

# CALCUTTA HIGH COURT

Birla Brothers, Ltd

Vs.

Commissioner of Income-tax

Income-tax Ref. No. 38 of 1950

(Harries, C.J. and Banerjee, J.)

06.12.1950

## JUDGMENT

**Harries, C.J.**

1. This is a Reference under Section 66 (1) of the Indian Income-tax Act made by the Income-tax Appellate Tribunal, Calcutta Branch for the opinion of this Court upon the following question :

"In the circumstances of this case is the Income-tax Appellate Tribunal right in deducting proportionate expenses incurred by the applicant company in British India in the management of Jaijeerao Cotton Mills Limited, Gwalior in order to determine the profits of the Gwalior Mills which are to be exempted from taxation under Section 14 (2) (c) of the Indian Income-tax Act?"

2. The case is concerned with assessments made on the assesseees in respect of the years 1943-44, 1944-45 and 1945-46. The point raised is the same in respect of all three assessments and therefore only one question of law has been formulated.

3. The assesseees Messrs. Birla Brothers Limited are a company residing in British India which have business activities in Calcutta, Delhi, Bombay and in the Indian State of Gwalior. The company's activities consist of banking, moneylending, trading in commodities, dealing in shares and securities and conducting the business of managing agents of various concerns all over India. As part of the managing agency business the assesseees were the managing agents of a cotton mills in Gwalior State known as the Jaijeerao Cotton Mills.

4. The assesseees had a number of directors who were appointed under the Articles of Association of the company and were paid a remuneration which had been fixed under those articles. There is no suggestion in this case and no finding that any portion of the fees payable to the directors or

any of them was appropriated to any particular work in India or outside India. The Articles provide for the payment of fees to the directors for the work of directors of the assessee company.

5. It is conceded that the profits arising to the assessees from the managing agency connection in Gwalior were not brought into British India or received here and were therefore not taxable in British India by reason of Section 14 (2) (c) of the Indian Income-tax Act. That sub-section is in these terms :

"The tax shall not be payable by an assessee in respect of any income profits or gains accruing or arising to him within a part B State (formerly an Indian State) unless such income profits or gains are received or deemed to be received in or are brought into the taxable territories in the previous year by or on behalf of the assessee or are assessable under Section 12B or Section 42."

6. In arriving at their assessable income in India the assessees set off as against their gross income their legitimate expenses or outgoings including the total amount paid to their directors as fees. Ordinarily of course the directors' fees are legitimate expenses which can be set off against the earnings for the purposes of arriving at the net income.

7. The taxing authorities however contended that as part of the income of Messrs. Birla Brothers was not liable to tax by reason of Section 14 (2) (c) of the Indian Income-tax Act the whole of the directors' fees could not be treated as legitimate expenses which could be deducted from the gross income for the purposes of arriving at the taxable income.

8. It was suggested that only a proportion of the directors' fees could be allowed as a legitimate expense for earning the income taxable in India and therefore it was said that the proportion of the directors' fees which could be properly attributable to earning the income at Gwalior which was excluded for the purposes of taxation would have to be excluded from the total of directors' fees for the purposes of assessing the taxable income.

9. Dr. Gupta who has appeared on behalf of the taxing authorities has argued that before the deduction from the total income of this company can be made as provided by Section 14 (2) (c) of the Indian Income-tax Act an estimate must be made of the amount of the directors' fees which could be attributed to earning the income of the company in Gwalior and as that had to be done the whole of the directors' fees could not be regarded as a legitimate expense for earning the income taxable in India and therefore all that could be allowed the assessees in their assessment in India was such proportion of the directors' fees as could be attributed to their operations in British India which gave rise to income taxable in British India.

