FEDERAL HIGH COURT

A.H. Wadia as agent of the Gwalior Durbar

Vs

Commissioner of Income tax

(Kania, C.J.)

24.11.1948

JUDGMENT

Kania, C.J.

1. The appellant is the agent of Gwalior Durbar. The Durbar was participating in various trade and business operations, in and outside the Gwalior State for many years. The record shows that those activities in any event existed in 1924 when the predecessor of the present Maharaja was on the throne. That Maharaja had appointed Mr. F.E. Dinshaw as his agent in Bombay for his trade or business operations. The record shows that money was advanced as loan and also on the security of immovable properties. The Gwalior Durbar as such has not been treated as an assesses under the Income Tax Act but in respect of certain trading and business operations of the Durbar the Income Tax authorities sought to make the Durbar liable under the Government Trading Taxation Act, III [3] of 1926. Section 2 of that Act, which alone is material for the present case, runs as follows:

> 2. (1) Where a trade or business of any kind is carried on by or on behalf of the Government of any part of His Majesty's Dominions, exclusive of British India, that Government shall in respect of the trade or business and of all operations connected therewith, all property occupied in British India and all goods owned in British India for the purposes thereof, and all income arising in connection therewith, be liable
>
> (a) to taxation under the Indian Income Tax Act, 1922, in the same manner and to the same extent as in the like case a company would be liable;
>
> (b) to all other taxation for the time being in force in British India in the same manner as in the like case any other person would be liable.
>
> (2) For the purposes of the levy and collection of Income Tax under the Indian Income Tax Act, 1922, in accordance with the provisions of Sub-section (1), any Government to which that sub-section applies shall be deemed to be a company within the meaning of that Act, and the provisions of that Act shall apply accordingly.

2. The Maharaja died in about 1925 and a Council of Regency was appointed, presumably as the

present Maharaja was a minor at the time. Till his death Mr. F.E. Dinshaw continued to act as the agent of the Durbar. Thereafter the present, appellant was appointed the agent of the Durbar.

3. In response to notices issued under the Income Tax Act Mr. Dinshaw and thereafter the present appellant submitted returns to the income tax authorities in Bombay from year to year. The disputes between the parties in the present appeal relate to the assessment of the Durbar for the assessment year 1939-40. Being dissatisfied with the assessment order of the Income Tax Officer the appellant filed an appeal to the Appellate Assistant Commissioner, Income Tax, Bombay. Being dissatisfied with the order of the Appellate Assistant Commissioner the appellant asked for a reference to elicit the opinion of the High Court on certain questions. That application was made in 1940. The Income Tax Commissioner made a reference to the Court on 17th October 1946. We are unable to find any, much less satisfactory, reasons for this deplorable delay. As will be noticed hereafter, this delay has contributed largely to the difficulties of the High Court and of this Court in satisfactorily disposing of the matter. The statement of facts in the letter of reference is far from satisfactory, is scrappy and leaves the Court to find out relevant facts from different papers, if it can do so. These defects were noticed by the High Court and adversely criticized in the judgment of that Court. We endorse the observations of the High Court in this respect.

4. The six questions submitted for the opinion of the High Court were in these terms:

> (1) Whether in the circumstances of this case the interest of ₹ 2,49,726/- received by the Durbar on the loan advanced to the Provident Investment Co. Ltd. is assessable under the provisions of the Income Tax Act read with the Government Trading Taxation Act, III [3] of 1926.
>
> (2) Whether the sum of ₹ 3,57,112/- received by the Durbar out of the managing agency commission paid by the Tata Iron & Steel Co. Ltd., to Tata Sons Ltd., is assessable under the provisions of Income Tax Act read with the Government Trading Taxation Act, III [3] of 1926.
>
> (3) Whether the income derived from the property situated in Bombay and other places in British India purchased by the Durbar at execution sales in enforcement of mortgage decrees against mortgagors who had failed 10 pay the amounts advanced to them in course of the money-lending business of the Durbar, is income arising in connection with the said business within the meaning of Section 2. Government Trading Taxation Act, and whether the income arising from such property is liable to assessment under the provisions of the Income Tax Act read with the Government Trading Taxation Act, III [3] of 1926.
>
> (4) Whether the dividend of ₹ 1,88,030/- received by the Durbar from the Sir Shapurji Bharucha Mills Ltd is taxable in the circumstances of this case under the provisions of the Income tax Act read with the Government Trading Taxation Act, III [3] of 1926.
>
> (5) Whether the dividend of ₹ 83,447/- received by the Durbar from the CP. Cement Co

Ltd., is taxable in the circumstances of this case under the provisions of the Income Tax Act read with the Government Trading Taxation Act, III [3] of 1926, and,

(6) Whether the Durbar is entitled under the provisions of the Income Tax Act read with the Government Trading Taxation Act III [3] of 1926 to a refund under Section 48(1) or a set off under Section 18 '5), Income Tax Act of income tax alleged to be deemed under Section 49-B thereof to have been paid by it as a share-holder in respect of the dividend received by it during the previous year.

5. The High Court of Bombay answered all the six questions against the appellant. It also granted a certificate under Section 205, Government of India Act, 1935. The appellant has therefore filed this appeal. The appellant asked for leave to argue the other questions also and leave having been granted all the questions were fully argued before us.

6. The material facts, as set out in the reference made by the Commissioner, on the first question are these. A company styled the Provident Investment Co. Ltd., was incorporated in British India in 1927 with headquarters in Bombay. It was practically a one-man company as all the shares were either owned by the Gwalior Durbar or its nominees. In 1933 the Durbar advanced to this company a loan of ₹ 50/- lacs on the security of its first mortgage debentures of an equal nominal value. The loan was advanced at Gwalior; the interest was payable there and the debentures were also deposited there. Admittedly the Provident Investment Co. Ltd., brought the borrowed money into British India and utilised it for the purpose of its business in British India. The interest on the loan, received by the Durbar for the accounting year, amounted to ₹ 2,59,726/-. It was receivable and actually received at Gwalior.

7. On these facts it was contended on behalf of the appellant that the income did not accrue to the Durbar in British India and was therefore not liable to Income Tax. It was first argued that on the terms of Section 2(1) Government Trading Taxation Act, III [3] of 1926, only income which arose in British India in respect of trade or business and operations connected therewith was liable to tax. It was next contended that income which was deemed to accrue under the provisions of the Income Tax Act was not covered by this Act, which alone was the basis for taxing the Durbar I am unable to accept these contentions. I see no justification for reading the words "in British India" after the words "all income arising..." in Section 2(1), Government Trading Taxation Act. A similar contention, to read with the same words after "trade or business" in the same section was rejected by the Judicial Committee in The *Patiala State Bank v. The Commissioner of Income tax Bombay*[1] Section 2(1) Clauses (a) and (b) of the Trading Act clearly show that once the income was shown to have arisen in respect of the trade or business and any operation connected therewith the same was to be treated as if it was the income of a company and liable to be taxed in the same manner and to the same extent as a company in like circumstances would be liable to be taxed under the Income Tax Act. As held in the Patiala Bank case A.I.R. (30) 1943 P.C. 181 it was not necessary that the trading or business should be in British India. It is sufficient if the State is trading or doing business. To the limited extent mentioned in Section 2, Government Trading Taxation Act, such trading States are to be considered a company for income tax purposes, irrespective of the other definition of a company in the Income Tax Act. Therefore, if the income of a company would be liable to be taxed on the ground that the income was deemed to have accrued to the company under the Income Tax Act,

the income of the Durbar, in the like case, would be similarly liable to tax, if it arose out of the trading or business operations of the Durbar.

8. The further contention that Section 2(1)(a) of the Trading Act only made the machinery sections of the Income Tax Act applicable to the Durbar, is also unsound. The words used in the section are not merely "in the same manner" but also "and to the same extent". Section 2(2) of the Trading Act refers to the machinery sections and makes provision for the levy and collection of Income Tax from the Durbar.

9. It was next argued that the Government Trading Taxation Act, III [3] of 1926, should be construed as covering only income which was liable to tax under the Income tax Act as it existed in 1922. Although in that Act in addition to income which had actually accrued, the expression "deemed to accrue" was used in the charging section, the subsequent expansion of that expression, so as to cover other classes of income mentioned in Section 42(1), Income Tax Amendment Act of 1939, could not make the Durbar's income, which was not liable to tax under the Income Tax Act of 1922, taxable. It was argued that in effect it was an attempt to amend the Government Trading Taxation Act, in [3] of 1926. I am unable to accept this argument because the Government Trading Taxation Act puts the Durbar in the same position-as a company in like case would be dealt with under the Income Tax Act, 1922 The taxation is under the Income Tax Act of 1922 and the amendment of 1939 is an amendment of that Act. In my opinion the Amending Act of 1939 is clearly applicable in respect of the assessment for 1939-40, because the only question is how and to what extent a company will be assessed for the year 1939-40.

10. The Income Tax authorities have sought to assess this income, on the ground that the same is deemed to have accrued to the Durbar under Section 42(1), Income Tax Act. Inasmuch as the sections sought to make a foreigner liable in respect of income earned outside India., it was contended on behalf of the appellant that Section 42(1) was extra territorial and ultra vires the Indian Legislature. It is found that the Gwalior Durbar has been carrying on a large trading and money-lending business in British India and has in fact very substantial income accruing therefrom in British India. It the Durbar having such activities gives a loan at interest outside British India, on the mortgage of debentures which cover property in British India, and the amount of such loan is brought into British India, the question is whether the interest on the loan should be considered income deemed to have accrued to the Durbar in British India. The Appellate Assistant Commissioner has found that this loan was a part of the operations of the Durbar connected with its money-lending business. That finding is relevant to be considered in deciding the question before us. I do not propose to discuss in abstract the question which may arise in respect of a complete foreigner having an isolated transaction of loan in a foreign country and receiving interest on the loan in the foreign country and in respect of property which is not situate within India. The question has to be answered on the facts found in the present ease and my opinion and conclusion are on those facts.

11. The respondent's reply is twofold. It was first argued that the impugned provisions were not extra-territorial in their operation. It was next argued that even if they should be found to operate to a certain extent extra-territorially, that would he no ground to hold them invalid, by the municipal Courts. I shall deal with these contentions separately.

12. Section 42(1), Income tax Act, mentions income arising under specified circumstances under

four heads. It brings within the ambit of the charging section (Section 4) income accruing or arising whether directly or indirectly, in the following cases :

(a) when arising through or from any business connection in British India;

(b) when arising through or from any property in British India;

(c) when arising through or from any estate or source of income from British India; and

(d) when arising from any money lent at interest and brought into British India in cash or in kind.

On a scrutiny of the four heads mentioned above it is clear that there is some connection between the person earning income in that way and British India, in each case. In the first, it is the business connection, in the second it is the property, in the third it is the estate or source and in the last it is the money brought in cash or in kind out of which the interest or income arose. Each of these is capable of falling under the expression "taxes on income" and item 54 in the Government of India Act, 1935, in my opinion, is wide enough to cover each of these heads. In his judgment in the Bombay High Court in *Wallace Bros. Go. Ltd. v. The Income Tax Commissioner of Bombay*[2] Sir John Beaumont C.J. stated as follows:

> There is clearly no provision in the Government of India Act which say that any extra-territorial legislation shall be outside the powers of the Indian Legislature.

He quoted with approval the observations of Dixon J. in *Colonial Gas Association Ltd. v. Federal Commissioner of Taxation*[3] at p. 187 to the following effect:

> To derive income from a country involves the person deriving It in a territorial connection with the country sufficient to support the validity of an exercise of the power in respect of the person as distinguished from the income.

In *Wanganui Rangitikei Electrio Power Board v. Australian Mutual Provident Society*[4] Dixon J. said:

> So long as the statute selected some fact or circumstance which provided some relation or connection with New South Wales and adopted this as the ground of its interference, the validity of an enactment would not be open to challenge.

In the Broken Hill South case (1937) 56 com. L.R. 337, Latham C.J. said that the case was perhaps an extreme one but at p. 361 he accepted in any event the observation of Rich J., in his dissenting judgment in the above case to the following effect:

> I do not deny that once any connection with New South (sic) appears, the Legislature of that State may make that connection the occasion or subject of the imposition of a liability.

But he added:

> The connection with New South Wales must be a real one and the liability sought to be imposed must be pertinent to that connection.

Dixon J. in the same case at p 375 observed:

> If a connection exists, it is for the Legislature to decide how far it should go in the exercise of its powers. As in other matters of jurisdiction or authority, Courts must be exact in distinguishing between ascertaining that the circumstances over which the power extends exist and examining the mode in which the power has been exercised. No doubt there must be some relevance to the circumstances in the exercise of the power. But it is of no importance upon the question of validity that the liability imposed is, or may be, altogether disproportionate to the territorial connection.

In *The Governor-General in Council v. Raleigh Investment Co. Ltd*[5]. Sir Patrick Spans C.J. after citing the above passages with approval observed as follows:

> If some connection exists the Legislature is not compelled to measure the taxation by the degree of benefit received in particular cases by the taxpayer. This affect the policy and not the validity of the legislation.

13. In my opinion, these cases lay down the correct principles to determine whether the legislation in question is extra-territorial or not. All the four heads of income mentioned in Section 42(1) show a real connection between the person receiving income under the particular head and India. Once such connection is held to exist it is unnecessary to ascertain the extent of the connection. In *Wallace Bros. Co Ltd. v. The Commissioner of Income Tax Bombay City and Bombay Suburban District*[6] their Lordships of the Privy Council after referring to *Croft v. Dunphy* [7]observed as follows:

> The point of the reference is emphatically not to seek a pattern to which a due exercise of the power must conform. The object is to ascertain the general conception involved in the words used in the enabling Act.... The resulting general conception as to the scope of Income Tax is that given a sufficient territorial connection between the person sought to be charged and the country seeking to tax him Income Tax may properly extend to that person in respect of his foreign income.
>
> * * * *
>
> The result is that the validity of the legislation in question depends on the sufficiency, for the purpose for which it is used, of the territorial connection set forth in the impugned portion of the statutory test. Their Lordships propose to confine themselves to that short point and do not propose to lay down any general formula defining what territorial connection is necessary.

14. The Commissioner of Income Tax has found that as the money lent was brought by the company into British India the income therefrom is deemed to accrue or arise in British India by

virtue of Section 42(1), Income Tax Act. Evidently he has relied on the fourth sub-head of Section 42 for his conclusion. The exact words used in the section are "arising from any money lent at interest and brought into British India in cash or in kind." (The italics are mine). In my opinion it is proper to read this as one head and as indicating one composite transaction. The interest must be the result of the loan of money and the money must be brought into British India in cash or in kind. Reading it in that way, the incident of bringing the money into British India in cash or in kind to the knowledge of the lender and borrower is an integral part of the transaction. After the money is brought into India, how it is used by the borrower, to my mind, is an irrelevant question. The short question to be decided is whether income arising out of a transaction with these incidents establishes some real territorial connection between the person and British India or not. In my opinion the answer is in the affirmative because the source i.e., the source from which the income accrues to the lender, is known to be going into British India in ca3h or in kind and this incident is an integral part of the money-lending transaction. As mentioned above, the extent of the connection, if it is real, is not relevant to be discussed in considering the validity of the legislation. That is a matter of policy to be considered by the Legislature.

