CALCUTTA HIGH COURT

Commissioner of Income Tax

Vs

Tea Producing Co of India Ltd

(G.K.Mitter, J.)

23.03.1962

JUDGEMENT

G.K.Mitter, J.

(1.) IN this reference the question involved is whether in computing the income of a company which received a certificate of commencement of business on 21st June, 1951, but actually took over a business on 1st Dec., 1951, the profit and loss for the period 1st Jan., 1951 to 31st Dec., 1951 can be taken into account in view of the fact that the promoter of the company had entered into an agreement with a third person formerly owning the business to be entitled to the profit and loss, if any, from 1st Jan., 1951.

(2.) THE facts lie within a very short compass. On 29th March, 1951, one B. L. Lahoty entered into an agreement with Duncan Brothers and Co. Ltd., agents of the Indian Tea Co. of Cacher Ltd. owning a tea garden in Assam by the name of Rosekandy Tea Estate to purchase the said estate as a going concern subject to a good marketable title being made out as from 1st Jan., 1951, together with all moveable and immoveable properties, etc., attached to or belonging to the tea estate and quota rights but excluding all stocks, stores, manures, tea chests, coal, oil, consumer goods, foodstuff and clothing as shown in the books of the company as on the date of the handing over of the tea estate to the purchaser or its nominee for the sum of Rs. 6,00,000 on terms and conditions mentioned. THE purchaser paid in Rs. 60,000 as earnest money and agreed to accept the title within eight weeks from the date of acceptance of the offer made by him. THE relevant terms of the offer contained in a letter and accepted by Duncan Brothers and Co. Ltd. on behalf of their principals are as follows: Cl. 7.--"I understand and agree that the sale does not include the tea manufactured at the estate prior to 31st Dec., 1950, nor any unused stores, tea boxes, coal, oil, foodstuff, clothing, consumer goods and tools on the said tea estate nor any book debts, outstandings, advances (save as provided in cl. 12 hereof), unadjusted profits, cash reserves, balance investments and sums of money belonging to the company in respect of the said tea estate nor any securities for the same as at the date of your handing over the said tea estate to me or my nominee." Cl. 12.--"At the time of completion of the purchase I undertake to take over and pay to the company all advances made by the company to working garden labourers or other garden employees, whom I or my nominee will retain, towards wages or salary as will be outstanding in the books of the company on the date of your handing over the said tea

