

# **BOMBAY HIGH COURT**

Salt and Industries Agencies Ltd

Vs.

Commissioner of Income-tax

Income-tax Reference No. 5 of 1949

(Chagla, C.J. and Tendolkar, J.)

16.09.1949. 15.09.1949

## **JUDGMENT**

### **Chagla, C.J.**

1. At the instance of the assessee the Tribunal referred the following question to the High Court :

"Whether in the circumstances of the case the commission, this, Rs. 88,065, received by the assessee company from the United Salt Works and Industries, Ltd., accrued in the State of Cutch or In British India."

2. The assessee before us is a joint stock company incorporated in Bombay and they are the managing agents of the United Salt Works and Industries, Ltd., which company also is incorporated in Bombay. The assessee company was appointed the managing agents under the managing agency agreement, dated 1st June 1944, and in this reference we are concerned with the assessment year 1945-46, the relevant previous year being the year ended 30th September 1944. During the year of account the United Salt Works and Industries, Ltd., made a profit of Rs. 10,12,402 from its business at Aden and a profit of Rs. 7,61,165 from its business at Kandla. The Tribunal took the view that the total commission payable to the assessee company amounted to Rs. 2,10,815 and out of that Rs. 1,22,750 was attributable to the Salt Works at Aden and Rs. 88,065 was attributable to the Salt Works at Kandla.

3. In this reference we are only concerned with the sum of Rs. 88,065, and the narrow question that we have to consider is whether this sum accrued or arose at Kandla or it accrued and arose in British India, because if it accrued and arose in Kandla, it is common ground that it was never brought into British India and as the amount accrued and arose in a Native State, under Section 14(2)(c) the assessee would not be liable to pay any tax on that amount. Under the managing agency agreement the assessee were entitled to a commission at the rate of 15 per cent. per

annum on the annual net profits of the company. The agreement also provided that in any event they were entitled to a minimum of Rs. 30,000 per annum. The agreement also provided that such portion of the commission as shall be attributable to the net profits of the company arising or accruing in an Indian State shall be payable and be paid to the said agents in such Indian State, unless and until the said agents otherwise direct in writing, and with regard to the minimum commission of Rs. 30,000 the agreement provided that half of such minimum commission shall be payable and be paid to the agents in such Indian State or States where during such year the company may have carried on any part of the business. In my opinion, this provision with regard to the income in an Indian State merely provides for the mode of payment. Under Article 83 of the articles of association power is given to the board of directors to allot to such member or members of their body as they think fit the supervision of any specified department or departments of the company, or any company under the management of the company and any director to whom the supervision of any department has been allotted shall personally attend to and supervise the work of that department and shall manage and control the affairs of the department allotted to him but subject nevertheless to the control and supervision of the board of directors. Pursuant to this article, the board of directors of this company passed a resolution on 1st June 1944, whereby they delegated Yuvraj Maharaj Kumar Shree Madansinghji to guide the company's operations in the State of Kutch, and it is not disputed that the Salt Works at Kandla were attended to and the business supervised by Yuvraj Maharaj Kumar Shree Madansinghji during the year of account.

4. What is contended before us by Mr. Kolah is that the business at Kandla was attended to by Madansinghji and, therefore, the profits that arose out of that business at Kandla accrued at Kandla, and as the profits accrued at Kandla, therefore, the commission attributable to those profits must also be taken to have accrued or arisen at Kandla. Mr. Kolah further argued that even though the head office of the company may be in Bombay, even though the board of directors may have the power and the right to control the business of the assessee company, if in fact and in actuality a particular business was done not in Bombay but elsewhere, then the profits attributable to that business must be considered to have accrued or arisen in that part where the business was carried on. Mr. Kolah has relied on various authorities which, as I shall presently point out, have more to do with the question of the residence of the company rather than with the question with which we are concerned as to where the profits of a particular company arise or accrue. The question of residence as far as our law is concerned is to be found in Section 4A(c), and one of the conditions which makes a company resident in British India in any year is if the control and management of its affairs is situated wholly in British India in that year, and Mr. Kolah's argument is that the control and management contemplated by this section is not de jure control and management, but de facto control and management, and the whole of Mr. Kolah's argument is that as in the year of account the control and management of the Kandla affairs of the company was de facto not in British India but in Kutch, therefore, the profits of that business must be considered to have accrued and arisen in Kutch. Mr. Kolah has relied on and decision of the House of Lords, *Mitchell v. Egyptian Hotels, Limited*<sup>1</sup>, There the company was