15. Although in stating his opinion the Commissioner has relied on the last sub-head of income mentioned in Section 42(1), it may be noted that in the question submitted for the Court's opinion the reference is not limited to that sub-head only. The question is broad enough to cover any of the four heads of income mentioned in Section 42(1). In his judgment under appeal, Stone CJ. in the Bombay High Court has referred to the business connection of this transaction in British India. In my opinion all the four sub heads of income mentioned in Section 42(1) show a real connection between the person sought to be taxed in India and therefore the legislation is within the powers of the Indian Legislature. The contention of the appellant that Section 42(1) is extra territorial in its operation and is therefore invalid, fails.

16. In the view I have taken it is unnecessary to discuss in detail the second contention of the respondent against the legislation being ultra vires, although in my opinion it is well founded. Generally, States can legislate effectively only for their own territories but for purposes of taxation and similar matters, a State makes laws designed to operate beyond its territorial limits. In the case of a sovereign Legislature, like the British Parliament, the question of extra territoriality of any enactment can never be raised in the municipal Courts as a ground for challenging its validity. The legislation may offend the rules of International Law, may not be recognised by foreign Courts or there may be practical difficulties in enforcing them, but these are questions of policy with which the domestic tribunals are not concerned. This was recognised in *Ashbury v. Ellis (1893) A.C. 339* and *Croft v. Dunphy*[8]

17. Having regard to the fact that the Indian Legislature is supreme within the ambit of the legislative heads mentioned in the Government of India Act, 1935, I am unable to consider that the legislation in question is ultra vires As mentioned above, the aspect of it affecting persons who are beyond the jurisdiction of the municipal Courts cannot be considered sufficient for the Court to hold it ultra vires The municipal Courts are bound to enforce the law. Whether after obtaining the opinion or decree the same is enforceable against the other side or not, is not a matter for the Court's consideration. The Court has only to see that the legislation is within the ambit of the powers of the Legislature. In this connexion Spens C.J, in his judgment in Raleigh's case A.I.R. (31) 1944 F.C. 51 pointed out that. Section 99, Government of India Act, 1935, was

deliberately couched in language different from that employed in Section 65 of the earlier Act of 1915 and that sub.s. (1) of Section 99 did not in terms exclude extra-territorial legislation nor did sub.s. (2) specify exhaustively the subjects upon which such legislation was permissible. In *Wallace Bros, Co. Ltd. v. The Commissioner of Income-tux, Bombay City and Bombay Suburban District*[9] their Lordships of the Judicial Committee observed that the relevant power (Sections 99(1) and 100, Government of India Act, 1935) is a power to make laws for the whole or part of British India or any federated State with respect to "taxes on income other than agricultural income"....Only Sub-section (2) of Section 99 need be particularly referred to. That sub-section provides that without prejudice to the generality of the powers conferred by the preceding sub-section no Federal law shall on the ground that it would have an extra territorial operation be invalid so far as it applies to certain persons and things. In their Lordships' view this Sub-section does no more than assume that there may be some laws having. extra-territorial operation validity made pursuant to Sub-section (1), It is no help one way or another in determining the authorised area of taxes on income.

In my opinion, the contention of the appellant that the legislation is ultra vires, cannot, therefore, be entertained by this Court. The answer to the first question is correctly given by the High Court against the appellant.

18. As regards the second question, the relevant facts are these. The Gwalior Durbar did money-lending business on a fairly extensive scale. On 23rd June 1924 Mr. Dinshaw entered into an agreement with the Tata Iron & Steel Co. Ltd. and Tata Sons Ltd., to advance to the first named party a sum of ₹ 1 crore at interest and on the terms contained in the agreement. This money was of the Gwalior Durbar and Mr. Dinshaw was the agent of the Durbar at the time One of the material terms of the agreement was that a six-annas share in the remuneration of Tata Sons Ltd, as agents of the Tata Iron & Steel Co. Ltd. was to be paid to Mr. Dinshaw, irrespective of the fact of the loan remaining due or not to the lender from the company under the agreement. Out of this Mr. Dinshaw retained a two annas share for himself and the Gwalior Durbar was to receive the balance of four annas share. The late Maharaja died some time in 1925 and it appears that the Regency Council thereafter urged that under the terms of the will of the late Maharaja this loan was not permissible. About that time the Tata Iron & Steel Co. Ltd. and Messrs. Tata Sons Ltd. also appeared to be in a position and desirous of paying back the loan. On the loan being repaid, two fresh agreements were made on 29th July, 1927 in substitution of the original one. Under the first of those agreements Mr. Dinshaw was to be paid in his name a two annas commission, while under the second agreement F.E. Dinshaw Ltd. was to be paid another two annas commission. The first two annas was the reduced share of the Gwalior Durbar in the agency commission. In the accounting year, the appellant received from the executors of Mr. Dinshaw on account of this two annas share of commission a sum of ₹ 3,57,112/-. It is admitted that the sum was paid to the appellant as the agent of the Gwalior Durbar in British India.

19. On behalf of the appellant, different grounds on which the sum was paid to the appellant were urged at different times. Before us the only ground urged was that this sum was paid by the executors of Mr. Dinshaw to the appellant, not as income arising out of the trade or business of the Durbar but as compensation for breach of duty on the part of Mr. Dinshaw to lend money to the Tata Iron & Steel Co. Ltd. Reading the three agreements of 1924 and 1927 together it is clear that the effect of the second set of two agreements was to reduce the original commission of

Gwalior Darbar from four annas to two annas, and the right to receive this arose under the first agreement and was a part of the loan transaction. By reason of the second agreement the rate of commission was only reduced. There appears no foundation of fact for the alleged dereliction of duty on the part of Mr. Dinshaw in giving the loan, nor is there any fact to support the contention that this was compensation paid for such alleged dereliction on the part of Mr. Dinshaw. In my opinion the conclusion of the Income Tax authorities and the High Court is correct and the contention of the appellant is rejected.

19a. As regards question three, the Commissioner of Income tax in his letter of reference has stated as follows:

> During the course of Durbar's money-lending transactions in Bombay and elsewhere some of the mortgagors made default in payment of the principal and interest and the Durbar filed suits to enforce the mortgages and obtained decrees for the sale of the properties The mortgaged properties which are all in British, India were put up for sale in execution of these decrees and were purchased in court auctions by the Darbar and the Durbar still continues to own these properties. Item C represents income from these properties.

20. From this recital it only appears that the original money lending transactions consisted of advancing loans on mortgages. They had come to an end with the sale of the properties under the directions of the Court. The purchase by the Durbar of these properties can be either a continuation of the money lending transactions, coupled with the desire at a proper time to sell the properties and realise the amounts lent, or retaining the properties as investments, like other properties purchased by the Durbar in British India. The fact that the properties are left on the hands of the Durbar, in my opinion, leads to no conclusion one way or the other. This is not a case where a money-lender sets apart a specified sum for his business and continues to keep an account of the properties as a part of the same business. The question whether the properties so left on the hands of the Durbar form part of his money-lending business or not is a conclusion to be drawn from the evidence led before the taxing authorities. The recital of facts by the Commissioner, quoted above, overlooks his duty to determine whether these properties retain the character of assets in the money-lending business. If that is not done, the income of these properties does not come under the Government Trading Act and the Durbar is not liable. Under the circumstances of this case, I am unable to accept the view of the High Court that the burden of proof is on the Durbar to establish that the properties had been taken out of the money-lending business. In the absence of a finding by the Commissioner that these properties form part of the trading assets of the Durbar the assessment cannot be upheld, and the answer of the Court should be that the Durbar is not liable in respect of the income of these properties for the year of assessment. This answer is obviously limited to the evidence adduced in this year and does not lead to any conclusion in respect of future years. The conclusion is based on the absence of a finding of fact, rather than on the existence of definite evidence one way or the other.

21. As regards questions four and five, the Commissioner has come to the conclusion that the shares and debentures continued to be the trading assets of the Durbar. In this connection he relied particularly on the claim made on behalf of the Durbar for business losses when the Durbar took up 75,212 shares of the Shapurji Bnarucha Mills Ltd. In the three years, 1931-34, a total

deduction of 28 lakhs in the assessment of those years was permitted by the Income Tax authorities on this ground. The assessee appears to have conceded that the items mentioned in questions four and five stood on the same footing and therefore there was evidence before the Commissioner on which he could come to the conclusion that the shares and debentures mentioned in these questions retained the character of business assets. The Commissioner further relied on the fact that in the previous year the appellant had applied to make a reference to the Court in respect of the income derived from these shares and debentures, but withdrew his application. This does not of course operate as an estoppel against the appellant, but is a fact which I do not think the Commissioner was bound to exclude from his consideration. Having regard to this conclusion of the Commissioner, for which there was certainly evidence, I do not think that the Court is justified in disturbing the finding and the answers to the two questions mu3t be against the appellant.

22. Question six: From the judgment of the High Court it is not clear if the change in the wording of Section 49, Income Tax Act, introduced by the Amending Act of 1939 was noticed. There is no difference however in the result. The amended Section 49. B only purported to state that the Income Tax charged to the company was to be deemed as paid on behalf of the shareholder. That-is not a section under which any claim could be made by the appellant. His claim must rest on the applicability of Section 48 to him. Under the Government Trading Act (III [3] of 1928) the Durbar has not become an assessee or an individual liable to tax under the Income Tax Act generally. Only to a limited extent and for a limited purpose it is made liable to taxation. By that enactment, for the purpose of Income Tax generally, the legal position of the Durbar is not altered in respect of the rest of its income. It may be noted that in respect of the immovable properties owned by the Durbar in British India (other than those covered by question 3) income has accrued to the Durbar in British India. The Income tax Officer has not taxed that income. If the Durbar was an individual or company under Section 48 it would be also an individual or company under Sections 3 and 4, Income Tax Act, and there would be no justification to exclude the State generally from liability to tax. I agree with the line of reasoning adopted by the High Court for its conclusion on this question and the answer to the question must therefore be against the Durbar.

23. The result is that except for the variation in answer to question (3), the appeal fails and is dismissed. The appellant to pay three fourths of the costs of the appeal of the respondent.

Fazl Ali, J.

24. I have nothing to add to what my Lord the Chief Justice has said on questions (a) to (6), but I wish to express as briefly as I can my own views on question (1). That question has been framed in these words:

> Whether in the circumstances of this case the interest of ₹ 2,49.726/- received by the Durbar on the loan advanced to the Provident Investment Co. Ltd. is assessable under the provisions of the Indian Income Tax Act read with the Government Trading Taxation Act (III [3] of 1926).

On the question so framed, we are not called upon to express an opinion on any abstract point of law dissociated from the facts of the particular case before us. On the other hand, we are called

upon to apply the existing law to the facts of the case. It is to be noted that no specific section of the Income tax Act is mentioned in the question, but we are simply required to state whether the assessee is liable under the provisions of the Income Tax Act, read with the Government Trading Taxation Act, to taxation, in the circumstances of the case.

25. Our first duty then is to ascertain the facts of the case, and, for this purpose, we have to look at the admitted facts and the findings arrived at by the final income tax authority. The admitted facts are stated by the Commissioner of Income Tax in his letter of reference in these words:

> A company styled the Provident Investment Co. Ltd. was incorporated in British India in 1927 with head quarters in Bombay, with 4968 shares of rupees 1,000 each. It is practically a one man company as all the shares are either owned by the Gwalior Durbar or its nominees. In 1933 the Durbar advanced this Company a loan of ₹ 50/- lakhs on the security of its first mortgage debentures of an equal nominal value. The loan was advanced at Gwalior. The interest was payable there and the debentures also were deposited there. But admittedly the Company brought the borrowed money to British India and utilised it for the purposes of its business in British India. The interest on the loan received by the Durbar for the year amounted to ₹ 2,59,728/- referred in item (A) above. The interest was receivable and actually received at Gwalior.

These facts are to be read with the findings set out in the appellate order of the Assistant Commissioner of Income Tax, which are to the following effect:

> It is admitted that the Durbar carried on banking business and this so because the Durbar has a lot of surplus money to invest and earn interest. The loan advanced in this case is part of operations connected with that money lending business. Hence the income therefrom is liable to be taxed.
>
> These findings are reiterated in the Commissioner's letter of reference in these words:
>
> The Durbar admittedly carried on money-lending business and the transaction in question, namely, the loan of ₹ 50/- lakhs to the Provident Investment Co. Ltd , was a part of that business or an operation connected with that business.

The learned Chief Justice of the Bombay High Court, who delivered the leading judgment in the present case when it was before that High Court, after reciting the facts of the case, has referred to the crucial finding in these words:

> In addition to these facts, there is the further finding of fact, that this loan of ₹ 50/- lakhs formed part of the operations connected with the money-lending business of the Durbar. So that it comes to this, that the income belonged to or was connected with the Gwalior Durbar's money-lending business in British India, but accrued or arose to it outside British India.

26. It may be stated here that it has been admitted throughout the proceedings that the Gwalior Durbar has been carrying on money-lending business in British India through its agent, Mr. Wadia. That fact was stated in ground (5) of the memorandum of appeal to the Assistant Commissioner, and it is also stated in-the order of the Assistant Commissioner. The point which was raised before the Appellate Assistant Commissioner was that the loan in question was a stray casual transaction and did not constitute or was not part of any money-lending business. This contention however was negatived, and the Assistant Commissioner found that "the loan was part of operations connected with the money-lending business.

27. The question we have to decide is whether, having regard to the facts set out above, the assessee is (to quote the words used in the question framed by the Commissioner) assessable under the provisions of the Income Tax Act read with the Government Trading Taxation Act, III [3] of 1926.

28. That the Government Trading Taxation Act applies to the assessee cannot be controverted and has not been controverted. That being so, the assessee is liable to taxation under the Income Tax Act, in the same manner and to the same extent as in the like case a company would be liable. In the present ease, the interest on the loan which is said to represent the income was paid at Gwalior, and therefore the question arises as to whether in spite of this fact, the income is to be deemed to have accrued in British India. For this, we have to refer to Section 42, Income Tax Act, which, being a general section, would apply to a company also. Under S'. 42, all income, profits or gains shall be deemed to be income accruing or arising within British India, if they accrue or arise directly or indirectly in the following cases :

(1) through or from a business connection in British India ;

(2) through or from any property in British India;

(3) through or from any asset or source of income in British India;

(4) through or from any money lent at interest and brought into British India; and

(5) through or from the sale, exchange or transfer of a capital asset in British India.

(This was added in 1947, and may be ignored for the purpose of this appeal, as the assessment was for a prior period.) Prima facie, therefore, the appellant will be liable to taxation in the present case, if his case falls under either Clause (1) or Clause (4). From the judgment of the learned Chief Justice of the Bombay High Court, as I read it, I find that he has nowhere stressed the fact that the assessee is liable because the money was lent at interest and brought into British India. On the other hand, the first alternative stated in Section 42, which relates to income accruing through or from a business connection in British India, has been throughout emphasized in his judgment. As I have already stated, the learned Chief Justice starts by saying "So it comes to this, that the income belonged to or was connected with the Gwalior Durbar's money-lending business in British India." Then, dealing with the question of ultra, vires, which was raised on behalf of the appellant in the High Court, he further stated:

> But in my opinion this is not so for as long as there is a residential or business connection with British India, no question of the law being extra-territorial can arise. There is a

territorial connection in this case through the nexus of the Gwalior Durbar's money-lending business carried on in British India.

Again, after referring to certain observations of Dixon J in an Australian case, *Colonial Gas Association Ltd. v. Federal Commrs, of Taxation*[10] Ed he added:

That is to say, if a person is deriving income from a business carried on in a country, he has a sufficient territorial connection with that country to prevent a law imposing a tax upon him being regarded as extra-territorial.

