Mazagaon Dock Ltd.

Vs

Commissioner of Income-Tax and Excess Profits Tax

Civil Appeal No. 381 of 1956

(T. L. Venkatarama Ayyar, P. B. Gajendragadkar, A. K. Sarkar JJ)

12.05.1958

JUDGMENT

VENKATARAMA AIYAR, J. -

This is an appeal against the judgment of the High Court of Bombay in a reference under section 66(1) of the Indian Income-tax Act, 1922, hereinafter referred to as the Act.

The appellant is a private limited company incorporated under the Indian Companies Act, and is carrying on business as marine engineers and ship repairers. Its registered office is in Bombay and it is resident and ordinarily resident in India. Its entire share capital is beneficially owned by two British companies, the P. & O. Steam Navigation Co. Ltd. and the British Indian Steam Navigation Co. Ltd., whose business consists in plying ships for hire. Under an agreement, entered into with the two companies aforesaid, which will be referred to hereinafter as the non-resident companies, the appellant repairs their ships at cost, and charges no profits. Now, the point for determination is whether, on these facts, the appellant is chargeable to tax under section 42(2) of the Act. That sub-section runs as follows :

> "Where a person not resident or not ordinarily resident in the taxable territories carries on business with a person resident in the taxable territories, and it appears to the Income-tax Officer that owing to the close connection between such persons the course of business is so arranged that the business done by the resident person with the person not resident or not ordinarily resident produces to the resident either no profits or less than the ordinary profits which might be expected to arise in that business, the profits derived therefrom, or which may reasonably be deemed to have been derived therefrom, shall be chargeable to income-tax in the name of the resident person who shall be deemed to be, for all the purpose of this Act, the assessee in respect of such income-tax."

The Income-tax Officer, Bombay, who dealt with the matter took the view that the appellant company had so arranged its business with the non-resident companies that it did not produce any profits to it, and that was because it was those companies that really owned its share capital, and that therefore the profits which it could ordinarily have made but for their close financial connection were liable to be taxed under section 42(2), and he computed the same at Rs. 6,80,000 for the account year 1943-1944, at Rs. 4,67,559 for the account year 1944-1945 and at Rs. 4,68,963 for the account year 1945-46. On the basis of the above findings, orders of assessment of income-tax were made for 9the account years 1944-1945 and 1945-46 and of excess profits tax for the account years 1943-1944, 1944-1945 and 1945-1946. Against these five orders, the appellant preferred appeals to

the Appellate Assistant Commissioner, who by his order dated July 3, 1952, confirmed the same. Then there was a further appeal by the appellant to the Appellate Tribunal, and the Bench which heard the same having been divided in its opinion, the matters came up for hearing before the President, who by his order dated March 19, 1954, held that section 42(2) was inapplicable and he accordingly set aside the orders of assessment of income-tax and excess profits tax made on the appellant. On the application of the Department, the Tribunal referred the following question for the opinion of the High Court of Bombay :

> "Whether on the facts and in the circumstances of the case any income falls to be included in the appellant's assessment under section 42(2)."

The reference was heard by Chagla, C.J., and Tendolkar, J., who by their judgment dated February 24, 1955, held that on the facts found, section 42(2) was applicable and that the appellant was liable to be assessed to income-tax and excess profits tax under that section. The appellant applied under section 66A for leave to appeal against this judgment to this court, and that application was dismissed. The appellant thereafter applied for and obtained leave to appeal to this court under article 136, and hence this appeal.

It must be mentioned that on December 31, 1948, an order of assessment had been made in respect of the income-tax payable by the appellant for the account year 1943-1944, and therein, the profits chargeable under section 42(2) had not been included. But subsequently, the Income-tax Officer took action under section 34 of the Act, and on May 29, 1953, made an order assessing the appellant to tax for that year on the profits deemed to have been made by it under section 42(2), and against that order, an appeal is pending before the Appellate Assistant Commissioner. That order is not subject-matter of the present proceedings, which are concerned only with the assessment of income-tax for the account years 1944-1945 and 1945-1946 and of excess profits tax for the account years 1943-1944, 1944-1945 and 1945-1946.

