

ALLAHABAD HIGH COURT

Commissioner of Income Tax, U.P

Vs.

Bijli Cotton Mills Ltd.

Misc. Case No. 214 of 1947

(Malik, C.J. and V. Bhargava, J.)

03.09.1952

JUDGMENT

Malik, C.J.

1. This is a reference under Section 66 (1), Income-tax Act. Two questions have been referred to us, one at the instance of the Commissioner of Income-tax and the other at the instance of the assessee. The questions referred for decision are :

"1. Whether in the circumstances of the case the Appellate Assistant Commissioner was empowered under the law to cancel the assessment and whether the order in appeal passed by the Appellate Assistant Commissioner was within the ambit of his powers under Section 31, Income-tax Act?

2. Whether in the circumstances of the case the income of the period from 11th December 1942, to 10th December 1943, could be legally assessed in the hands of the assessee company which was incorporated on 11th December 1943?"

2. The facts found in the appellate order of the income-tax Tribunal and which are stated in the statement of the case are that Messrs. David Mills Ltd. were previous owners of the Bijli Cotton Mills at Hathras. Messrs. Shyamlal Chimanlal, a partnership firm, thought of acquiring the Bijli Cotton Mills for a sum of 15 lacs on behalf of a company, which they were going to get incorporated. Messrs. Shyamlal Chimanlal paid the stipulated price to Messrs. David Mills Ltd., purporting to do so on behalf of the company which they were going to float. On 10th December 1942, they obtained possession of the Bijli Cotton Mills as representing the purchaser company which had not yet come into existence but which they specifically mentioned they had decided to get incorporated. On 11th December 1943, the company was duly incorporated and on 2nd January 1945, a formal conveyance was executed by Messrs. David Mills Ltd. in favour of the new company, called the Bijli Cotton Mills Ltd., Agra. On 14th March 1945, the Income-tax

Officer assessed the Bijli Cotton Mills Ltd. on the income from 11th December 1942, to 31st December 1943. This assessment could only be on the basis that the Bijli Cotton Mills Ltd. had earned profits from the date that Messrs. Shyamlal Chimanlal had commenced business after taking over possession of Bijli Cotton Mills from Messrs. David Mills Ltd. The Bijli Cotton Mills Ltd. had claimed certain sums of money as depreciation. They were not satisfied with the depreciation allowed by the Income-tax Officer and filed an appeal under Section 30, Income-tax Act against the assessment order. While the appeal was still pending the Income-tax Officer thought that he had made a mistake in assessing the Bijli Cotton Mills Ltd., on the income from 11th December 1942, and came to the conclusion that he should have assessed the Bijli Cotton Mills Ltd. only from the date of its incorporation, i.e. 11th December 1943, and that the liability for the payment of Income-tax for the period from 11th December 1942, to 10th December 1943, was of Messrs. Shyamlal Chimanlal, the promoters, who had during that period continued the business. He drew the attention of the Appellate Assistant Commissioner to this, setting forward his views. The Appellate Assistant Commissioner held that the Bijli Cotton Mills Ltd., was assessable only from the period of its incorporation i.e. 11th December 1943, to the end of the year, i.e. 31st December 1943. He, therefore, cancelled the assessment.

3. Against the order of the Appellate Assistant Commissioner the Bijli Cotton Mills Ltd., (which for the sake of brevity we shall henceforward call the assessee) filed an appeal before the Income-tax Appellate Tribunal. Before the Tribunal two points were raised. It was urged that the Appellate Assistant Commissioner was seized merely of the appeal filed by the assessee and he could not entertain a sort of cross-objection on behalf of the Income-tax Officer and hold that the assessee was liable for the income only from the date of its incorporation. In other words, the suggestion was that the Appellate Assistant Commissioner was confined only to the points raised by the assessee and he had no right to annul the assessment. It was further urged that it was the assessee which was liable to be taxed for the period from 11th December 1942 to 10th December 1943, as the business was carried on for its benefit and the promoters, Messrs. Shyamlal Chimanlal, were not liable for assessment for that period.

4. The Appellate Tribunal held on the first point against the assessee and on the second point in favour of the assessee and it was thereafter that the assessee and the Commissioner made applications that the points mentioned above may be referred to this Court for its decision.

