Shoorji Vallabhdas & Co., Bombay vs The Commissioner Of Income-Tax/Excess ... on 19 April, 1960

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Bench: J.L. Kapur, M. Hidayatullah, S.K. Das

JUDGMENT

S.K. Das, J.

1. This is an appeal with special leave from the judgment and orders dated March 31, 1952, and March 2, 1953, of the High Court of Bombay in an Income-tax Reference No. 48 of 1951 made by the Income-tax Appellate Tribunal, Bombay, under s. 66(1) of the Indian Income-tax Act, 1922, and s. 21 of the Excess Profits Tax Act, 1940.

2. We may shortly state the relevant facts first. The assessee, Messrs. Shoorji Vallabhdas and Company, Bombay, appellant herein, is a firm registered under the Indian Income-tax Act. It held the managing agency of three companies, namely - (1) the Malabar Steamship Company Ltd., (2) the New Dholera Steamships Ltd., and (3) the New Dholera Shipping and Trading Company Ltd., for the periods material in this case. The appellant as also the aforesaid three managed companies were resident in the taxable territories within the meaning of the Indian Income-tax Act. The business of the Malabar Steamship Company Ltd. and of the New Dholera Steamships Ltd. was to carry cargo in cargo boats which touched ports in British India, Cochin State, Travancore State and Saurashtra, as they were then known. The appellant became the managing agent of the Malabar Steamship Company Ltd. with effect from April 1, 1943, and the firm consisted of Shoorji Vallabhdas and his two sons. Formerly, Shoorji Vallabhdas alone was the managing agent of the Malabar Steamship Company Ltd. and a managing agency agreement dated September 16, 1938, was executed between the managing agent and the managed company, and that agreement as varied by two subsequent deeds dated June 26, 1942, and December 7, 1943, constituted the contract of managing agency between the appellant and the managed company. Under the managing agency contract the remuneration payable to the appellant after September 1, 1943, was expressed in the following terms :

> "That the remuneration of the Managing Agents as and from 1st September one thousand nine hundred and forty-three shall be ten per cent. (10%) on the freight

> charged to the shippers instead of annas fourteen per ton as mentioned in clause (1) of the said first supplemental agreement dated the 26th day of June, 1942."

3. The managing agency agreement dated June 8, 1946, between the appellant and the second managed company, New Dholera Steamships Ltd., provided inter alia as follows :

> "That the Managing Agents shall as and by way of remuneration for their services in relation to the shipping business of the Company receive a commission of ten per cent. (10%) of the gross freight charged to the shippers and/or passage money charged to the passengers. Such remuneration shall be payable to the Managing Agents at the place where the same is earned by the Company unless otherwise requested by the Managing Agents. The remuneration of the Managing Agents in relation to the business of the Company other than the shipping business shall be (10%) ten per cent. on the gross profits that may be earned in such business."

4. It may be stated here, however, that no question arose as to the remuneration of the Managing Agent in relation in business other than shipping business, because no business other than shipping business was carried on by the managed company during the relevant period.

5. The third managed Company, viz., the New Dholera Shipping and Trading Company Ltd., confined its business during the relevant accounting period to stevedoring and trading only. The managing agency agreement also dated June 8, 1946, with the third managed company provided inter alia for the payment of remuneration in the following terms :

> "That the Managing Agents shall as and by way of remuneration for their services receive a commission at the rate of 25 per cent. of the net profits of the company. Such remuneration shall be payable to the Managing Agents at the place where the same is earned by the Managing Agents unless otherwise requested by the Managing Agents."

