrue" or "arise" if the profits attributable to the manufacturing business are said to arise or accrue at the place where the manufacture is being done and the profits which arise by reason of the sale are said to arise at the place where the sales are made and the profits in respect of the import and export business are said to arise at the place where the business is conducted. This apportionment of profits between a number of businesses which are carried on by the same person at different places determines also the place of the accrual of profits."

The phraseology of Section 42(3) of the Act also repels the con tension in so far as the profits and gains of the business which are referred to therein and which are capable of apportionment as therein mentioned are deemed to accrue or arise in the taxable territories thus using the words "accrue" and "arise" as synonymous with each other.

The above passage is also sufficient in our opinion to establish that the apportionment of income, profits or gains between those arising from business operations carried on in the taxable territories and those arising from business operations carried on without the taxable territories is based not on the applicability of Section 42(3) of the Act but on general principles of apportionment of income, profits or gains. That was really the ratio of the judgment of the majority in Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai & Co., Bombay and any attempt to distinguish that case from the present one by having resort to the statutory provisions of the Excess Profits Tax Act is really futile. We are accordingly of the opinion that the answer given by the High Court to Question No 2 also was correct.

The appeal before us will accordingly be allowed and the answers to Questions Nos. 1 and 2 reframed by us will be as under :-

> Question No. 1 - In the negative; and
>
> Question No. 2 - The income received in British India cannot be said to wholly arise in India within the meaning of Section 4A(c)(b) of the Act and that there should be allocation of the income between the various business operations of the assessee company demarcating the income arising in the taxable territories in the particular year from the income arising without the taxable territories in that year for the purposes of Section 4A(c)(b) of the Act.

In so far as the appellant has failed in one part of the case and succeeded in another part we think that the proper order of costs should be that each party bears and pays his own costs of this appeal including the costs of the remand before the High Court.

Appeal allowed.

</html