incorporated in England. It had two hotels which were both situated in Egypt and a local board was appointed by an amendment of the articles of association of the company which managed the hotels in Egypt and on these facts the House of Lords came to the conclusion that the company was assessable to tax only in respect of the profits remitted to England and not in respect of the profits which were not so remitted. It is important to note that the basis of taxation in England, as far as the profits of a company are concerned, is the place where the business is carried on by the company. If the business is carried on not in England but abroad, then

<sup>1</sup>1915 AC 1022 : (84 LJ KB 1772)

its profits are taxed only to the extent of these being received in England, and therefore in this case the House of Lords had to consider where the actual control of the company was in order to determine where the business was carried on. But no question arose or could arise under the English law as to where the profits of the company had accrued or arisen. Similarly, in *Bhimji Naik v. Commissioner of Income-tax, Bombay*<sup>2</sup>, Sir Leonard Stone, Chief Justice, and Kania, J., as he then was, were also considering the residence of a firm where one of the partners Mr. Naik was in Bombay and the other partners were in South Africa, and what they there laid down was that residence was to be determined by de facto control and management and not by de jure control and management, and according to those two learned Judges, although the partnership agreement gave powers of supervision and control to Mr. Naik, still, as the de facto control of the business was in South Africa, they held that the company was not resident.

5. What we, therefore, have to consider is not where the control of the business is, but where the profits of the business had arisen or accrued, and I agree with Mr. Kolah that as a general proposition the profits of a business arise or accrue at the place where the business is carried on. It is the place where the business yields profits which are sought to be taxed which must be considered to be the place of the accrual or arising of those profits, and therefore what we have to determine in this case is where did the commission of the managing agents arise or accrue which is sought to be taxed. On this point, with regard to accrual or arising of profits, there is a decision of this Court which might be of some help, and that is. *In re Aurangabad Mills, Ltd*<sup>3</sup>. There a joint stock company was registered in Bombay and the board of directors were also in Bombay. The company owned a textile mill which was worked at Aurangabad in the Nizam's territory and the whole work of the mill was done at Aurangabad by a paid manager who held a power-of-attorney from the directors, though the accounts were made up in Bombay, and the question was whether the profits of the company arose or accrued in the territory of the Nizam or in British India, and Sir Norman Macleod in taking the view that the profits arose in the Nizam's territory stated (p. 119) :

"No authorities have been cited for the proposition that because the affairs of a company are directed from a particular place while the actual business of the company is carried on in another therefore the profits accrue or arise in the former place."

Therefore, the test to be applied in order to determine where the profits accrue or arise is to find

out where the actual business of the company is done which yields the profits which are sought to be taxed. The question as regards control or appreciation is material and irrelevant as far as this particular question is concerned. Therefore, applying that test to the facts of this case, what we have to ask ourselves is, where did the commission of the assessee company accrue or arise, and for that purpose we have also got to consider where was the business of the managing agency done which made it possible for the managing agents to earn this commission.

6. Now, Mr. Kolah wants the work of the managing agents to be divided, as it were, into watertight compartments. According to him, the managing agents rendered certain