5. Taking up the first question first, we have no doubt that the decision of the Tribunal was right and on appeal by the assessee the Assistant Commissioner was not confined to the reliefs claimed by the assessee. His powers under Section 31 (3), Income-tax Act are very wide. It is true that the Income-tax Officer has not been given a right of appeal, and a right of appeal is given only to the assessee objecting to the assessment, but this is for the obvious reason that the Income-tax Officer cannot have a right to appeal against his own decision. If, therefore, the assessee does not appeal, the Income-tax Officer cannot bring the matter before the Appellate Assistant Commissioner and if a mistake has been made in the assessment which is prejudicial to

the interest of the revenue the Commissioner under Section 33 (B) has been given the right to correct the error. Under Section 33 (A) the Commissioner has also been given the right to call for the record of any proceeding under the Act, of his own motion, in which an order has been passed by any authority subordinate to him, and to make an order in accordance with the provisions of that section. Though, therefore, the Appellate Assistant Commissioner could interfere with the assessment order only if an appeal had been filed before him by the assessee, but once the appeal is before him he can, under Section 31 (3) in disposing of the appeal, confirm, reduce, enhance or annul the assessment. He can also while setting aside the assessment direct the Income-tax Officer to make a fresh assessment in accordance with the provisions of sub-S.3(b) of that section. Learned counsel has relied on the words "in disposing of an appeal" in Section 31 (3) and has contended that these words govern all the clauses of the sub-section so that it is only the point relevant to the reliefs claimed in the appeal that can be considered and the appropriate relief granted. We do not agree with this contention as Clause (a) not only gives the Appellate Assistant Commissioner the power to confirm, reduce or annul the assessment but also gives him the power to enhance the assessment and no assessee is likely to ask for enhancement. The first proviso to the sub-section lays down that the Appellate Assistant Commissioner shall not enhance an assessment unless the appellant had a reasonable opportunity of showing cause against such enhancement. If the enhancement can only be as a result of the grounds taken by the assessee himself or as a result of the reliefs claimed by him, there can be no question of giving the assessee a reasonable opportunity because the result follows from his own grounds or from the reliefs claimed by him. We are, therefore, satisfied that though the Appellate Assistant Commissioner may not be able to interfere with the erroneous order of the Income Tax Officer, if there is no appeal pending before him, on appeal by the assessee the Appellate Assistant Commissioner has got the right to pass any of the orders mentioned in the various clauses of sub-section (3) of Section 31.

6. That is our answer to the first question.

7. Coming to the second question, the facts stated above, which have been reproduced from the statement of the case, show that Messrs. Shyamlal Chimanlal entered into an agreement to purchase the Bijli Cotton Mills not for themselves but for a company which they were going to float. It also appears that when they took possession they made it clear that they were not taking possession of the Bijli Cotton Mills in their own right but on behalf of the private limited company which they were going to have incorporated. The company was no doubt incorporated almost one year afterwards, i.e. on 11th December 1943, and the sale-deed in its favor was not executed till the 2nd January 1945, by Messrs. David Mills Ltd. who were the owners. It further appears from the statement of the case that, after the assessee company was incorporated, the assessee chose to accept the profits made before its incorporation and treated the promoters as accountable for all profits made during the period 11th December 1942, and 10th December 1943. In the circumstances the question arises whether it can be said that the business was carried on by the assessee, during the relevant period.

8. Learned counsel for the Department has laid great stress on the language of Section 10, Income-tax Act and has pointed out that under Section 10 tax is payable by an assessee in respect of the profit or gains of any business carried on by him. The argument is that the assessee cannot be said to have been carrying on a business prior to its incorporation on 11th December 1943 when it did not exist and during the period from 11th December 1942, to 10th December 1943, the promoters. Messrs. Shyamlal Chimanlal, must be deemed to have been carrying on the business and they are, therefore, the persons who are liable to assessment.

9. It is true that under the law the assessee the Bijli Cotton Mills Ltd. came into existence only on its incorporation on 11th December 1943, and it is not possible to hold that the legal title in the business or its profits vested in it before its incorporation. It is, however, well settled that if the promoters of a company buy a property or carry on a business on behalf of a company which they intend to float, on the incorporation of the company, the company has a right to either accept what has been done on its behalf by the promoters or repudiate the same. If the company accepts what the promoters have done on its behalf it has a right to claim from the promoters the entire income of the property since its purchase or the entire income for the period during which the business was carried on for the benefit of the company.

