

BOMBAY HIGH COURT

The Motor Union Insurance Co. Ltd

Vs

Commissioner of Income-Tax

(L Stone, Kt., C.J. Kania, J.)

13.09.1944

JUDGMENT

Kania, J.

1. This is a reference made' under Section 66(1) of the Indian Income-tax Act by the Income-tax Appellate Tribunal.

2. The applicant is a non-resident company incorporated in the United Kingdom. In and before 1939 the company carried on insurance business in British India in lines other than life insurance. In respect of their profits of the accounting year 1939, questions now submitted for the opinion of the Court arose in the assessment year 1940-41.

3. For the assessment of its income the Bombay office filed before the Income-tax Officer a revenue account for the year 11939. Under the Insurance Act Form F is prescribed to be filed before the Superintendent of Insurance by companies which do not carry on life insurance business. That form, inter alia, contains an item of "Interest, dividends and rents" received in respect of its funds. The assessee-company has its head office in England. In the course of hearing of the appeal before the Tribunal it was admitted that no portion of the premium receipts from the Indian business was invested in any form in India, and that all sums as received were sent to the head office, and remittances were received for meeting claims, etc., as and when the claims fell to be met, except to the extent of certain deposits kept in the Indian banks in current account which brought in no interest. In its revenue account, which was filed before the Income-tax Officer, the assessee-company showed on the credit side items under the headings:

(1) Reserves brought forward: Outstanding claims....

(2) Unexpired risks....

(3) Premiums, less Re-insurances On the other side the headings were:

Claims paid, less Re-insurances Commission, less Re-insurances Branch expenses Head Office expenses Reserves carried forward.... Outstanding claims Unexpired risks. It is common ground that the first item on the credit side represents claims which were put forth by the assured but which were not met and were pending investigation. The second item represents 40 per cent. of the premium income of the company in India in the previous year. The third item represents the whole premium received during the accounting year. On the debit side the last item is made up of 40; per cent. of the last item on the credit side. The item of "Reserves carried forward in respect of Outstanding claims" represent claims made on the company in the accounting year, which had not been met but were pending investigation. It is a counterpart of the first item on the credit side. Correctly speaking, this is not a revenue account only, but includes the profit and loss account of the Bombay office.

4. The assessee-company filed with the Income-tax Officer in Bombay also a balance sheet and accounts showing the results of their world business and profit and loss account of the head office. That deserves careful consideration. As usual, in the case of such companies, the different businesses are put under different headings, viz. "Fire Insurance Account", "General Accident Insurance Account", and "Marine Insurance Account". The fire insurance account starts on the credit side with "Amount of Fire Insurance Fund at the beginning of the year". It must be remembered that this is the fire insurance account of the company as a whole. The next item on the credit side is "Reserve for Unexpired risks". Then there is : "Premiums, less Re-insurance". This includes premia received by the company in its business in India also. The last item is : "Interest, dividends and rents-ess Income-tax thereon". It is, therefore, clear that interest, dividends and rents on the Fire Insurance Fund, which is shown in this summary, is brought to account. On the debit side there are items showing amounts paid for claims made during the year. To that are added : "Total estimated liability in respect of outstanding claims at the end of the year, whether due or intimated" (but which were not in fact paid during the year) "Less outstanding at the end of the previous year". This item, therefore, includes claims paid during the year, plus an amount in respect of which claims were made, less claims which were made in the previous year and which may be either included in the first item of claims paid, or were rejected and the matter came to an end. Then follow the items: Commission Expenses of management Bad Debts Amount transferred to Profit and Loss Account.

