Lakshminarayan Ram Gopal and Son Limited

Vs

The Government of Hyderabad

Civil Appeals Nos. 120 and 121 of 1357F

(S.R. Dass, N.H. Bhagwati, B. Jagannath Das JJ)

01.04.1954

JUDGMENT

BHAGWATI, J. -

These are two appeals from the judgment and decisions of the High Court of Judicature at Hyderabad answering certain question referred at the instance of the appellants by the Commissioner of Excess Profit Tax, Hyderabad, and adjudging the liability of the appellants for excess profits tax in regard to the amounts received by them as remuneration from the Dewan Bahadur Ramgopal Mill Company Ltd. as its agents.

The Mills Company was registered on February, 1920 at Hyderabad in the then territories of His Exalted Highness the Nizam. The appellants were registered as a private limited company at Bombay on March 1, 1920. On April 20, 1920, an agency agreement was entered into between the Mills Company and the appellants appointing the appellants its agents for a period of 30 years on certain terms and conditions therein recorded. The appellants throughout worked only as the agents of the Mills Company and for the Fasli years 1351 and 1352 they received their remuneration under the terms of the agency agreement. A notice was issued under Section 13 of the Hyderabad Excess Profit Tax Regulation by the Excess Profits Tax Officer calling upon the appellants to pay the amount of tax appertaining of these chargeable accounting periods. The appellants submitted their accounts and contended that the remuneration received by them from the Mills Company was not taxable on the ground that it was not income, profits or gains from business and was outside the pale of the Excess Profits Tax Regulation. This contention of the appellants was negative and on April 24, 1944, the Excess Profits Tax Officer made made an order assessing the income of the appellants for the accounting periods 1351 and 1352 Fasli at Rs. 8,957 and Rs. 83,768 respectively and assessed the tax accordingly. An appeal was taken by the appellants to the Deputy Commissioner of Excess Profits Tax who disallowed the same. An application made by the Profits Tax who disallowed the same An application made by the appellants under Section 48(2) for statement of the case to the High Courts was rejected by the Commissioner and the appellants filed a petition to the High Court under Section 48(3) to compel the Commissioner to state the case to the High Court. An order was made by the High Court on this petition directing the Commissioner to state the case and the statement of the case was submitted by the Commissioner on February 26, 1946. Four questions were referred by the Commissioner to the High Court as under :-

(1) Whether the petitioner company is a partnership firm or a registered firm ?

(2) Whether under the terms of the agreement the petitioner is an employee of the Mills Company or is carrying on business ?

(3) Whether the remuneration received from the mills is on account of service or is the remuneration for business ?

(4) Whether the principle of personal qualification referred to in Section 2, clause (4), of the Excess Profits Regulation is applicable to the petitioner company ?

These questions were of considerable importance and were referred for decision to the Full Bench of the High Court. On the July 22, 1947, the Full Bench of the High Court delivered their judgment the majority deciding the question (2) and (3) which were the only questions considered determinative of the reference against the appellants. The appellants appealed to the Judicial Committee. But before the Judicial Committee heard the appeals there was a merger of the territories of Hyderabad with India. The appeals finally came for hearing before the Supreme Court Bench at Hyderabad on the December 12, 1950, when an order was passed transferring the appeals to this Court at Delhi. These appeals have now come for hearing and final disposal before us.

The questions (1) and (4) which were referred by the Commissioner to the High Court at Hyderabad have not been seriously pressed before us. Whether the appellants are a partnership firm or a registered company the principle of exclusion of the income from the category of business income by reason of its depending wholly or mainly on the personal qualifications of the assessee would not apply because the income could not be said to be income from profession and neither a partnership firm nor a registered company as such could be said to be possessed of any personal qualifications in the matter of the acquisition of that income.

The principal questions which were therefore argued before the High Court at Hyderabad and before us were the question (2) and (3) which involved the determination of the position of the appellants whether they were servants or agents of the Mills Company and the determination of the character of their remuneration whether it was wages or salary or income, profits of gains from business.

The appellants were registered as a private limited company having their registered office in Bombay and the objects for which they were incorporated were the following :-

(1) To act as agents for Governments or Authorities or for any bankers, manufacturers, merchants, shippers, joint stock companies and others and carry on all kinds of agency business.

