

L.N. Gadodia & Co. vs The Commr. Of Income-Tax, United And ... on 11 May, 1950

Equivalent citations: AIR1953ALL271, AIR 1953 ALLAHABAD 271

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Bench: V. Bhargava

JUDGMENT

V. Bhargava, J.

1. This is a reference under Section 66 (I), Income-tax Act, read with Section 21, Excess Profits Tax Act. The question referred to us for opinion runs as follows:

"Whether in the circumstances of this case the applicant firm is liable to be assessed to Excess Profits Tax for the chargeable accounting period 30-10-1940 to 19-10-1941 on the income, profits and gains derived by it from:

(a) the selling agency of the Cawnpore Cotton Mills Co. (branch of the British India Corporation, Ltd.) and

(b) the running or the management of the retail cloth shop of the Cawnpore Cotton Mills Co.?"

2. Messrs. L.N. Gadodia & Company, which is a registered partnership firm, secured the selling agency business of the Cawnpore Cotton Mills Company, which is a branch of the British India Corporation, Limited, by means of a written agreement drawn up on 1-3-1938. The case of the firm is that the income derived by it from this selling agency business is not the income, profits or gains from a business but is the payment for services rendered by the Company in the capacity of a servant, the master being the British India Corporation, Limited. The claim thus was that all the income received from this selling agency business was salary which was outside the scope of the Excess Profits Tax Act. The Excess Profits Tax Officer, the appellate Assistant Commissioner, Excess Profits Tax, the Income-tax Appellate Tribunal held that the receipts from this business were business profits and consequently assessed Excess Profits Tax on it.

3. In addition to this selling agency business, a retail cloth shop was also run at Kanpur which was managed by this firm. For the chargeable accounting period, the Company was paid a sum of Rs. 27,030-15-0 purporting to be payment for meeting costs of advertisement and salaries of: travelling representatives in respect of the running and management of this retail shop. The Excess Profits Tax

Officer treated this amount also as income, profits or gains from business and assessed this amount to Excess Profits Tax. The contention of the firm was that this amount was paid to it to meet the expenses so that it was not the income, profits or gains at all; and, in the alternative, it was contended that, in any case, this amount must be treated as salary paid to the firm for managing and running the retail shop and it did not represent the income, profits or gains from the business of this shop. The appeal to the Appellate Assistant Commissioner, Excess Profits Tax, failed and so did the appeal to the Income-tax Appellate Tribunal. The Income-tax Appellate Tribunal, in addition, held that, even if this amount be deemed to have been paid to the Company to meet the expenses incurred by the firm in running the retail shop, the amount would be liable to be added to the income, profits or gains of the Company, because this amount was already included in the expenses shown by the Company in its accounts, so that if this amount is not taxed separately as income, profits or gains, the expenses set off in the accounts should be reduced by this amount and the income, profits Or gains calculated according to the accounts should thereby be increased to the extent of this amount.

4. The answer to the question referred to us depends principally on the determination of the question whether the income of the Company from the selling agency business and the running or the management of the retail cloth shop is to be deemed to be the profits of the business of the Company, or whether it should be treated as salary paid to the Company which was functioning as a servant of the British India Corporation Limited. Under Section 4, Excess Profits Tax Act, only the income, profits or gains from a business are liable to Excess Profits Tax whereas the income received as salary is outside the scope of that Act. It was contended by Mr. Pathak on behalf of the firm that in this case there was no material for the Tribunal to come to a finding that the selling agency business was a business of the Company as an agent and that the only possible finding in this case was that there existed a relationship of a master & servant between the British India Corporation, Limited, and the firm, Messrs. L.N. Gadodia and Company, so that whatever was received by the Company was received as salary. He argued that the criterion for determining whether a firm is acting in the capacity of a servant or in the capacity of running its own business as an agent should be the amount of control that was exercised by the principal firm. He referred to the agreement between the Corporation and Messrs, L.N. Gadodia & Company to show that in the following matters, the latter came completely under the control of the former: (a) All sales were to be effected by Messrs. L.N. Gadodia & Company at current market rates subject to the approval of the Managing Directors of the Corporation or the Management of the Cawnpore Cotton Mills Company: (b) the services of Mr. D. Sharma were not to be dispensed with by Messrs. L.N. Gadodia & Company without the prior sanction of the Corporation: (c) Messrs. L.N. Gadodia & Company were, at all times, to use their utmost endeavours to dispose of the entire production of Bazar Yarns and Cloth by the Cawnpore Cotton Mills Company at market rates ruling at the time of sale : and (d) The proprietors of Messrs. L.N. Gadodia & Company or their representative, Mr. D. Sharma, were required to attend daily, or as required, at the office of the Corporation. From those four ingredients of the agreement an inference was drawn that Messrs. L.N. Gadodia & Comany in running this selling agency business were under the control of the Corporation in the detailed management of the agency business and, therefore, they must be deemed to have been acting in the capacity of a servant of the Corporation and not as agents running their own agency business, Eeliance was placed on the following remarks of Lord Sterndale, Master of the Rolls, made during arguments in the case of

Bobbins v. Commrs. of Inland Revenue, (1920) 2 K. B. 677 at p. 679;

"The test is whether the employer has the right to determine how the employee shall do his work in details."