Now the sold point for determination in this appeal is whether on the facts found the appellant is chargeable to tax under section 42(2) of the Act. Mr. Palkhivala, learned counsel for the appellant, contends that it is not and urges two grounds in support of his contention : (1) that section 42(2) imposes a charge only on a business carried on by a non-resident, and that therefore no tax could be imposed under that provision on the business of the appellant who is a resident; and (2) that it is a condition for the levy of a charge under section 42(2) that the non-resident must carry on business with the resident, and that in the instant case it is not satisfied. The first ground does not appear to have been put forward in the court below, but before us it has been presented with great elaboration and pressed with considerable insistence. The argument in support of it may thus be stated : section 42(2) imposes a charge on profits of a business, actual or notional, when the conditions specified therein are satisfied; but the section does not, in terms, say who the person is whose business is liable to be taxes, but that that can only be the non-resident is clear from other parts of the section. Thus, the tax is imposed under section 42(2) on profits "derived" from business, which must mean profits actually made therein. Ex hypothesi, the resident has so arranged his business that it produces little or no profits to him. If it has produced some profits, then they are taxable in his hands even apart from this provision, and if he has made no profits, then the word "derived" would be inapplicable to his business. Therefore, the profits "derived" and taxable under the section can have reference only to the business of a non-resident. Then again, the profits are chargeable under this section in the name of the resident. If the profits chargeable under section 42(2) accrue from a business of the resident, he would be the person who would, even apart from the section, be liable for the tax, and in that situation, the expression "in the name of the resident" would be inappropriate.

It would make sense if, in fact, the profits accrued in a business carried on by a person other than the resident, and the Legislature sought to tax them in his hands. The true intention behind the legislation, it is said is that the profits of the non-resident should be taxed, but that the tax should fall on the resident by reason of his close connection with the non-resident. Support for this contention is sought in the provisions in section 42(2) that the resident shall be deemed to be the assessee for all purposes of the Act. The word "deemed" imports it is argued,, a legal fiction, and if it was the business of the resident that was intended to be taxed, then he is, in fact, the assessee, and it would be inconsistent with that position that he should be treated as an assessee by a legal fiction. It is also urged that sub-section (1) and (3) of section 42 deal with the profits of a non-resident and prescribe the conditions under which and the manner in which the tax could be imposed and collected, and section 42(2) must, in this setting, be construed as referring to the business of the non-resident.

There would have been considerable force in this argument, had there been any ambiguity or uncertainty in the wording of section 42(2) as to whether it is the business of the resident that is sought to be taxed or that of the non-resident. But that is not so. The language of the enactment imposing the charge is too plain to admit of any doubt. Now, section 42(2), is, it may be noted, in two parts. The first part commencing with the opening words "Where a person not resident" and ending with the words "which may reasonably be deemed to have been derived therefrom" prescribes the conditions on which the charge arises. It does not of itself impose the charge. That is done by the second part, which provides that "the profits derived therefrom or which may reasonably be deemed to have been derived therefrom shall be chargeable to income-tax". The word "therefrom" is very important for the purpose of the present discussion. In the context, it can refer only to the business of the resident, and it is this business therefore that is the subject of the charge under section 42(2). It was suggested for the appellant that the word "therefrom" has reference to the arrangement between the non-resident and the resident, but a part from the fact that such a construction would, on the grammar of it, be untenable, it is impossible to conceive how an arrangement relating to the conduct of business can, as such, be the subject-matter of income-tax, apart from the business in which profits or gains are made. The language of the section is clear beyond all reasonable doubt as to what it is that is sought to be taxed under this section. That is only the business of the resident and not that of the non-resident. In this view, it is only necessary to consider whether there is anything in the wording of the other parts of section 42(2) relied on for the appellant, which precludes us from giving effect to the plain import of the word "therefrom".

It is on the expression "profits derived" in the charging part of the enactment that the appellant leans heavily in support of his position that it is the business of the non-resident that is really intended to be taxed. But then those words do not stand alone. They are associated with the words "or which may reasonably be deemed to have been derived" and this association has its origin in the preceding clause "produces to the resident either no profits or less than the ordinary profits which might be expected to arise in that business." This clause contemplates two classes of cases, one where the business of the resident produces no profits and the other where it produces less than the normal profits. The charge is imposed on both these classes of cases, and the word "derived" has reference to the latter, while the words "profits which may reasonably be deemed to have been derived" relate to the former. That both these clauses relate to the business of the resident is clear from words "to the resident" occurring therein. The word "derived" in section 42(2) must therefore be interpreted as referring to the business of the resident.