6. The appellant was assessed to income-tax for three assessment years, namely, 1945-1946, 1946-1947 and 1947-1948, the previous years being the financial years 1944-1945, 1945-1946 and 1946-1947 respectively. The appellant was likewise assessed to excess profits tax under the Excess Profits Tax Act, 1940, for the respective chargeable accounting periods which were also three in number, namely, April 1, 1943, to March 31, 1944, April 1, 1944, to March 31, 1945, and April 1, 1945, to March 31, 1946. The Income-tax Officer and the Excess Profits Tax Officer assessed the appellant to tax in respect of the whole of the managing agency commission received from the three managed companies on the footing that the entire managing agency commission accrued or arose in British India. The appellant went up in appeal to the Appellate Assistant Commissioner from the assessment orders on the ground inter alia that a part of the managing agency commission received from the three managed companies accrued in the Cochin and Travancore States and not in British India and was therefore exempt from tax under the relevant provisions (as they stood at the material time) of the Indian Income-tax Act, 1922, and the Excess Profits Tax Act, 1940. Thus, the dispute was about the place of accrual of the income in question. As to the managed companies, the

Income-tax authorities accepted the position that the profits of the three managed companies partly accrued in British India and partly in the Indian States; but they did not accept the claim of the appellant that part of its managing agency commission from the three managed companies accrued or arose in the Cochin and Travancore States. The Appellate Assistant Commissioner by different orders all dated May 4, 1950, dismissed all the appeals. The Appellant went in appeal to the Income-tax Appellate Tribunal. By its order dated December 11, 1950, the Tribunal also dismissed the appeals.

7. The appellant then made an application to the Tribunal to refer certain questions of law which arose out of its order, to the High Court of Bombay. The Tribunal referred two such questions :

> "(1) Did a part of the managing agency commission earned by the assessee accrue or arise in the Cochin State inasmuch as the managing agency commission is computed on the basis of the freight earned by the managed company in the Cochin State or otherwise ?
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> (2) Did the whole or part of the dividend income accrue or arise in the Cochin State ?"

8. The expression Cochin State in the questions obviously referred to both Cochin and Travancore States. On March 31, 1952, the reference came up for consideration before the High Court, and after hearing Counsel, the High Court reformulated the first question as follows :

> "Where the actual business of managing agency was done which yielded the commission which is sought to be taxed ?"

9. The High Court directed the Tribunal to submit a supplemental statement of the case on the first question as reformulated. The second question was not pressed by learned counsel for the appellant and does not now survive.

10. The Tribunal submitted a supplemental statement of the case on August 29, 1952. The reference was finally heard on March 2, 1953, and the High Court answered the question by saying that the actual business of the managing agency which yielded the commission was done at Bombay and not at Cochin. In arriving at the conclusion the High Court proceeded on the footing that the finding of the Tribunal in effect was that barring freight and collecting it at Cochin, all other important and responsible work of managing the managed companies was done from the head office at Bombay.

11. It has been argued on behalf of the appellant that the High Court erroneously reformulated the question, and that the real question of law is whether on the facts and circumstances of the case, any part of the managing agency commission accrued outside British India so that the appellant would be entitled to an apportionment of the managing agency commission and to claim exemption from tax in respect of the commission which accrued outside British India under s. 14(2)(c) of the Indian Income-tax Act, 1922 (as it then stood) and the third proviso to s. 5 of the Excess Profits Tax Act, 1940. It has been further contended that in view of the findings of the Tribunal that (a) the commission earned was a percentage of the freight and passage money received by two of the

managed companies in Cochin and Travancore States, (b) a part of the commission was payable there and (c) a part of the services was also rendered by the appellant as managing agent in those States, the High Court was in error in coming to its conclusion that the whole of the managing agency commission accrued or arose in Bombay. While we agree with learned counsel for the appellant that the real question in this case is whether any part of the managing agency commission accrued outside British India, we do not agree with him that the High Court was wrong in reformulating the question. The Tribunal formulated the question as though the computation of the appellant's remuneration on the basis of freight determined the place of accrual; in this the Tribunal was in error, and the High Court rightly pointed out that the test to be applied was not how the remuneration was to be computed or quantified, but where the services were performed by the appellant, which yielded the profits sought to be taxed. The High Court rightly reformulated the question on that basis, and asked the Tribunal to submit a supplemental statement of the case on the materials available and placed before it by the appellant bearing on the question as reformulated by the High Court.