10. The question whether the promoters can be said to be trustees for a company not in existence and what exactly is the relationship between a promoter and a company, which comes into existence later, has been the subject-matter of several decisions. Though, strictly speaking, it cannot be said that a person is a trustee for a beneficiary not in existence, it has been held that, on the company being floated, the relationship between a promoter and the company that he has floated must be deemed to be a fiduciary relationship from the day the work of floating the company had been started. In - *'Lydney and Wigpool Iron-Ore Co. v. Bird'*. Lindley, L.J., said that although the promoter is

"not an agent of the company nor a trustee for it before its formation, the old familiar principles of the law of agency and of trusteeship have been extended, and, very properly extended, to meet such cases; and using the word promoter' to describe a person acting as James Bird did, it is perfectly well settled that a promoter of a company is accountable to it for all moneys secretly obtained by him from it just as if the relationship of principal and agent or of trustee and 'cestui que trust' had really existed between them and the company when the money was so obtained."

In - *'Omnium Electric Palaces Ltd. v. Baines'*, it was doubted whether this was strictly accurate and whether it did not merely confuse matters to attempt to identify the fiduciary duties of a promoter with ordinary out-and-out trusteeship. Buckley in his Companies Acts, 12th edn. at page 108, dealing with this matter says :

"The case of a promoter is a strong case of fiduciary relationship, inasmuch as the trustee or agent, so far from being selected by his 'cestui que trust' or principal actually creates the principal in whose affairs he acts."

If, therefore, the promoters have not bought some property or business for their own use but on behalf of or for the benefit of a company which they were about to float, though the company when floated may have the option to accept the benefit of the contract entered into by the promoters, or buy the property purchased for its benefit, the promoters have no right to refuse to give the property or the business or the benefit derived there from to the company if the company wants to acquire that property or the business.

11. There is, therefore, no doubt that Messrs. Shyamlal Chimanlal, as promoters, were accountable to the assessee, Bijli Cotton Mills Ltd., on its incorporation on 11th December 1943, for the entire profits made from 11th December 1942, when they commenced business after getting possession of the property on behalf of the assessee. The fact that the assessee could not claim legal title from 10th December 1942, would for

¹(1886) 33 Ch D 85 at p.94

²(1914) 1 Ch 332

purposes of income-tax make no difference as on equitable grounds the assessee could claim the entire profits of the business run from 11th December 1942 and in the case before us it did and realized the whole amount. It must be held, therefore, that the business was run on its behalf.

12. In - '*the Commissioner of Income-tax, Bombay v. Abubaker Abdul Rehman*³', the point arose whether the 'mutwallis' were taxable under Section 3. Income-tax Act as owners of the properties and whether the Income-tax Authorities were not bound to assess them in respect of the income of the 'wakf'. It was conceded by the learned Advocate General that in Section 9 the word 'ownership' was not confined to legal ownership but also to beneficial ownership and the beneficiary should be treated as the owner of the property. It was held in that case that the beneficiaries were directly assessable for the income of the trust property coming into their hands. The learned Judges held that if the income was earmarked and came into the hands of the beneficiaries then the beneficiaries were primarily liable to be taxed. To the same effect are the observations of Viscount Cave in - '*Williams V. Singer Pool v. Royal Exchange Assurance*⁴', He held that if the Income-tax Acts are examined, it will be found that the person charged with tax is neither the trustee nor the beneficiary as such, but the person in actual receipt and control of the income which it is sought to reach. The point is well illustrated in the case of the - '*Commissioner of Income-tax, Bombay v. Trustees of the Sir Currimbhoy Ebrahim*⁵', a decision of the Bombay High Court which was affirmed by the Privy Council. ('*Trustees of the Sir Currimbhoy Ebrahim Baronety Trust v. Commissioner of Income-tax, Bombay*⁶'), It was pointed out that if the income of the trust property as it accrued was earmarked and had to be handed over by the trustee to the

beneficiary, the beneficiary could be said to be in receipt of that income and could be taxed directly. If, on the other hand, the income came into the hands of the trustee and he had the right to dispose it of and it was only the balance left over that was payable to the beneficiary then the income was taxable in the hands of the trustee.