He then referred to the contention put forward on behalf of the Income Tax department in these words:

Mr. Setalvad contends that inasmuch as the whole basis of the liability to tax under the impugned Sub-section is based on the bulk of the assessee's income arising in British India, the sub-section would not fall within an express prohibition against any extraterritorial legislation.

It seems to me that the learned Chief Justice has, in the treatment of the case, rightly laid stress on the crucial point in the case, viz., that what brings the assessee within the ambit of the operation of the Income Tax Act is the fact that the income in question was connected with his money-lending business in British India, and the loan from which the income arose was not an isolated transaction but formed part of the operations connected with the money-lending business of the Durbar.

29. It is true that the Commissioner of Income Tax, in making his reference, had expressed an opinion to the following effect:

As the money lent was brought into British India, the income therefrom is deemed to accrue or arise in British India, by virtue of Section 42(1), Income Tax Act.

But the High Court was not bound by this opinion, and the question which was submitted to it was in general terms, without any specific reference to that part of Section 42, upon which the Commissioner had based his opinion. Nevertheless, the new clause in Section 42, which deals with money lent at interest and brought into British India, and which seems at first sight to furnish the easiest solution of the difficulty presented by the case, appears to have been referred to and relied on in the High Court, and Chagla J., the other learned Judge of the Bombay High Court, does appear to have rested his decision on the ground that under this clause, the income which accrued to the assessee must be deemed to have accrued in British India. It has been strenuously argued before us that inasmuch as the case was argued in the High Court on the footing that the assessee is liable only under the new Clause (money lent at interest and brought into British India), it is not open to this Court to rest its decision on any other part of Section 42. No doubt, as a rule, this Court will hesitate to base its decision on a point, which is raised for the first time in this

Court, especially when it cannot be substantiated without further investigation, or when it amounts to springing a sudden surprise upon the litigant against whom it is raised. But the point on which I wish to lay stress, viz., that the facts of the case bring it under Clause (1) of Section 42 which deals with income accruing directly or indirectly through a business connection in British India, seems to me to rest on foundations which are well laid in the proceedings prior to the appeal to the High Court. As I have already stated, it clearly arose before the Appellate Assistant Commissioner, and also commended itself to the learned Chief Justice, if my reading of his judgment is correct. It is, in my opinion, not a new point, and there is no question of springing a surprise upon the appellant, because the appellant being aware of this aspect of the case, tried to contend before the Appellate Assistant Commissioner that the loan with which we are concerned, was a solitary transaction, having no connection with his money-lending business. Sir Jamshedji Kanga, who appeared for the assessee, stated in the course of his arguments, that if the decision of the case is rested on the first part of Section 42, i.e., if the interest to be taxed is held to be income, profit or gain accruing directly or indirectly through or from any business connection of the assessee in British India, then the question of ultra vires would not arise in regard to the Government Trading Taxation Act, and there was nothing further to be said in the appeal In my opinion, the case is covered by that part of the section, and that is sufficient to dispose of the appeal. It seems to me that the fact of money being lent and brought into British India, apart from being the basis of an important clause in Section 42 as it now stands, may be a very important circumstance in a particular case. It is certainly in this case a very important link in the chain of facts which may be relied upon for making the assessee liable to taxation. In the first place, all the shares in the Provident Investment Co. Ltd., are owned either by the Gwalior Durbar or its nominees. This fact by itself might be held to constitute a business connection. See *Commissioner of Income Tax, Bombay Presidency and Aden v. Gurrimbhoy Ebrahim and Sons Ltd*[11]. where Sir George Rankin, negativing the plea of business connection in that particular case, remarked : "It is not shown that the Nizam had at any time an interest direct or indirect in the respondent company." Then, there is the fact that the Gwalior Durbar has been carrying on money-lending operations in British India. Lastly, there is the finding that the lending of money and its being brought into British India are matters connected with the money-lending operations of the Durbar, These facts, in my opinion, would have been sufficient to attract the operation of Section 42(1), as it stood before it was amended in 1939, i.e., before the clause "through or from any money lent at interest and brought into British India in cash or in kind" was inserted, I am fully aware that our decision should not be founded on new facts, but the facts stated above are not new facts, but are facts which are to be found in the statement of the case before us.

30. I will now briefly deal with two main points which were urged before us on behalf of the appellant. It was contended in the first place that Section 2, Government Trading Taxation Act, deals only with income arising in British India, and that it cannot be applied to income which does not actually arise in British India but is deemed to arise in British India, by calling in aid the

fiction embodied in Section 42, In my opinion that is not a sound contention. Section 2(1)(a) provides that a foreign Government referred to in Section 2(1) shall be liable under the provisions of the Income Tax Act, to taxation, in the same manner and to the same extent as in the like case a company would be liable. Therefore, a foreign Government is placed on the same footing as a company. A company may be liable to taxation in respect of income arising in British India as well as income which is deemed to arise in British India, Therefore, the effect Section 2(1)(a) is to make a foreign Government liable also in respect of income which is deemed to arise in British India.

31. The other argument, which seems to be a more serious one, is that the new words introduced in Section 42 in the year 1939, which stretch the section to cover all income, profits or gains from any money lent at interest and brought into British India in cash or in kind do not establish such a nexus or territorial connexion between the taxing State and the assessee, as to give jurisdiction to the Indian Government to tax a foreigner or a foreign Government. This argument was advanced in a very complicated and somewhat obscure form before the High Court, as will appear from a perusal of the judgments of the learned Chief Justice and Chagla J. But, when put in the form stated above, it appears to me to be quite an intelligible and serious contention, and I must confess that so far as this contention is concerned, I share the opinion expressed by Sastri J. with regard to the illusory character of the so-called nexus or territorial connexion, if the case is to be brought under the provision in question. The nexus or connexion may appear to be a substantial one in a particular case in view of the facts of that case, but, in many cases, it may be brought down to a vanishing point. The question we have to answer is whether the word used in the new Clause (which is intended to be of general application), standing by themselves are sufficient to constitute such a nexus as is contemplated by the authorities which deal with the subject. My brothers Mahajan and Mukherjea JJ. have suggested that the lending of the money at interest and its being brought into British. India should be treated as part of one transaction or scheme, and they have also observed that the new words were intended to guard against any subterfuge, which might be adopted for the purpose of escaping Income Tax by showing that money was lent outside British India though, to all intents and purposes, it is money lent in British India. This may well have been the intention of the Legislature, but the bare words as they stand, are hardly sufficient to convey such a comprehensive meaning. These words, as we know, were inserted after the decision of the Privy Council in *Commissioner of Income tax, Bombay Presidency and Aden v. Currimbhoy Ebrahim and Sons Ltd. A.I.R. (23) 1936 P.C. 1* (Supra)in which it was held that where a loan was an isolated transaction, there was not a business connexion in British India and the lender could not be taxed. After that decision, all that appears to have been done was to pick up certain words which would just cover the facts of that case and make the assessee liable to tax in circumstances similar to those of that case. The choice of the words, however, does not seem to be very happy, because, under the new provision, there may arise a number of anomalous situations, including those where the creditor does not intend or even know that his money is to be brought into British India and when money is brought into British India at different stages and through different channels. If the principle that some kind of tangible or intelligible nexus or territorial connexion between the taxing State and the assessee is necessary in order to confer jurisdiction on the State to tax the assessee is of any importance, that principle seems to have not received adequate consideration in framing the new clause. I do not wish to pursue the matter further, because, in my opinion, the earlier part of Section 42 is sufficient to cover this case. In my judgment the High Court has rightly answered the first question in the affirmative.

Patanjali Sastri, J.

32. As I agree with my learned brothers with regard to the answers which they propose to make to questions Nos. 2 to 6, I do not think it necessary to encumber this judgment with a restatement of the facts giving rise to this reference. I will accordingly refer to them only so far as it is necessary to make intelligible what I have to say on question No. 1, as to which I have reached a different conclusion.

33. That question is:

> Whether in the circumstances of this case the interest of ₹ 2,59,726/- received by the Durbar (i.e., the Government of Gwalior, the appellant herein) on the loan advanced to the Provident Investment Co. Ltd., is assessable under the provisions of the Income Tax Act read with the Government Trading Taxation Act (No. III [3] of 1926).
>
> It is somewhat unfortunate that a question of law said to arise in the case should have been formulated in this unspecific form which allows of any point relating to the assessment of the sum in question being argued, the scope of the argument being. limited only by the ingenuity of counsel. And the position is by no means improved when the statement of the case submitted by the referring authority also leaves the matter equally vague and indefinite. It was therefore not a matter for surprise that much of the debate at the bar was taken up with an avoidable controversy as to the precise point or points on which the referring authority intended to seek the opinion of the Court. While on the one hand it is not desirable to state the questions of law in a purely abstract form without relating them to the facts of the particular case, it is, on the other hand, embarrassing if it is left to the Court, by the use of such expressions as "in the circumstances of the case", to find out for itself which circumstance gives rise to what question and to determine generally whether the assessment is right or wrong. It should be borne in mind that the Court in such cases is not dealing with a general appeal against the assessment but is only called upon to determine specific questions of law on which its opinion is sought.

34. There was no dispute as to how the sum of ₹ 2,59,726/- came to be included in the assessment of the appellant for the year ended 31st March 1940. The Durbar was carrying on extensive money-lending business through its agents in British India, and in the year 1927 it formed a private company known as the Provident Investment Company, Limited, all the shares of which were owned by the Durbar or its nominees. The company was incorporated in British India and had its headquarters in Bombay where it was carrying on business. In 1933 the Durbar advanced to the company a loan of ₹ 50/- lakhs on the security of first mortgage debentures of an equivalent nominal value issued by the company. The loan was advanced at Gwalior and the debentures were also delivered there to the Durbar but the amount was admittedly brought into British India and was utilised by the company for the purposes of its business. One of the terms of the loan was that interest on the money was to be paid to the Durbar in Gwalior. The sum of ₹ 2,69,726/- was accordingly received in Gwalior as interest accrued due in the previous year that

is, the year ended 31st March 1939. It appears that there were also other loans advanced to the company on which a sum of ₹ 61,300/- was paid as interest in the same year, but the number and extent of such loans and the circumstances in which they were advanced have not been stated because, presumably, no objection was taken to the assessment of that sum.

35. The question having been framed, as already stated, in vague terms, the learned Advocate-General of India sought to justify the assessment of the sum in question on various grounds. At one stage it was suggested that, on the finding of the Income Tax authorities that the Durbar was carrying on money-lending business through its agents in British India and that the loan of ₹ 50/- lakhs to the company was "a part of their business or an operation connected with that business", the interest in question accrued or arose in British India and was therefore properly assessed. This suggestion is clearly untenable as the loan was admittedly advanced in Gwalior and the interest was paid and received in Gwalior. The fact that the Durbar was carrying on money-lending business in British India cannot make the interest received in Gwalior in respect of a money-lending operation effected in Gwalior income arising or accruing in British- India. The Commissioner of Income Tax in his statement of the case no doubt found that the loan in Gwalior was part of the Durbar's business operations. But that was for the purpose of bringing the case within the Government Trading Taxation Act (No. III [3] of 1926) which brings within the net of British Indian taxation only "income arising in connection" with the business carried on by a Dominion Government. Indeed, the learned Advocate-General did not seriously press this extreme suggestion.

36. It was next urged with more plausibility that the sum in question was properly assessed to Indian Income Tax, as on the facts found, it could be regarded as income received "directly or indirectly through or from any business connection in British India" within the meaning of Section 42(1), Income Tax Act, 1922, and could therefore be "deemed to be income accruing or arising in British India" so as to fall within the charging Sections 3 and 4 of the Act. This might, perhaps, have been a more fruitful line of argument for the respondent, had the foundation for the same been properly laid by elucidation of all the facts bearing on the relation between the Durbar and the Provident Investment Co. Ltd., in the way of business including facts relating to the loans in respect of which a sum of ₹ 61,300/- was taxed as interest arising in British India. But this, as already stated, was not done, probably because it was considered unnecessary to rely on "business-connection" as another limb of Section 42(1), namely "through or from any money lent at interest and brought into British India in cash or in kind" appeared exactly to fit the facts of the case. Indeed, in submitting his opinion on the questions raised, as he was required to do under Section 66 of the Act before its amendment in 1939, the Commissioner concluded this part of the case by stating "And as the money lent was brought by the company into British India, the income therefrom is deemed to accrue or arise in British India by virtue of Section 42(1), Income Tax Act." In such circumstances, the respondent cannot, in my opinion, now seek to sustain the assessment on the ground of the supposed existence of a business connection between the Durbar and the borrowing company, as to which, the facts have not been fully investigated nor any clear and definite finding made by the Income Tax authorities. It is significant that while both the Commissioner of Income Tax in his statement of the case and the Appellate Assistant Commissioner in his order on appeal are at pains to show that the loan advanced to the company was part of operations connected with the money-lending business of the Durbar in order to bring the case within the Government Trading Taxation Act, 1926, neither of them uses the expression

"business connection" with which they were perfectly familiar. It is clear to my mind that they did not purport to tax the sum of ₹ 2,59,726/- received from the company as having arisen through or from a business connection in British India, though possibly on the facts before them the assessment could have been sustained on that ground. As I read the letter of reference and the Appellate Assistant Commissioner's order, there is no finding that the Durbar derived the income in question through any business connection within the meaning of Section 42(1), though it would appear from the judgment of the learned Chief Justice in the High Court some reference was made to that aspect of the matter.

37. Learned Counsel for the appellant contested the liability to assessment of this sum (₹ 2,59,726) on two grounds. In the first place, it was urged that, on a proper construction of Section 2, Government Trading Taxation Act, 1926, read with the Income Tax Act, 1922, any income that does not actually "arise" in British India to the Government- concerned could not be subjected to Income Tax. Section 2 runs thus:

> 2 (1) Where a trade or business of any kind is carried on by or on behalf of the Government of any part of His Majesty's Dominions, exclusive of British India, that Government shall, in respect of the trade or business and of all operations connected therewith, all property occupied in British India and all goods owned in British India for the purposes thereof, and all income arising in connection therewith, be liable
>
> (a) to taxation under the Indian Income Tax Act, 1922, in the same manner and to the same extent as in the like case a company would be liable,
>
> (b) to all other taxation for the time being in force in British India in the same manner as in the like case any other person would be liable.
>
> (2) For the purposes of the levy and collection of Income Tax under the Indian Income Tax Act, 1922, in accordance with the provisions of Sub-section (1), any Government to which that sub-section applies shall be deemed to be a company within the meaning of that Act, and the provisions of that Act shall apply accordingly.

38. It has been decided by their Lordships of the Judicial Committee in the Patiala State Bank case A.I.R. (30) 1943 P.C. 181, that the section is not confined to trades or businesses carried on in British India as the words of the section are quite general in terms. Their Lordships, however, recognised that the effect of Section 2, Government Trading Taxation Act, 1926, and Sections 3 and 4, Income Tax Act, 1922, was to make a Dominion Government carrying on business anywhere "liable to British Indian Income Tax in respect of the income, profits and gains of that business which accrue or arise or are received in British India." Relying on this passage and the words "all income arising in connection therewith" in Section 2 (1), Government Trading Taxation Act, 1926, learned Counsel for the appellant contended that a Dominion Government carrying on business in and outside British India cannot be made liable for the income, profits and gains which do not actually accrue or arise or are received in British India but are to be "deemed to accrue or arise or to be received" in British India. I do not think the decision of the Privy Council referred to above is an authority for this proposition. The income in dispute in that

case admittedly arose in British India and no question arose as to the liability to tax of income which did not actually accrue or arise, but was to be deemed to accrue or arise in British India by virtue of the provisions of the Income Tax Act, 1922. The only question was whether Section 2, Government Trading Taxation Act, 1926, applied to the business of the bank although it was carried on exclusively in the State of Patiala. In the passage quoted above, their Lordships were merely emphasising that although the language used in Section 2 of that Act was general, Sections 3 and 4, Income Tax Act, 1922, imported a territorial limitation on the income liable to be taxed in such cases.