The last item is : "Reserve for Unexpired risks, being 40 per cent. of premium income of the year". That is exactly forty per cent of the item of "Premiums, less Re-insurance" shown in the account on the credit side. This account thus clearly shows that the amount of Fire Insurance Fund, at the beginning of each year, consists of the forty per cent. of the premium income of the preceding year. This item includes the last item on the debit side of the Revenue account for India for 1939. It further shows that this sum was invested, and 'interest, dividends and rents' on

this Fund are credited to this account. The general accident insurance account and marine insurance account are similarly kept. The items of "Reserve for Unexpired risks" of the three accounts are totalled and also taken to the balance sheet, and shown on the credit side. In the same way the items of "Claims admitted or intimated but not paid" are totalled and included in the balance sheet. The balance sheet, on the other side, shows investments of all the funds. From these facts the irresistible conclusion must follow that these funds, which were kept in the account as fire insurance fund etc., were invested by the head-office and shown as such in their balance sheet.

5. When the matter came before the Income-tax Officer, on these documents it was contended on behalf of the assessee-company that as no investment was made in British India, there was no income from investments in British India, and, therefore, the company was not liable to be taxed on the income which had accrued in England. That contention was negated on the ground that Indian money was invested, and the company was liable to be taxed under Section 42(2) of the Indian Income-tax Act. In arriving at the amount of interest which had been earned by the company out of Indian premia, it was urged on behalf of the assessee-company that large amounts had remained in local banks. The Income-tax Officer accepted that contention, and, taking into account the entries in the books of the assessee-company, allowed credit for the amounts which remained in British India. Having arrived at the balance of premia remitted to England, (and which was held to be so invested in England) the Income-tax Officer fixed the rate of interest on the total investment and apportioned it in proportion to the premia held to have been remitted, during the accounting year, to the head office. Working out the figure in that way the Income-tax Officer had held that the first two sums shown on the credit side in the revenue account, less a sum of Rs. 1,33,341, was invested on account of the Indian business in the hands of the head office, and earned the average rate of 461 per cent. on the investment. He made the order of assessment on those lines.

6. Being aggrieved by this decision, the assessee-company appealed to the Appellate Assistant Commissioner. In the grounds of appeal it was contended that the amounts; shown in the revenue account were not actual funds invested, but were mere book entries. It was, therefore, contended that no interest had accrued in respect of the amount shown against "Unexpired Risks". In respect of the amount shown against "Reserves brought forward-Outstanding claims" (in respect of losses), it was urged that it was a liability and not assets. The Appellate! Assistant Commissioner went into the question and upheld the contention of the Income-tax Officer. In the course of his judgment he said as follows:My view is that from the Head Office accounts it is seen that in all trading accounts separately given, such reserves for unexpired risks are shown and interest is also credited in these accounts which distinctly proves that interest must have been earned on such reserve funds for unexpired risks as well.

7. Being dissatisfied with this decision, the assessee appealed to the Tribunal. In the memorandum of appeal it had taken several grounds. Grounds 1 to 7 were, however, withdrawn at the time of hearing before the Tribunal. Ground 8 was that the appellants were a non-resident company for the purposes of the Income-tax Act. Ground 9 was that the appellants were not liable to be assessed on the computed interest of Rs. 7,615 nor any other interest earned abroad under the Income-tax Act. The Tribunal, after considering whether the amounts shown in the balance sheet and in the insurance accounts were invested, investigated whether there was sufficient fund to meet the outstanding claims in the shape of liquid assets, and ascertained that liquid assets were not sufficient to meet such claims. It then recorded its finding of fact as follows: It is quite plain from the figures abstracted above that the sums represented by 40 per cent. of the premium receipts, which were described as Reserves for unexpired risks, form part in their entirety of the investments of the company which earn interest and that practically the whole of the amount shown against outstanding claims was also invested in interest-bearing sources. These investments were made before the said sums were earned outright by the company as profits. Having regard to those findings it rejected the contention of the assessee-company that interest was not earned out of the premium income earned by the assessee-company in the accounting year. It also held that by reason of Section 42(1) the assessee-company was liable to be taxed,

8. The Income-tax Officer, in arriving at the figure had applied Rule 33 of the Income-tax Act read with Rule 6 of the schedule prescribing "Rules for the computation of the profits and gains of Insurance business". When the matter was argued before the Tribunal, it thought that those were not the rules under which the income arising in the shape of interest should be computed. In the opinion of the Tribunal Rule 8 of the schedule prescribing rules for the computation of income of insurance business was applicable. The legal adviser of the insurance company was asked about it, and after hearing him the Tribunal held that the method of assessment adopted by the Income-tax Officer and the Appellate Assistant Commissioner was wrong, and it directed the Income-tax Officer to compute the income in accordance with the principle contained in Rule 8. The result was that the interest item instead of being Rs. 7,615, was increased to Rs. 49,549.

