CALCUTTA HIGH COURT

Molins of India Ltd

Vs

Commissioner of Income-Tax

(S Mukharji, C.J. Suhas Chandra Sen, J.)

15.10.1982

JUDGMENT

Suhas Chandra Sen, J.

1. Molins of India Ltd., Calcutta, is the assessee in this case. The relevant assessment year is 1974-75. The corresponding accounting period ended on 31st December, 1973. The accounts of the assessee-company were maintained on mercantile system.

2. During the relevant previous year, the assessee-company was engaged in the manufacture of cigarette making and packing machineries. Net profit as per profit and loss account was Rs. 58,77,411. Income disclosed by the assessee was Rs. 62,98,280 but the ITO computed the total income at Rs. 66,91,550.

3. The assessee preferred an appeal against the assessment order. Before the AAC, the assessee filed an additional ground stating that the ITO should have allowed the surtax liability of the assessee-company as a deduction. In support of its claim, the assessee relied upon a decision of the 'D' Bench of the Appellate Tribunal, Bombay Benches, in I.T.A. Nos. 3068 & 3097 (Bom) of 1972-73, dated 24th February, 1975. Being not satisfied with the delay in raising the additional ground, the AAC refused to admit the same.

4. The assessee appealed to the Appellate Tribunal which decided the issue with the following observation :

> "We have heard both sides. This is purely a legal contention and, in our opinion, the Appellate Assistant Commissioner should have admitted the appeal and disposed of the same. However, with the approval of the parties before us and considering the nature of the issue, instead of asking the Appellate Assistant Commissioner to admit the point and to decide thereon, we prefer to dispose of the appeal on merits ourselves here in this order.
>
> Before us, we have a copy of the order dated 1st December, 1977, in I.T.A. No. 3643

(Born) of 1974-75, for the assessment year 1970-71 in the case of M/s. Amar Dye Chem Ltd. v. ITO, passed by the Special Bench of the Appellate Tribunal, Bombay Bench 'B'. A similar point which was raised there, was decided by the Special Bench against the assessee and the same was discussed in paragraphs 101 to 131 of the aforesaid order, The disallowance was obviously made under Section 40(a)(ii) of the Act. Respectfully following the said decision, we reject the assessee's contention that the surtax liability under the Companies (Profits) Surtax Act, 1964, for the relevant year should be deducted in arriving at the total income under the Income-tax Act, 1961."

5. At the instance of the assessee-company, the Tribunal has referred the following question of law to this court under Section 256(1) of the I.T. Act, 1961, arising out of the Tribunal's order dated 9th February, 1978, "Whether, on the facts and in the circumstances of the case, and on a correct interpretation of the provisions of the Income-tax Act, 1961, the Tribunal was right in holding that the surtax liability under the Companies (Profits) Surtax Act, 1964, for the relevant year should not be deducted in arriving at the total income under the Income-tax Act, 1961 ?"

6. The first argument of the assessee before us is that the surtax liability under the C. (P.) S.T. Act, 1964, is a statutory charge on the income of the company, Therefore, the income of the assessee has been statutorily diverted at source. The real income of the assessee, therefore, must be taken to be reduced by the quantum of the surtax liability. It has been argued that the I.T. Act also imposes a liability on the income of the assessee and that liability would have been deductible from the total income of the assessee on the principle of real income. Because of the provisions of Section 40(a)(ii), income-tax is not allowable as a deduction for the purpose of computation of taxable profits. It has further been argued that there are significant changes in the phraseology of Section 40(a)(ii) of the 1961 Act from the language used in Section 10(4) of the 1922 Act. Because of these changes, it cannot be said that the surtax liability comes within the mischief of Section 40(a)(ii). Therefore, the Revenue will not be able to rely on Section 40(a)(ii) and disallow the deduction that has been claimed in this case.

7. It has further been argued that, in any event, the surtax liability under the C. (P.) S,T. Act should be allowed as a deduction, as business expenditure under Section 37 of the I.T. Act. It has been argued that Section 40(a)(ii) has been incorporated only for the purpose of excluding the liability of income-tax and the liability for surtax should be allowed as expenditure wholly and exclusively laid out for the purpose of business.

8. The concept of real income was explained by the Privy Council in the celebrated case of *Raja Bejoy Singh Dudkuria v. CIT*[1], Lord Macmillan observed at p. 138 of the report:

"When the Act by Section 3 subjects to charge 'all income' of an individual, it is what

> reaches the individual as income which it is intended to charge. In the present case the decree of the court by charging the appellant's whole resources with a specific payment to his step-mother has to the extent diverted his income from him and as directed it to his step-mother; to that extent what he receives for her is not his income. It is not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands."

9. As its name denotes, the C. (P.) S.T. Act is a tax on profits. It is an additional tax levied on the total income of a company after making various adjustments and deductions in accordance with the provisions of the Act. But the levy of the C. (P.) S.T. Act is only attracted when the income, it intends to charge reaches the assessee. Payment of surtax by an assessee cannot be described as an allocation of a sum out of his revenue before it becomes income in his hands.

10. The test laid down by the Privy Council in the case of Raja Bejoy Singh Dudhuria v. CIT [1933] 1 ITR 135(Supra), has been applied by the Supreme Court in a number of cases.

11. In the case of CIT v. Sitaldas Tirathdas , the Supreme Court stated the principle of real income in the following terms (p. 374):

> "In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive factor. There is a difference between an amount which a person is obliged to apply out of his income and an amount, which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible ; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable."