39. Nor can I accede to the argument that the phrase " all income arising in connection therewith " control and qualify the words " to the same extent as in the like case a company would be liable," so as to exclude the operation of those provisions of the Income Tax Act, 1922, which render certain categories of income which do not actually arise but are to to be deemed to arise in British India. It was urged that when the Government Trading Taxation Act, 1926, was passed, all that could have been contemplated was that only income arising in British India in connection with the trading operations of a Dominion Government should be subject to taxation and not income earned abroad. It is, however, to be observed that the Income Tax Act even in its original form made certain categories of income not strictly arising in British India chargeable to tax by providing that they shall be deemed to have accrued or arisen or to have been received in British India (Section 4(1) and Section 42(1)), though other categories of such income also, including the one now in question, (namely, income derived through or from any money lent at interest and brought into British India in cash or in kind) have since been swept in by amendments from time to time. If it was the intention of the Indian Legislature to exempt such categories of income from taxation and to tax only income actually arising in British India in the case of Dominion Governments which trade or carry on business, nothing could have been easier than to make it clear by inserting suitable words in Section 2, Government Trading Taxation Act, 1926. As the section stands, however, the "extent" of the liability to taxation must, in my opinion, be determined with reference to the Income Tax Act, 1922, without in any way being limited by the words "all income arising in connection therewith" which, like those which precede, merely indicate that the income made chargeable by Section 2 should be solely derived from or connected with the trade or business carried on by the Government concerned.

40. It was further suggested that the extent of liability to taxation should be limited to what it was under the Income Tax Act, 1922, as it stood when the Government Trading Taxation Act, 1926, was passed, and should not be widened by subsequent amendments to the Income Tax Act, more especially as Dominion Governments were not within the scope of Indian legislation, but were brought under the charge to Income Tax as a result of agreement among the States concerned. I see no force in this argument. The reference to the Income Tax Act, 1922, in Section 2, Government Trading Taxation Act, 1926, must be taken to refer to. the Income Tax Act, 1922, as it stands amended at the time when the tax is sought to be imposed, that is to say, in the year ended 31st March 1940, which is the year of assessment in this case. As the words "through or from any money lent at interest and brought into British India in cash or in" kind" were introduced in Section 42(1) by the Amending Act (VII [7] of 1989) which came into force on 1st April 1939, the "extent" of the appellant's liability to British Indian taxation must be determined with reference to that section as so amended.

41. Lastly, the validity of this newly introduced provision in Section 42(1) which read with

Sections 3 and 4 purports to bring into the charge, by means of a statutory fiction, income derived abroad in the case of a non-resident assessee was challenged as being ultra vires the Indian Legislature on the ground of its extra-territorial operation. The provision clearly assumes that the money is lent abroad and the relevant interest accrues or arises or is received outside British India, and also that the person receiving it is not resident in British India; for, otherwise, the interest would be taxable under the general provisions of the Act and this special provision in Section 42(1) would be unnecessary. The expression "all income, profits or gains accruing or arising through or from any money lent at interest" might suggest that such money should form the source from which the interest is to arise-a construction which might obviate the constitutional objection as the source would then be in British India. (See *Governor-General in Council v. Raleigh Investment Co., Ltd*[12]. But such a construction would restrict the application of the provision only to those rare but possible cases where the payment of interest is dependent on the earning of profits. think that the provision was intended to cover ordinary cases where interest is stipulated for at a specified rate per centum, whether or not any profits are earned by the utilisation of the money lent-cases such as *Commissioner of Income tax, Bombay v. Currimbhoy Ibrahim & Sons A.I.R (23) 1936 P.C. 1(Supra)*, which indeed appears to have led to the introduction of these words in Section 42(1) by the Amending Act of 1939. I think that the phrase. " arising...through or from any money lent at interest and brought into British India" means no more than income arising from lending money at interest, provided the money is in fact brought into British India. The question is whether the enactment of such a provision is beyond the powers of the Indian Legislature. In determining this question, the facts of the particular case, such as for instance, that the Durbar was carrying on business in British India and had a controlling interest in the borrowing company, must be disregarded as being irrelevant, and it must be assumed that there was no connection between the creditor who receives the interest and British India which seeks to tax the interest save that the money lent was brought by the borrower into British India.

42. The learned Advocate-General of India placed strong reliance on the observations in *Governor-General v. Raleigh Investment Co., Ltd. A.I.R. (31) 1944 F.C. 51(Supra)* where, this Court, while dismissing the assessee's suit for recovery of the tax paid under protest as not maintainable, went into the merits of the case and upheld the validity of the provisions of the Income Tax Act, 1922, authorising the taxation of dividends paid to a foreign company in a foreign country out of profits earned in British India. Such taxation was held to be justified according to the recognised principles of international law as the "source" of the dividend was in British India. This Court was also of opinion that, on a proper construction of Section 99, Government of India Act, 1935, the Indian Legislature had power to enact such provisions. On appeal, however, the Privy Council expressed no opinion on these points but merely confirmed the dismissal of the suit.

43. In the subsequent case of *Wallace Brothers & Co., Ltd. v. The Commissioner of Income Tax, Bombay City and Bombay Surburban District*[13] their Lordships had to consider the power of a subordinate Legislature to pass a taxing law having extra-territorial operation. The question arose whether a company incorporated in England and having its central management and control in that country was liable to pay Indian Income Tax on its foreign income also because it earned the major part of its profits in British India in a business carried on through its partner. The provisions of Section 4(1)(b)(ii) read with Section 4A(c), Income Tax Act, 1922, as amended in 1939, which have the effect of bringing into charge the foreign income of a company

incorporated and having its management and control in a foreign country, provided the major portion of its income arises in British India, were impugned as being ultra vires the Indian Legislature. Indicating the correct approach in such cases, their Lordships made the following pertinent observations:

> Their Lordships do not approach the matter on the formal lines embodied in these contentions (which were also more or less the lines on which this Court proceeded in Raleigh Investment Co's. case A.I.R. (31) 1944 P.C. 51 as well as in the case then under appeal. There is no rule of law that the territorial limits of a subordinate Legislature define the possible scope of its legislative enactments or mark the field open to its vision. The ambit of the powers possessed by a subordinate Legislature depends upon the proper construction of the statute conferring those powers. No doubt the enabling statute has to be read against the background that only a defined territory has been committed to the charge of the Legislature. Concern by a subordinate Legislature with affairs or persons outside its own territory may therefore suggest a query whether the Legislature is in truth minding its own business. It does not compel the conclusion that it is not. The enabling statute has to be fairly construed.

44. Their Lordships brushed aside Section 99, Constitution Act, which this Court interpreted as conferring power of extra-territorial legislation in Income Tax matters, as of "no help one way or another in determining the authorised area of taxes on income", while recognising that there may be some laws having an extra-territorial operation validly made by the Indian Legislature pursuant to that section. They found the key to the solution of the problem in the true, construction of the expression "taxes on income" in Item 54 of List I of Schedule 7 to that Act in the light of the principle recognised in *Croft v. Dunphy A.I.R. (20) 1933 P.C. 16(Supra)*, that:

> Where Parliament has conferred a power to legislate on a particular topic it is permissible and important in determining the scope and meaning of the power to have regard to what is ordinarily treated as embraced within that topic in the legislative practice of the United Kingdom.
>
> Finding that the general conception as to the scope of Income Tax legislation in England had been that a person could be charged to Income Tax in respect of his foreign income if "a sufficient territorial connexion" existed between the person sought to be charged and the country seeking to tax him, their Lordships laid down that the validity of such legislation in India depended on "the sufficiency for the purpose for which it is used of the territorial connexion set forth in the impugned portion of the statutory test." Applying the principle to the case before them, which related to a company, their Lordships held that the "statutory test" set forth in the impugned provision, namely, the derivation from British India of the major part of its income, (Section 4A(C)) was a territorial connexion "at least as solid as the connexion given by the place of central control" and was therefore sufficient to justify the company being treated as liable to British Indian taxation even in respect of its foreign profits.

45. In view of this important pronouncement it seems no longer useful, in judging the validity of an Indian Income Tax law having elements of extra-territoriality, to enquire what are the limitations, according to international law based on the comity of nations, on the power of a sub-ordinate Legislature or whether the Indian Legislature has full power under its constitution to make laws having extra-territorial operation. The question reduces itself simply to this : Is the territorial connexion relied on in the impugned provision as justifying its extra-territorial operation sufficient for the purpose for which it is used ? The only territorial connexion set forth in the impugned portion of Section 42(1) is the bringing of the borrowed money into British India and the purpose for which it is used is the taxation of the interest received abroad by the non-resident lender. To my mind, there is no relevant and sufficient nexus between bringing the borrowed money into British India and the receipt abroad of the interest sought to be taxed, for the payment of the interest would not ordinarily be dependent on the earning of profits by the utilisation of the money in British India. The tax is laid upon income which has no necessary relation with the territorial connexion set forth in the impugned provision. If I may repeat an illustration which I put during argument, a financier in London lends money at interest which the borrower brings into British India and spends on the race course. If the impugned provision is upheld as valid, he would be liable to contribute to the Indian Exchequer tax on the interest received by him in London. This may be an extreme case but it serves to illustrate the illusory character of the territorial connexion on the strength of which the impugned provision seeks to bring into charge the income received abroad by a non-resident foreigner.

46. The learned Advocate-General suggested that the words "money lent at interest and brought into British India" might be construed as referring not to two independent and unconnected acts-lending abroad and bringing into British India-but to parts of one and the same transaction the lender and the borrower both agreeing that the money should be invested in British India though ostensibly lent abroad. It was said that the object underlying the provision was to prevent evasion of tax under colour of lending money and receiving interest outside British India, though in substance the money is lent and the interest arises in British India. That may be so, but the words used are far too wide and, in my opinion, stretch the section beyond the legitimate ambit of the powers of legislation in regard to "taxes on income" granted to the Indian Legislature by the British Parliament, as those powers have been authoritatively explained by their Lordships of the Judicial Committee in Wallace Brothers & Co's case A.I.R. (35) 1948 P.C. 118.

47. Our attention was drawn to the observations in Raleigh Investment Cos. case A.I.R. (31) 1944 F.C. 51 already referred to, where this Court quoted with apparent approval certain passages from judgments of the Australian High Court which would seem to suggest that, if there is any territorial connexion, the State has the power to make a law, however extra-territorial its operation, the degree of such connexion being a matter affecting the policy and not the validity of the law. It appears to have been recognised even in those cases that the connexion must be real and relevant. It is, however, unnecessary to enter upon a detailed discussion of those cases as the decision referred to above clearly indicates the principles which should guide us in the determination of questions such as the one now before us.

48. I am therefore of opinion that, judged by the test indicated by their Lordships, the impugned provision is ultra vires the Indian Legislature, and the Durbar is in consequence not chargeable to tax in respect of the sum of ₹ 2,59,726/-. I would accordingly allow the appeal in regard to this sum and answer question 1 in the negative. On the other question I substantially concur in the

judgment of my Lord the Chief Justice,

Mahajan, J.

49. This is an appeal, on a certificate granted by the High Court of Bombay under Section 205, Constitution Act of 1935, from a judgment of that Court answering in favour of the respondent, the Commissioner of Income Tax, Bombay, certain questions of law referred to the High Court by him.

50. The constitutional question is in issue in one of the six questions answered by the High Court, Leave of the Court under Section 205(2), Government of India Act, 1935, was asked and granted for an appeal on other questions as well in view of their general importance, and we heard arguments on all the points that were originally referred' to the High Court by the Commissioner of Income Tax.

51. All the questions in issue concern the liability of the Gwalior Durbar to tax. The Durbar admittedly did money-lending business and thus became chargeable to tax in India, in view of the provisions of the Government Trading Taxation Act III [3] of 1926, but subject to the limitations contained therein. Section 2 of that Act provides:

> 2. (1) Where a trade or business of any kind is carried on by or on behalf of the Government of any part of His Majesty's Dominions, exclusive of British India, that Government shall, in respect of the trade or business and of all operations connected therewith, all property occupied in British India and all goods owned in British India for the purposes thereof, and all income arising in connexion therewith, be liable
>
> (a) to taxation under the Income Tax Act, 1922, in the same manner and to the same extent as in the like case a company would be liable,
>
> (b) to all other taxation for the time being in force in British India in the same manner as in the like case any other person would be liable.
>
> (2) For the purposes of the levy and collection of Income Tax under the Income Tax Act, 1922, in accordance with the provisions of Sub-section (1), any Government to which that sub-section applies shall be deemed to be a company within the meaning of that Act, and the provisions of that Act shall apply accordingly.

52. It was. not denied that the Durbar as an entity is within the purview of this Act. It was however contended that the scope of the section is limited to income actually arising in British India, and not to income which, under the Income Tax Act, 1922, or by its amendment in 1939, is deemed to arise or accrue in British India. The validity of the amendment in the Income Tax Act, bringing within the scope of the charging section interest earned out of money lent outside but brought into British India was questioned on the ground of its being extraterritorial in character.

53. Sections 4(1) and 42(1), Income Tax Act, 1922, as these stood in 1926, read as follows:

> 4. (1) Save as hereinafter provided, this Act shall apply to all income, profits or gains, as described or comprised in Section 6, from whatever source derived, accruing, or arising, or received in British India, or deemed under the provisions of this Act to accrue, or arise, or to be received in British India.
>
> 42. (1) In the case of any person residing out of British India, all profits or gains accruing or arising, to such person, whether directly or indirectly, through or from any business connexion or property in British India, shall be deemed to be income accruing or arising within British India, and shall be chargeable to Income Tax in the name of the agent of any such person and such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such Income Tax.

Provided that any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non-resident person which are, or may at any time come, within British India.

54. Income deemed to arise in British India, though not actually arising, was chargeable to a certain extent under the Act. By the amendment of Section 42 in the year 1939, the scope of the section was enlarged, and in that year, the amended section was in these terms:

> 42. (1) All income, profits or gains accruing or arising, whether directly or indirectly, through or from any business connexion in British India, or through or from any asset or source of income in British India, or through or from any money lent at interest and brought into British India in cash or in Rind, shall be deemed to be income accruing or arising within British India and where the person entitled to the income, profits or gains is not resident in British India, shall be chargeable to Income Tax either in his name or in the name of his agent, and in the latter case such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such Income Tax....
>
> Regarding the last part of the section it was said that the Indian Legislature could not legislate about the income of a foreign Government arising in a foreign country, and though it has sovereign powers, it can only exercise these powers within the field open to its vision under the provisions of Sections 99 and 1oo, Constitution Act.

55. The material facts relevant to Gwalior Durbar's liability to tax in British India, which raise the constitutional question, may best be left for consideration at a later stage, so that the question of the scope and vires of the section can be examined detached from the facts of the case.