9. The assessee-company being aggrieved by this decision asked the Income-tax Tribunal to state for the opinion of the Court several questions. The Tribunal has referred the following three questions for the Court's" opinion:

(i) On the facts found by the Tribunal in its order under Section 33, is the whole or any portion of the interest on Rs. 1,65,180 (representing the difference between the aggregate of the 'Reserve for unexpired risks' and the ' Reserve for outstanding claims' and the cash-in-hand and the average bank balances) chargeable to income-tax under the Indian Income-tax Act?

(ii) If the interest-income is taxable, what is the proper basis of computation, the principle laid down in the first part of Rule 8 or the method adopted by the Income-tax Officer? and

(iii) Is the order of the Tribunal in regard to the basis of the computation that should be applied to the case in excess of the powers conferred on it by Section 33(4), by reason of the circumstances that the carrying out of the order would result in the enhancement of the assessment?

10. The first question largely depends on findings of fact. It can be divided in two parts : (i) Whether the whole or any portion of the interest was earned on the amount mentioned in the question; and (ii) if so, whether the assessee-company is liable to be taxed on the whole or any portion of that interest under Section 42(1) and (3) of the Act? I have summarized above the facts in relation to the investment of the funds and to premium income earned by the assessee-company in British India. The Tribunal has found as a fact that the funds were invested and the income accrued thereon. In the course of its judgment the Tribunal had observed that, as this was an inference, it had submitted the matter for the Court's opinion. The correct question on this point would be : Whether there was evidence before the Tribunal on which it could come to that conclusion? Having regard to the facts summarized above and the entries found in the balance sheet of the company, read along with the fire, marine and general accident account of the head office, (which entries admittedly include the entries of the revenue account of the assessee-company), there can be no doubt that there was ample evidence before the Tribunal on which it could come to the conclusion it did. In the statement of the case it is stated: That the sum of Rs. 1,66,160, found by the Income-tax Officer to be the Indian reserve available for investment (after deducting from the aggregate of the two reserves, the cash-in-hand and the monthly average of bank balances) was, as a matter of fact, remitted to the United Kingdom and invested in that country in interest-bearing sources, before the said amount was earned outright by the company as profits. It has, therefore, found that in the accounting year the Indian funds were invested in the United Kingdom and interest was earned thereon. We agree with the Tribunal that the conclusion, on the materials put before the Income-tax Officer, and Appellate Assistant Commissioner and the Tribunal under the circumstances, was fully justified.

11. The next question is whether the assessee-company's case comes under Section 42(1) of the Income-tax Act. Having regard to the conclusion reached in the previous part of the judgment, it is clear that the interest-income had accrued, directly or indirectly, through the business connection in British India and out of the assets of British India. It is, therefore, clear that Section 42(1) applies, and apart from Section 42(3), if the matters rested there, the assessee-company will be liable to be taxed on the interest ascertained as earned out of the Indian assets.

12. It was argued that if profits were taken from India to England and after they were taxed in India invested in any manner the home office thought fit, the income from such investment could

not be assessable under Section 42 of the Income-tax Act. A short answer to the argument is that we are not concerned with that question in this reference. The assessee-company in the present case during the accounting year had earned interest (as found, as a fact, by the Tribunal) on its Indian funds, during the accounting year which were remitted in the course of the year to England as trade funds, and which funds were liable to be remitted back for payment of claims, if and when they matured. In this reference there is nothing to show that the profits, which were ascertained to be of the Indian branches and which were taxed in India, were remitted to England, were capitalised and invested there, and those profits earned interest on which income-tax was claimed by the Income-tax Officer in Bombay. The question submitted by the Tribunal is limited to the figure mentioned in the reference. In arriving at that total it has not taken into consideration the balance of the profit shown at the foot of the revenue account.