(2) To carry on in India and elsewhere the trade or business of merchants, importers exporters in all their branches etc., etc.....

Under Article 115 of the articles of association of the Mills Company the appellants and their assigns were appointed the agents of the company upon the terms, provisions and conditions set out in the agreement referred to in clause 6 of the company's memorandum of association. Article 116 provided that the general management of the business of the company subject to the control and supervision of the directors was to be in the hands of the agents of the company, who were to have the power and authority on bahalf of the company, subject to such control and supervision, to enter into all contracts and to do all other things usual, necessary and desirable in the management of the affairs of the company or in carrying out its objects and were to have power to appoint and employ in or for the purposes of the transaction and management of the affairs and business of the company,

or otherwise for the purposes thereof, and from time to time to remove or suspend such managers, agents, clerks and other employees as they thought proper with such powers and duties and upon such terms as to duration of employment, remuneration or otherwise as they thought fit and were also to have powers to exercise all rights and liberties reserved and granted to them by the said agreement referred to in Clause 6 of the company's memorandum of association including the rights and liberties contained in Clause 4 of the agreement. Article 118 authorised the agents to sub-delegate all or any of the powers, authorities and discretions for the time being vested in them, and in particular from time to time to provide by the appointment of an attorney or attorneys, for the management and transaction of the affairs of the company in any specified locality, in such manner as they thought fit.

The agency agreement which was executed in pursuance of the appointment under Article 115 provided that the appellants and their assigns were to be the agents of the company for a period of 30 years from the date of registration of the company and they were to continue to act as such agents until they of their own will resigned. The remuneration of the appellants as such agents was to be a commission of 2 1/2 per cent. on the amount of sale proceeds of all yarn cloth and other produce of the company (including cotton grown) which commission was to be exclusive of any remuneration or wages payable to the bankers, solicitors, engineers, etc., who may be employed by the appellants for or on behalf of the company. The appellants were to be paid in addition all expenses and charges actually incurred by them in connection with the business of the company and supervision and management thereof and the appellants were entitled to appoint any person or persons in Bombay to act as their agents in Bombay and any other places in connection with the business of the company.

Clauses 3 and 4 of the agency agreement are important and may be set out in extenso :-

3. Subject to the control and supervision of the directors, the said Lachminarayan Ramgopal and Son Limited shall have the general conduct and management of the business and affairs of the company and shall have on behalf of the company to acquire by purchase lease or otherwise lands tenements and other buildings and to erect maintain alter and extend factories warehouses engine house and other building in Hyderabad and elsewhere in the territories of His Exalted Highness the Nizam and in India and to purchase, pay for, sell, resell, and repurchase machinery, engines, plant, raw cotton, waste, jute, wool and other fibres and produce, stores and other materials and to manufacture yearn cloth and other fabrics and to sell the same either in the said territories as well as elsewhere in India and either on credit or for cash, or for present or future delivery, and to execute become parties to and where necessary to cause to be registered all deeds, agreements, contracts, receipts and other documents and to insure the property of the company for such purposes and to such extent and in such manner as they may think proper; and to institute, conduct, defend, compromise, refer to arbitration and abandon legal and other proceedings, claims and disputes in which the company is concerned and to appoint and employ, discharge, re-employ or replace engineers, managers, retain commission dealers, muccadums, brokers, clerks, mechanics, workmen and other officers and servants with such powers and duties and upon such terms as to duration of office remuneration or otherwise as they may think fit; and to draw, accept, endorse, negotiate and sell bills of exchange and hundies with or without security and to receive and give receipts for all moneys payable to or to be received by the company and to draw cheques against the moneys of the company and generally to make all such arrangements and do all such acts and things on behalf of the company, its successors and assigns as may be necessary or expedient and as are not specifically reserved to be done by the directors.

4. The said Lachminarayan Ramgopal & Son Ltd., shall be at liberty to deal with the company by way of sale to the company of cotton, all raw materials and articles required for the purpose of the company and the purchase from the company of yarn cloth and all other articles manufactured by the company and otherwise, and to deal with any firm in which any of the shareholders of the said Lachminarayan Ramgopal & Son Ltd., may be directly or indirectly concerned, provided always such dealings are sanctioned, passed or ratified by the board of directors either before or after such dealings.