12. What did the Tribunal find in this case as to the place where the actual business was done, i.e. the services were performed by the appellant as managing agent, which yielded the commission ? After referring to the agreements relating to the computation of remuneration, the Tribunal said in its order dated December 11, 1950, that (a) from time to time one of the partners of the appellant firm went to Cochin to attend to the business, (b) the managed companies had an officer in Cochin, and (c) the payments said to have been made to certain employees at Cochin were fictitious. In the supplementary statement, the Tribunal pointed out that it was not known whether the partner who went to Cochin went in his capacity as partner of the appellant firm or as a director of one of the managed companies; the appellant firm had rented a flat at Cochin on Rs. 20 per month and maintained some employees at Cochin for securing freight; and the local office of the appellant firm at Cochin rented at Rs. 10 per month maintained only one book containing cash, journal and ledger. The Tribunal concluded its supplementary statement thus :

> "As for the staff maintained at Cochin, it was alleged that K. P. Joshi and subsequently G. H. Narechania were paid Rs. 18,000 each year. The so-called payment was disallowed by the Appellate Tribunal. It observed that debit entries in regard to the salaries paid by the assessee firm were collusive and fictitious. As for the presence of the partners of the assessee firm at Cochin, it appears from the Appellate Assistant Commissioner's order that it was admitted before him that none of the partners of the firm ever attended to the company's business at Cochin or Alleppey.
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> .....
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> ....."
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> "There is no clear evidence on the record as to what the assessee firm did as the managing agents of the three managed companies; in other words, how the assessee firm was carrying on the managing agency business. The partners of the assessee firm (not necessarily all) were on the Board of Directors of the managed companies. They

> held a large number of shares in the managed companies. The Malabar Steamship Co. Ltd. had an office of its own "to secure freight". The Cochin office of the assessee firm, as far as one could make out, did practically nothing, except receive 10% of the gross freight at Cochin and retain the net income therefrom".

13. Now, the question is - on the aforesaid findings of fact reached by the Tribunal - where did the commission payable to the managing agent accrue ? It is well to remember that the problem in this case is not so much when the commission accrued as where it accrued, though the question as to where and when may be interlinked. We think that normally, the commission payable to the managing agents of a company accrues at the place where the services are performed by the managing agents. It was so held by this Court in K.R.M.T.T. Thiagaraja Chetty and Company v. Commissioner of Income-tax, Madras, No. 2 . The assessee in that case, Thiagaraja Chettiar, claimed that a portion of the commission credited to it in the company's accounts accrued to it in the Indian States where the company had opened branches for selling yarn and as the commission was not remitted to British India, it was not assessable to tax. This Court observed :

> "The short answer to this argument is that the business of the company was carried on in British India, that the commission earned by the firm on the profits made by the company in the States arose out of one indivisible agreement to charge the reduced commission of 5 per cent. on the profits of the company and that the managing agents had been doing the business of the agency in British India and not in the States. It is not suggested that the managing agents performed any functions in the States."

14. The same question of the place of accrual arose in a somewhat different context in Commissioner of Income-tax, Bombay Presidency and Aden v. Chunilal B. Mehta ((1938) 6 I.T.R. 521), where a person resident in British India and carrying on business there controlled transactions abroad, and the question was if he was liable to pay tax upon profits derived by him from contracts made for the purchase and sale of commodities in various markets - Liverpool, London, New York, etc. The assessee disputed his liability in respect of such profits on the ground that they were not profits "accruing or arising in British India". It was held that the mere fact that the profits made depended on the exercise in British India of knowledge, skill and judgment on the part of the assessee did not mean that the profits arose or accrued in British India, and there was no necessity arising out of the general conception of a business as an organisation that the profits of the business must arise only at one place, namely, the place of central control of the business. Delivering the judgment of the Privy Council in that case, Sir George Rankin observed :

> "The words "accruing or arising the British India" may be taken, provisionally and in the first place, as an ordinary English phrase which derives no special meaning from the Act. The alternative "accruing or arising in" and the antithesis between these words and the words "received in" or "brought into" afford no safe inference of any special meaning. "Profit.....accruing or arising in British India" are words which in their ordinary meaning seem to require a place to be assigned as that at which the result of trading operation comes, whether gradually or suddenly, into

existence."..... ....