13. The Income-tax Officer has also taken into consideration the fact that out of the premium income received in India certain amount remained in India and was not remitted to the assessee-company's home office. It is, therefore, futile to contend that interest on the whole premium income, in the accounting year, is assessed. In analysing the balance sheet and the different accounts of the head office, I have already shown that the two funds, of which the total is made by the Income-tax Officer, were specifically shown in the balance sheet against the investments made in England.

14. As questions (2) and (3) submitted by the Tribunal for our opinion deal with the rate of interest and calculation of interest-income, before dealing with Section 42(3), it will be convenient to deal with those questions. The next question is about the rate at which income has to be calculated on this investment. The Income-tax Officer had arrived at the rate of 4.61 per cent. The assessee did not complain against that calculation when it appealed to the Appellate Assistant Commissioner. When the assessee appealed to the Tribunal, it did not contest that the rate was not properly calculated. The contention contained in ground 9 was that the assessee-company was not liable for the amount of Rs. 7,615 or any other sum. The Commissioner at no stage contended that Rule 33 and Rule 6 were not applicable, or that the Income-tax Officer was in error in arriving at this figure and had applied the wrong principle in calculating it. Before the Tribunal, therefore, the question : whether this was the proper rate of interest to be charged, or whether the Income-tax Officer had adopted the proper method in calculating interest on which income-tax was to be charged to the assessee-company in the year, was not urged by either side. The Income-tax Appellate Tribunal of its' own motion considered that the principle contained in Rule 8 was applicable. In doing so, it relied on the words of Section 33 of the Income-tax Act. In order to appreciate the powers of the Tribunal, it is necessary to take into consideration Sections 30, 31 and 33 of the Act.

15. After the Income-tax Officer has made an order, if the assessee feels aggrieved, he can appeal to the Appellate Assistant Commissioner. The powers of the Appellate Assistant Commissioner in such a case are defined in Section 31. Sub-section (3) Clause (a) in terms provides that in disposing of an appeal the Appellate Assistant Commissioner may confirm, reduce, enhance or annul the assessment. He has also power under Clause (b) to set aside the assessment and direct the Income-tax Officer to make a fresh assessment, after making such inquiry as the Income-tax Officer thinks fit, or the Appellate Assistant Commissioner may direct. The Appellate Assistant Commissioner under Section 31(2) is himself authorized to make such further inquiry as he thinks fit, or cause further inquiry to be made by the Income-tax Officer. It is significant that there is no provision for appeal to the Appellate Assistant Commissioner by the Department against the assessment made by the Income-tax Officer. Under Section 33 a right of appeal to the Appellate Tribunal is given, on the order made by the Appellate Assistant Commissioner. That right is given both to the assessee and to the Commissioner. Under Sub-section (3) the appeal has to be filed in the prescribed form and verified in the prescribed manner. Under Sub-section (4) the Appellate Tribunal may, after giving both parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, and shall communicate the orders to the assessee and to the Commissioner,

16. In pursuance of the powers given to the Tribunal to frame rules, it has framed and published rules. In addition to prescribing the form and specifying that separate grounds for appeal should be distinctly set out, Rule 21 provides as follows: The appellant shall not, except by leave of the Tribunal, urge or be heard in support of any ground of objection not set forth in the grounds of appeal; but the Tribunal, in deciding the appeal, shall not be confined to the grounds of objection set forth in the grounds of appeal or taken by leave of the Tribunal under this rule. Provided that the Tribunal shall not rest its decision on any other ground unless the party who may be affected thereby has had a sufficient opportunity of contesting the case on that ground.