12. When a tax is imposed on the income of the company the company will have to pay that tax but it cannot be said that a part of the income of the company was received for and on behalf of the Revenue. In the case of *L.C. Ltd. v. G.B. Ollivant Ltd*[2]. varying a famous phrase of Lord Machaghten, Viscount Simon L.C., observed : "excess profits tax, if I may be pardoned for saying so, is a tax on profits". The Companies (Profits) Surtax is also a tax on profits. Until and unless the profits are earned, the liability to pay income-tax or surtax does not arise. It is only

because the income has reached the assessee that the tax is being imposed.

13. The I.T. Act imposes a charge on the total income of an assessee. The C. (P.) S.T. Act levies an additional tax on the total income of a company after certain adjustments in accordance with the principles laid down in that Act. Income or profits on their coming into existence attract tax at that point, but if no profit or income was earned or received by an assessee, there will not be any question of imposition of income-tax or surtax. Charge of surtax presupposes existence of income; it does not prevent accrual of income or receipt of income by diverting a portion of the income to the Revenue at source.

14. The assessee's total income has been computed by the ITO under the provisions of the I.T. Act to be Rs. 66,91,550. The Revenue cannot claim any part of the company's total income of Rs. 66,91,550 as its own even before it reached the assessee. It has not got any overriding title to this income or any portion of it. What the Revenue, however, can do is to levy a tax on this total income under the I.T. Act. The Revenue can also levy an additional tax on this income, after some adjustments and deductions under the C. (P.) S.T. Act. But both under the I.T. Act and the C. (P.) S.T. Act, it is the income of the assessee that is brought to the charge of taxation. What is taxed is the entirety of the income. The Revenue cannot be heard to say that any portion of the amount of Rs. 66,91,550 was its own income and the company received it for and on behalf of the Revenue. The Revenue is entitled to levy tax on the income only because the entire amount is the income of the assessee. What comes within the net of assessment is the totality of the income of the assessee.

15. The case of Poona Electric Supply Co. Ltd. v. CIT , also does not support the contention of the assessee. In that case under an Act the company's profit could not exceed a stated amount. The excess realization had to be credited to a fund known as "Consumers Benefit Reserve Account". This amount had to be refunded to the subscribers by way of rebate. There the Supreme Court observed (p. 525):

> "The real profit of a businessman under Section 10(1) of the Income-tax Act cannot obviously include the amounts returned by him by way of rebate to the consumers under statutory compulsion. It is as if he received only from the consumers the original amount minus the amount he returned to them..... The amount returned is not a part of the profits at all."

16. In the case before us it cannot be said that the company's profits could not exceed a stated amount in view of the C. (P.) S.T. Act. The surtax is leviable only upon the profits of the company. The question of payment of surtax arises only after the profits have been ascertained. The Supreme Court quoted with approval the observation of Halsbury L.C. in the case of

Gresham Life Assurance Society v. Styles [1892] 3 TC 185, 188, 189(HL):

> "The word 'profits' I think is to be understood in its natural and proper sense--in a sense which no commercial man would misunderstand. But when once an individual or a company has in that proper sense ascertained what are the profits of his business or his trade, the destination of those profits, or the charge which has been made on those profits by previous agreement or otherwise is perfectly immaterial. The taxis payable upon the profits realised, and the meaning to my mind is rendered plain by the words 'payable out of profits'."

17. In the case of Murlidhar Himalsingka v. CIT , the question was whether the interest of a sub-partnership in the profits received from the main partnership was of such a nature as to divert the income from the original partner to the sub-partnership.

18. The Supreme Court held that in the case of a sub-partnership, the sub-partnership created a superior title and diverted the income from the main firm before it became the income of the partner. In other words, the partner in the main firm received the income not only on his own behalf but on behalf of the partners of the sub-partnership. This case, in our opinion, does not throw any light on the problem before us.

19. In the case of CIT v. Travancore Sugars and Chemicals Ltd. , the promoters of the assessee-company entered into an agreement with the Government of Travancore whereby the assets of a sugar company and a distillery and a tincture factory run by the Government were agreed to be sold to a company to be floated for that purpose. Apart from cash consideration it was provided that the Government shall be further entitled to 20% of the annual net profit up to a maximum of Rs. 40,000 after providing for depreciation and remuneration of the secretaries and treasurers. The Supreme Court held that the amount paid was either a revenue expenditure or diverted by an overriding charge or an expenditure laid out wholly or exclusively for the purposes of trading.

20. In the case of Official Trustee of West Bengal v. CIT , the principle was stated in the following language (headnote):

> "The true test to determine, whether in a particular case, a payment is on account of an overriding charge or is a mere application of income, must be to find out in the background of the obligations imposed whether the amount in question reaches the assessee as his income."

21. These are cases of diversion of income by an overriding title before it reaches the assessee. But unless the income in question reaches the assessee as income, there cannot be any question of imposition of income-tax or surtax. Whatever income has reached the assessee has been

brought under the pale of taxation under these two Acts.

22. An argument similar to what has been contended in this case was repelled in the well-known case of Ashton Gas Co. v. Attorney-General [1906] AC 10 (HL). In that case it was statutorily provided that the profits of the Ashton Gas Company to be divided among the shareholders in any year should not exceed the rate of 10% per annum on the ordinary share capital. The company distributed 10% as dividend tax-free. The argument on behalf of the company was that the income-tax was a charge on the profits before distribution to the shareholders ; it was one of the charges which had to be deducted before arriving at the profits and calculating the dividend. The tax was charged upon the company and the company was entitled to adopt the principle upon which it had acted. Buckley J. (Attorney-General v. Ashton Gas Co. [1904] 2 Ch 621, 624 (Ch D & CA)) observed as follows:

> "The profits are not arrived at after deducting income-tax. The income-tax is part of the profits--namely, such part as the Revenue is entitled to take out of the profits. A sum which is an expense, which must be borne whether profits are earned or not, may no doubt be deducted before arriving at profit. But a proportionate part of the profits payable to the Revenue is not a deduction before arriving at, but a part of, the profits themselves."