56. By the comity of nations, sovereign rulers of States are not subject to the municipal laws of any particular country, but by Act III [3] of 1926, His Majesty's Dominions and territories under His Majesty's protection were made subject to payment of Income Tax under certain conditions and limitations. The charging section of the Act places trading Dominions and Indian States doing trade on the same footing as companies. The extent of chargeability is the same as that of a company. For levy and collection of tax, they are deemed to be a company. In other words, the effect of the section is to enlarge to a limited extent the scope of the definition of 'company' given

in the Income tax Act, and to include within its ambit Governments of Indian States and other Dominions carrying on business or trade. The effect of the section is not to add to the categories of persons liable to tax under Section 4, Income Tax Act, but to include within one of those categories trading States and Dominion Governments carrying on trade. If this is the c6rrect reading of the section, then the contention of the learned Counsel for the Durbar that income deemed to arise in British India is outside the charging section cannot be sustained, because of the unambiguous language employed in Clause (a) of Section 2 of Act III [3] of 1926. The Government of a State or a Dominion, when trading, has the status of a company, and can be taxed in like manner and to the like extent. A company can be taxed for income which is deemed to arise in British India. So can a foreign Government carrying on trade within India or elsewhere. The decision of their Lordships of the Privy Council in *Patiala State Bank v. The Commissioner of Income Tax, Bombay A.I.R. (30) 1943 P.C. 181(Supra)* has settled the point that Section 2, Government Trading Taxation Act, 1926, is not confined in its operation to trade or business carried on in British India, and that, if any Indian State carries on a banking business, the income, profits and gains of that business which accrue, arise or are received in British India would be liable to taxation under the Income Tax Act, even though the head office and all the branches of that Bank are situated in the State and banking business is not carried on in British India. The result of this decision is that the location of trade is not material, so far as the charging section of Act III [3] of 1926 is concerned. It was not disputed that the income sought to be taxed need not always actually arise in British India, to make it liable to tax under the Income Tax Act. It was however urged that, though in Sections 4 and 42, Income Tax Act of 1922 express reference was made to income "deemed to accrue or arise", in Section 2 of Act III [3] of 1926 no mention was made of such income; on the other hand, the scope of the section was limited to income actually arising. This argument would have force but for the language used in Clause (a) of Section 2 of the Act. The extent of the liability of the Government is the same as that of a company, and, if a company is liable to tax in respect of its artificial income, so would the Government of a State be liable when carrying on any business or trade.

57. The question of the validity of the impugned part of Section 42 may now be considered. The approach to the decision of a question like this has been indicated by their Lordships of the Privy Council in *Wallace Brothers & Co., Ltd. v. The Commissioner of Income Tax, Bombay City and Bombay Suburban District A.I.R. (35) 1948 P.C. 118(Supra)* in the following terms:

> There is no rule of law that the territorial limits of a subordinate Legislature define the possible scope of its legislative enactments or mark the field open to its vision. The ambit of the powers possessed by a subordinate Legislature depends upon the proper construction of the statute conferring those powers. No doubt the enabling statute has to be read against the background that only a defined territory has been committed to the charge of the Legislature. Concern by a subordinate Legislature with affairs or persons outside its own territory may therefore suggest a query whether the Legislature is in truth minding its own business. It does not compel the conclusion that it is not. The enabling statute has to be fairly construed. The relevant power (Sections 99(1) and 100, Government of India Act, 1935) is a power to make laws for the whole or part of British India or any Federated State with respect to "taxes on income other than agricultural income." The power to tax agricultural income is given to the Provincial Legislatures and

> the exception throws no light on the construction of the phrase "taxes on income". None of the other provisions of the Act affords any guidance as to the income or persons who may be subjected to tax. Only Sub-section (2) of Section 99 need be particularly referred to. That sub-section provides that "without prejudice to the generality of the powers conferred by the preceding sub-section no Federal law shall, on the ground that it would have an extra-territorial operation, be invalid so far as it applies to certain persons and things. In their Lordships' view this sub-section does no more than assume that there may be some laws having an extra-territorial operation validly made pursuant to Sub-section (1). It is no help one way or another in determining the authorized area of taxes on income....
>
> The resulting general conception as to the scope of Income Tax is that given a sufficient territorial connexion between the persons sought to be charged and the country seeking to tax him, income tax may properly extend to that person in respect of his foreign income.
>
> In their Lordships' view that general conception finds a place in the phrase "taxes on income" as used in the Government of India Act, 1935. That conclusion marches with the construction which their Lordships would, without the aid of a consideration of the British legislation, have placed on the Government of India Act, 1935.
>
> The principle-sufficient territorial connexion-not the rule giving effect to that principle-residence-is implicit in the power conferred by the Government of India Act, 1935.
>
> The result is that the validity of the legislation in question depends on the sufficiency for the purpose for which it is used of the territorial connexion set forth in the impugned portion of the statutory test.

58. The rule as to territorial connexion of the foreigner with the country seeking to tax him was laid down by Dixon J. in *Wanganui Rangitikei Electric Power Board v. Australian Mutual Provident Society*[14] in the following terms:

> So long as the statute selected some fact or circumstances which provided some relation or connection with New South Wales and adopted this as the ground of its interference, the validity of an enactment would not be open to challenge." Rich J. in Broken Hill South case, observed: "I do not deny that once any connection with New South Wales appears, the legislature of that State may make that connection the occasion or subject of the imposition of a liability. But the connection with New South Wales must be a real one and the liability sought to be imposed must be pertinent to that connection.

Dixon J. in the case cited above further observed:

> If a connection exists, it is for the legislature to decide how far it should go in the exercise of its powers,. Courts must be exact in distinguishing between ascertaining that the circumstances over which the power extends exist and examining the mode in which the

power has been exercised. No doubt there must be some relevance to the circumstances in the exercise of the power. But it is of no importance upon the question of validity that the liability imposed is, or may be, altogether disproportionate to the territorial connection.

If some connection exists, the legislature is not compelled to measure the taxation by the degree of benefit received in particular cases by the taxation. This affects the policy and not the validity of the legislation.

59. The validity of the arguments of Sir Jamshedji Kanga that the impugned part of Section 42 makes liable to tax in British India foreign money paid in a foreign country to a foreigner towards payment of interest on a debt which was borrowed in foreign territory and is therefore ultra vires of the powers of the Indian legislature may now be examined. The section read as a whole brings within the ambit of the charging section all income accruing or arising, whether directly or indirectly, in the following cases:

(a) when arising through or from any business connection in British India ;

(b) when arising through or from any property in British India;

(c) when arising through or from any asset or source of income in British India, and

(d) when arising from any money lent at interest and brought into British India in cash or in kind.

It is the business connection in Clause (1) the situation of property in British India and the existence of any asset or source of income in British India in Clauses (2) and (3) and the bringing in British India of lent money at interest in the last clause, that is the basis of liability. The territorial connection with British India of the foreigner is presumably furnished by the different links that connect him with this country, and justify the legislation. A foreigner cannot escape liability to tax by resorting to a device or subterfuge, when, in effect, he is deriving income from a field of activity that is in India, or, where a contract of loan ostensibly made outside, is, in effect made in India. By changing the venue of the contracted loan, the jurisdiction of the Indian legislature cannot be avoided, when the real purpose is to lend money in India. The words "money lent at interest and brought into British India in cash or in kind" read as a whole lead me to think that the legislature thought that in such a situation, the loan be treated as having been advanced in British India (the lending outside a mere formality) when actually the money had to be brought out here. To all intents and purposes, the advance is in British India. When the field in the view of the lender for his money-lending operation is India, then his modus operandi cannot affect the territorial connection of these operations.

60. Once the clause is interpreted in the manner above-mentioned, then it cannot be seriously contended that there is no sufficient territorial connection to attract the jurisdiction of the Indian legislature to make a law for taxing interest payable on such a loan, and the argument as to ultra vires loses all force. It cannot be denied that when money is actually lent in India, the Indian legislature will have jurisdiction to tax interest payable on the loan. The situation is not very different when the money lent is brought into India.

61. It was urged that the lent money may not be used in British India, when it is brought there. It may be lost on the racecourse. It may be stolen, or it may be thrown away and may not produce any income. It is said that in these situations, when the lender has lost all control over, and his ownership in the money lent outside British India, no real connection could be held to exist between the lender and the country where the money is brought, particularly, when the interest on that money is payable in a foreign country. Here there is not necessarily any such nexus as to justify legislation taxing such interest. As above stated, the assumption underlying the legislation is that when money is lent at interest and is brought into British India, it is done under an arrangement and with the object of earning profits in British India. It may. be otherwise in certain cases. It is possible that the borrower, after raising the loan, may change his mind, and, after bringing the money in India, may not use it for earning a profit. Such cases are conceivable, but all legislation has to be construed in a reasonable manner and considered as dealing with a normal man and a normal situation. Normally a person who raises money at interest outside British India (when he intends to bring) and brings it in British India, it may be presumed that he does so with the object of earning profit and paying interest out of that profit. Some exceptional cases may not fall within the presumption on the basis of which the impugned clause of Section 42 has been enacted. But that fact would not make the clause ultra vires. In my view, money lent outside British India and brought in India is almost on par with the existence of an asset in British India, or with the clause regarding business connection of a non-resident in British India. Every legislature has power to legislate and enact laws in such a way that its revenue laws are not defeated by a subterfuge, and the impugned words in the section embody a legislation of that kind, I cannot subscribe to the view that the nexus conferring jurisdiction to legislate in the case in question is illusory, and that there is no connection of this country with the interest payable to a foreigner outside India.

62. Having examined the arguments on the question of vires without reference to the facts of this case, it is now convenient to examine the question referred to the High Court on the facts of this particular case. A sum of ₹ 2,59,726/- is involved in this question. The facts are:

> A company styled the Provident Investment Co., Ltd., was incorporated in British India in 1927 with headquarters in Bombay, with 4966 shares of ₹ 1000/- each. It is practically a one man company as all the shares are either owned by the Gwalior Durbar or its nominees. In 1933 the Durbar advanced to this company a loan of rupees fifty lakhs on the security of the first mortgage debentures of an equal nominal value. The loan was advanced at Gwalior. The interest was payable there and the debentures also were deposited there. But admittedly the company brought the borrowed money to British India and utilized it for the purposes of its business in British India. The interest on the loan received by the Durbar for the year amounted to ₹ 2,59,726/-. The interest was receivable and actually received at Gwalior.
>
> On the above statement of facts, it is difficult to dissociate the loan advanced at Gwalior from the security of debentures on property that exists in British India, The loan was a secured loan, and the giving of security cannot be treated as a different transaction from the advancing of the loan itself. The transaction in substance was a transaction of loan in

British India.

63. In the High Court, reliance was placed for the assessability of this income on the decision of their Lordships of the Privy Council in *Patiala State Bank v. The Commissioner of Income Tax, Bombay A.I.R. (30) 1943 P.C. 181(Suupra).* That decision, however, only decided that the provisions of the section of the Government Trading Taxation Act III [3] of 1926, were attracted to income earned in British India, even though the trading operations were conducted outside British India. That decision does not meet the whole of the argument of Sir Jamshedji Kanga in this case.

64. The learned Advocate-General attempted to support the answer given by the High Court on question 1 on two other grounds. He urged that the loan of fifty lakhs advanced to the Provident Investment Company was connected with the money-lending operations of the Durbar, and that it directly fell within the purview of Act III [3] of 1926. The Assistant Commissioner of Income Tax, in deciding the appeal, did record a finding to that effect. But the learned Commissioner, in his statement of the case to the High Court, did not advert to that finding and agreed that the question as framed by the appellant be referred to the High Court. In my view, no question of law could arise or could have been referred to the High Court on the finding of fact that the loan was a part of the money-lending operations of the Durbar and the income arose by reason of the Durbar's business connection in British India. The High Court could have declined to answer the question of law referred to it on the ground that, on the finding of fact recorded by the Assistant Commissioner of Income Tax, no question of law arose. It seems to me that the statement of facts on which the question was framed by the Commissioner is not open to question at this stage and as remarked by Sir Jamshedji Kanga, this argument amounts to laying down a thin ice for the Court for easy skating. The objection raised by the learned Counsel that the line of argument adopted by the learned Advocate-General is not open in this Court has force. The proper stage to raise the point was when the Commissioner of Income Tax called upon the parties to raise objections to the statement of facts drawn up by him or at the stage of appeal in the High Court. I had the advantage of perusing the judgment just delivered by my brother, Sir Fazl Ali, and though I have considerable hesitation in disagreeing with anything that he says, I regret I have not been able to subscribe to his line of thought on this aspect of the case. My learned brother, Patanjali Sastri, gave me the privilege of perusing his judgment which has just been delivered. It took me considerable time to make up my mind before I decided to express a different opinion than his. It is unfortunate that on the first question I have to disagree with him. For the reasons given above, I consider that the High Court returned a correct answer to the first question.

65. The second question referred to the High Court was whether the sum of ₹ 3,57,112/- received by the Durbar out of the managing agency commission paid by the Tata Iron and Steel Co. Ltd., to Tata Sons Ltd., is assessable under the provisions of the Income Tax Act read with the Government Trading Taxation Act III [3] of 1926. This question arose on the following statement of facts:

> The late Mr. F.E. Dinshaw, who was the agent of the Durbar for its money-lending operations, entered into an agreement with Tata Iron and Steel Co., Ltd., to finance the company, at a time when it was badly in need of funds, up to a total of one crore rupees, on certain terms and conditions referred to in the agreement. The interest was 11/2% over

the Imperial Bank of India rate for the time being but with a minimum of 61/2 % per annum. In addition to the interest, it was provided that Messrs. Tata & Sons Ltd., who were the agents of the Tata Iron and Steel Co. Ltd., should give to Mr. Dinshaw a share of six annas in the rupee on the commission and other remuneration which, as agents, they were entitled to recover from the company. It was specifically provided that such share, should continue throughout the unexpired period of the agency whether any monies were due to the lender by the company or not. Mr. Dinshaw used the Durbar money for making this loan and, out of the six anna share of the commission received by him, passed a four anna share to the Durbar and kept two anna share to himself. When the loan came to the notice of the. Council of Regency, they objected to it on the ground that it was against the provisions in the will of the late Maharaja. Luckily, the Tata Iron and Steel Co. Ltd., itself wanted to pay off the loan at that time, and Mr. Dinshaw agreed to the termination of the loan, provided, as consideration therefor, the Tata Sons Ltd. agreed to give four anna share in the commission as managing agents of the Tata Iron & Steel Co., Ltd. Accordingly, the loan was paid off. Fresh agreements were entered into on 29th July 1927, according to which the share in the commission as managing agents, payable by Tata Sons Ltd., was reduced to four annas in the rupee. The amount payable to the Durbar was correspondingly reduced from four to two annas. The Durbar continued to receive two anna share of the commission from Mr. Dinshaw, and, during the assessment year, the sum received by the Durbar according to the two anna share amounted to ₹ 3,57,112/-.