13. These cases, however, make it clear that under Sections 9 and 10, Income-tax Act, it is not only the legal ownership that has to be looked to but the Courts can also go into the question of beneficial ownership and decide who should be held liable for the tax after taking into account the question as to who is as a matter of fact in receipt of the income which was going to be taxed. If we are correct in this view, then there can be no doubt that after the assessee had adopted the action of the promoters and had decided to take over the business the profits for the whole of the period during which the promoters ran the business which they had to hand over to the Company and which they could not claim that they had a right to keep for their own benefit became income of the assessee. It will be of interest in this connection to quote the observations of Lord Justice Cotton in - '*Ladywell Mining Co. v. Brookes*⁷', - '*Ladywell Mining Co. v. Huggons*⁸', where he said :

"The money was all paid by Palin and his friends and in my opinion they bought for themselves, and without putting themselves into such a position as to entitle

³(1939) 7 ITR 139 (Bom)

⁵ AIR 1932 Bom 106

⁷(1886) 34 Ch D 398

⁴(1921) 7 Tax Cas 387

⁶1 Ind App 209 (PC)

⁸(1897) 35 Ch D 400 at p.413

the company when formed to say, 'You were acting for us; you were in a fiduciary position as regards this property, and now, therefore, as you have purported to sell this to us, we are entitled to take it at the price you originally gave for it.'"

14. In that case on the evidence it was held that the promoters had got the mine for their own benefit but if it had been found that the promoters had got the mine for the benefit of the company which they were going to float, the judgment of Cotton L.J. makes it clear that the promoters could not have kept all the profits they made by selling the mine to the company at a higher price than the price they paid for it.

15. Reference has also been made to Sections 40 and 41, Income-tax Act and it has been urged that in all cases not coming under those sections the trustee is liable to be assessed personally and the income of the property of which he may be merely the trustee may be added to his income. Section 40 (1) deals with cases of guardians and trustees of persons who are minors, lunatics or idiots and makes a special provision that though in such a case the tax was levied upon and recoverable from such guardian or trustee but it would be livable and recoverable only on the income of the beneficiary being a minor, a lunatic or an idiot. Sub-section (2) of Section 40 deals with cases of a trustee or agent of a non-resident. That also is a special provision made where the person primarily liable for the tax is not easily approachable. Section 41 deals with a special set of persons who are generally responsible not for one trust but a number of trusts and if no special provision had been made the whole of the income in their hands from whichever source derived, would have had to be, taken into account and made liable to tax. This would have worked great

hardship as the tax is on a sliding scale and on higher slabs the rate is much higher.

This section was amended after the decision in the case of - 'Trustees of Sir Currimbhoy Ebrahim Baronetcy Trust', 61 Ind App 209 (PC) and is applicable to the Court of Wards, the Administrator-General, the Official Trustees, any receiver or manager appointed by or under any order of a Court, or any trustee or trustees appointed under a trust declared by a duly executed instrument in writing. In all these cases each trust can be treated as a separate entity and the income derived there from as one unit for purposes of assessment.

16. We have already quoted the decision of the Privy Council in the case of - 'Trustees of Sir Currimbhoy Ebrahim Baronetcy Trust', 61 Ind App 209 (PC), where their Lordships have laid down in what cases a trustee can be directly assessed and made liable for income-tax payable on the income of the trust property and in what cases a beneficiary can be made directly liable. In a case where the income when it comes into the hands of the trustee becomes immediately earmarked as payable to the beneficiary and all that the trustee has to do is to hand over that income to the beneficiary, it appears reasonable that the beneficiary should be directly assessed. Where, however, the money is not immediately ear-marked for the beneficiary and the trustee has a right under the trust to dispose of the income and it is only the balance if any that is payable to the beneficiary it cannot be said that the money received belonged to the beneficiary and the income in the hands of the trustee has to be assessed to income-tax in accordance with the provisions of the Income-tax Act.

17. We have already held that in the case before us though the assessee company came into existence almost a year afterwards, the assessment proceedings were started at a time when the assessee company had already decided to accept what had been done on its behalf by the promoters and take over the property and business and the income made there from from 11th December 1942, and it was in the same position as a beneficiary for whom the income was earmarked as payable to it. The case is, therefore, to our minds governed by the principle laid down in - 'Trustees of Sir Currimbhoy Ebrahim Baronetcy Trust case', 61 Ind App 209 (PC) and the income from 11th of December 1942 to 10th December 1943, could be legally assessed in the hands of the assessee.

18. The result, therefore, is that we answer the first question in favour of the Department and the second question in favour of the assessee. In the circumstances of the case it is just and proper that the parties should bear their own costs.

Answer accordingly.