23. On further appeal, Halsbury L.C., observed as follows ([1906] AC 10, 12(HL)):

> "Profit is a plain English word ; that is what is charged with income tax..... The income tax is a charge upon the profits; the thing which is taxed is the profit that is made, and you must ascertain what is the profit that is made before you deduct the tax--you have no right to deduct the income tax before you ascertain what the profit is. I cannot understand how you can make the income tax part of the expenditure. I share Buckley J.'s difficulty in understanding how so plain a matter has been discussed in all the courts at such extravagant length."

24. In the case before us it is the total income of the company after some adjustment which is being charged with surtax. The thing which is being taxed is the profit that the company has made.

25. On behalf of the assessee strong reliance was placed on the following passage from the Valuation of Company Shares and Business by A.V. Adamson, 5th Edn., p. 105 :

"Taxes on company income An English legal interpretation of the nature of these taxes may be found in a decision of the House of Lords in the case of *G.B. Ollivant Ltd*[3]. which dealt with the question as to whether excess profits tax should be deducted in arriving at net profit. Ford Greene stated :'It is indisputable that for the purpose of drawing up the profit and loss account of a

trading company excess profits tax must be deducted if ordinary commercial practice is to be followed...it is not merely common knowledge but common-sense that the divisible profits of a trading company cannot properly be ascertained without first making that deduction'."

26. That all statutory dues including taxes on income will have to be deducted from the income of a company for the purpose of computing its divisible profit for the purpose of distribution of dividend cannot be disputed. In the case of *L.C. Ltd. v. G.B. Ollivant Ltd. [1942] 2 AH ER 528(Supra)*, the Court of Appeal was faced with the problem of construction of an agreement which provided for sale of property including the business of West African merchants formerly carried on by the vendor-company. The agreement provided that the purchasers should pay by instalments in eight years "of one-half the sum which the auditors of the purchasers... should certify to be the profits of such financial year" without deduction for income-tax. Lord Greene M.R. observed at p. 531 as follows:

> ".....the instruction to the auditors is that, in making their computation of the profits of the purchasers for the purposes of this agreement, they are to start with and work upon the general principles of ordinary commercial practice in computing the profits of a trading company. That, however, does not quite answer the question, because it may still be asked : computing the profits of a trading company for what purpose ? Now there again it seems to me that the answer is a clear answer for the ordinary purpose for which profits of a trading company are computed, namely, the profit and loss account of the company on the basis of which the profits are to be distributed. I can think of no other ordinary commercial practice in computing the profits of a trading company save the practice of computing such profits for such a purpose."

27. The dispute in the cape of G.B. Ollivant Ltd., was whether the profit that was to be computed and certified by the auditors were the ordinary profits of the company or the divisible profits. Lord Greene M.R. was of the view that calculation of profits in accordance with ordinary commercial practice under the agreement meant divisible profits. This view was also adopted in the House of Lords by Lord Thankerton, Lord Russell of Killowen and Lord Wright. As Lord Wright put it "whether these profits are so divided or are used for developing the company's business or in other similar ways did not affect the position".

28. There cannot be any two opinions about it that for the purpose of computation of distributable or divisible profits of a company, the surtax payable by the company will have to be deducted. In fact, there is a specific provision under the C. (P.) S. T. Act, 1964, to that effect. It has been provided under Section 15 that in computing the distributable income of a company for the purposes of Chap. XI-D of the I.T. Act, the surtax payable by the company for any assessment year shall be deductible from the total income of the company assessable for that

assessment year.

29. But in the case before us the problem is not of computation of divisible profits. The question is what are the profits of the assessee-company ? In that context the views of Viscount Simon L.C. and Lord Macmillan will be more helpful for our present purpose. Viscount Simon L.C. and Lord Macmillan were of the view that under the agreement profits did not mean divisible profits of the company.

30. Viscount Simon L. C. observed at p. 26 of 13 ITR (Suppl.): "The word 'divisible' or 'distributable' does not occur in the agreement from beginning to end, and, to my mind, the profits of a trading company when ascertained in accordance with ordinary commercial practice are the profits before, and not after, deducting the direct taxation which has to be paid in respect of them. It is not to be disputed that this is the case with income tax, for income tax is not a deduction which has to be made in order to arrive at profits; it is the Crown's share of the profits. All this has been explained once and for all in the well-known case of *Ashton Gas Co. v. Attorney-General*[4] Counsel for the respondents admitted that this would be true whether the express provision excluding income tax was in the agreement or not.

31. Why is not the same thing true about excess profits tax ? Varying a famous phrase of Lord Macnaghten in *London County Council v. Attorney-General*[5] I venture to observe that excess profits tax, if I may be pardoned for saying so, is a tax on profits. It is a tax (very elaborately calculated it is true) on profits, for it is a tax on excess profits--it skims the cream off profits so far as they are in excess of the standard profit."

32. Lord Macmillan observed at p. 34 of the report:

> "It is enough for my purpose to emphasise that, as its name denotes, the tax is a tax on profits, namely the profits earned in excess of a fixed standard and that for the purpose of computing it the profits are, subject to certain special provisions, to include all such income arising from the trade or business as is chargeable to income-tax under Case I of Schedule 'D': see the Finance (No. 2) Act, 1939, Schedule VII, para. 7. It is in short a super income tax."