estate to me or my nominee." Cl. 13.--"All claims of garden employees including salaries, bonuses, provident fund, commission, etc., up to and including 31st Dec., 1950, will be paid by you and I or my nominee will not be responsible in any way for any such claims." Cl. 14.--"It is understood that the services of the present employees of the said tea estate will be terminated by you on or before my or my nominees taking possession of the said tea estate from you. It will be my or my nominee's option to re-employ any of the previous employees on terms which I or my nominee will fix with such employees." Cl. 15.--"I understand and agree that until completion of the sale the management and the operational control of the said tea estate will be in the hands of the company and the company will have absolute control in the purchases of stores, garden appliances, tea seed, manures, fuel and other items necessary for the working of the said tea estate and I will have to pay to the company at the time of completion all expenditure outlaid by the company in respect of the tea estate as from 1st Jan., 1951, including the salary of the European and the Indian staff and labour, all other expenditure incurred by the company whether in the said tea estate or in London or in Calcutta in connection with the management and working of the said tea estate and also such remuneration to the secretaries and agents of the company for supervision as may be mutually agreed until delivery of possession to me." Cl. 16.--"I further understand and agree that in addition to the purchase price and the sums mentioned above I shall have to pay to the company at the time of completion of the transaction for the stocks, unused stores, tea chests, manures, coal, oil, consumer goods, foodstuffs, clothing and tools, such sums as are lying on the said tea estate and shown in the books of the company as at the date of handing over the said tea estate to me or my nominee at the landed cost price thereof as per company's books of account." Cl. 17.--"Upon payment of the balance of the purchase price and the sums mentioned in the clauses, viz., cls. 12, 15 and 16, the Rosekandy Tea Estate will be transferred to me or my nominee as the case may be free from encumbrances but subject to the terms of the grants of pattahs under which the same are held and possession of the movable and immoveable properties appertaining to the said tea estate will also be made over to me at the same time. I shall also be entitled to the proceeds of the sale of any crop made for the season 1951, viz., crop manufactured on or after 1st Jan., 1951, and to all profits of the said tea estate as from 1st Jan., 1951." Cl. 18.--"It being understood and agreed that I shall receive the entire benefit of the working of the said tea estate from the period commencing 1st Jan., 1951, I agree to reimburse the company for any income-tax, national defence contribution, profits tax and agricultural income-tax or any other tax or duty which may be levied on it in India or in the United Kingdom calculated by reference to profits arising or deemed to arise to the company from the working of the estate subsequent to 31st Dec., 1950. I agree to accept for this purpose a certificate of such liability (if any) from the auditors of the company in London or in Calcutta. I will also be liable to pay revenue rents, taxes, local rates and other impositions in respect of the said tea estate and will be liable for all expenses incurred by the company for the working of the said tea estate as from 1st Jan., 1951, as hereinbefore mentioned in cl. 15 hereof." The assessee-company was incorporated on 29th May, 1951. The object with which it was formed included the taking over of the Rosekandy Tea Estate from M/s Duncan Brothers and Co. Ltd., agents of the Indian Tea Company of Cachar Ltd., as a going concern on and from 1st Jan., 1951, as per agreement dt. 29th March, 1951, above mentioned. The assessee-company was incorporated on 29th May, 1951. The certificate of commencement of business was granted to the company on 21st June, 1951. On 23rd June, 1951, an agreement was entered into between B. L. Lahoty and the company to the effect that B. L. Lahoty would nominate the company as the purchaser under

the agreement dt. 29th March,1951. The company would pay to B. L. Lahoty the sum of Rs. 60,000 advanced by him to M/s Duncan Brothers and Co. Ltd. with interest and, pending such payment, the charge in favour of B. L. Lahoty on the said tea estate would continue. The company would also pay to Lahoty all costs and expenses incurred by him on account of legal charges, travelling expenses and otherwise. Under cl. 4 of this agreement the company adopted the agreement dt. 29th March, 1951, and covenanted to observe and carry out all the terms and conditions thereof. Further, the company undertook to save, defend and keep harmless and indemnified the said B. L. Lahoty from and against all manner of claims and demands or liabilities in respect of or arising out of the said agreement dt. 29th March, 1951. The conveyance of the tea estate was executed by Duncan Brothers and Co. Ltd. in favour of the assessee-company in November, 1951. Actual possession of the tea estate was taken over on and from 1st Dec., 1951. The trading results of the year ended in a loss computed at Rs. 1,05,593. The ITO took 40 per cent of the aforesaid loss as a loss for the tea business. He held that as the company commenced business only w.e.f. 23rd June,1951 the proportionate loss for the period worked out to Rs. 20,808 and that the balance of the loss should be disallowed in the hands of the assessee. The assessee's appeal to the AAC was unsuccessful. On a further appeal to the Tribunal it was held that the decision in *CIT vs. Bijli Cotton Mills Ltd*[1]. applied to the facts of the case and the company was entitled to claim the loss for the entire period as its loss. In my opinion, the Tribunal did not come to the right conclusion. I am unable to guide myself by the decision in Bijli Cotton Mills' case (supra). Under s. 2(2) of the IT Act "assessee" means a person by whom income-tax or any other sum of money is payable under the Act. Under s. 10 tax has to be paid by an assessee under the head "profits and loss of business, profession or vocation" in respect of the profits or gains of any business, profession or vocation carried on by him. Therefore, before a person can be assessed under s. 10 it must be shown that it was he who carried on the business, profession or vocation. In the case of a business, it is open to any person to put another else in charge thereof and, although ostensibly such person would appear to be carrying on the business, in reality the business would be that of the person who owned it and under s. 10 of the Act such owner of the business would be the assessee. If a business carried on by A is transferred to B as from a certain point of time B alone can be assessed to tax in respect of the period subsequent to the change of the ownership. A and B may agree that any profits or loss of the business as from a date anterior to that of the change of ownership will be on B's account. In such a case A will have to account to B for the income and profits of the business covered by the period of the agreement and A may be held to have carried on the business as B's agent from the agreed date. I cannot see how a person can be said to have carried on a business during a period when he was not born or how he can be assessable to tax in respect thereof. It may be open to B to enter into an agreement with A that the business as from a certain date will be on the account of B's son not yet born in which case A may be accountable to B's son for the period before his birth during the subsistence of the agreement on the ground of some sort of fiduciary relationship. But this cannot affect the liability of A to tax before the date of the birth of B's son. Although B's son may not be able to carry on a business for some years after his birth as the owner of the business, of necessity it would be carried on for him by some guardian or trustee. Sec. 40 of the Act makes provision for assessment of the guardian or trustee in such a case. As in the case of a natural born person, so in the case of a legal entity like a company, liability to pay tax can only arise after the date of birth or incorporation. Under s. 27 of the Specific Relief Act it is no doubt open to a company to adopt and ratify the benefits and advantages under the contract, the liability of the company to pay