"Their Lordships are not laying down any rule of general application to all classes of foreign transactions, or even with respect to the sale of goods. To do so would be nearly impossible and wholly unwise. They are not saying that the place of formation of the contract prevails against everything else. In some circumstances it may be so, but other matters - acts done under the contract, for example - cannot be ruled out a priori. In the case before the Board the contracts were neither framed nor carried out in British India; the High Court's conclusion that the profits accrued or arose outside British India is well-founded."

15. A similar view was expressed in two earlier decisions : (1) In Re : The Aurangabad Mills Ltd. ((1921) I.L.R. 45 Bom. 1286), where a reference was made to Commissioner of Taxation v. Kirk, (1900) Appeal Cases, page 588 and it was pointed out that the circumstance that the affairs of the company were directed from Bombay was not the determining test; but the test was where the processes which yielded the income were carried out and that was outside British India; (2) The Commissioner of Income-tax, Bombay Presidency v. Messrs. Sarupchand Hukamchand of Bombay, a firm ((1930) I.L.R. 55 Bom. 231), where the assessees acted as the secretaries, treasurers and agents of a mill company registered at Indore, outside British India, and under the terms of agreement, the assessees were entitled to charge and receive as selling agents commission on the gross sale proceeds of all cloth produced by the mill and the company opened a shop in Bombay for the sale of cloth produced by the mill which was managed by the assessees. The sale proceeds were sent to Indore and the assessees were paid the commission at Indore. The question arose whether the commission was liable to be assessed to income-tax in Bombay, and it was held that the income accrued in British India. In Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai and Co., Bombay ((1950) S.C.R. 335), this Court dealt with a case where a firm resident in British India carried on the business of manufacturing and selling groundnut oil; it owned some oil mills within British India and a mill in Raichur in the Hyderabad State where oil was manufactured. One of the questions for decision was whether the profits of that part of the business, viz., the manufacture of oil at the mill in Raichur accrued or arose in Raichur within the meaning of the third proviso to s. 5 of the Excess Profits Tax Act, 1940. A majority of Judges held that the profits arose in Raichur, and in a composite business, the profits need not arise at one place only but may arise at more than one place and an apportionment may be necessary. This was not, however, a case of managing agency.

16. We now come to the decision in Salt and Industries Agencies Ltd., Bombay v. Commissioner of Income-tax, Bombay City , a decision of the same learned Chief Justice, in respect of which learned counsel for the appellant has made some very serious comments. The facts of that case were these : the assessees, a company incorporated in Bombay were the managing agents of another company incorporated in Bombay and having its salt works at Aden and at Kandla in the Kutch State. The assessee's registered office was in Bombay, where the board of directors met, the books of account were maintained and various types of work connected with the company were done. Under the managing agency agreement the assessees were entitled to a commission at the rate of 12 1/2 per cent. per annum on the annual net profits of the company and in any event a minimum of Rs.

30,000 per annum. The agreement also provided that such portion of the commission as was attributable to the net profits of the company arising or accruing in the Indian State was to be paid to the managing agents in such State and that with regard to the minimum commission half of it was to be paid in the State. In pursuance of the assessees' articles of association the board of directors passed a resolution delegating a particular director to guide the company's operation in the State of Kutch and during the year of account that director supervised the salt works at Kandla. The question was whether the sum of Rs. 88,065 representing assessee's commission attributable to the salt works at Kandla accrued or arose at Kandla or in British India. First, the learned Chief Justice referred to the test to be applied in order to determine where the profits of the assessee company accrued or arose, and he said that the test was to find out where the actual business of the company was done which yielded the profits sought to be taxed. In that connexion he said :

> "The work of the managing agents must be looked upon as a unit and not as divided up into so many different categories, to each one of which a certain portion of the commission earned by the managing agents can be attributed or allocated."