33. Surtax like excess profits tax is basically an additional tax levied on the income of a company. It does not divert any portion of that income at source by an overriding title. It is a tax on so much of the chargeable profits of the previous year as exceed the statutory deduction at the rate specified in the Act. Chargeable profits has been defined to mean total income of an assessee as computed under the I.T. Act and adjusted in accordance with the provisions of the First Schedule. The Legislature by this Act has imposed an additional levy on the total income of a company. The subject-matter of the levy is the income of the company. That income does not

cease to be the income of the company merely because an additional tax is imposed upon it. It is one thing to say that the Revenue is entitled to levy surtax on this income but it is quite another thing to say that the Revenue is entitled to get a portion of this income by an overriding title even before it reaches the company.

34. We shall now consider the argument that the liability for surtax must be allowed as business expenditure in computing the total income of the assessee under the I.T. Act and the embargo contained in Section 40(a)(ii) of the I.T. Act must be confined to income-tax only.

35. In order to appreciate this argument it is necessary to set out Section 10(4) of the Indian I.T. Act, 1922, and Section 40(a)(ii) and Section 2(43) of the I.T. Act, 1961 :

Indian Income-tax Act, 1922.

> "10. (4) Nothing in Clause (ix) or Clause (xv) of Sub-section (2) shall be deemed to authorise the allowance of any sum paid on account of any cess, rate or tax levied on the profits or gains of any business, profession or vocation or assessed at a proportion of or otherwise on the basis of any such profits or gains ;....."

Income-tax Act, 1961, "40. Amounts not deductible.--Notwithstanding anything to the contrary in Sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head 'Profits and gains of business or profession'-

(a) in the case of any assessee--.....

(ii) any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains;..... "

> "2. (43) 'Tax' in relation to the assessment year commencing on the 1st day of April, 1965, and any subsequent assessment years means income-tax chargeable under the provisions of this Act, and in relation (o any other assessment year income-tax and super-tax chargeable under the provisions of this Act prior to the aforesaid date."

36. It has been argued that under the Act of 1922, an assessee could not claim deduction on account of payment of any tax calculated on the basis of profits or gains of business and, therefore, an assessee could not have claimed any deduction on account of excess profits tax or business profits tax because these taxes were in the ultimate analysis levied on the profits of a company calculated in a certain manner. It has been argued that because of the changed phraseology and also the definition of "tax" in the Act of 1961, the statutory disallowance is now limited only to income-tax.

37. It has been argued that the Legislature wanted in confine the disallowance only to income-tax and super-Lax chargeable under the provisions of the I.T. Act and after 1st April, 1965, only to income-tax. The phrase "chargeable under the provisions of this Act" clearly shows that the Legislature intended the disallowance in Section 40(a)(ii) to be confined to a tax on income which was chargeable under the I.T. Act; 1961, and nothing else.

38. It has been argued that, in any event, the scope of Section 40(a)(ii) must be confined to a tax on the business income of the assessee which has been charged to tax under Section 28 under the head "Profits and gains of business or profession". The chargeable profits under the C. (P.) S. T. Act is computed on the basis of the total income assessed under the I.T. Act and cannot be confined to profits or gains of business or profession only. Therefore, the levy of surtax does not come within the mischief of Section 40(a)(ii).

39. We are unable to accept the contention that "tax" in Section 40(a)(ii) must be understood to mean only income-tax. The definition given in Section 2(43) only will apply "unless the context otherwise requires". The expression "any rate or tax" in Section 40(a)(ii) means any rate or any tax and not income-tax only. That the Section is not confined to income-tax only is made clear by the words "levied on the profits or gains of any business or profession or assessed at a proportion of or otherwise on the basis of any such profits or gains".

40. The Legislature has refrained from using the expression "profits and gains of business or profession" to indicate that the exclusion from deduction in Section 40(a)(ii) was not to be confined to a tax imposed on income computed under Section 28 of the I.T. Act. The expression "profits or gains" must be understood in its ordinary sense. "Profits" in common parlance means excess of income over expenditure. "Gains" is also a word of very wide connotation. A man working for gain is not necessarily engaged in a trade or business. The word "business" has been denned in Section 2(13) of the I.T. Act:

> "'Business' includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

41. The profits made by a company including its income from dividend, interest and rent will have to be shown in the profit & loss account. For the purpose of computation of total income under the I.T. Act the profits made by a company will have to be split up under different heads of income as laid down in Section 14 of the I.T. Act. But the profit of a company does not change its character only because it is classified in a certain way under the I.T. Act for the purpose of assessment. The Supreme Court in the case of CIT v. Chngeyidas and Co. , observed at p. 24 :

> "Section 2(4) of the Indian Income-tax Act, 1922, defines 'business' as including any trade, commerce or manufacture, or any adventure or concern in the nature of trade,

commerce or manufacture. Business is therefore an activity of a commercial nature.... ...The heads described in section 6 and further elaborated for the purpose of computation of income in Sections 7 to 10 and 12, 12A, 12AA and 12B are intended merely to indicate the classes of income : the heads do not exhaustively delimit sources from which income arises. This is made clear in the judgment of this court in the United Commercial Bank Lld.'s case , that business income is broken up under different heads only for the purpose of computation of the total income : by that break up the income does not cease to be the income of the business, the different heads of income being only the classification prescribed by the Indian Income-tax Act for computation of income."