income-tax for any business carried on by the promoter can only be in respect of the period subsequent to its incorporation. It cannot go beyond that. If the above reasoning be correct then it would appear that the assessee could not possibly own any business before the date of its incorporation, i.e., 28th May, 1951 and could not be assessable to tax in respect thereof prior to that date. Mr. Mitra appearing for the assessee did not rely on the case of Bijli Cotton Mills Ltd. (Supra) He put his client's case as follows: According to him one must scan the contract entered into on 29th March, 1951, and the surrounding circumstances down to the period when the assessee took over the business itself and find out to whom the income of the Rosekandy Tea Estate from 1st Jan., 1951, belonged. He referred to the clauses in the agreement of 29th March, 1951, already mentioned from which according to him the following facts emerge : (1) The tea estate was to be sold as a going concern, all the tea manufactured after 31st Dec., 1950, was to belong to the purchaser including quota rights of the garden and all moveable and immoveable properties excepting those specifically mentioned, namely, unused stores, tea boxes, food-stuff, clothing, etc. (2) At the time of the completion of the purchase the purchaser was to take over and pay to the vendor all advances made by it to garden labourers or employees. (3) All claims of garden employees including salaries, bonuses, provident fund, commission, etc., up to and including 31st Dec., 1950, were to be paid by the vendor. (4) The services of the employees of the garden were to be terminated before the purchaser took over possession and it would be the purchaser's option to re-employ any of the previous employees or not. (5) The vendor would have only the operational control of the tea estate as from 1st Jan., 1951, and all expenses incurred after that date including the salaries of the staff and labour, all costs and charges incurred either in the tea estate or in London in connection with the management of the estate as also such remuneration to the secretaries and agents of the company for supervision would be on the account of the purchaser. (6) At the time of the completion of the transaction the purchaser would pay for the stocks, unused stores, tea chests, lying in the garden. (7) Upon payment of the amounts mentioned in cls. 12, 15 and 16, the tea estate would be transferred to the purchaser free from encumbrance and the purchaser would be entitled to the proceeds of the sale of any crop made for the season 1951 on or after 1st Jan.,1951, and to all profits of the tea estate as from the said date. (8) The purchaser would reimburse the vendor for any income-tax, national defence contribution, profits tax and agricultural income-tax or any other tax or duty which might be levied on the tea estate calculated by reference to profits subsequent to 31st Dec., 1950.