17. On behalf of the Commissioner it is urged that Section 33(4) does not circumscribe the powers of the Tribunal, and leaves the Tribunal at large to raise any question it pleases and decide the same. In our opinion, this argument is unsound. Apart from statute, it is elementary that if a party appeals, he is the party who comes before the Appellate Tribunal to redress a grievance alleged by him. If the other side has any grievance, he has a right to file a cross-appeal or cross-objections. But if no such thing is done, the other party, in law, is deemed to be satisfied with the decision. He is, of course, entitled to support the judgment of the first Officer on any ground open to him, but he is not entitled to raise a ground so as to work adversely to the appellant and in his favour. Apart from that, the section, in our opinion, does not permit the course adopted by the Tribunal in this case. Under Section 31, when the Legislature thought of giving power to the Appellate Assistant Commissioner to enhance the assessment, it has in terms

enacted that. In our opinion, that fact is against the contention that the words of Section 33(4) are wide enough to include a power of enhancement, without an appeal by the Commissioner. The word "thereon" used in Section 33(4) only means "on the appeal", which must mean on the grounds raised in the appeal. Read in that way, the sub-section only gives power to the Appellate Tribunal to give its decision and pass orders in respect of all grounds urged (which must be on behalf of the appellant) in respect of the decision appealed against. In deciding those grounds it can pass appropriate orders. But, in our opinion, it is not open to the Tribunal itself to raise a ground or permit the party, who has not appealed, to raise a ground, which will work adversely to the appellant.

18. Rule 21 framed by the Tribunal also is against the contention urged by the Commissioner. In terms, it limits the appellant to the grounds urged in his memorandum of appeal, and prescribes that if he wishes to raise any further ground, he has to do so after obtaining the leave of the Tribunal. The proviso does not enlarge the powers of the Tribunal to raise grounds of appeal against the appellant. It only says that the Tribunal is not obliged to rest its decision on the grounds urged by the appellant; it recognizes the principle that the judgment of the lower Court may be supported on any ground, even though it is not raised in the memorandum of appeal. That, however, does not allow the Tribunal to suggest another mode of assessment altogether.

19. In this case the facts are somewhat peculiar. The interest income of the assessee-company earned in the United Kingdom is sought to be taxed, under certain rules adopted by the Income-tax Officer as found in the Act. The Appellate Tribunal has sought to rely on Rule 8. That rule runs as follows: The profits and gains of the British Indian branches of an insurance company not resident in British India, in the absence of more reliable data, may be deemed to be the proportion of the total world income of the company corresponding to the proportion which its British Indian premium income bears to its total premium income. In the first place, this rule of assessment is to be adopted in the absence of more reliable data. Therefore, if the Appellate Tribunal thought of adopting this rule, the first question for consideration was whether more reliable data were available or not. This question cannot be raised, debated and disposed of merely in the course of argument. It is a question of fact. Moreover, the rule itself cannot apply to the facts here, because the profits and gains of the assessee-company in British India are not held liable to be assessed by the Tribunal under this rule. It has stated that the principle of this rule should be applied in respect of one portion of the income of this company, namely, the interest earned by it in the United Kingdom. There is no justification for an extension of this rule in that manner. Plainly read, the rule only means that, after making all reasonable efforts to ascertain the income of an insurance company, if no reliable data is found in the case of a non-resident company, the rule of thumb there prescribed may be adopted; but that is in respect of the whole income of the company. There is no warrant for holding that in respect of individual items any

such principle may be applied. The duty of the Income-tax Officer is to find out the profits and gains of the assessee; and, in our opinion, it is not open to him to adopt such principle in respect of one item, when he is in effect assessing the whole income on adequate materials before him.