Clause 8 provided that two of the members for the time being of the appellants were at the option of the appellants to be the ex-officio directors of the company and clause 9 empowered the appellants to assign the agreement and the rights of the appellants thereunder subject to the approval and sanction of the board to any person, firm or company having authority by its constitution to become bound by the obligations undertaken by the appellants.

No materials other than these were placed by the appellants either before the Income-tax authorities or the High Court and the questions that arise before us have to be determined only on these materials. If on the construction of these documents we arrive at the conclusion that the position of the appellants was not that of servants but the agents of the company the further question would have to be determined whether the activities of the appellants amounted to the carrying on of business. If they were not the servants of the company the remuneration which they received would certainly not be wages or salary but if they were against of the company the question would still survive whether their activities amounted to the carrying on of business in which case only the remuneration which they received from the company would be income, profits or gains from business.

The distinction between a servant and an agent is thus indicated in Powell's Law of Agency, at page 16 :-

> "(a) Generally a master can tell his servant what to do and how to do it.
>
> (b) Generally a principal cannot tell his agent how to carry out his instructions.
>
> (c) A servant is under more complete control than an agent," and also at page 20 :-
>
> (a) Generally, a servant is a person who not only receives instructions from his master but is subject to his master's right to control the manner in which he carries out those instructions. An agent receives his principal's instructions but is generally free to carry out those instructions according to his own discretion.
>
> (b) Generally, a servant, qua servant, has no authority to make contracts on behalf of his master. Generally, the purpose of employing an agent is to authorise him to make contracts on behalf of his principal.
>
> (c) Generally, an agent is paid by commission upon effecting the result which he has been instructed by his principal to achieve. Generally, a servant is paid by wages or salary."

The statement of the law contained in Halsbury's Laws of England- Hailsham Edition - Vol. 22, page 113, Para. 192 may be referred to in this connection :-

> "The difference between the relations of master and servant and of principal and agent may be said to be this : a principal has the right to direct what work the agent has to do : but a master has the further right to direct how the work is to be done."

The position is further clarified in Halsbury's Laws of England- Hailsham Edition - Vol. 1, at page 193, Art. 345, where the positions of an agent, a servant and independent contractor are thus distinguished :-

> "An agent is to be distinguished on the one hand from a servant, and on the other from an independent contractor. A servant acts under the direct control and supervision of his master, and is bound to conform to all reasonable orders given him in the course of his work; an independent contractor, on the other hand, is entirely independent of any control or interference and merely undertakes to produce a specified result, employing his own means to produce that result. An agent, though bound to exercise his authority in accordance with all lawful instructions which may be given to him from time to time by his principal, is not subject in its exercise to the direct control or supervision of the principal. An agent as such is not a servant, but 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."

Considering the position of the appellants in the light of the above principles it is no doubt rue that the appellants were to act as the agents of the company and carry on the general management of the business of the company subject to the control and supervision of the business of the company subject to the control and supervision of the directors. That does not however mean that they acted under the direct control and supervision of the directors in regard to the manner or method of their work. The directors were entitled to lay down the general policy and also to give such direct ions in regard to the management as may be considered necessary. But the day to day management of the business of the company as detailed in Article 116 of the articles of association and clause 3 of the agency agreement above set out was within the discretion of the appellants and apart from directing what work the appellants had to do as the agents of the company the directors had not conferred upon them the further right to direct how that work of the general management was to be done. The control and supervision o f the directors was a general control and supervision and within the limits of their authority the appellants as the agents of the company had perfect discretion as to how that work of general management was to be done both in regard to the method and the manner of such work. The appellants for instance had perfect latitude to enter into agreements and contracts for such purpose and to such extent and in such manner as they thought proper. They had the power to appoint, employ, discharge, re-employ or replace the officers and servants of the company with such powers and upon such terms as to duration of office remuneration or otherwise as they thought fit. They had also the power generally to make all such arrangements and to do all such things and acts on behalf of the company, as might be necessary or expedient and as were not specifically reserved to be done by the directors. These powers did not spell a direct control and supervision of the directors These powers did not spell a direct control and supervision of the directors as of a master over his servant but constituted the appellants the agents of the company who were to exercise their authority subject to the control and supervision of the directors but were not subject in such exercise to the direct control or supervision of the principals. The liberty given to the appellants under clause 4 of the agency agreement to deal with the company by way of sale and purchase of commodities therein mentioned also did not spell a relation as between master and servant but empowered the appellants to deal with the company as principals in spite of the fact that under Clause 8 of the