66. On the above statement of facts, it is quite clear that it was by reason of the payment . of the loan to Tatas out of Gwalior Durbar's money, by Mr. Dinshaw that the Durbar became not only entitled to interest on the principal sum advanced but also to commission, and this commission was to continue even if the loan was discharged. "Whether Mr. Dinshaw disclosed the name of his principal or not, the fact remains that he, in the capacity of an agent, entered into this transaction, and it was on account of this transaction that he earned the commission from the Tatas out of which he gave a four-anna share to his principal. Even if he was acting against the directions of the principal in making this loan, he would still be liable under the provisions of Section 216, Contract Act, to pay to the principal all the profits that he would earn on the loan transaction, whether in the nature of. interest or commission. As above stated, the discharge of the loan did not, in any way, affect the earning of the commission, because, under the original agreement under which the loan was advanced this payment was to continue even in the event of the loan being repaid. The subsequent agreement entered into by Mr. Dinshaw with the Tatas after the repayment of the loan, was only a modification of the original one, and did not discharge it. The effect of the subsequent agreement was only to reduce the amount of the commission that Dinshaw was entitled to or which he had to pay to the Durbar. This was not in the nature of an agreement arrived at independently of the terms of the original document and completely dissociated from it. It was not in the nature of a new transaction or deal of Mr. Dinshaw with the Tatas. Mr. Dinshaw entered into this agreement in the same capacity in which he entered into the original one. His position was that of an agent of the Durbar for its financial operations in its inception and that relationship was not in any way altered or changed when the subsequent agreement was made. The result therefore is that the earning of the commission by the Durbar was not in any way dissociated from or independent of its money-lending operations.

The agent who paid this commission to the Durbar, was employed by it for those operations, and any commission earned subsequent to the termination of the agreement still remained the income earned out of those operations and cannot be said to be income earned from any other source. In these circumstances, I am of the opinion that the High Court returned a correct answer to question 2.

67. It was urged before this Court that when the loan was repaid, the relationship of borrower and lender between the Tatas and Mr. Dinshaw as an agent for an undisclosed principal ceased, and what the agent got later from the Tatas by way of commission was income earned independently of his connection with the Durbar as its agent for financial or money-lending operations in India. It was suggested that this commission may have been earned by the agent on account of his own misconduct or misbehaviour in that capacity, but it could not be said to be part of the money-lending operations of the Durbar conducted by him. This argument seems to be devoid of force, in view of the clear terms of the original agreement, under which commission was payable even if the loan was terminated. The period during which the commission was payable was the period of the managing agency which the Tata Sons Ltd. had obtained from Tata Iron & Steel Co. Ltd. The commission was payable in India, and the income thus arose in this court try and could be taxed, because it was part and parcel of the money-lending operations of the Durbar. It may be pointed out that the Durbar has been taking up different positions in respect of this matter on different occasions. Before the Commissioner of Income Tax, it took up the attitude that the commission was payable by Tata Sons Ltd. to Mr. Dinshaw, because he agreed to cancel the loan transaction. Before the High Court, it was urged that by making the advance, Mr. Dinshaw committed a breach of duty as agent of the Durbar and that when the loan was terminated the payment of two annar commission to the Durbar was payment in the nature of compensation or damages for breach of duty as agent. This suggestion was rightly described as 'fantastic' by Chagla J., as the agreement on the record did not support it. The facts of the case show that Mr. Dinshaw, in the capacity of an agent, advanced the Durbar's money to Tata Sons Ltd. on certain terms, and one of the terms of the advance wa3 the payment of the commission by them to him, part of which he, in his own turn, agreed to pay to the Durbar. So far as the Durbar was concerned over and above the interest that it earned on its loan, by reason of Dinshaw's deal with Tatas, it also became entitled to receive a part of the agency commission. But it became entitled to it, because of the use of the Durbar's money in the money-lending transaction. Independently of the loan transaction, the Durbar would have been entitled neither to the interest nor to the commission. That being so, there is no substance in the contention raised on behalf of the Durbar that the income arising or accruing to it by way of the commission above-mentioned is not connected with its money-lending operations. It has been rightly held by the High Court to be within the clear provisions of the Government Trading Taxation Act, III [3] of 1926.

68. The third, fourth and fifth questions were treated on the same footing by the Commissioner of Income Tax, and by the High Court. I however consider that question 3 can more appositely be dealt with independently of questions 4 and 5.

69. Question 3 is in these terms:

> Whether the income derived from the property situated in Bombay and other places in British India purchased by the Durbar at execution sales in enforcement of mortgage decrees against mortgagors who had failed to pay the amounts advanced to them in course

> of the money-lending business of the Durbar, is income arising in connection with the said business within the meaning of Section 2, Government Trading Taxation Act, and whether the income arising from such property is liable to assessment under the provisions of the Income tax Act read with the Government Trading Taxation Act III [3] of 1926.

The facts on which this question has been framed are these:

> During the course of the Durbar's money-lending transactions in Bombay and elsewhere, some of the mortgagors made default in payment of the principal and interest and the Durbar filed suits to enforce the mortgages and obtained decrees for the sale of the mortgage properties. The mortgaged properties which are all in British India were put up for sale in execution of these decrees and were purchased in court auctions by the Durbar and the Durbar still continues to own these properties.

70. On the facts stated, it is difficult to reach the conclusion arrived at by the High Court to the effect that the case is covered by the observations made by Sir John Beaumont in the Patiala State Bank case A.I.R. (30) 1943 P.C. 181 with reference to the Mussoorie properties held by that Bank. These observations were to the following effect:

> Whether the property situate at Mussoorie taken over by the Patiala State Bank from its debtor, a subject of the Patiala State, in part satisfaction of a loan advanced to him, is property occupied in British India for the purposes of its trade or business in British India within the meaning of Section 2, Government Trading Taxation Act and whether all income arising from such property is liable to assessment by virtue of the provisions of the said Act? Substantially I think the answer to this question must be in the affirmative, but I think that the property, which has been taken over in respect of a bad debt of the banking business, is not property occupied in British India for the purposes of the business, but the income derived from such property is income arising in connexion with such business and in that sense falls to be taxed.

These observations may be apposite in the case of a banking institution which uses all its income in connexion with its banking business, but they have no application to the case of a Dominion Government or of the Government of a State whose business is not banking, though one of its activities may be money-lending. It was a question of fact that had to be determined in this case whether the properties after they were purchased, or their income was still a part of the assets used by the Durbar in the money-lending business. If it was found that the income of these properties was still being used in money-lending operations or any operations connected with the money-lending business, the answer to the question would obviously be against the Durbar. But in the absence of that finding, and in the absence of any statement by the Commissioner to that effect in his reference order, it is difficult to presume that these properties are still part of the assets of the Durbar employed in-money-lending operations or that their income has ever been used to any such operations. Chagla J. in dealing with this question, made the following observation:

Ordinarily to my mind these properties would continue to remain in the money-lending business as assets of that business standing to the credit of that business. It was for the assessee to show and to establish that he did something whereby he withdrew these properties from the money-lending business and constituted them an independent investment. There is nothing whatever on the record to establish that position.

With great respect to the learned Judge, it has to be observed that no such presumption can be raised under any of the provisions of law against the assessee. It may be that in determining the question of fact, under certain circumstances, an inference would be drawn under the provisions of Section 114, Evidence Act, one way or the other. But no onus can be said to rest on the assessee to prove that he did some unequivocal act by which he withdrew these properties from his money-lending business and constituted them an independent investment. The decision of the Bombay High Court in *Himatlal Motilal and Ramanlal Lallubhai v. The Commissioner of Income Tax, Bombay* [15]is authority for the proposition that where in part satisfaction of a mortgage debt, the mortgagee purchases mortgage-property and sells it later on, he cannot claim the loss as an allowable business loss in the loan transaction. It was held that the loss was loss of capital invested in the purchase of the property. In that case, it was observed that once the properties were purchased by the moneylender, they became his absolute ownership. Any subsequent loss arising on re-sale of these properties was loss on capital invested in purchase of property and not invested in the money-lending business. With great respect, I am in agreement with the observations stated above. Mere ownership of properties even if purchased from a source which originally was employed in the money-lending business, does not automatically make such properties part of such business, in the absence of any finding that the income of these properties was being used in that business or that those properties were subsequently treated as stock-in-trade of that business except perhaps in the case/of banking institutions. In this case it was asserted before the Income Tax authorities that the properties were purchased in lieu of the debt, between the years 1924-35, and since their acquisition, the money-lending business ceased, that no new loan was advanced after the year 1930 and that the income was not used for money-lending purposes. This assertion of fact was not controverted by the Income Tax authorities. In such a situation, it must be accepted as correct. That being so, no presumption could be raised that these properties or their income was part of the money-lending operations of the Durbar.

71. I have already said that the observations made in the Patiala State Bank case A.I.R. (30) 1943 P.C. 181, lend no support to the proposition enunciated by the High Court on this question. Reference was also made to the case of *S.A.S.S. Chellappa Chettiar v. The Commissioner of Income tax, Madras* [16]S.B. In that case, the assessee carried on business as a money-lender in India, Burma and the Federated Malay States. Owing to certain of his constituents in Burma being unable to meet their obligations, the assessee received in repayment of loans made by him to them, agricultural lands in Burma. The money which had been lent to those constituents had originally been borrowed by the assessee for the purpose of his money-lending business. The

assessee admittedly carried on only one business for the year of assessment. He received the said lands in repayment of the loans made by him not of his own volition but of necessity, there being no other method of getting payment, and therefore those lands came into his possession directly in the course of his money-lending business and represented the capital originally borrowed. The assessee did not retain and cultivate those lands of his own inclination, but, owing to the fall in the price of agricultural lands, he was in possession and preserved his capital in the only way open to him pending a return of agricultural economic conditions which would make it possible for him to realise, if not all, at least some of the capital originally lent to the borrowers, the previous owners of the said lands. On these facts, it was held that he was entitled to a deduction of the interest paid by him on so much of the capital borrowed by him for business purposes as was represented by the agricultural lands, under Section 10(2)(iii), Income Tax Act, 1922.

72. The facts of this ease bear no analogy to the facts of the present case. My brother Patanjali Sastri, who in that case represented the Commissioner of Income Tax, argued therein that the Commissioner did not question the proposition that the lands formed the assets of the business. In the present case, that is a matter that has to be determined as a question of fact and not as a matter of law. On the question of fact all that the Commissioner has stated is that the Durbar owns these properties. He has not proceeded further to say that the Durbar is still employing these properties as assets for its money-lending business. On this statement, in my opinion, the High Court was not justified in answering the question framed, in favour of the Commissioner of Income Tax. Mere purchase of property out of the capital once employed in money-lending does not necessarily make that property part of the money-lending business of a person, without further proof of the treatment of that property as part of the business. The result therefore is that question 3 should be answered in favour of the Durbar, and the decision of the High Court on this point reversed.

73. Questions 4 and 5 are in these terms:

> (4) Whether the dividend of ₹ 1,88,030/- received by the Durbar from Sir Shapurji Bharucha Mills Ltd., is taxable in the circumstances of this case under the provisions of the Income Tax Act read with the Government Trading Taxation Act III [3] of 1926.
>
> (5) Whether the dividend of ₹ 83,447/- received by the Durbar from the C.P. Cement Co. Ltd., is taxable in the circumstances of this case under the provisions of the Income Tax Act read with the Government Trading Taxation Act III [3] of 1926.

The High Court held that the income derived from the dividends on these shares was income arising in connexion with the money-lending business of the Durbar and, in that sense, falls to be taxed. The answer given by the High Court is supported by the findings of fact recorded by the Assistant Commissioner of Income Tax. Those are to the following effect:

> The Durbar was doing money-lending business in Bombay, and as such advanced money to the said companies. In course of time, they were financially involved and were unable to meet their liability. A scheme of re organisations was made, under which the Durbar gave up a considerable portion of their claim and took shares for the balance thereof. The

Durbar gave up nearly 75 lakhs in the case of Sir Shapurji Bharucha Mills Ltd. and took 75,212 shares of the face value of ₹ 100/- , in satisfaction of the debt of ₹ 75,21,200/-. Similarly, owing to the failure of the Central Provinces Portland Cement Co. Ltd., the Durbar- accepted preference shares in the new Company named the C.P. Cement Company in satisfaction of the amount due on the security of the debentures held in the C.P. Portland Cement Co. Ltd. Both the transactions, Mr. Dinshaw contends, amount to an investment of money in shares of the Companies. The shares, in his opinion, should be treated as part of the investments of the Durbar, and when money lent was converted into shares in joint stock companies, it ceased to be part of the money-lending business. It is contended that the income from the original loan was income earned from business, but when shares were taken in satisfaction of the loan, the loan ceased to exist, and the shares became an investment of the Durbar on the same footing as any other investment. Hence, income arising from such investment should not be included for purposes of supertax. From the record of this case, I find that this question was raised before the Assistant Commissioner of Income Tax during the assessment for the Income Tax year 36-37, and was decided against the Durbar. This decision was upheld by an order of the Commissioner of Income Tax passed on 16th June 1938. He too definitely held that dividends amounting to ₹ 4,91,104/- received in respect of 75,212 shares in the Sir Shapurji Bharucha Mills Ltd. and 4553 preference shares in C.P. Cement Co. should be regarded as income from assets pertaining to the money-lending business, as they were taken up in lieu of money advanced in the course of that business. The position of such income and dividends has not changed since then. In view of the fact that this view was acquiesced in by the Durbar when the Assistant Commissioner sent the papers to the Commissioner for reference to the High Court, the Assistant Commissioner is justified in treating the total amount of dividends received not as income from investment but as income from business falling under Government Trading Taxation Act.

From the conduct of the Durbar, the Assistant Commissioner of Income Tax was entitled to draw the inference that it acquiesced in the finding which was to the effect that these shares and their income were still part of the stock-in-trade used by the Durbar in its money-lending operations. There is therefore material to justify the finding, and the High Court, in answering the question, was bound by it. That being so, the income charged clearly fell within the provisions of the Government Trading Taxation Act, III [3] of 1926. Sir Jamshedji Kanga, the learned Counsel for the Durbar, urged that the investment in these shares by the Durbar stood on the same footing as the Immovable properties purchased by it, and dealt with in question No. 3. But this contention is not tenable because the statement of facts in the two cases is not the same. In the case of Immovable properties the statement ends by saying that the Durbar owns them, while in the case of shares it proceeds further and says that the dividends on these shares are still used in Durbar's money-lending operations.

74. The only question that now remains to be dealt with is question No. 6, which has been framed as follows:

> (6) Whether the Durbar is entitled under the provisions of the Income Tax Act, read with the Government Trading Taxation Act III of 1926 to a refund under Section 48(1) or a set-off under Section 18(5), Income Tax Act of the Income Tax alleged to be deemed under Section 49-B thereof to have been paid by it as a shareholder in respect of the dividend received by it during the previous year.

The facts as stated in the reference are:

> The Durbar invested large sums in shares in various public companies besides the shares in the two companies referred to in questions Nos. 4 and 5. The dividends received during the year from these companies were ₹ 11,52,359/-. As these were treated to be income from investments not coming within the scope of the Government Trading Taxation Act, the Income Tax Officer did not include these in the assessment. The Durbar however claimed that it was entitled to a set-off or refund of Income Tax deemed under the provisions of Section 49-B to have been paid by it.

Section 49B as it stood in the year 1939 provides:

> Where a shareholder has received a dividend from a company which has paid Income Tax imposed in British India or elsewhere, he shall be deemed, in respect of such dividend, himself to have paid the Income Tax (exclusive of super-tax) paid by the company on so much of the dividend as bears to the whole the same proportion as the amount of income on which the company has paid, such Income Tax bears to the whole income of the company.