42. In the case before us the question is whether surtax payable by the assessee comes within the mischief of Section 40(a)(ii). It is stated in the preamble of the C.(P.)S.T. Act that "it is an Act to impose a special tax on the profits of certain companies". Although chargeable profits are computed on the basis of the total income of a company, assessed under the I.T. Act, but none the less it is a profit made by the company that is taxed under the I.T. Act. In this connection it is to be borne in mind that the assessee under the Surtax Act is a company and not an individual. The importance of this distinction was pointed out by Jessel M.R. in the case of *Smith v. Anderson*[6]

> "There are many things which in common colloquial English would not be called a business, even when carried on by a single person which would be so called when carried on by a number of persons. That is a distinction not to be forgotten, even if we were trying the question by the ordinary use of the English language. For instance, a man who is the owner of offices, that is, of a house divided into several floors and used for commercial purposes, would not be said to carry on a business because he let the offices as such ; but suppose a company was formed for the purpose of buying a building, or leasing a house, to be divided into offices, and to be let out, should not we say, if that was the object of the company, that the company was carrying on business for the purpose of letting offices or was an office-letting company, trying it by the use of ordinary colloquial language ? The same observation may be made as regards a Single individual buying or selling land, with this addition, that he may make it a business, and then it is a question of continuity. A man occasionally buys and sells land, as many land-owners do, and nobody would say he was a land-jobber or dealer in land, but if a man made it his particular business to buy and sell land to obtain profit, he would be designated as a land-jobber or dealer in land.
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> When you come to an association or company formed for a purpose, you say at once that it is a business, because there you have that from which you would infer continuity....."

43. Although the judgment of Jessel M.R. in that case was ultimately overruled, the oft-quoted

passage extracted above has never been doubted.

44. In our opinion, it cannot be said that the tax sought to be imposed by the C.(P.) S.T. Act will not come within the mischief of Section 40(a)(ii) of the Income-tax Act.

45. Moreover, in the case before us the assessee filed a return disclosing an income of Rs. 62,98,220. The ITO computed the assessee's income at Rs. 66,91,550 out of which business income came to Rs. 63,99,391 after making various disallowances. The surtax imposable in this case has to be calculated on the basis of the total income of the assessee-company after making statutory adjustments. If the tax that is sought to be imposed is not on the profits or gains of the business of the assessee, it is certainly levied on the basis of the profits or gains made by the assessee-company in its business.

46. Even apart from Section 40(a)(ii) the amount of surtax payable by the assessee cannot be allowed as deduction in the computation of its total income. We are unable to accept the argument that on principle the tax payable under the C.(P.)S.T. Act should be deducted as business expenditure under Section 37 of the I.T. Act.

47. In this connection it will be useful to compare the provisions of the C.(P.)S.T. Act with the provisions of the Excess Profits Tax Act and the Business Profits Tax Act. The Excess Profits Tax Act imposed a tax "on the amount by which the profits during any chargeable accounting period exceeded the standard profits". Profits had to be calculated in accordance with the provisions of the First Schedule wherein it was provided that the profits of a business were to be computed "on the principles on which the profits of a business are computed for the purpose of income-tax under Section 10 of the Indian Income-tax Act, 1922". It was specifically provided under Section 12 that the amount of excess profits tax payable in respect of a business shall be allowed to be deducted as an expense for the purpose of income-tax or. super profits tax. It was provided in that Act that any repayment of excess profits tax would be chargeable to tax in computing the profits and gains of the business for the purpose of income-tax as if the amount were a profit of the business accruing in the year in which the amount was repaid.

48. Under the provisions of the Business Profits Tax Act, a tax was imposed on the amount of the "taxable profits" of the business. "Deductible profit" was defined to mean the amount by which the profits during a chargeable accounting period exceeded the abatement in respect of that period. It was provided in the First Schedule that the profits of a business should be computed in accordance with the provisions of Section 10 of the Indian I.T. Act, 1922. Under Section 10 it was provided that the amount of business profits tax payable by any person for any chargeable accounting period shall, in computing the total income for the purpose of income-tax or super-tax, be allowed as deduction. It was also provided that if any amount of excess profits tax was

refunded it would be taken into account in computing the profits and gains of a business for the purpose of income-tax as if the amounts were profits accruing in the relevant previous year.

49. The provisions of the C.(P.)S.T. Act are significantly different. Section 2(5) defines chargeable profits. It means total income of an assessee computed under the I.T. Act, 1961, and adjusted in accordance with the provisions of the First Schedule. Section 4 imposes a charge of tax in respect of so much of chargeable profits as exceed the statutory deduction at the rate specified in the Third Schedule. Statutory deduction has been defined in Section 2(8) to mean an amount equal to 10% of the capital of the company computed in accordance with the provisions of the Second Schedule or an amount of two hundred thousand rupees, whichever is greater.

50. The First Schedule which contains rules for computing the chargeable profits has provided under r, 2 as under:

> "2. The balance of the total income arrived after making the exclusions mentioned in Rule 1 shall be reduced by-
>
> (i) the amount of income-tax payable by the company in respect of its total income under the provisions of the Income-tax Act after making allowance for any relief, rebate or deduction in respect of income-tax to which the company may be entitled under the provisions of the said Act or the annual Finance Act....."

51. Section 14 of the C.(P.)S.T. Act empowers the ITO to recompute and determine the surtax payable or refundable when an order has been passed under Section 154, 155, 250, 254, 260, 262, 263 or 264 of the I.T. Act and the period of limitation for such recomputation shall be four years from the date of the relevant order passed under the I.T. Act. This goes to show that the total income must be computed first under the I.T. Act and the surtax assessment will follow the income-tax assessment. If there is any reduction or enhancement of the amount of income-tax payable by an assessee as a result of any proceeding by way of rectification or revision or appeal or reference, then the surtax assessment will have to be modified accordingly. The I.T. Act, however, does not contain any similar provision for rectification of the assessed income pursuant, to any modification in the amount of surtax payable as a result of any appeal, revision, rectification or reference.

52. The computation of income for the purpose of the I.T. Act must precede an assessment under C.(P.)S.T. Act. The total income under the I.T. Act must be calculated, the tax payable under the I.T. Act has to be determined and then only the question of computation of chargeable profits of the company will arise. In computing the chargeable profits the amount of income-tax has to be deducted. There is no provision similar to Section 12 of the Excess Profits Tax Act or Section 10 of the Business Profits Tax Act wherein it was specifically provided that these two taxes will be

deductible from the total income for the purpose of computation of income-tax.