(3.) IT was argued that the above make it sufficiently clear that a line was to be drawn as from 1st Jan., 1951. On and from this date the tea estate, its business including all its income and profits, were to belong to the purchaser and, consequently, the IT authorities could thereafter only look on the purchaser as the person assessable to tax under s. 10 of the Act. IT was contended that s. 10 of the Act does not lay down that the business for the whole of the accounting year should be carried on by the assessee and, therefore, even if the assessee itself carried on the business for a fractional period during the accounting year by an agreement with the previous owner of the business the whole of the income and profits could become the assessee's, that is to say, the purchaser's. I find myself unable to accede to this contention. According to s. 10 tax has to be paid by the assessee in respect of the profits or gains of the business carried on by him. If he carries on the business for a short period during the accounting year he will be assessable to tax only for that period, Further, although it is open to a vendor and a purchaser of the business to agree that as from a certain date the business will be carried on by the purchaser, the vendor may

be treated as an agent of the purchaser as from that date and the entire income of the business will be assessable in the hands of the purchaser but the purchaser must be a living person; he must be in existence. No such arrangement or agreement is possible between a living person and a person who is yet to be born. Reliance was placed by Mr. Mitra chiefly on the case of *E. D Sassoon and Co. Ltd. vs. CIT*[2] There the facts were as follows: E. D. Sassoon and Co. Ltd. (hereinafter referred to as the assessee) were the managing agents of three mills : (1) E. D. Sassoon United Mills Ltd. (2) Elphinstone Spinning and Weaving Mills Co. Ltd. and (3) Apollo Mills Ltd., under various agreements. The assessee agreed to transfer its managing agencies of the said companies to M/s Agarwal and Co., Chidambaram Mulraj and Co. Ltd. and Rajputana Textile (Agencies) Ltd., by letters dt. 3rd Sept., 1943, 16th April, 1943, and 27th April, 1943. The consent of the shareholders of the respective companies to the agreements for transfer was duly obtained and the managing agencies were ultimately transferred to the respective transferees with effect from 1st Dec., 1943, 1st June, 1943, and 1st July, 1943. The assessee executed in favour of the transferees formal deeds of assignment and received from them Rs. 57,8,000, Rs. 12,50,000 and Rs. 6,00,000 respectively. The accounts of the managing agency commission payable by the respective companies to the managing agents for the year 1943 were made up in the year 1944 and the three transferees received respectively Rs. 27,94,504, Rs. 2,37,602 and Rs. 3,82,608 by way of commission. For the asst. yr. 1944-45 and the chargeable accounting period, 1st Jan.,1943 to 31st Dec., 1943, the original income-tax and excess profits tax assessments of the assessee were made on 31st May, 1945, at a total income of Rs. 46,48,483. This income did not include any part of the managing agency commission received by the transferees. The entire amounts of the managing agency commission received by the transferees were assessed by the ITO for the asst. yr. 1945-46 as the income of the transferees. This was confirmed by the AAC but on a further appeal to the Tribunal, the latter body by its order dt. 28th Dec., 1949, accepted the transferees' contention that the managing agency commission received by them should be apportioned on a proportionate basis and the transferees should be made liable to pay tax only on the commission earned by them during the period that they had worked as the managing agents of the respective companies. Thereupon, the ITO and the EPTO issued notices under s. 34 of the Indian IT Act and s. 15 of the EPT Act upon the assessee on the ground that the income from the managing agency had escaped assessment. The ITO and the EPTO wanted to include in the assessable income of the assessee the various amounts by reason of the apportionment of the managing agency commission between the transferees and the assessee under the order of the Tribunal. In course of time assessments were made in spite of the objection of the assessee. After losing before the Tribunal the assessee got the Tribunal to refer the question "Whether, in the circumstances of the case, the managing agency commission was liable to be apportioned between the assessee-company and the assignee ?" under s. 66(1) of the IT Act and s. 21 of the EPT Act. According to the Tribunal, the question was not when the managing agency commission accrued but the real question was to whom it accrued. The Supreme Court examined the terms of the managing agency agreement with a view to find out whether the assessee was entitled thereunder to remuneration or commission for the broken periods. With regard to the E. D. Sassoon United Mills Ltd., the Supreme Court found that cl. 2(d) of the agreement specified that the commission was to be due to the managing agents yearly on 31st March, in each and every year during the continuance of the agreement. The Court observed that "the commission was thus an annual payment calculated upon the annual net profits of the company and was to be due to the managing agents yearly on the 31st March in each and every year. Unless and until the

