Inderchand Hari Ram vs Commissioner Of Income-Tax And C.P. & ... on 4 March, 1952

Equivalent citations: AIR1952ALL706, [1952]22ITR108(ALL)

Author: V. Bhargava

Bench: V. Bhargava

JUDGMENT

V. Bhargava, J.

1. These two references arise out of the assessment of the same assessee Messrs. Inderchand Hari Ram, Gorakhpur, in respect of two different assessment years, viz., 1940-41 and 1941-42. Since the question, that arose, was common to both the references, the Income-tax Appellate Tribunal, Allahabad, made one consolidated order of reference and, by it, referred the following question to this Court for opinion:

> "Whether, in the circumstances of the case, the income derived by the applicant firm both as Managing and Sole Agents of Messrs. Shankar Sugar Mills, Limited, Captainganj, Gorakhpur, was rightly assessed under Section 10 or whether the income is assessable under Section 7 of the Indian Income-tax Act?"

2. The facts relating to these references, as given in the statement of the case, are that the assessee is a firm registered under the Indian Partnership Act, having come into existence through a deed of partnership which mentioned that it was being constituted with a view to floating a private limited company to be called the Shankar Sugar Mills, Limited with a capital of 13 lacs out of which a sum of 12 lacs of rupees was to be subscribed by the partners according to their shares in the firm and to securing its Managing Agency. The partnership deed provided that "The business of the partnership shall be to float and obtain the Managing Agency of the proposed Shankar Sugar Mills, Limited, and shall be carried on at Captainganj, District Gorakhpur, and at such other place or places as the partners may from time to time agree upon."

In pursuance of this deed of partnership, a private company called the Shankar Sugar Mills, Limited, was actually floated and the Managing Agency of the company was obtained by the assessee firm. According to the Memorandum and Articles of Association of the Shankar Sugar Mills, Limited, the assessee firm styled as Inderchand Hari Ram or their assignees or successors in business were entitled to remain and continue as Managing Agents for the period (of 31 years certain?) from the incorporation of the company. The partnership deed had further provided that "The partnership shall not be dissolved by the death of any of the partners, the deceased partner's legal heir and

representative shall become partner 'ipso facto'."

The appointment of the assessee firm as Managing Agents of the Shankar Sugar Mills, Limited, carried with it the right to receive an allowance of Rs. 1,000/- a month, a commission of 1 per cent. on all sales of the company's products and a commission varying from 5 to 10 per cent. on the profits of the company for working as such. Consequently, the assessee firm received a total sum of Rs. 34,177/6/3 for remuneration and commission in the previous year corresponding to the assessment year 1940-41 and a sum of Rs. 34,440/- in the previous year corresponding to the assessment year 1941-42. In addition, during both these years, the assessee firm worked as the sole selling agents of Messrs. Shankar Sugar Mills, Limited, and received commission on sales if sugar and income under some other heads which, after deduction of expenses, gave a net revenue of Rs. 11,847/- in the previous year corresponding to the assessment year 1940-41. In the next year, the income from this sole agency business was Rs. 13,139/-. The total income of the assessee firm in the two years in dispute was thus Rs. 46,024/6/3 and Rs. 47,579/- respectively.

The Income-tax Officer assessed this entire income of the assessee firm in each of the years as income from business under Section 10 of the Indian Income-tax Act. The contention of the assessee firm that the income received by it for working as Managing Agents as well as for working as Sole Agents of Messrs. Shankar Sugar Mills, Limited, should be treated as salary and assessed under Section 7 of the Act was rejected by the Income-tax Officer. The assessee appealed to the Appellate Assistant Commissioner of Income-tax and on dismissal of the appeal to the Income-tax Appellate Tribunal. The latter also dismissed the appeals and consequently, the assessee applied for these references.

3. The only question to be decided in these references is whether the assessee firm, in working as Managing and Sole Agents of Messrs. Shankar Sugar Mills, Limited, was working as a servant earning salaries falling within Clause (i) of Section 6 of the Indian Income-tax Act, or earning profits and gains of business, profession or vocation mentioned in Clause (iv) of that section. We may first take up the question of the capacity in which the firm worked as Managing Agents of Messrs. Shankar Sugar Mills, Limited. In Clause (9A) of Sub-section (1) of Section 2 of the Indian Companies Act, a managing agent is defined as meaning "a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the company, and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement and includes any person, firm or company occupying such position by whatever name called: 'Explanation': If a person occupying the position of a managing agent calls himself a manager, he shall nevertheless be regarded as managing agent and not as manager for the purposes of this Act."