20. For these reasons, we think that the Appellate Tribunal was in error in holding that assessment might be made under Rule 8, and in raising the question whether the mode of assessment adopted by the Income-tax Officer was proper or not, when that question was not raised by the assessee or by the Commissioner at any stage. In framing the third question the Tribunal has limited it to a case where the result would be an enhancement of the assessment. Our answer to Question (ii) will be : Rule 8 does not apply on the facts of this case in computing the interest-income of the assessee-company which is sought to be taxed in British India. The method adopted by the Income-tax Officer has not been challenged as improper either by the Commissioner or by the assessee. Our answer to Question (iii) is in the affirmative.

21. That leaves for consideration the question of the liability of the assessee, having regard to Section 42(3) of the Indian Income-tax Act. The question is whether Section 42(3) gives the assessee-company some relief. The answer to this depends on the true meaning to be given to the word "operation" in connection with the earning of interest in the present case.

22. On behalf of the assessee-company it is urged that it builds up funds, as an insurance company, although the Insurance Act does not require it to do so. The premium collected and received in India is remitted to the United Kingdom, invested there, and interest is earned thereon. This is a business transaction, of the assessee-company and is as much a part of its business as the earning of premium on insurance policies. It is, therefore, contended that as portions of these operations took place in the United Kingdom, there must be an apportionment of the interest-income, and what could be reasonably attributed to that part of the operation carried out in the United Kingdom should be exempted from tax. On behalf of the Commissioner it is urged that this is not a proper reading of Section 42(5) at all. The business operations of the assessee-company are advertising its business, canvassing business and receipt of premia. It is contended that you cannot separate each of these items as an independent operation and allocate the interest-income to a particular portion. In our opinion, this argument of the Commissioner is unsound. The investment of premia is as much a part of the business of the insurance company, as the earning of premia. If its investments could be separated, it is open to the assessee to urge that portions of this business operation are carried out in British India and portions outside British India, and such incomes as could reasonably be attributed to that part of the operations carried out outside British India, should be exempted.

23. The question before the Court is in respect of the gain or interest arising out of these foreign investments. It appears that although the premium was received in British India, the operation

would necessarily include the transmission of the fund to the United Kingdom, investing it there, and the receipt of income there. We are not concerned as an advisory body in finding out what portion, if any, of the income arose out of these portions of operations which took place in the United Kingdom. The whole amount, by the investment of which the income accrued, was sent from India. We are only concerned with the construction of Section 42 (3). Our attention was drawn in this connection to *Re Rogers Pyatt Shellac & Co. v. Secretary of State for India*¹ The Commissioner of Income-tax, *Burma v. Messrs. Steel Brothers & Co. Ltd.*². and *Port Said Salt Association Ltd. v. The Commissioner of Income-tax, Bengal*³ All these were, however, cases of the production of manufactured articles from raw materials and the sale thereof in another country. Although the cases are not directly applicable, they show that a transaction of the kind mentioned in those cases could be divided into separate operations, and relief could be granted. Those cases were all decided before Section 42(3) was enacted. In the judgments it is however clearly pointed out that a transaction which earns profit is capable of being divided into separate operations. In our opinion, in the present case, the investment of the premium earned in British India, which resulted in the interest income sought to be taxed, is capable of being so divided into separate operations some of which took place in India and some outside and, therefore, relief under Section 42(3) should be given to the assessee-company on that basis.

24. answer to Question (i), therefore, is : That portion of the interest-income on Rs. 1,65,180 worked out at the rate of 4.61 per cent, which is reasonably attributable to that part of the operations carried out in British India is liable to be assessed under the Indian Income-tax Act.

25. Having heard counsel on the question of costs, it seems that the assessee-company has failed in its contention that there was no investment of the premium income and there is no interest-income for which it is liable to be assessed. On the other hand, it has succeeded in the dispute about the jurisdiction of the Tribunal to adopt a new mode of assessment and the) application of Rule 8. The assessee-company has also succeeded in respect of its contention under Section 42(3). Having considered all the facts, we think that the fair order is that each party should bear his own costs.

Cases Referred.

1(1924) I.L.R. 52 Cal. 1

2(1925) I.L.R. 3 Ran. 614

3(1932) 6 I.T.C. 123