17. He then went on to consider when the right to managing agency commissioner arose in that case and came to the conclusion, which was decisive in his opinion, that it arose when all the accounts of the working of the company were submitted to the head office in Bombay and the profits were determined; therefore, the sum of Rs. 88,065 accrued or arose to the assessees in Bombay and not in the Indian State both for purposes of income-tax and excess profits tax.

18. Now, learned counsel for the appellant has no quarrel with the decision in so far as it laid down that (a) the test is to find out where the business is actually done, i.e., where the services are performed, and (b) the right to managing agency commission arose in that case when all the accounts of the working of the company were submitted to the head office in Bombay and the profits were determined. Learned counsel has contended that in the case under our consideration the services were performed partly in British India and partly in Cochin and the right to managing agency commission arose as soon as the freight was paid at least in respect of two of the managed companies. He has submitted, however, that the learned Chief Justice was in error if he intended to lay down a rule of universal application that the work of the managing agents must always be looked upon as a unit and can never to be divided into categories. It is contended that the services of a managing agent can be performed at more than one place, and legally it is possible to apportion the commission and attribute a part of it to services rendered outside the taxable territories.

19. We consider it unnecessary in the present case to decide the question of performance of services and resultant apportionment, if any, of a theoretical or hypothetical basis, because the case can be disposed of on the short ground that on the findings of the Tribunal, the remuneration of the managing agents accrued at Bombay. We had referred earlier to the findings reached by the Tribunal. These findings show that except for an attempt at make-believe, no services were really performed by the appellant at Cochin. No doubt, some freight was secured and paid for at Cochin. But the managed company also had an office at Cochin to secure freight. It has been argued that under the terms of the managing agency agreements, the managing agents employed the staff, etc., and for two of the companies which carried on the cargo business, securing freight was the principal

part of the managing agency business. The High Court, however, rightly pointed out :

> "In our opinion, it is not possible to read the managing agency agreement in that light. All that clause 2 of the agreement does is to lay down the standard by which the commission is to be computed and determined, and it lays down two different standards, one with regard to the shipping business and the other with regard to the other businesses, but as far as the business of the managing agency is concerned their responsibilities and their duties are integrated duties and responsibilities which are set out in the different clauses of the agreement. It is impossible to contend that they had not to supervise, control and manage the shipping business and, as we have already said the business of a shipping company is vastly more detailed and responsible than the mere task of finding people to go by ship or send their goods by ship and for that purpose paying freight. Freight is merely the resultant profit which accrues to a shipping company. In order that that profit should result the company has got to have ships, it has got to have seaworthy ships, it has got to have sailors and officers, it has got to look to the repairs of the ships, the renovation of the ships and the replacements of the ships. All this is part of the shipping company's business and all this business had to be attended to by the managing agents and the question is, where did they attend to this business. The finding on this question is clear. The finding, in effect, is that barring booking freight, and collecting freight at Cochin, all other important and responsible work of managing the managed companies was done from the head office at Bombay and not from Cochin."

20. On the findings reached, the position in law is quite clear. The decisions to which we have referred clearly establish that normally, the commission payable to the managing agents accrues at the place where the business is actually done, that is, where the services of the managing agents are performed. In this case the appellant practically performed all the services at Bombay, and therefore the commission which it earned though computed on the percentage of freight and/or passage money in respect of two of the managed companies, accrued or arose in British India. As to the third managed company whose business was stevedoring and trading and the remuneration was payable at 25 per cent. of the net profits, there can be no doubt that the remuneration accrued at Bombay. Therefore, the High Court of Bombay correctly answered the question against the appellant.

21. The appeal accordingly fails and is dismissed with costs.

22. Appeal dismissed.