<sup>2</sup>47 Bom LR 187 : AIR 1945 Bom 271

<sup>3</sup>23 Bom LR 570 : AIR 1921 Bom 159

services at Aden and they rendered certain services in Kutch, and according to him, to the extent that these services were rendered at Kandla in Kutch, the commission attributable to those services must be considered to have arisen or accrued at Kandla. In my opinion, that is not the correct way to look at either the managing agency agreement or the scope of the work and activities of the managing agents. The managing agents under the managing agency agreement have to do all the work of the company and to be responsible for the general conduct and management of the business and affairs of the company. For this purpose they have to enter into agreements with Government or Municipal and local authorities, they have got to keep proper and complete books of account, they have to be in charge and custody of all the proper books of account, papers, documents and effects belonging to the company, and they have to discharge various other duties mentioned in the managing agency agreement. The registered office of the assessee company is in Bombay, the board of directors meet in Bombay, the books of account are maintained in Bombay and various types of work connected with the company has got to be done in Bombay, and in attending to the work at Kandla what the managing agents were doing were attending to one part of their duties and obligations under the managing agency agreement. It would be erroneous to say that the business of the managing agents was done at Kandla because one of the directors was delegated with the power to super, vise that particular work in Kutch. The work of the managing agents must be looked upon as unit and not as divided up into so many different categories, to cash one of which a certain portion of the commission earned by the managing agents can be attributed or allocated. But what to my mind is conclusive of the matter is the consideration as to when the right to managing agency commission arises and when does the company become liable to pay managing agency commission to the managing agents. In my opinion, the Tribunal was in error in coming to the conclusion that separate commission was attributable to profits at Aden and profits at Kandla. That is not the scheme of the managing agency agreement. It is not as if the managing agents were entitled to commission if there was profit at Kandla irrespective of what happened at Aden. Their right to earn any commission at all depended upon the profits being made not at Kandla or at Aden, but profits being made by the company in all its operations, and the commission was to be calculated on the net; profits of the company. It was only then that the managing agents would become entitled to a commission of 12-1/2 per cent. on the net profits. It may conceivably be that although there was a profit at

Kandla there might be a large loss at Aden which might completely wipe off the profit at Kandla. In that event, the managing agents would not be entitled to a 12-1/2 per cent. commission because there would be no profits, but then they would only be entitled to their minimum of Rs. 30,000. Therefore, the commission to which the managing agents are entitled under the agreement would only arise or accrue to them after the profits of all the undertakings of the company were determined, and then only it could be said that the managing agents were entitled to a particular commission. Till then it would not be possible to say what their commission would be, whatever might be the result of the working of the company at Kandla or at Aden. Mr. Kolah has really, with respect to him, mixed up the profits of the parent company with the profits of the managing agency company. It is perfectly true that as far as the parent company is concerned, the profits made at Kandla could be said to have arisen and accrued at Kandla, but as far as the managing agents are concerned, their commission has nothing whatever to do with those profits. Their commission is only concerned with the ultimate determination of all the workings of the company and the finding out whether and what profit has been earned by the company. It cannot be said that as profits were earned by the parent company, the commission also was accruing or arising to the managing agents.

7. Mr. Kolah has strenuously urged upon us that the ascertainment of profits has nothing whatever to do with the accrual or arising of profits. As a bald statement perhaps it is true and correct, but in this case it is much more than mere ascertainment of profits which have already accrued or arisen. If we were satisfied that commission had already accrued or arisen to the company and what was being done in Bombay was merely the ascertainment of it then certainly the fact that these profits or this commission were ascertained in Bombay could have had no elegance to the question as to where the commission arose or accrued. But, as I said before, no commission did arise or accrue to the assessee at Kandla at all. It only arose and accrued to them when all the accounts of the workings of the company were submitted to the head office in Bombay and the profit was determined, and then it could be said that a right to receive a commission at the rate specified in the managing agency agreement had arisen and the managing agents were entitled to a certain specified commission.

8. Therefore, in my opinion, the Tribunal was right in coming to the conclusion that the sum of Rs. 88,065 accrued and arose to the assessee in Bombay and not in a Native State.

9. The assessee has taken out a notice of motion for the purpose of raising a question as to his liability to pay excess profits tax on the commission and which is the subject-matter of this reference. We do not think it necessary that a separate and further question should be raised in order to meet the application of the assessee. What we propose to do is to amend the question which has been framed by the Tribunal so as to read as follows:

"Whether in the circumstances of the case the commission, viz. Rs. 88,065, received by the assessee company from the United Salt Works and Industries Ltd. accrued in the State

of Kutch or in British India, both for the purpose of income-tax and excess profits tax."

And we answer the question, in British India. There will be no order as to costs of the notice of motion. Assessee to pay the costs of the reference.

Answer accordingly.