This definition of managing agent makes it clear that a managing agent need not necessarily be a servant of the company whose affairs are managed by that managing agent. All that is needed is that the managing agent should have an agreement with the company under which he receives the right of management of the whole affairs of the company though this management of the affairs of the company is to be under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement. Such an agreement may be entered into between a person

who is already a servant of the company or it may be entered into between the company and some person who may not be a servant of the company. The mere appointment as a managing agent or working as such would not necessarily make the person a servant of the company. Whenever any one works as a managing agent of a company, that person must be reimbursed in some form or the other for the work done by him. In a case where a managing agent happens to be a servant of the company, the payment to him of his salary as servant may compensate the person for the whole work done by him as the managing agent and the servant of the company and no separate or additional remuneration may be provided for working as managing agent. On the other hand, if the managing agent does not happen to be a servant of the company, then the payment would be made, under the agreement, for the work done as managing agent and not as salary for services rendered by him as a servant. It thus appears to be clear that, under the Indian Companies Act, a managing agent may either be a servant of the company or a mere agent without being a servant. In this connection, the definition of manager may also be considered. Manager has been defined to mean, "a person who, subject to the control and direction of the directors, has the management of the whole affairs of a company, and includes a director or any other person occupying the position of a manager by whatever name called and whether under a contract of service or not."

It is clear that there are only two main distinctions between a manager and a managing agent. The chief distinction is that a manager need only have the management of the whole affairs of the company whereas the managing agent is entitled to the management of the whole affairs of the company which means that any person, who actually happens to be managing the affairs in any capacity whatsoever, will be deemed to be a manager whereas to be a managing agent, he must be entitled, as of right, to the management of the affairs of the company, the right being granted by an agreement with the company. The second difference is that a manager must always work subject to the control and direction of the directors whereas the control and direction of the directors over the managing agent may be modified by the terms of the agreement.

4. The third distinction between a managing agent and a manager is that while a managing agent may be a person, a firm or a company, the manager can be only a person. The explanation added to the definition of managing agent further lays down that if a person happens to occupy the position of a managing agent, he shall be regarded as such even though he may call himself a manager and shall thereupon not be regarded as a manager.

5. These definitions of manager and managing agent make it quite clear that the managing agent occupies a position which is normally not the position of a servant of the company. No servant can claim the management of the company as of right, nor can a manager do so. The managing agent, on the other hand, manages the affairs of the company by virtue of a right acquired by him by an agreement with the company. The circumstance that the managing agent receives an allowance for the work done as such is certainly an incident which also occurs in the case of a servant but the existence of one such single circumstance cannot be held to constitute a managing agent a servant of the company by being merely appointed as such.

In the present case, the actual agreement, by which the assessee was appointed as managing agent of Messrs. Shankar Sugar Mills, Limited, does not form part of the paper-book, nor have the terms

of that agreement been set out by the Income-tax Appellate Tribunal in the statement of the case. The Tribunal has referred to the agreement concluded between the firm and the company in their statement of the case and have held that the partnership deed read along with the agreement makes it clear that the firm is not an officer or servant of the company in the strict sense of the word. We have, therefore, to take it for granted that whatever agreement was concluded between the assessee and Messrs. Shankar Sugar Mills, Limited, did not contain any specific term or condition by which the firm was made an officer or servant of the company. The agreement merely appointed the firm as managing agent.

The copy of Articles of Association contained in one of the appendices attached to the statement of the case also does not contain any clause clearly laying down that the assessee firm was being appointed as a servant of the company. It only recites that "that Firm, Messrs. Indarchand Hari Ram, has been, since the incorporation of the company, and are on the date of the adoption of these Articles the Managing Agents of the Company. The said firm Messrs. Indarchand Hari Ram, as it is at present constituted or as it may be from time to time constituted or their assigns or successors in business whether under the same or any other name, style or firm whether incorporated or unincorporated, shall be entitled to remain and continue as such Managing Agents (unless it be resigned by them) for a period of thirty-one years certain from the date of the incorporation of the Company, and thereafter until they be removed therefrom by a special resolution of the share-holders of the Company....."