agreement two of their members for the time being were to be the ex-officio directors of the company. The power to assign the agreement and the rights of the appellants thereunder reserved to them under clause 9 of the agency agreement though subject to the approval and sanction of the board was hardly a power which could be vested in a servant. There was further the right to continue in employment as the agents of the company for a period of 30 years from the date of the registration thereof and thereafter until the appellants of their own will resigned, which also would be hardly consistent with the employment of the appellants as mere servants of the company. The remuneration by way of commission of 21/2 per cent. of the amount of sale proceeds of the produce of the company savoured more of the remuneration given by a principal to his agent in the carrying out of the general management of the business of the principals than f wages or salary which would not normally be on such a basis. All these circumstances together with the power of sub- delegation reserved under Articles 118 in our opinion go to establish that the appellants were the agents of the company and not merely the servants of the company remunerated by wages or salary.

Even though the position of the appellants qua the company was that of agents and not servants as stated above it remains to be determined whether the work which they did under the agency agreement amounted to carrying on business so as to constitute the remuneration which they received thereunder income, profits or gains from business. The contention which was urged before us that the appellants only worked as the agents of the Mills Company and no others and therefore what they did did not constitute a business does not avail the appellants. The activities in order to constitute a business need not necessarily be concerned with several individuals or concerns. They would constitute business in spite of their being restricted to only one individual or concern. What is relevant to consider is what is the nature and scope of these activities though either by chance or design these might be restricted to only one individual or concern. It is the nature and scope of these activities and not the extent of the operations which are relevant for this purpose.

The activities of the appellants certainly did not come within the inclusive definition of business which is given in Section 2, clause (4), of the Excess Profits Tax Regulation, Hyderabad. Business is there defined to include any trade, commerce or manufacture or any adventure in the nature of a trade, commerce or manufacture or any profession or vocation but not to include a profession or vocation but not to include a profession carried on by an individual or by individuals in partnership if the profits of the profession depend wholly or mainly on his or their personal qualifications unless such profession consists wholly or mainly in the making of contracts on behalf of other persons or giving to other persons of advice of a commercial nature in connection with the making of contracts. The work which the appellants did under the terms of the agency agreement constituted neither trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture nor was it a profession or vocation.

The activities which constitute carrying on business need not necessarily consist of activities by way of trade, commerce or manufacture or activities in the exercise of a profession or vocation. They may even consist of rendering services to others which services may be of a variegated character. The considerations which apply in the case of individuals in the matter of determining whether the activities constitute a business within the meaning of the inclusive definition thereof set out above may not apply in the case of incorporated companies. Even though the activities if carried on by individuals might constitute business in that sense they might not constitute such business when carried on by incorporated companies and resort must be had to the general position in law in order to determine whether the incorporated company was carrying on business so as to constitute the income earned by it income, profits or gains from business. Reference may be made in this contest to William Esplen, Son and Swainston, Limited v. Commissioners of inland Revenue. In that case a

private limited company was incorporated for carrying on business as naval architects and consulting engineers. Before the formation of the company, a partnership had existed for many years between three persons who, on incorporation, became the sole shareholders and directors of the company. The partnership had carried on the profession of naval architects and consulting engineers and the work done by the company was identical in character with that formerly done by the partnership which it succeeded. The work done by the company was identical in all respects with the work of a professional naval architect and consulting engineer, and was performed by the said three shareholders and directors of the company personally. A question arose whether the company was carrying on a profession within the meaning of Section 39, Para. C, of the Finance (No. 2) Act, 1915. It was contended that it carried on a profession of naval architects and consulting engineers because the members composing it were three naval architects. That contention was however negatived and it was held that even though what was to be looked at was the character of the work done by the company, it was not carrying on the profession of the naval architects within the meaning of the section, because for that purpose it was of the essence of a profession that the profits should be dependent mainly upon the personal qualifications of the person by whom it was carried on and that could only be an individual. A company such as that could only do a naval architect's work by sending a naval architect to its customers to do what they wanted to be done and it was held that the company was not carrying on a profession but was carrying on a trade or business in the ordinary sense of the term.