53. The amount of surtax paid by a company has been specifically made deductible from the total income under Section 15 of the Surtax Act.

> "15. Surtax deductible in computing distributable income under Income-tax Act.--Notwithstanding anything contained in Clause (i) of Section 109 of the Income-tax Act, in computing the distributable income of a company for the purposes of Chapter XI-D of that Act, the surtax payable by the company for any assessment year shall be deductible from the total income of the company assessable for that assessment year."

"Distributable income" has been defined in Section 109 of the I.T. Act; the material part of that Section is as under :

"109. For the purpose of Sections 104, 105 and 107A and this Section ,---

(i) 'distributable income ' means the gross total income of a company as reduced by -

(a) the amount of income-tax payable by the company in respect of its total income, but excluding the amount of any income-tax payable under Section 104 ;....."

54. If we accept the contention made on behalf of the assessee and hold that the surtax payable by the assessee is eligible for deduction under Section 37 of the I.T. Act, for the purpose of computation of the total income of the assessee, then Section 15 of the Surtax Act becomes meaningless and otiose. Section 15 makes it clear that the liability for payment of surtax is not a deductible expenditure for the purpose of computation of total income of the company, but the distributable income of a company must be computed after deducting the surtax payable by the company from its total income.

55. The English courts have consistently held that but for the specific provision contained in the statute, excess profits tax would not have been deductible for the purpose of computation of profits under the I.T. Act. It has been held that there is no distinction in principle between payment of excess profits tax under the laws of England and under the laws of a foreign country in this respect. The amount of excess profits tax paid under a foreign statute is not allowable as deduction because there is no specific provision of law to that effect. Therefore, on general principle an amount paid by way of excess profits tax under foreign law cannot be allowed as deduction in England.

56. It has been argued that in order to decide the question that has arisen before us, reliance should not be, placed on the English cases because the phrase "wholly and exclusively for the purpose of business" has been construed by the Supreme Court in a very wide sense. The English

courts have construed that expression in the context of the English statute in a much narrower sense. It has been argued that the Supreme Court in the case of Indian Aluminium Co. Ltd. v. CIT [I972] 84 ITR 735, has not accepted the test of capacity in this connection. It has further been argued that in the case of CIT v. Birla Cotton Spinning and Weaving Mills Ltd. , the Supreme Court has differed from the majority judgment of the House of Lords in the case of Smith's *Potato Estates Ltd, v. Bolland*[7] and has allowed deduction of law charges incurred for conducting proceedings before the Investigation Commission for the assessment years 1941-42 to 1947-48.

57. In the case of Indian Aluminium Co. Ltd. v. CIT , the Supreme Court held that the wealth-tax paid by the assessee, a trading company, on assets held by it for the purpose of its business, was deductible as business expenditure in computing the assessee's income from business. The Supreme Court in that case reversed its earlier decision in the case of Travancore Titanium Product Ltd. v. CIT , in which it has held that the amount of wealth-tax paid by the assessee was not a permissible deduction as business expenditure because wealth-tax was imposed on the ownership of assets and not on any commercial activity. In the case of *Rushden Heel Co. Ltd. v. Keene*[8] Lord Greene M.R. held that an expense was not deductible if it fell on a trader in some character other than that of a trader. This test, however, was not applied by the other judges of the House of Lords who agreed with Lord Greene M.R. in that case. The unsoundness of the test of capacity or character in which the tax was paid was pointed out in the case of *Harrods (Buenos Aires) Ltd. v. Taylor-Gooby* [9]

58. In the case of Indian Aluminium Co. Ltd. , the Supreme Court has relied on the ratio of the decision in the case of Harrods (Buenos Aires) Ltd. v. Taylor-Gooby in holding that wealth-tax was an allowable deduction as business expenditure. The Supreme Court has not differed from that judgment in any way.

59. In the case of Harrods (Buenos Aires) Ltd. v. Taylor-Gooby, it was held that a tax known as the substitute tax payable by the company in Argentina which was charged annually at the rate of one per cent. of the company's capital and was payable whether or not there was profit liable to Argentina income tax, was deductible as a business expenditure. It was held by Buckley J., at p. 461 :

> "The tax is not, in my judgment, a tax which is of the same character as income tax or excess profits tax ; it is not a tax which can only be measured and the liability to which can only be ascertained after the profits position of the company has been finally determined in any year. Payment of that tax is not, as it seems to me, an application of the company's profits, nor is it a payment which in its nature could be said to fall to be made out of the earned profits of the company, for it is not a tax the liability to which depends

upon the company having earned any profits. It is a liability which the company has exposed itself to, or undertaken, in order that it may be able to carry on its business in the Argentine. And so it is, in my judgment, a liability which the company has undertaken for the purposes of its trade, and the payment of the tax is, in my judgment, a payment wholly and exclusively made for the purposes of the company's trade, just as in the Lion Brewery case [1910] 5 TC 568 (HL), the liability of the landlord to make compensation fund contributions was a liability which it subjected itself to by assuming the character of landlord for the purposes of its trade as brewer."