These words used in the Articles of Association do not give any indication that the assessee firm was being appointed managing agents as servants and not merely as agents under a contract. In this case, therefore, a consideration of 'the documents appointing the assessee as managing agents of Messrs. Shankar Sugar Mills, Limited, does not make it clear whether the work as managing agents was to be done by the assessee as a business of theirs or as a servant.

6. Learned counsel for the assessee referred us to a few cases in support of his contention that persons otherwise connected with a company in the capacity of a director or a managing agent may also be working in the capacity of servants of the company. In 'COMMR OF INCOME-TAX, BOMBAY v. L. ARMSTRONG SMITH', 1946-14 I T R 606 (Bom), it was held that "a director of a company as such is not a servant of the company and 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."

In that case, a business carried on by the assessee was taken over by a private limited company in which the assessee held most of the shares while two of his nominees held the rest. The Articles of Association of the company provided that the assessee was to be the Chairman and Managing Director of the company until he resigned office or died or ceased to hold at least one share in the capital of the company, that all the other directors were to be under his control and were bound to conform to his directions in regard to the company's business, and that his remuneration was to be voted by the company at its annual general meeting. The assessee devoted his whole time to the management of the company's affairs. He received a sum of Rs. 48,000/- as his remuneration in the

year of account. It was further held that "the remuneration of Rs. 48,000/- received toy the assessee was for managing the company's business and arose from his contractual relation with the company provided by the articles for performing the services of managing the company's business and that, therefore, his remuneration fell to be taxed under Section 7 and not under Section 12 of the Income-tax Act."

Obviously, the facts of that case were different from the facts of the case before us. In the present case, there is no evidence of any contractual relationship by which the assessee firm might have been given the status of a servant of the company.

Learned counsel also referred to the remarks of Chagla, J. in 'COMMR. OF INCOME-TAX, BOMBAY CITY v. LADY NAVAJBAI R. J. TATA', 1947-15 ITR 8 at p. 14 (Bom), to the effect that "in the case of a director there may be special terms in the articles of association, or there may be an independent contract which may bring about contractual relationship between the company and the director and constitute the director an employee of the company; but independently of such special contract, a director of a company is not the employee of a company."

in support of his arguments that, by contractual relationship between the company and the director, a director can be constituted an employee of the company. This view is also of no assistance to the assessee in the present case where, as we have said before, there is no evidence at all to show that the agreement between the assessee and Messrs. Shankar Sugar Mills, Limited, or the Articles or Memorandum of Association of the latter created any contractual relationship by which the assessee was constituted an employee of the company. In this case, therefore, in order to determine the status of the assessee while working as managing agents of Messrs. Shankar Sugar Mills, Limited, the point has to be examined on other considerations.

7. It appears to us that a very important and significant point that has to be considered is that the assessee is a firm constituted under the Indian Partnership Act which limits the purposes for which a firm can be brought into existence. This is the consideration that weighed with the Income-tax Appellate Tribunal for holding that the firm, in working as Managing Agents of Messrs. Shankar Sugar Mills, Limited, was carrying on a business. In 'THE COMMRS. OF INLAND REVENUE v. THE KOREAN SYNDICATE LTD.'. (1921) 12 Tax Cas. 181 at p. 202, Lord Sterndale, M. R. had to consider the case of a work being done by a company in order to decide whether it constituted business of the company. In dealing with this question, he held as follows:

> "A great deal of argument was addressed to us to this effect that you could not possibly say that in this case if the respondents were an individual, he was carrying on a business, and that there can be no difference between an individual and a limited company. Now I am sorry to say I do not assent to either of those two propositions. I do not think it would have been at all clear that if the respondents were an individual, he was not carrying on a business; and for this reason. You would have to see what he was doing and why he was doing this, and if he was "doing it under the circumstances under which the Company were doing it, namely, trying to attain the object of acquiring a concession and turning the same to account, then I

> think he might very well be carrying on a business; I do not assent, either, that there can be no difference between an individual and a company.
>
> If you once get the individual and the company standing exactly on the same basis, then there would be no difference between them at all. But the fact that the limited company comes into existence in a different way is a matter to be considered. An individual comes into existence for many purposes, or perhaps sometimes for none, whereas a limited company comes into existence for some particular purpose, and if it comes into existence for the particular purpose of carrying out a transaction by getting possession of concessions and turning them to account, then that is a matter to be considered when you come to decide whether doing that is carrying on a business or not."