When a partnership firm comes into existence it can be predicated of it that it carries on a business, because partnership according according to Section 4 of the Indian partnership Act is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. (See Inderchand Hari Ram v. Commissioner of Income-tax U.P. & C.P.) But when a company is incorporated it may not necessarily come into existence for the purpose of carrying on a business. According to Section 5 of the Indian Companies Act any seven or more persons (or, where the company to be formed will be a private company, any two or more persons) associated for any lawful purpose may, by subscribing their names to a memorandum of association ....form an incorporated company, and the lawful purpose for which the persons become associated might not necessarily be the carrying on of business. When a company is incorporated for carrying out certain activities it would be relevant to enquire what are the objects for which it has been incorporated. As was observed by Lord Sterndale, M.R., in Commissioners of Inland Revenue v. The Korean Syndicate Limited :-

> "If you once get the individual and the company spending exactly on the same basis, then there would be no difference between them at all. But the fact that the limited company comes into existence in a different way is a matter to be considered. An individual comes into existence for many purposes, or perhaps sometimes for none, whereas a limited company comes into existence for some particular purpose, and if it comes into existence for the particular purpose of carrying out a transaction by getting possession of concessions and turning them to account, then that is a matter to be considered when you come to decide whether doing that is carrying on a business or not."

Justice Rowlatt followed the above view of Lord Sterndale, M.R., in Commissioners of Inland Revenue v. Birmingham Theatre Royal Estate Co., Limited, and held that 'when you are considering whether a certain form of enterprise in carrying on business or not, t is material to look and see whether it is a company that is doing it." The objects of an incorporated company as laid down in the memorandum of association are certainly not conclusive of the question whether the activities of

the company amount to carrying on of business. (See Commercial properties Ltd., In re and East India Prospecting Syndicate v. Commissioner of Excess Profits Tax, Calcutta). But they are relevant for the purpose of determining the nature and scope of such activities.

The objects of the appellants in this case inter alia were to act as agents for Government or Authorities or for any bankers, manufacturers, merchants, shippers, joint stock companies and others and carry on all kinds of agency business. This object standing by itself would comprise within its ambit the activities of the appellants as the agents of the company and constitute the work which they did by way of general management of the business of the company an agency business. The words "carry on all kinds of agency business" occuring at the end of the object as therein set out were capable or including within their general description the work which the appellants would do as agents for Governments or Authorities or for any bankers, manufacturers, merchants, shippers and others. When they acted as agents of the company which were manufacturers inter alia of cotton piece goods they would be carrying on agency business within the meaning of this object. Apart however from this there is the further fact that there was a continuity of operations which constituted the activities of the appellants in the general management of the company a business. The whole work of management which the appellants did for the company with the powers conferred upon them under Article of the articles of association and clause 3 of the agency agreement consisted of numerous and continuous operations and comprise of various services which were rendered by the appellants as the agents of the company. The appellants were also entitled though with the sanction or ratification by the board of directors either before or after the dealings to enter into dealings with the company by way of sales and purchases of various commodities. There was nothing in the agency agreement to prevent the appellants from acting as the agents of other manufacturers, joint stock companies etc., and the appellan ts could have as well acted as the agents of other concerns besides the company. All these factors taken into consideration along with the fixity of tenure, the nature of remuneration and the assignability of their rights, are sufficient to enable us to come to the conclusion that the activities of the appellants as thee agents of the company constituted a business and the remuneration which the appellants received from the company under the terms of the agency agreement was income, profits or gains from business.

The appellants were therefore rightly assessed for excess profits tax and these appeals must stand dismissed with costs.

Appeals dismissed.

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