The respondent sought further support for this conclusion in the words "which may reasonably be deemed to have been derived" in section 42(2), and contended that those words could apply only to

a business which does not yield profits, and that will fit in, in the context, only with the business of the resident and not of the non-resident. The answer of the appellant to this contention is that the words in question should be construed as meaning not notional profits but such proportion of the actual profits of the non-resident as could reasonably be apportioned to the business in India. Reliance was placed in support of this contention on rules 33 and 34 of the Indian Income-tax Rules, 1922. Rule 33 provides for the determination of the profits of a non-resident in cases falling within section 42(1), and one of the modes prescribed for such determination is to fix an amount which bears the same proportion to the total profits of the non- resident as the Indian receipts bear to the total receipts in the business. Rule 34 then provides that the "profits derived derived from any business carried on in the manner referred to in section 42(2) of the Act may be determined for the purposes of assessment to income-tax according to the preceding rule". Now, the argument of Mr. Palkhivala is that the interpretation put on section 42(2) by the rule making authorities as manifest in rule 34 is that the business chargeable under section 42(2) is that of the non-resident, and that words "which may reasonably be deemed to have been derived therefrom" had reference to the apportionment of the Indian Out of the total profits. We see no force in this contention. There is nothing in rule 34 to justify the assumption that the rule-making authorities considered either that section 42(2) applied to the business of a non-resident or that the words "which may reasonably be deemed to have been derived therefrom" meant apportionment of the Indian out of the world profits of the non- resident. And even if those be the assumption on which the rule is based, that can have no effect on the true interpretation of section 42(2). And whatever doubts one might had as to the meaning to be given to the words "derived therefrom or which may reasonably be deemed have been derived therefrom" if they had to be construed in isolation, in the context of the section and read in conjunction with the words "to the resident" and "therefrom", there cannot be any doubt that they have reference to the business of the resident and not that of the non-resident.

The word "or" in the clause would appear to be rather inappropriate, as it is susceptible of the interpretation that when some profits are made out but they are less than the normal profits, tax could only be imposed either on the one or on the other, and that accordingly a tax on the actual profits earned would bar the imposition of tax on profits which might have been received. Obviously, that could not have been intended and the word "or" would have to be read in the context as meaning "and" : vide Maxwell's Interpretation of Statutes, Tenth Edition, pages 238-239. But that, however, does not affect the present question which is whether the word "derived" indubitably points to the business of the non-resident as the one taxable under section 42(2), and for the reasons already given, the answer must be in the negative.

The appellant also relied on the clauses in section 42(2) that "the profits shall be chargeable to tax in the name of the resident" and that "he shall be deemed to be the assessee for all purposes of the Act" as indicating that it is not the business of the resident that is really sough to be taxed. But these clauses are explainable with reference to the fact that the profits taxed are not actual profits but what are deemed to be profits. It was argued that if it was the intention of the Legislature that what was not profits should be deemed to be profits, that should have been independently provided for before the tax is imposed, and that in the absence of such a provision for before the tax is imposed, and that in the absence of such a provision, then word "deemed" must be construed as referring not to notional profits being treated as actual profits, but to a person who is not, in fact, an assessee, being treated as an assessee. We see no substance in this argument. There is no reason why an enactment should not bother declare notional profits as taxable profits and at the same time impose a charge on the resident in respect of those profits, and that, quite clearly, is what section 42(2) has done. It may be that its language is not felicitous. But there can, however, be no mistaking its sense that it is the resident that is to be dealt with an assessee in respect of profits which he had not, in fact, made.

Nor, do we see much force in the argument that section 42, sub- sections (1) and (3) relate to income of the non-resident and that section 42(2) which is wedged in between them should therefore be interpreted as having reference to the profits of the non-resident. If the language of section 42(2) is clear that it is the resident who is chargeable to tax, it is no consequences that under section 42, sub- sections (1) and (3) it is the non-resident that it taxed. It should be remembered that section 42 occurs in Chapter V headed "Liability in Special Cases", and section 42(2) is a liability which is out of the ordinary run, and it is not inapporpriate to deal with it in section 42, because while section 42(1) seeks to bring within the ambit of taxation the profits for his business association with a non-resident. On the other hand, on the construction contended for by the appellant section 42(2) would become practically useless because a non-resident whose profits could be taxed under section 42(2) could also be taxed under section 42(1), as also the resident if he were the agent. None of the considerations put forward by the appellant is of sufficient weight to displace the conclusion to be drawn from the words "to the resident" and "therefrom" in section 42(2), and we must hold that the business which is the subject-matter of taxation under that provisions is that of the resident and not of a non-resident. This contention must accordingly be found against the appellant.