60. The judgment of Buckley J. was affirmed on appeal. Willmer L.J. rejected the proposition that the answer to the question depended on the capacity in which the taxpayer paid the tax. Willmer L.J., however, distinguished the substitute tax payable in Argentina with the case of an English company which pays income-tax, corporation profits tax and excess profits tax in Ireland. It was held by Willmer L.J. that the substitute tax was a disbursement wholly and exclusively laid out or expended for the purposes of the trade of the company. Diplock L.J. who agreed with Willmer L.J. also rejected the distinction between expenditure in the capacity of a trader and expenditure in some other capacity. Diplock L.J. observed (p. 469 of 41 TC):

"Liability to the tax does not depend upon whether profits are made or not. It is a payment which the company is compelled to make if it has a business establishment in the Argentine at all, and it must have a business establishment if it is to carry on its trade. I can see no relevant difference between this tax and rates upon its business premises ....."

61. In the case before us the question of capacity or the character of the taxpayer really does not arise. The real question is whether a tax which has been imposed on the total income of a company after some adjustments can be allowed as a deduction in computing total income of that company under the I.T. Act. Is it a business expenditure of the company ? In his concurring judgment in the case of Indian Aluminium Co. Ltd. v. CIT the distinction between the two types of taxes were brought out by Beg J., in the following words (p. 749):

"In other words, where profits, the net gains of business determined after making all permissible deductions, are taxed, the disbursements to meet such taxes cannot be deducted. But, where the tax was levied, as it was in Harrods' case [1964] 41 TC 450 (CA)(Supra), on capital or assets used for the purpose of earning these profits, it was a permissible deduction in calculating profits."

62. The question of deducibility of excess profits tax paid by a company as business expenditure came up for consideration before the House of Lords in the case of *IRC v. Dowdall O'Mahoney & Co. Ltd*[10]. In that case the House of Lords held unanimously that such payments were not

deductible. It was held that it could not be allowed as a deduction on the ground that excess profits tax was a tax on profits and it could not be allowed on the same principle that income-tax was not allowed as a deduction in making assessment of income. This case is important for our purpose and the principle laid down in this case is equally applicable to surtax which is a tax, of the same character as income-tax or excess profits tax.

63. Lord Oaksey observed, at p. 274 of the report, as follows :

> "On the first question I am of opinion that taxes such as those now in question, namely, income-tax, corporation profits tax and excess profits tax, are not, according to the authorities, wholly and exclusively laid out for the purposes of the company's trade in the United Kingdom. Taxes such as these are not paid for the purpose of earning the profits of the trade they are the application of those profits when made and not the loss so that they are exacted by a dominion or foreign government. No clear distinction in point of principle was suggested to your Lordships between such taxes imposed by the United Kingdom government and those imposed by dominion or foreign governments."

64. Lord Reid observed at pp. 282-283 ;

> "It is true that the payments which the respondents seek to have allowed as deductions were payments of Eire taxes and not of United Kingdom taxes, but the parties have admitted that the relevant legislation in Eire corresponds to that in the United Kingdom, and I cannot see that there is any distinction in principle between them for present purposes. Certainly no authority for any such distinction was cited. It therefore appears to me to be established that there is not and never was any right under the principles applicable to Case I to deduct income tax or excess profits tax, British or foreign, in computing trading profits."

65. Lord Reid mentioned another practical difficulty for allowing this claim at p. 284 as follows:

> "Moreover the present case is an example of a puzzling situation which would arise if the respondents were right. It is admitted that tax in Eire is assessable on the same principles as in the United Kingdom. So, if the respondents are right here, they would have been entitled in Eire to a deduction of United Kingdom excess profits tax payable by them. The amount of tax payable in the one country could not be determined until the amount of the deductions allowable there had been determined; but one deduction would be the amount of tax payable in the other country. The amount of tax payable in the other country could not be determined until the deductions allowable there had been determined : but one of those deductions would be the amount of tax payable in the first country. I see no way in which this circle could be broken." ...

66. Lord Radcliffe observed at p. 285 as follows :

> "It is true that both those decisions bore upon the question of deducting excess profits tax paid in this country in a computation of pro fits, and the question before us relates to a deduction of income and profit taxes paid in another country. But once it is accepted that the criterion is the purpose for which the expenditure is made in relation to the trade of which the profits are being computed. I have been unable to find any material distinction between a payment made to meet such taxes abroad and a payment made to meet a similar tax at home."

67. On behalf of the assessee reliance was placed on the judgment of the Supreme Court in the case of Vazir Sultan Tobacco Co. Ltd. v. CIT . But that case, in our opinion, does not support the contention of the assessee in any way. In that case the Supreme Court explained the meaning of "provision" and "reserve" under the S.P.T. Act, and the C. (P.) S. T. Act. In that case the question was whether the provisions for taxation, for retirement gratuity and for dividends could be treated as reserves for computing the capital for the purpose of the S.P.T. Act, 1963, for the assessment year 1963-64.

68. In the case of *L. C. Ltd. v. G.B. Ollivant Ltd*[11]. the dispute was about the construction of an agreement and the question that arose in the House of Lords was whether the expression "profits" in that agreement meant divisible profits. There were illuminating passages in the judgments of Viscount Simon L.C. and Lord Macmillan about the true nature of excess profits tax which have already been set out.

69. Lord Wright was also of the view that the amount paid by way of excess profits tax was not actually an expenditure but was to be deducted as an expenditure from the profits of the company because of the specific, provision made in the Finance Act, 1939. Lord Wright observed at pp. 37, 38 of the report as follows;

> "The Finance Act, 1939, expressly provides that in computing the profits and gains for the purpose of income tax, the excess profits tax shall be allowed to be deducted as an expense incurred. I do not take that as meaning that it is actually an expense, because it is clearly not so; what is meant is that it is as much to be deducted from the earnings as if it were an expense in the strict sense."