In the case before us also, the assessee is not an individual but a juristic person which can be brought into existence only for purposes permissible under the Indian Partnership Act. These purposes are therefore, a matter to be considered when deciding whether the firm is carrying on a business or not. Rowlatt, J. in 'COMMRS. OF INLAND REVENUE v. BIRMINGHAM THEATRE ROYAL ESTATE CO., LIMITED'. (1921) 12 Tax Cas 580 at p. 584, followed the above view of Lord Sterndale, M. R. and held that "when you are considering whether a certain form of enterprise is carrying on business or not, it is material to look and see whether it is a company that is doing it."

8. Under Section 4 of the Indian Partnership Act (No. IX of 1932), partnership is denned as the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Under this Act, therefore, the relationship of partners can be brought into existence only when there is a 'business' carried on by all or any of them acting for all partners. 'Business' under the Act is defined as including every trade, occupation and profession. The partnership collectively entered into by persons is called a 'firm'. The Act, therefore, envisages the creation of a firm only for the purpose of carrying on a business which includes every trade, occupation and profession.

Whenever, therefore, a firm comes into existence, the purpose of the firm must be business. The word 'business' as defined under the Partnership Act, does not include employment as a servant. In this case, the assessee-firm, according to the deed, of partnership was constituted for doing the business of floating and obtaining the managing agency of the proposed Shankar Sugar Mills, Limited. The partnership deed went on to recite that this business of the firm was to be carried on at Captainganj, District Gorakhpur, and at such other place or places as the partners may, from time to time, agree upon. Avowedly, therefore, the assessee-firm was to take up the work of floating and obtaining the managing agency of Messrs. Shankar Sugar Mills, Limited, as the business to be carried on by the partnership. We have already expressed our opinion that the work of managing agents of a company can be carried on by a servant as well as a business by a person working as managing agent. If the managing agent happens to be an individual, he can take up the work of a managing agent in either of the two capacities of a servant or as a personal business of his own. In the case of a firm, which can be constituted only for the purpose of sharing profits of a business, the work of managing agency must be held to be the business of the firm.

9. Learned counsel for the assessee-firm drew our attention to the difference between the definitions of the word 'business', as given in the Indian Partnership Act and in the Indian Income-tax Act. As we have already mentioned, 'business' under the Indian Partnership Act is defined as including every trade, occupation and profession. Under the Indian Income-tax Act, 'business' has been defined to include any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. Further, Clause (iv) of Section 6 of the Indian Income-tax Act, when classifying the heads of income, profits and gains chargeable to income-tax, puts together profits and gains of business, profession or vocation.

The three words, 'business, profession or vocation', used in this Clause (iv) of Section 6 of the Act are precisely the words also used in Section 10 of the Indian Income-tax Act and they clearly include the full meaning of the word 'business' as defined in the Indian Partnership Act. In fact, if at all, the three words, 'business, profession or vocation', used in the Indian Income-tax Act are wider than the word 'business' in the Indian Partnership Act as including every trade, occupation and profession. The difference between the definitions of the word 'business' in the Indian Partnership Act and in the Indian Income-tax Act, is therefore, of no consequence. The profits of a business using the word 'business' as defined in the Indian Partnership Act would be all the profits of a business, profession or vocation falling within Section 10 of the Indian Income-tax Act. Consequently, the profits, which the assessee-firm earned from their business of working as managing agents of Messrs. Shankar Sugar Mills, Limited, must be held to be their profits or gains from business, profession or vocation assessable to income-tax under Section 10 of the Indian Income-tax Act.

10. Learned counsel for the assessee-firm argued that in this case, the firm was constituted merely for the purpose of floating a sugar company and taking its managing agency and that there is nothing to indicate that the floating of the company and taking over of its managing agency were to be carried on by the firm as a regular business involving continuity of activity. The mere taking over of managing agency of one company could not, therefore, be held to be the business of the firm. Learned counsel relied on the remarks of Rowalatt, J. in 'COMMRS OF INLAND REVENUE v. MARINE STEAM TURBINE CO., LTD.', (1920) 1 K B 193 at p. 203, to the effect that "the word 'business', however, is also used in another and a very different sense, as meaning an active occupation or profession continuously carried on, and it is in this sense that the word is used in the Act with which we are here concerned."