We shall next consider the second ground urged in support of the appeal that it is a condition for the levy of a charge under section 42(2), that a non-resident should carry on business with the resident, and that, on the facts found, that condition is not satisfied, and that therefore the tax is unauthorised. It is argued that the business of the non-resident companies is to ply ships for hire, and that the appellant has not concern with that; that the business of the appellant is to repair ships and that the non-resident companies do is to get their ships repaired by the appellant, and that does not amount to carrying on any business with the appellant. A person who regularly purchases his goods from a particularly dealer does not, it is said, carry on business with that dealer, and on the same analogy, in getting their ships repaired by the appellant the non-resident companies cannot bear said to carry on business with them in the real sense of that word.

We are unable to agree with this contention. The word "business" is, as has often been said, one of the wide import and in fiscal statutes, it must be construed in a broad rather than a restricted sense. Discussing the connotation of the word "trade",. Scott, L. J., observed in Smith Barry v. Cordy :

> "The history of judicial decisions has been similar showing a strong tendency not to restrict the scope of Schedule D; a tendency which was, we think, in sympathy with the general social and economic outlook of the country. There is hardly any activity for gaining a livelihood and not covered by the other schedules, which does not seem to us to be swept into the fiscal net by the Schedule D."

"The word business' connotes", it was observed by this court in Narain Swadeshi Weaving Mills v. Commissioner of Excess Profits Tax, some real, substantial and systematic or organised course of activity or conduct with a set purpose." Now, it may be conceded that when a person purchases his requirements from a particular dealer, he cannot without more be said to carry on business with him. But here there is much more. The non-resident companies send their ships for repair to the appellant, not as they might to any other repairer but under a special agreement that repairs should be done at cost. And further unlike customers who purchases goods for their own consumption or use, the non-resident companies get their ships repaired for use in what is admittedly that they constitute business. We are not even concerned in this appeal with the larger question whether the activities of the non-resident companies in connection with the non-resident companies and the appellant it can be said of the former that they carry on business with the latter within the meaning

of section 42(2). Now it should be observed that section 42 speaks not of the non-residents carrying on business in the abstracts but of their carrying on business with the resident, and in the contest, it must include all activities between them having relationship to their business. That is the view taking by the learned Judge in the court below, and we are in agreement with it.

In this connection, reference may be made to section 42(1) under which a charge is imposed on income, profits or gains accruing to a non- resident throughout any business connection in the taxable territories. In Commissioner of Income-tax, v. Currimbhoy Ebrahim & Sons. it was observed by the Privy Council that business connection in section 42(1) was different from business as defined in section 4(2) of the Act. "The phrase 'business connection' observed Sir George Rankin," is different from, through not unrelated to, the word 'business' of which there is a definition in the Act". And in Anglo- French Textile Co., Ltd v. Commissioner of Income-tax, Madras this court has observed that "when there is a continuity of business relationship between the "when there is a continuity of business relationship between the person in British India who helps to make the profits and the person outside British India who receives or realises his profits, such relationship does constitute a business connection." Vide also the observations in Bangalore Wollen, Cotton and Silk Mills Co., Ltd. v. Commissioner of Income-tax Madras The words "where a persons not resident in the taxable territories carries on business with a person resident" in section 42(2) must be similarly interpreted, and a non-resident should be held to carry on business with a resident, if the dealing between them form concerned and organised activities of a business character. We are accordingly of opinion that on the facts found, the non-resident companies must be held to have carried on business with the appellant as provided in section 42(2).

It was argued that the result of this arrangement was only to reduce the repairing charges and enable the non-resident companies to thereby make a savings; that was profit or gains of a business liable to be taxed under the Act, and the decisions in Tenant v. Smith. and Major John, In re, were cited in support of this positions. But, as already held by us, the subject matter of the tax under section 42(2) is the business of the resident and not that of the non-resident, and what we have to decide is not whether the non-resident companies made profits in their dealings with the appellant but whether what they did was business, and for that purposes it is immaterial that the business was carried on by them in such manner that no profits could accrue to them therefrom. Vide the observations of Coleridge, C.J., at page 113 in Commissioners of Inland Revenue v. Incorporated Council of Law Reporting. The fact therefore that the non-resident companies could derive no profits from the dealing with the appellant. This contention must, therefore, be rejected.

It was finally contended that the profits chargeable under section 42(2) must be separately assessed and not added on to the other profits or income of the appellant. This contention is based on the assumption that section 42(2) imposes on the appellant a vicarious liability, the charge being in reality on the profits of the non- resident. On our finding that the charge is on the business of the appellant and not of the non-resident companies, this contention does not survive.

In the result, the appeal fails and is dismissed with costs.

Appeal dismissed.

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