annual net profits of the company were determined the 7--1/2 per cent commission could not be ascertained but the sum nonetheless became due on the 31st March in each and every year following the close of the accounting year of the company. The amount of such commission did not become a debt owing by the company to the managing agents until the 31st March in each and every year and was to be paid immediately after the annual accounts of the company had been passed by the shareholders. . . Until and unless the accounting year of the company had gone by and the managing agents have served the company as their agents for the full period no part of the managing agency commission which was payable per year in the manner aforesaid could become due to them and the performance of the service for the year was a condition precedent to the managing agents being entitled to any part of the remuneration or commission for the accounting year of the company. The managing agency agreement therefore was an entire and indivisible contract stipulating a payment of remuneration or commission per year and enjoined upon the managing agents the duty and obligation of rendering the services to the company for the whole year by way of condition precedent to their earning any remuneration or commission for the particular accounting year." Before the Supreme Court it was urged that "cl. 10 of the managing agency agreement itself contemplated a broken period, because there was nothing therein to prevent the managing agents from assigning the agreement and their rights thereunder at any time in a particular year during the continuance of the agreement. If the managing agents therefore could assign the agreement and their rights thereunder it could not be suggested that neither the transferors who could not complete the year of service nor the transferees who had also not rendered the services as the managing agents for the whole of the accounting year could earn any remuneration or commission which would be payable to the managing agents only if they rendered the services to the company for the whole year". The Supreme Court pointed out that "this argument however ignores the fact that whatever be the position as between the transferor and the transferee, whatever be their arrangements, inter se, whatever be the periods of the year during which they might have served the company in their capacity as the managing agents, the managing agents, as described in the recitals and cls. 1 and 3 of the managing agency agreement, were one entity and no severance of such periods of service during the course of a particular year was ever contemplated under the agreement. On assignment, the transferee became the managing agents as if its name had been inserted in the managing agency agreement from the beginning". Reliance was also placed on the observation of the Supreme Court in the above case at page 51 reading : "It is clear therefore that income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income". The Supreme Court went on to add : "What has however got to be determined is whether the income, profits or gains accrued to the assessee and in order that the same may accrue to him it is necessary that he must have acquired a right to receive the same or that a right to the income, profits or gains has become vested in him though its valuation may be postponed or though its materialisation may depend on the contingency that the making up of the accounts would show income, profits or gains. The argument that the income, profits or gains are embedded in the sale proceeds as and when received by the company also does not help the transferees, because the managing agents have no share or interest in the sale proceeds received as such. They are not co-sharers with the company and no part of the sale proceeds belongs to them. Nor is there any ground for saying that the company are the trustees for the business or any

of the assets for the managing agents. The managing agents cannot therefore be said to have acquired a right to receive any commission unless and until the accounts are made up at the end of the year, the net profits ascertained and the amount of commission due by the company to the managing agents thus determined." It will therefore be noticed that the Supreme Court held that there could be no question of apportionment of the managing agency commission, the same becoming due only on the completion of service for the whole year. ;

Cases Referred.

1(1953) 23 ITR 278 (All)
2(1954) 26 ITR 27 (SC) : TC14R 1023