This section in plain terms says that where a. company has paid or distributed to a shareholder any dividends, then such shareholder shall be deemed in respect of such dividends himself to have paid Income Tax at the rate applicable to the total income of the company for the financial year in which the dividend has been paid, credited or distributed. In other words, though the Income Tax has been paid by the company, yet, artificially, by the operation of this section, this Income Tax, to the extent that it relates to the dividend received by the shareholder, is considered to have been paid by such shareholder. This affords no assistance to the Durbar as regards its claims to refund. It substitutes the share-holder for the company in respect of Income Tax paid by it on the dividends distributed. In order to entitle the Durbar to a refund of Income Tax paid on such dividends, the case must fall within the ambit of Section 48 of the Act, which provides:

> If any individual, Hindu undivided family, company, local authority, firm or other association of persons, or any partner of a firm or member of an association, individually satisfies the Income Tax officer or other authorities appointed by the Central Government in this behalf that the amount of tax paid by him or on his behalf or treated as paid on his behalf for any year exceeds the amount with which he is properly chargeable under this

Act for that year, he shall be entitled to a refund of any such excess.

The learned Judges of the High Court, while dealing with this question, made reference to Section 49-B as amended after the year 1939. The amended section provides that only a person specified in Section 3 and who is a share-holder of a company assessed to Income Tax in British India of elsewhere is entitled to the benefit of the section. On the language of the amended section, it was held that the Durbar, though undoubtedly a share-holder of a company assessed to tax, was not a person specified in Section 3, and, therefore, was disentitled from claiming the refund. This view of the High Court cannot be sustained because the section as it stood before its amendment did not say that "a person specified in Section 3 of the Act" alone was entitled to the benefit of refund. That section simply made reference to a shareholder who had received a dividend from a company. Such a shareholder was deemed in respect of dividends to have paid the Income Tax himself. The error committed in the High Court decision however does not affect the merits of the decision in any manner because, as already stated, Section 49-B is not decisive of the point. No refund is permissible under the law unless the claim is brought under Section 48 of the Act. That section, as it stood in the year 1939, entitled certain persons mentioned therein to the benefit of refund. The question therefore for decision is whether the Gwalior Durbar as a "State" comes within the category of persons mentioned in Section 48, i.e., whether the Durbar is an individual, a company or local authority or a firm or other association of persons. The learned Judges of the High Court held that the Gwalior Durbar being a State, is outside the description of persons mentioned in the above section. This answer, in my opinion, is a correct one, and nothing that Sir Jamshedji Kanga said in his arguments justifies the taking of a different view. As I visualize the situation, it is this. The Gwalior Durbar enjoys a double status. It is the Government of a State and the ruler of the State represents it. As a sovereign State, it is outside the Income Tax Act. In that capacity, it is neither an individual nor a company, nor an association of persons. The ruler as an individual is not the State, though he represents it. If he in his individual capacity earns income in British India, he as such is within the ambit of the Act. But the Government of a Dominion or of an Indian State, if it earns income in India, is outside the contemplation of the Act. Such a Government cannot be described or styled as an individual. By reason of the Government Trading Taxation Act, III [3] of 1926, such a Government in one capacity alone, i.e., when trading, has been given the status of a company, for purposes of the Indian Income Tax Act. In the capacity which it has acquired by force of the statute, it comes within one of the categories of persons mentioned in Section 48 of the Act. But in that capacity alone and within the limitations and conditions mentioned in the section, it is deemed to be a company. If any dividends were received in connection with trading operations carried on by the Durbar, then, undoubtedly it would be entitled to a refund of Income Tax on these dividends. The dividends on shares of companies dealt with in questions 4 and 5 would fall in this class, and the Durbar would be entitled to refund in respect of them. But the dividends involved in question 6 are wholly independent of the trading operations of the Durbar. These

represent the income earned out of investments of the Government of Gwalior in its capacity as a State and are not chargeable to tax under any of the provisions of the Act. In the limited status of a company, it cannot claim this refund, as it bears no relation to its money-lending operations. It was however urged by Sir Jamshedji Kanga that the State of Gwalior is an individual and falls within that word used in Section 48, Income Tax Act. It is difficult to hold that the Government of a State is an individual, The word 'individual' conveys a single person, usually a man or woman. It may be that by fiction of law, certain artificial persons may be described as individuals, but the Government of a State, even though represented by the ruler for the time being, cannot appositely be described as an individual. It is certainly a corporation sole, but corporations have been separately mentioned in the section itself. Firms, companies, associations of persons, undivided families, are categories apart from one another stated in the section, and it could not be the intention of the legislature to bring within the purview of the word 'individual' corporations or corporations sole. Such an interpretation of the word 'individual' would conflict with the language employed in the Government Trading Taxation Act. Therein the trading State was given the status of a company for Income Tax purposes and the status of an individual for other taxes. There would have been no necessity to confer a new status on a person who already fell within one class of persons mentioned in the Income Tax Act. In common parlance, the Government of a country can hardly be described as an individual. In my opinion, therefore, the learned Judges of the High Court rightly held that the Gwalior Durbar in its status as the Government of a State, did not fall within the ambit of Section 48, Income Tax Act, and was not entitled to a refund.

75. It was, however, urged that even persons who are not chargeable to Income Tax under Section 4 of the Act, can claim a refund under Section 48. By way of illustration, it was urged that trustees of charitable institutions are not liable to Income Tax on the income of the charity; yet they can claim a refund of Income Tax under Section 48 read with Section 49-B. The analogy of persons whose income is exempt from the Income Tax Act was also pressed in support of the argument. Reference was also made to the case of persons who received agricultural income, which was not taxable, and yet were entitled to claim refund on dividends paid to them on shares held by them in certain companies. In my opinion, the analogies mentioned above are not relevant to the decision of the question discussed above. The cases of charitable institutions, of agricultural income, of persons whose income is not liable to Income Tax, stand on an entirely different footing. All of them fall within the category of persons mentioned in Ss, 4 and 48 of the Act. In their case, however, the Act allows certain exemptions. It is by force of the statute that those incomes are exempt from tax. It is not independently of the statute that they are so exempt. This is the distinction between the two cases, and shows the fallacy underlying the contention of the learned Counsel. But for the exemptions given in the Act, all such persons would be within the category of persons mentioned in Section 4 and would be chargeable to Income Tax. As the Gwalior Durbar however falls outside the contemplation of the Act and the categories of persons mentioned in Sections 4 and 48 of the Act, it cannot claim the benefit of refund of Income Tax on the dividends. It must, therefore, be held that the question was correctly answered by the High Court.

76. The result, therefore, is that this appeal fails except on one point, i.e., question 3. My answer on that question is in favour of the appellant, while on the other questions the answer is the same as given by the High Court. To this limited extent the appeal is allowed.

B.K. Mukherjea, J.

77. I agree with my Lord the Chief Justice that this appeal should be allowed in part, only to this extent, that our answer to question 3 formulated by the Income Tax Commissioner of Bombay should be given in the negative and in favour of the assessee, and that in respect to all the other points, the judgment appealed against should stand confirmed.

78. As regards questions 2 to 6, the facts have been dealt with at great length by my Lord the Chief Justice in his judgment and as I substantially concur in the reasons given by him, there is nothing material which I can profitably add. I desire, however, to say a few words expressing my own views on the points raised in connection with question 1 which is by far the most important question in this case and upon which the views of all my learned brothers have not been altogether uniform.

79. The circumstances giving rise to question 1 are very short. The Gwalior Durbar had admittedly been doing money-lending business in British India on a fairly extensive scale. Some time in 1927, a company known as Provident Investment Co., Ltd. was incorporated in British India with its headquarters in Bombay and almost all the shares of this company were held by the Gwalior Durbar or its nominees. In 1933, the Durbar advanced, at Gwalior, a loan of ₹ 50/- lakhs to the said company on the security of its first mortgage debentures of the face value of the same amount. The debentures were deposited at Gwalior and interest on the loan was also payable at that place. The interest received by the Durbar from the said loan during the year 1938-39 amounted to ₹ 2,59,726/-. This interest, as said above, was paid at Gwalior which is outside British India but it was in respect of money lent at interest and brought into British India. The question is whether this sum of money earned by the Gwalior Durbar as interest on money lent could be assessed to Income Tax, under the provisions of the Income Tax Act read with the Government Trading Taxation Act of 1926?

80. This question was answered by the Bombay High Court adversely to the contentions of the assessee and this money was held to be taxable in the hands of the Gwalior Durbar under the provisions of the Income Tax Act which are attracted by Section 2, Government Trading Taxation Act of 1926.

81. The propriety of this decision was vigorously challenged by Sir Jamshedji Kanga who appeared on behalf of the appellant, and he contended in the first place that as the sum of ₹ 50/- lakhs was advanced by his client to the Provident Investment Co., Ltd. at Gwalior which is outside British India, and as the interest due on the same was also received at Gwalior, it was not income arising in British India and the provisions of the Government Trading Taxation Act could not be applied to a case like this. The contention is that the language of Section 2(1) of the Act confines it to income actually "arising" in British India and does not include an income which might be "deemed to arise" in British India within the extended meaning of that expression given by the Income Tax Act. I do not think that this contention can be accepted as sound. Section 2,

Government Trading Taxation Act, nowhere speaks of income arising in British India. The language of Clause (a) of Sub-section (1) of Section 2 shows that no matter where the Dominion Government carries on its trade or business or earns profits thereof, its liability to assessment to Income Tax in respect of such income would be the same as that of a company under the Income Tax Act doing business and. earning profits in an identical manner. This is clear from the words "in the same manner and to the same extent" occurring in Clause (a) and I am unable to agree with Sir Jamshedji Kanga that these expressions refer only to the machinery employed for purposes of assessment or to the rates at which a company could be taxed. In respect to matters coming under the Government Trading Taxation Act, a Dominion Government occupies the same position as a company and it is liable to be taxed in the same manner as a company is liable under the Income Tax Act.

82. In the case before us, the business in respect to the profits of which the Gwalior Durbar has been assessed to Income Tax, is money-lending business, and it was undoubtedly in connexion with this business that a sum of ₹ 50/- lakhs was advanced to the Provident Investment Co., Ltd. It is true that the money was advanced at Gwalior and the interest payable on it was also received at that place but nevertheless it would come within the purview of the clause added to Section 42(1), Income Tax Act, by the amendment of 1939 which makes a company liable to be taxed for income accruing or arising "from any money lent at interest and brought into British India in cash or in kind,"

83. Sir Jamshedji concedes that if this clause applies, his client would have no case on this point, and the position that he takes up is this, that even if the operation of this clause is not excluded by the language of Section 2, Government Trading Taxation Act, the clause itself must be hold to be inoperative as being a piece of extraterritorial legislation which is ultra vires the Indian Legislature.

84. Now, as a general principle, it need not be disputed that States can legislate effectively only for their own territories. But occasions do arise when for purposes of taxation, custom, defence or other matters and even for proper enforcement of its own laws, a State makes legislative provisions which are designed to operate beyond its territories. In the case of a Sovereign Legislature like the British Parliament, the question of extra-territoriality of any enactment can never be raised in the Municipal Courts as a ground for impugning its validity. The legislation may offend the rules of International Law and hence may not be recognised by foreign Courts or there may be practical difficulties in the way of enforcing the extraterritorial provisions of a taxing statute; but these are questions of policy with which the domestic tribunals are not concerned vide *Mortensen v. Peters (1906) 8 F. (J.C.) 93, 101(Supra)*. So far as a subordinate or non-Sovereign Legislature is concerned, its powers must certainly be determined with reference to the authority granted to it by the parent Legislature and if there are territorial limitations specified in-the very Act which created it, these limitations cannot be disregarded. But when there are-no such limitations, the trend of modern decisions is to regard the subordinate Legislatures as being vested with as much plenary powers as the Sovereign Parliament itself. The view expressed in *Macleod v. Attorney-General for New South Wales*[18] that subordinate Legislatures should not be held "to possess extra-territorial jurisdiction unless it is conferred upon them expressly or by necessary implication" is no longer a sound doctrine. With regard to the Dominion Parliament of Canada the law was thus laid down by Lord Macmillan in *Croft v. Dunphy A.I.R. (20) 1933 P.C. 16* (Supra)where his Lordship referred to the cases of *The Queen v.*

Burah [19]and *Hodge v. The Queen*[20] and observed as follows:

> Once it is found that a particular topic of legislation is among those upon which the Dominion Parliament may competently legislate as being for the peace, order and good government of Canada or as being one of the specified subjects enumerated in Section 91, British North America Act, their Lordships see no reason to restrict the permitted scope of such legislation by any further consideration than is applicable to the legislation of a fully Sovereign State.

85. The position undoubtedly has been made clear with regard to Dominion Parliaments by Section 3, Statute of Westminster 1931, which provides that "the Parliament of a Dominion has full power to make laws having extra-territorial operation." In the very recent case of *British Columbia Electric Railway Co. Ltd v. The King A.I.R. (33) 1946 P.C. 180* (Supra)decided by the Judicial Committee of the Privy Council, a question was raised as to whether Section 9-B, Sub-section (2)(a) which was added to the Income War Tax Act 1927, and which imposed an Income Tax of 5 per cent. upon all non-residents in respect of all dividends received from Canadian debtors, irrespective of the currency in which the payment was made, was ultra vires the Canadian Legislature, by reason of extraterritoriality. The question was answered in the negative and Viscount Simon, who delivered the judgment, quoted with approval the following passages from the judgment of Rand J. of the Supreme Court of Canada:

> The power of the Dominion to tax is to be interpreted as being as plenary and as ample within the limits prescribed...as the Imperial Parliament in the plenitude of its power possessed or could bestow : *Hodge v. The Queen (1883) 9 A.C. 117(Suupra).* But there is obviously a distinction between, the standing of legislative enactments by a Sovereign State within its boundaries and beyond them. In an effective sense a declaration by such a Legislature that it imposes a tax upon a citizen of a foreign country toward whom there is no internationally recognized bond or relation, is, beyond the territories of that State, a futile act, and it is futile for the reason that beyond them it is incapable of enforcement. Within the State however it is an obligatory rule to be enforced whenever enforcement is feasible.... That the enactment of Section 9-B is in exercise of taxing power within the jurisdiction does not, we think, admit of any doubt. There is admitted jurisdiction over an act essential to the subject-matter, i.e., the act of performance of an obligation; and these, taken with the language used, satisfy the taxation criteria. Legislation so enacted will be effective in and must be enforced by the Courts of this country.

86. Even though the Statute of Westminster was not applicable to India, it was held by this Court in *Governor-General in Council v. Raleigh Investment Co. Ltd. A.I.R. (31) 1944 P.C. 51* (Supra)that the position and powers of the Indian Legislature were substantially the same. The fact that this point was left undecided by the Privy Council does not in my opinion detract in any way from the weight which is to be attached to a clear pronouncement of this Court. This Court further pointed out in Raleigh's case A.I.R. (31) 1944 P.C. 61 that Section 99, Government of India Act, 1935, was deliberately couched in language different from that employed in Section 65 of the earlier Act of 1915; and it was held that Sub-section (1) of Section 99 did not in terms exclude extraterritorial legislation, nor did Sub-section (2) specify exhaustively the subjects upon

which such legislation was permissible. The position has now been made clear by repealing Sub-section (2) of Section 99 and inserting the words "including laws having extra-territorial operation in Sub-section (1)." It cannot be argued, therefore, that a statute passed by the Indian Legislature must be held to be invalid because there are extra-territorial elements in it.