These remarks were made by Rowalatt, J.

when considering the question whether the profits in respect of which the appellants made a claim to excess profits duty were profits arising from any "business" carried on in that country by the respondent company within the meaning of those provisions. In the case of 'COMMR. OF INCOME-TAX, BENGAL v. SHAW. WALLACE AND CO.', 59 Cal 1343 at p. 1351 (PC), their Lordships of the Privy Council held as follows:

> "By Section 2 (4) business "includes any trade, commerce or manufacture, or any adventure or concern in the nature of trade, commerce or manufacture'. The words used are no doubt wide, but underlying each of them is the fundamental idea of the

> continuous exercise of an activity. Under Section 10, the tax is to be payable by an assessee under the head business 'in respect of the profits or gains of any business 'carried on by him'. Again,..... the words underlined (here in inverted commas) are an essential constituent of that which is to produce the taxable income: it is to be the profit earned by a process of production. And this is borne out by the provision for allowances which follows. They Include rent paid for the premises where the business is carried on; the cost of current repairs in respect of such premises; interest on money borrowed for carrying on the business etc."

Learned counsel argued that, according to the view expressed in these cases, the word 'business' connotes an idea of continuity which, in the present case, is missing. He contended that the floating of the proposed Shankar Sugar Mills, Limited, and the securing of its managing agency were a single venture not involving any idea of continuity of business and consequently, it would not be correct to hold that the income accruing to the assessee-firm from the managing agency was income from 'business'. We are not inclined to accept this contention for two reasons: Firstly, the work of the partnership firm was not to come to an end with the mere floating of the Shankar Sugar Mills, Limited, and securing of its managing agency.

After the managing agency had been secured, the assessee-firm had to and did actually continue to work as managing agents of Messrs. Shankar Sugar Mills, Limited, and continued to manage its affairs. This continuous management of the affairs of the company was precisely the business of the assessee-firm which was one of the purposes of its formation under the Indian Partnership Act. In this case, therefore, there was a continuity of the business of the firm.

Secondly, even a single venture can sometimes constitute the business of a firm or a company. In 'RE ABENHEIM; EX PARTE ABENHEIM', (1913) 109 L T 219, Phillimore. J. held:

> "I think that from that time forward there can be no doubt that, if I am right in construing the word 'business' in the Partnership Act of 1890 as relating not merely to a life-long or a universal business or a long-undertaking, but to any separate commercial adventure in which people may embark, this was a contract which came within Section 2, Sub-section 3(d), of the Act with the liabilities imposed in such cases and possibly in accordance with a decision in the Court of Appeal in some others under Section 3 of the same Act. It has been suggested to me that 'business' does not mean an isolated adventure, but that it means the regular trade of people even though they may have two or three separate trades. I see no reason for construing it in this way. I look at Section 1, Sub-sections (1), (2) and (3), and the general trend of commercial law on this subject, and I come to the conclusion that there is no reason for limiting 'business' in the way suggested by the creditor."

In the present case also, a single venture of floating the Shankar Sugar Mills, Limited, securing its managing agency and subsequently managing its affairs was clearly intended by the partners of the assessee-firm to be an adventure in the nature of a business by them. We are, therefore, not impressed by the argument that because the assessee-firm had not taken up the business of

promoting companies and securing managing agency in general, it was not carrying on any business when it promoted one single company, secured its managing agency and thereafter managed its affairs in the capacity of managing agents.

11. The second part of the question referred to us relates to the profits earned by the assessee-firm as sole agents of Messrs. Shankar Sugar Mills, Limited. The work of sole agents can be taken on by a person in either of the two capacities. In one capacity, the person doing the business may be the servant of the principal whose agency he has taken over. In the other capacity, he may be selling goods as sole agent as his own business though receiving his profits only in the form of commission on the goods sold by him. The question as to the capacity, in which, in any particular case, the sole agent happens to be working, will depend on the facts of that case. In the case before us, there is nothing at all to indicate that the assessee-firm. in taking over the sole agency of Messrs. Shankar Sugar Mills, Limited, entered into any con-tract which created the relationship of master and servant. On the other hand, the considerations, which have weighed with us in holding that the work of managing agency of Messrs. Shankar Sugar Mills, Limited, was being carried on by the assessee-firm as their own business equally apply to their sole agency business also and it must be held that the income gained by the assessee-firm as sole agents was income or profit from their business.

12. We, therefore, answer the question referred to us in the affirmative. The Department is entitled to its costs which we assess at Rs. 300/- in each case. Reference answered in the affirmative.