70. It has also been argued on behalf of the assessee that the earning of profit and payment of taxes are not isolated and independent activities. Those activities are continuous and take place from year to year. The liability to pay income-tax and surtax arises because a person is carrying on the business by which he earns profits. Therefore, the liability to pay the tax is an incidence of carrying on of the business through which he earns profits. Strong reliance has been placed on

the decisions in Dekra Dun Tea Co. Ltd. v. CIT and Mitsui Steamship Co. Ltd. v. CIT . But these two cases merely reiterate the principles laid down in the case of Indian Aluminium Co. Ltd. v. CIT , which we have noted earlier. In the first of these two cases the Supreme Court allowed the tax levied by the U. P. Large Land Holdings Tax Act, 1957, on the ground that the tax was levied on the business assets by applying the ratio of the decision in the case of Indian Aluminium Co. Ltd. This was done on the basis of the finding that the tax was levied on lands owned by the assessee-company as its business assets. In the case of Mitsui Steamship Co, Ltd. v. CIT , the question was whether the property tax paid by the assessee in Japan on its vessels was allowable and the Supreme Court held that the expenditure was as owner-cum-trader and incidental to the carrying on of its business.

71. The question in this case is whether a tax imposed on the profits of a company is allowable as deduction in computing the total income of the company. The subject-matter of the tax is profits. Whatever profits the company has made are being brought to the charge of surtax. The tax will be calculated according to the amount of profits that the assessee has earned. It is very difficult to see how the tax proposed to be levied on the profits can be deducted from the profits on expenditure wholly and exclusively laid out for business. Without an express provision to that effect there is no scope for deducting the estimated amount of surtax from the profits for the purpose of arriving at the taxable income.

72. In the case of CIT v. Birla Cotton Spinning and Weaving Mills Ltd. , the question before the Supreme Court was whether law charges incurred in connection with the proceedings before Income-tax Investigation Commission were not allowable deduction in the computation of the profits of the business under Section 10(1) and under Section 10(2)(xv) of the Indian I.T. Act, 1922. The Supreme Court pointed out that the ultimate object of the investigation that was being conducted was collection of material showing evasion of tax so that the avoided income could be subjected to taxation and penalties imposed for evasion. The assessee had engaged lawyers and had incurred expenses in conducting proceedings before the Commissioner and also in courts where the vires of the Investigation Commission Act was challenged. The Supreme Court in that case relied on the views of Viscount Simon and Lord Oaksey in the case of Smith's Potato Estates Ltd, v. Bolland [1948] 30 TC 267 ; [1949] 17 ITR (Suppl.) 1 (HL)(Supra), in preference to the majority decision. The majority view in that case was that expenses incurred in filing an appeal against the decision of the Commissioners of Inland Revenue was not an allowable deduction for income-tax and excess profits tax purposes. The Supreme Court pointed out at p. 171 of 82 ITR as follows:

> "The essential test which has to be applied is whether the expenses were incurred for the preservation and protection of the assessee's business from any such process or proceedings which might have resulted in the reduction of its income and profits and

whether the same were actually and honestly incurred. It is not possible to understand how the expenditure on the proceedings in respect of the Investigation Commission by the assessee will not fall within the above rule. Even otherwise, the expenditure was incidental to the business and was necessitated or justified by commercial expediency. It must be remembered that the earning of profits and the payment of taxes are not isolated and independent activities of a business. These activities are continuous and take place from year to year during the whole period for which the business continues. 'If the assessee takes any steps for reducing its liability to tax which result in more funds being left for the purpose of carrying on the business there is always a possibility of higher profits... As was observed by Viscount Simon in Smith's Potato Estates case [1948] 30 TC 267; [1949] 17 ITR (Suppl.) 1 (HL), if the trader considers that the revenue seeks to take too large a share and to leave him with too little the expenditure which the trader incurred in endeavouring to correct this mistake is a disbursement laid out for the purposes of his trade. If he succeeds he will have more money with which to earn profits next year."

73. But the problem in this case is quite different. Law charges incurred has been justified as business expenditure on the ground of protection and preservation of assets and also on the ground that a businessman will legitimately try to get a larger share of the profit by reducing his tax liability. The assessee stands to gain by reduction of the burden of tax. Costs, charges and expenses for the purpose of reducing or avoiding liability for payment of income-tax or surtax may well be expenditure wholly and exclusively incurred for the purpose of business. But the tax imposed on the, total income of an assessee cannot be allowed on that ground as a business expenditure in the computation of total income. How can the tax that is sought to be imposed on income be a deduction from the very income which is being subjected to tax ? The tax imposed by the C. (P.) S. T. Act is essentially of the same character as income-tax or excess profits tax. Liability to pay this tax depends upon whether profits are made or not. It is a. tax which can only be measured and the liability to which can be ascertained only after the total income of the company has been finally determined and the income-tax payable thereon has been computed and deducted. To use the language of Lord Macmillan it is a super income-tax. In our opinion, having regard to the nature of the tax and the scheme of the Surtax Act, the liability to pay surtax cannot be allowed as a deduction from the total income of the assessee as expenditure wholly and exclusively laid out for the purpose of its business.

74. We, therefore, answer the question that has been referred in the affirmative and against the assessee.

75. The parties will pay and bear their own costs.

Sabyasachi Mukharji, J.

I agree.

Cases Referred.

1[1933] 1 ITR 135
2[1945] 13 ITR (Suppl.) 23 (HL)
3[1942] 2 All TCR 528 (CA)
4[1906] AC 10 (HL)
5(No. 1) [1901] AC 26 (HL)
6[1880] 15 Ch D 247, 260 (CA)
7[1948] 30 TC 267 ; [1949] 17 ITR (Suppl.) I (HL)
8[1948] 30 TC 298 ; [1949] 17 ITR (Suppl.) 19 (HL)
9[1964] 41 TC 450 (CA)
10[1952] 33 TC 259
11[1945] 13 ITR (Supp) 23 (HL)