87. Sir Jamshedji argues that even assuming that Section 99 does not in terms forbid extra-territorial legislation, the provision of the Income Tax Act, which is challenged here, is not a legislative provision which really relates to a subject-matter enumerated in Schedule 7, Government of India Act. Tax on income other than agricultural income is undoubtedly a subject upon which the Federal Legislature is competent to legislate, but what is said is, that the new clause in Section 42(1), Income Tax Act, goes against the very conception of Income Tax as it is recognised in the legislative practice in England. It is argued that the cardinal idea implicit in an Income Tax is that there must be a territorial connexion or nexus between the State imposing the tax and the person to be taxed, and this nexus being totally absent in the present ease, the impugned legislative provision is ultra vires the Indian Legislature The argument is seemingly attractive and it is necessary that it should be examined carefully.

88. I am not unmindful of the observations of *Lord Macmillan in Croft v. Dunphy A.I.R. (20) 1933 P.C. 16(Supra)*, that when a power is conferred to legislate on a particular topic it is important in determining the scope of the power to have regard to what is ordinarily treated as embraced within that topic in legislative practice and particularly in the legislative practice of the State which has conferred the power. The legislative practice in this country at the time when the Government of India Act was passed would, I think, afford very little assistance in this matter. In fact, in matters relating to taxing of non-residents or of foreign income, the Indian Legislature departed from their old policy only from the year 1939, which is much after the Government of India Act was passed. Whether the legislative practice in England is at all helpful in this connexion, I will consider presently.

89. Now, Section 42(1), Income Tax Act, as it stood before the amendment of 1939, applied to income arising through or from any business connexion or property in British India. Possibly with the object of bringing within the scope of taxation all income accruing primarily from British Indian sources the amendment was introduced in 1939 and income or profits 'arising from any asset or source of income in British India' or 'through or from any money lent at interest and brought in, British India' was brought within the net of taxation. There were various other substantial changes in the Income Tax law made by the amending Act of 1939 and two of them deserve special notice for our present purpose. Section 4(1)(c), Income Tax Act, as it stands after the amendment, provides that the total income of a person not resident in British India should include all income, profits and gains from whatever source derived, which accrue or arise or are 'deemed to accrue or arise' to him in British India during the previous year: Explanation 3 attached to Sub-section (1) of Section 4 then lays down that a dividend paid without British India shall be 'deemed' to be income accruing or arising in British India to the extent to which it has been paid out of profits subjected to Income Tax in British India. The other change material for our present purpose is to be found in Section 4(1)(b)(ii) read with Section 4A(c) of the Act. Under Section 4(1)(b)(ii), if a person is resident in British India, his total income shall include all income, profits and gains which accrue or arise to him without British India. The second part of Section 4A(c) provides that for purposes of the Act, a company is resident in India in any year if its income arising in British India in that year exceeds its income arising without British India in

that year. The validity of both these sets of provisions was called into question on grounds of extra-territoriality in two leading cases, both of which came up before this Court in appeal and ultimately went up to the Judicial Committee and in both these cases the validity of the impugned provisions was upheld. In the case of *Governor-General in Council v. The Raleigh Investment Co. Ltd. A.I.R. (31) 1944 F. C. 51(Suupra)* the respondent company which was incorporated and had its office in England was assessed to tax and supertax on the dividends it received from the shares it held in nine sterling companies which also were incorporated in England but carried on business in India. The respondent paid the tax under protest and then brought a suit in the original side of the Calcutta High Court for a declaration that the provisions in Section 4(1)(c) and Expln. 3 to Section 4(1), Income Tax Act, were ultra vires the Indian Legislature. The Calcutta High Court decreed the suit and pronounced the provisions noted above to be void and inoperative as being an attempt on the part of the British Indian Legislature to tax persons and property which were beyond British India and not subject to its laws. This decision was reversed on appeal by this Court and it was held, not only that the suit was not maintainable by reason of Section 226, Government of India Act, but that the impugned provisions were not ultra vires the Indian Legislature on grounds of extra-territoriality. It was held that there was territorial connexion between the taxing State and the person to be taxed by reason of the fact that the source of the dividends paid to the Raleigh Investment Co. Ltd., by the sterling companies was in British India. In coming to this conclusion, the learned Judges relied upon a number of decisions by the High Court of Australia where it was held that the existence of the source of income in the territory of a particular State established sufficient territorial connexion to justify the imposition of Income Tax by the State: vide in this connexion *Nathan v. Federal Commissioner of Taxation 25 com. L.R. 183(Supra)* and *Murray v. Federal Commissioner of Taxation 29 com. L.R. 134(supra)*. Quite apart from the Australian cases it seems to me that there are clear pronouncements of the highest Courts in England in support of the view that competency to tax is based not on residence alone; it is enough that the income was derived from property in the country which imposed the tax. It was said by Lord Herschell in *Colquhoun v. Brooks (1889) 14 A.C. 493:*

> The Income Tax Acts...themselves impose a territorial limit, either that from which the taxable income is derived must be situate in United Kingdom or the person whose income is to be taxed must be resident there.
>
> These words were quoted and applied by Lord Wrenbury in *Whitney v. Inland Revenue Commissioner (1926) A.C. 37(Supra)* and the principle has been reiterated in other cases since then, one of the latest pronouncements on the point being that of the Judicial Committee of the Privy Council in *Trinidad Lake asphalt Operating Co. Ltd., v. Commissioners of Income Tax for Trinidad and Tobago (1945) A.C. 1(supra)*.

90. With regard to the other set of provisions referred to above, the question of their invalidity by reason of extra-territorial operation came up for consideration both by this Court as well as by the Privy Council in the case of *Wallace Brothers Ltd. v. Commissioner of Income Tax, Bombay A.I.R. (32) 1945 P.C. 9 and A.I.R. (35) 1948 P.C. 118*.(Supra)

91. In this case, a company incorporated in the United Kingdom and having its management and control in that country owned a share in a firm which carried on business in Bombay. Under the

terms of partnership, the company had extensive powers of management and control over. the business of the firm. In a particular year, the income of the company arising in British India was over ₹ 17/- lakhs, whereas its income without British India amounted to about ₹ 7/- lakhs only. The company was treated as a resident of British India under the second part of Section 4A (c), Income Tax Act, and assessed to tax on its total income including the sum of ₹ 7/- lakhs which accrued to it out of British India. The question raised on behalf of the company was that the provisions of the Income Tax Act under which they were assessed were ultra vires the Indian Legislature by reason of extra-territoriality. This contention was negatived by the Bombay High Court before which the matter came up by way of reference under Section 66, Income Tax Act, and this decision was affirmed by this Court as well as by the Privy Council. The judgment of the Judicial Committee is important for our present purpose for more reasons than one. With reference to the dictum of Lord Macmillan in *Croft v. Dunphy A.I.R. (20) 1933 P.C. 16(Supra)* referred to above, that when Parliament has conferred a power to legislate on a particular topic it is permissible and important in determining the scope and meaning of the power to have regard to what is ordinarily treated as embraced within that topic in the legislative practice of the United Kingdom, their Lordships stated that the point of reference is certainly not to seek a pattern to which a due exercise of the power must conform. The object is to ascertain the general concept involved in the words used in the enabling Act, The general conception as to the scope of the Income Tax, according to their Lordships, is, that given a sufficient territorial connexion between the person sought to be charged and the country seeking to tax him, Income Tax may properly extend to the person in respect of his foreign income. This territorial connexion, however, need not be of the same type as is found in British Income Tax legislation, and in case of a company which has only an economic existence, the fact that it draws the major portion of its income from a particular country for a particular year can legitimately make it a resident of that country for that year even though its central management and control are located elsewhere.

92. These cases though they do not directly touch the point which is now for consideration before us can be taken to have laid down definitely: (i) that some sort of territorial connexion or nexus between the taxing State and the person whose income is to be taxed is absolutely necessary. The connexion may be slender or intimate but it must be an actual fact: (ii) that the connexion need not be of the type as is recognised in English income tax statutes. It can be founded on residence of the person or business connexion within the territory of the taxing State and the situation in a particular country of the money or property from which the taxable income is derived would be sufficient to establish a territorial connexion.

93. I will now examine the impugned clause in Section 42(1). Income Tax Act, and see whether it really ignores the territorial nexus which is essential in Income Tax legislation.

94. As has been said already, even before the amendment of 1939, all income, profits or gains arising directly or indirectly through or from any business connection in British India or through or from any property in British India could be taxed. If a foreign company carries on money-lending business in British India and earns profits by way of interest, there is no doubt that it can be validly taxed for the same, and Sir Jamshedji does not say that this clause in Section 42(1), Income Tax Act, is in any way void or inoperative. When the Legislature made the amendment in 1939, it apparently wanted to prevent circumvention of the existing provision by persons who in substance earned interest on money lent in British India but camouflaged the transaction by

advancing loan outside India, the money lent or its equivalent in kind being subsequently brought into British India. I agree with the learned Advocate-General that the words "money lent at interest and brought into British India either in cash or in kind" really contemplate different parts of one and the same transaction. To bring a case within the purview of this clause, it is not enough to show that money was advanced outside British India and then for some reason or other the borrower thought it fit to bring the money or its equivalent into British India. It must be the basic arrangement underlying the transaction that the money shall be brought into British India after it is taken by the borrower outside its territories. In such circumstances, I think the transaction in substance would be lending money at interest in British India, though ostensibly the loan is advanced outside its limits If this interpretation is put upon the words of the clause and in my opinion this is the only proper interpretation that can be put upon them-there would be absolutely no difficulty in holding that the impugned clause does really proceed on the basis of a territorial nexus actually existing between the taxing State and the person in respect of the income that is sought to be taxed.

95. Looked at from a somewhat different standpoint, it can, I think, be said with perfect propriety, that in cases coming under this clause a nexus is established by reason of the fact that the source of the income is situated in British India. It is true that interest payable to a creditor is quite a different thing from dividends paid to a share-holder. Dividends are paid out of the profits of a company, whereas interest on money lent has to be paid even though the borrower does not make any profit from the money borrowed by him. But the person that is taxed here is not the borrower but the lender, and so far as the latter is concerned, the source of income is the money which he lent and which in its original or converted form is actually in existence in British India.

96. This position, I think, receives support from some of the cases decided by the Australian High Court. In *Colonial Gas Association Ltd. v. Federal Commissioner of Taxation (1935) 51 com. L.R. 172(Supra)*, the High Court of Australia upheld a federal Income Tax imposed on interest paid or credited to persons who were not residents of Australia, on money raised by debentures of a company and used in Australia. The tax was imposed upon the company who paid the interest, though the company was entitled under the Act to deduct the amount paid in tax from the interest payable to the absentee debenture-holders. The intention of the Legislature was undoubtedly to tax the debenture-holders who actually received the interest, but as it was doubtful whether the Act could be enforced against them, they being non-residents, the primary liability was imposed upon the company. It was held by the High Court that the legislation was not invalid by reason of extra territoriality and Dixon J., in the course of his judgment observed as follows:

> To derive income from a country involves the person deriving it in a territorial connection with the country sufficient to support the validity of an exeroisa of the power in respect of the person as distinguished from the income.
>
> In *Broken Hill South Ltd v. The Commissioner of Taxation, New South Wales (1987) 56 Com. L.R. 337(Supra)*, it was held that a foreign company in receiving interest on debentures secured by mortgage of property situated in New South Wales could be taxed by the New South Wales State for the income received as interest. In this case it appears that the foreign company was also carrying on business in New South Wales but that fact

was not at all considered material by the learned Judges, whose judgment proceeded on the footing that the connection with New South Wales which was the basis of the legislation, was to be found in the fact that the money upon which interest was paid was secured upon property in New South Wales The mortgaged property itself might not be profitable but that was not material; if the property mortgaged was situated within the territory of a particular State, that was quits sufficient to establish the nexus.

97. It is well-known that the scheme of the English Income Tax statutes is essentially different from that of the Indian Income Tax law, and unless we are bound to conform to the pattern created by legislative practice in England, there can be no difficulty in holding that the territorial nexus, which is the essential ingredient in an Income Tax, can be founded on facts other than those upon which the English legislation on the subject is based. My conclusion, therefore, is that the clause in Section 42(1), Income Tax Act, which makes taxable the income or profits arising out of money lent and brought into British India in cash or in kind, is not ultra vires the Indian Legislature and the contention of Sir Jamshedji on this point must fail.

98. It may be pointed out in this connection that question l, as framed by the Income Tax Commissioner of Bombay under Section 66, Income Tax Act, is perfectly general in its terms and does not refer to any particular clause of Section 42(1), Income Tax Act. On the findings of the Income Tax authorities which were accepted by the High Court of Bombay, the loan of ₹ 50/- lakhs advanced by the Gwalior Durbar to the Provident Investment Company was not an isolated transaction but formed part of the money-lending business which was carried on by the Durbar in British India. On this finding, the Durbar would certainly come within the purview of Clause 1 of Section 42(1), Income Tax Act, and the interest earned by it would be liable to be assessed as income arising from business connection in British India. It is not the contention of Sir Jamshedji that Clause 1 in Section 42(1), Income Tax Act, which relates to income arising out of business connection in British India is in any way void or inoperative. Strictly speaking, therefore, question 1, as formulated by the Income Tax Commissioner, could be answered against the assessee without embarking on any discussion as to the validity of the later clause which makes taxable all income or profits arising out of money lent and brought into British India. The Commissioner of Income Tax, however, expressed his opinion on the basis of this later clause and as the point was raised and elaborately argued both in the High Court as well as before us, it is proper, I think, that we should record our definite opinion upon it.

99. By the Court. On question 3 submitted by the Commissioner of Income Tax, Bombay, we hold that the income derived from the property situated in Bombay and other places in British India purchased by the Durbar at execution sales in enforcement of mortgage decrees against mortgagors who had failed to pay the amounts advanced to them in the course of the money-lending business of the Durbar for the assessment year 1939-1940 is not income arising in connection with the said business within the meaning of Section 2, Government Trading Taxation Act, and that the income arising from such property is not liable to assessment under the provisions of the Income Tax Act read with the Government Trading Taxation Act, III [3] of 1926. The answer to this question should, therefore, be in the negative, and to that extent the appeal is allowed. On questions 2, 4, 5 and 6, it is the opinion of the Court and, on question 1, of the majority of us, that the appeal fails. The appeal is accordingly dismissed on the said five questions.

100. The case is remitted to the High Court of Judicature at Bombay for effecting the necessary substitution in its judgment and decree.

101. The appellant shall pay to the respondent three-fourths of the costs of the appeal to this Court.

Cases Referred.

1A.I.R. (30) 1943 P.C. 181
2A.I.R. (31) 1944 Bom. 1
3(1935) 51 com. L.R. 172
4(1934) 50 Com. L.R. 581 at p. 600
5A.I.R. (31) 1944 P.C. 51
6A.I.R. (35) 1948 P.C. 118
7A.I.R. (20) 1933 P.C. 16
8A.I.R. (20) 1933 P.C. 16
9A.I.R. (35) 1948 P.C. 118
10(1935) 51 Com. L.R. 172
11A.I.R. (23) 1936 P.C. 1
12A.I.R. (31) 1944 F.C. 51
13A.I.R. (35) 1948 P.C. 118
141934. 50 com. L.R. 581 [as quoted in] (1944) 12 I.T.R. 277
15(1932) 6 I.T.C. 159
16A.I.R. (24) 1937 Mad. 393
17(1891) A.C. 455
19(1879) 3 A.C. 889
20(1883) 9 A.C. 117