10. On the other hand Mr. Khaitan who appeared for the assessees urged that the directors' fees were legitimate expenses of a company resident and carrying on business in Calcutta. It was a

head office expense and the assesseees were entitled to set the whole of the directors' fees as against their gross income for the purposes of arriving at their assessable income. Mr. Khaitan relied upon a recent English Case '*McMillan v. Guest*<sup>1</sup>', In that case the appellant was a director of a company incorporated under the Companies Act, 1929. The directorship and the whole of the Government of the company were in England. The appellant was resident in the United States and had resided there since 1919. At no material time was the respondent ever in England but he devoted his time to furthering the interests of the company in North America. The appellant received remuneration as provided by the company's articles and it was paid to him as a director

<sup>1</sup>(1940) 4 All England Reporter 452; and *McMillan v. Guest*, (1942) 1 All England Reporter 606

without any reference to the particular tasks he performed in North America, in respect of which he received no additional remuneration. It was held by the General Commissioners that the appellant was chargeable to income-tax upon his remuneration as a director under Schedule E. B. 6, which provides that tax shall be charged in respect of every public office and employment of profit within the United Kingdom. The Court of Appeal held reversing Lawrence, J., that the appellant was properly assessed to income-tax under Schedule E, as a director of a company incorporated under the Companies Act, was the holder of a public office and that office was located where the company was namely in England. On appeal the House of Lords upheld the decision of the Court of Appeal.

11. In this case it is clear that the whole of the activities of the director were concerned with matters entirely outside England. He resided outside England and apparently was paid outside England. Nevertheless he was regarded as a director of a London Company carrying on his activities not abroad but in London.

12. From this case it is clear that the directors of Messrs. Birla Brothers Limited carry on their activities in Calcutta though some of those activities might be concerned with some factory in Gwalior. Further it seems clear from this decision of the House of Lords that if the directors of Messrs Birla Brothers, Limited deputed one of their number to look after their interests in Gwalior and that such a director lived in Gwalior and gave the whole of the time to the Gwalior business nevertheless the director would be regarded as earning his director's fees in Calcutta and would be liable to Indian Income-tax.

13. If these directors are carrying on their business in Calcutta then it appears to me quite clear that their remuneration is an expense which can be set off against the income of this Calcutta business. For the purposes of taxation the income made in Gwalior is excluded except for certain purposes. But that does not mean that the directors' fees are not to be deducted. It is conceded that there is no provision in the Income-tax Act for apportionment of directors' fees and unless there is some statutory provision I cannot see how such an apportionment could be made except by agreement. Had it been agreed that part of the fees should be specifically attributable to certain activities then no difficulty would arise. But as I have said there is no such arrangement

suggested in this case.

14. How, therefore, could such an apportionment, be made? It might well be that the Gwalior business has caused these directors no trouble or work at all, or it might be that the Gwalior business has given them far more trouble than the whole of the rest of the business of Messrs. Birla Brothers. In such circumstances how could an apportionment be made except on a rough and ready basis of the proportion of the Gwalior profits to the whole profits and that might mean a very serious and gross injustice to Messrs. Birla Brothers or even to the income-tax authorities.

15. In my judgment as the directors' fees are fees earned and payable in Calcutta by directors who must be deemed to carry on the business of the company in Calcutta, these fees must be regarded as expenses of the company incurred in earning the income upon which it is taxed. That being so, it appears to me that the view of the Appellate Tribunal that the question should be answered in the affirmative cannot be sustained.

16. If there is no agreement to apportion any part of the directors' fees to this particular work the whole of the payments to the directors must be regarded as an expense of the company which is assessed and therefore the whole can be deducted from the gross income for the purposes of arriving at the amount of tax. The amount of the expenses which can be deducted cannot be made to depend upon how much of their work is attributed to the income which is made assessable under the Indian Income-tax Act. Their work must be regarded as a whole. They worked and were paid as directors of the company and in assessing the company the payment must be regarded as a legitimate expense of the company for earning the income upon which they are assessed.

17. In our view the taxing authorities should have allowed the whole of the remuneration payable to the directors and should not have disallowed a proportion attributable to earning the income in Gwalior.

18. In the result therefore I would answer the question submitted in the negative. The assesseees will be entitled to the costs of these proceedings. Certified for two Counsel.

**Banerjee, J.**

19. I agree.

Reference answered.