

BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

L. Armstrong Smith

(Stone, C.J.)

07.03.1946

JUDGMENT

Stone, C.J.

1. This is a reference under Section 66(1) of the Income-tax Act. The question referred to us is :-
"Whether on the facts of the case the sum of Rs. 48,000 received by the assessee from Messrs. Armstrong Smith Ltd., is income from salary chargeable under Section 7 of the Indian Income-tax Act ?"

The assessment year in this case is the year 1943-44 and the accounting year is the calendar year 1943. There is no question but that this Rs. 48,000 is taxable; the only point is whether it falls to be taxed under Section 7 or under Section 12 of the Indian Income-tax Act. From the agreed statement of facts, it appears that the assessee, Mr. L. Armstrong Smith, was carrying on a business as general merchant and commission agent till 18th June, 1941, when his business was taken over by a private limited company of Armstrong Smith Limited. The company was incorporated under the Indian Companies Act (VII of 1913) on 24th June, 1941. Mr. Armstrong Smith holds most of the shares of the company while two of its nominees hold the rest. Under Article 58 of the Articles of Association of the company Mr. Armstrong Smith is the Chairman and Managing Director of the company. The articles further provides that he shall remain the Chairman and Managing Director until he shall resign office or die or cease to hold at least one share in the capital of the company, and that so long as he retains the said office all other directors for the time being shall be under his control and shall also be bound to conform to his directions in regard to the companys business. Mr. Armstrong Smith devotes his whole time to the management of the companys affairs. Under Articles 60 his remuneration is voted by the company at its annual general meeting. In the year of account material to the assessment he received a sum of Rs. 48,000 as his remuneration in accordance with the resolution of the annual general meeting. Now, that being the statement of facts the Appellate Tribunal came to the

conclusion that there was a relationship of employer and employee between the company and the assessee, and that consequently under Section 7 of the Act. The company is admittedly a legal entity, and it is a different legal entity from the assessee. The question is what is the legal relationship between the company and the assessee. It will be convenient at this stage to refer to the relevant sections of the Income-tax Act. "Salaries", which is the first head of the five heads of income set out in Section 6, is particularised and dealt with in Section 7(1) which provides that the tax shall be payable by an assessee under the head "Salaries" in respect of any salary or wages, any annuity, pension or gratuity, and any fees, commissions, perquisites or profits in lieu of, or in addition to, any salary or wages, which are due to him from, whether paid or not by, a company. To that sub-section there are certain provisos which, as Mr. Setalvad on behalf of the Commissioner points out, import the idea of the assessee being subject to conditions of employment or conditions of service. Section 12, which has been described by the Privy Council as being the true residual section, provides that the tax shall be payable by an assessee under the head "Income from other sources" in respect of income, profits and gains of every kind which may be included in his total income (if not included under any of the preceding heads), and the rest of the section deals with allowances. We have been referred to quite a number of English cases the effect of which can, I think, be summarised by saying that a director of a company as such is not a servant of the company and that the fees he receives are by way of gratuity, but that does not prevent a director or a managing director from entering into a contractual relationship with the company, so that, quite apart from his office of director he becomes entitled to remuneration as an employee of the company. Further that relationship may be created either by a service agreement or by the articles themselves. Now, in this case there is no question of any services agreement outside the articles and, therefore, the relationship between the company and the assessee, Mr. Smith, depends upon the articles. The group of articles which deals with directors commences with Articles 57 which provides for the number of directors. Article 58 is in these terms :- "Leslie Armstrong Smith shall be Chairman and Managing Director of the company until he shall resign office or die or cease to hold at least one share in the capital of the company and so long as he shall retain the said office shall have authority to exercise all the powers, authorities, and discretion vested in the Directors by the Indian Companies Act, 1913, or these articles and all other Directors of the company for the time being shall exercise such powers only as he may delegate to them and they shall be under his control and shall be bound to conform to his directions in regard to company's business."

Then Article 59 provides that two of the provisions in Article 63 which cause disqualification in a director and the articles with regard to the rotation of directors shall not apply to Mr. Smith. Under the heading of "Powers and Duties of Directors" come Articles 64 and 65 which are as follows :-

"64. The business of the company shall be managed by the Directors, who may exercise all such powers of the company as are not, by the Act, or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the company in General Meeting, subject nevertheless to any regulation of these articles, to the provisions of Act and to such regulation being not inconsistent with the aforesaid regulation or provisions, as may be prescribed by the company in General Meeting."

The rest of the article is not material. Then Article 65 :-

"The Directors may subject to the provisions of Article 58 from time to time appoint one or more of their number to the office of Managing Directors or Manager for such term and at such remuneration (whether by way of salary or commission or participation in profits or partly in one way and partly in another or others) as they may think fit and a Director so appointed shall not, while holding that office, be subject to retirement by rotation or taken into account in determining the rotation of retirement of Directors"

and then there is provision with regard to his appointment ceasing if he ceases to be a director of the company. It is to be observed that Mr. Smith is under Article 58 appointed for life and that there is vested in him the power to control and manage the whole of the company's business and that so long as he retains the said office no one else has any right to intervene in the management. In my opinion these articles fall under the head of creating a contractual relationship between the company and Mr. Smith by which Mr. Smith is to be in the service of the company. I do not think it is necessary to go through the English cases. The effect of them I have already stated, and a consideration of them leaves the matter in little doubt. There is only one Indian case on this subject and that is the case of Bhagwati Shankar. In that case the assessee was an Advocate appointed by the High Court as official liquidator of a company at a salary which was fixed by the High Court at five per cent. On the assets actually realised by him, and it was held the commission earned by the assessee could be taxed only under Section 7 of the Income-tax Act. Mr. Justice Din Mohammad delivering the judgment with which Mr. Justice Marten agreed said this :-

"From the two sections of the Companies Act referred to above, three things emerge quite clearly : (1) that an official liquidator holds an office; (2) that he is appointed by the Court; (3) that he is to receive either a salary or a remuneration, by way of percentage or otherwise, as the Court may direct. In these circumstances Section 7 evidently applies to all commissions received by an official liquidator in the course of his employment. These commissions are in lieu of salary and can therefore neither be described as professional earnings so as to be covered by Section 11, nor can they be classified under other sources so as to be governed by Section 12."

In my opinion, the remuneration of Rs. 48,000 received by the assessee is for managing this companys business, and arises from his contractual relationship with the company provided by the articles for performing the services of managing the companys business. In these circumstances his remuneration falls to be taxed under Section 7 and not Section 12, so that the question referred to us by the tribunal should be answered in the affirmative. Commissioner to pay the costs.

Kania, J.

I agree.

Reference answered in the affirmative.