That was, however, a case where Bobbins, the assessee, was required to give his whole time exclusively to pushing energetically the sale of goods of a company called in the agreement, for shortness, "Felt." The agreement further provided that "Felt" was to pay rent of the main office of Robbins in London. He agreed to pay for heating, cleaning, lighting, office furniture, supplies and postage--in fact, everything except travelling expenses; and also the salary of one stenographer or office girl--for London office, at an amount not to exceed a certain sum mentioned. It was provided in the agreement that "Felt" would pay the employer's contribution under the National Insurance Act. It was on these facts that it was held by Lord Sterndale that Robbins was acting as an assistant to "Felt" in order to carry on "Felt's" business, and the business which was being carried on was not his; the profits which were being made were not his. What was his was the remuneration that he got for his assistance in "Felt's" business. These ingredients are not present in this case. Messrs. L.N. Gadodia and Company were not required to devote their whole time to the business of the selling agency and were entitled to carry on even other independent business. They were only subject to control by the Corporation in a few matters. The agreement itself contains the following ingredients which would indicate that in the matter of the detailed running of the selling agency business Messrs. L.N. Gadodia & Company had the authority to act quite independently of any instructions from the Corporation: (1) The detailed running of the selling agency business vested entirely in Messrs. L.N. Gadodia & Company who had the power to choose their employees, to appoint and dismiss them. They had the choice of the parties with whom to enter into contracts for selling goods. They could appoint their own travelling agents and they were, in no way, subject to the control of the Corporation in the matter of establishment and organisation to be maintained by them. These powers of theirs were only subject to two conditions, viz., that the sale contracts entered into by them with other parties were subject to the approval of the Corporation and one of their employees, Mr. D. Sharma Manager, was not to be removed from service without the previous sanction of the Corporation; (2) the discount and brokerage on all transactions were to be paid by Messrs. L.N. Gadodia and Company out of their commission, (3) they were entitled to receive a commission even on direct sales effected by the Corporation to any customer, either in or out of Kanpur ; (4) they were liable to make payment for all the goods on delivery thereof whether or not the goods were actually paid for by the purchaser with whom they might have entered into contract of sale with the approval of the Managing Directors of the British India Corporation, Limited ; (5) they had to take delivery of all goods sold for ready delivery within 15 days from the date of any sale being effected and, failing this, the value of all such goods was to be debited to their account ; (6) in the event of unsold stocks of yarn or cloth reaching the equivalent of four months' production, the Corporation were at liberty to arrange for the sale thereof at current Market rates and would recover from the deposit of Messrs L.N. Gadodia & Company all expenses, commission and other charges which might be incurred in connection with such sales and no commission would be payable to them on such sales.

5. These terms contained in the agreement would clearly show that the selling agency business was being run by Messrs. L.N. Gadodia & Company as agents running their own business and not as servants of the Corporation. It is true that the contract between the two parties even required the attendance of the proprietor of Messrs. L.N. Gadodia & Company or of Mr. D. Sharma daily, or as required, at the office of the Corporation but this amount of control does not indicate that the running of the selling agency business was not in the hands of Messrs. L.N. Gadodia & Company and they had to act merely as servants under the instructions of the Corporation. The conditions relating to the payment of commission to Messrs. L.N. Gadodia & Company on direct sales, their liability for payment for all the goods on delivery thereof irrespective of the price being realised from the purchasers, their liability to take delivery in respect of accepted sales even if the purchasers failed to do so and their liability to meet expenses, commission and other charges which might be incurred in connection with direct sales by the Corporation in the event of unsold stocks of yarn or cloth reaching certain figures are all inconsistent with the relationship between a master and a servant. In these circumstances, it is not possible for us to hold that the Tribunal had no material to come to a finding that the selling agency business of the Cawnpore Cotton Mills Company run by Messrs. L.N. Gddodia & Company was their business and that the income, profits or gains from it were the income, profits or gains from that business and not the salary received as a servant. Consequently, all income profits or gains from the selling agency business iwere liable to be assessed to Excess Profits Tax.

6. The facts relating to the running or management of the retail cloth shop of the Cawnpore Cotton Mills Company are, however, different. The statement of the case shows that this retail shop was owned by the Cawnpore Cotton Mills Company though the management of 'the shop was entrusted to Messrs. L.N. Gadodia and Company. There was no written agreement relating to this business so that there was nothing to show what the relationship was between this firm and the owner of the shop and it was not known what sort of responsibility lay on the firm in the running or management of the shop. It was admitted that no fixed remuneration was to be paid to the firm and on behalf of the firm it was contended that it was entirely in the discretion of the management of the Corporation or of the Cawnpore Cotton Mills Company that the allocation of the profits of the retail shop was made. It was argued that if the Corporation did not pay the firm any portion of the profits of the retail shop, the firm would not be entitled to any payment. These contentions wore not found by the Tribunal to be wrong and the Tribunal proceeded to hold that, in spite of these contentions being accepted, the position of Messrs. L.N. Gadodia & Company could not be that of an employee. In this case when it was admitted that the shop belonged to the Corporation and even the remuneration to Messrs. L.N. Gadodia & Company who were managing the shop depended entirely on the discretion of the Corporation, it does not appear to us possible to hold that the retail shop was a business of the firm and not of the Corporation. The firm had no definite share in the profits which they could claim from the Corporation. The profits of the shop belonged entirely to the Corporation and were at their disposal. The firm only received what the Corporation chose to give to it. This position can only be consistent with the position of the firm as the employee and the corporation as the master and not with the position of the firm running the shop as their own business. The sum of Rs. 27,030-15-0 given by the Corporation to the firm, even if it be treated as an amount paid to the firm for the running or management of the retail shop, has to be treated as salary paid to the firm for doing the work of running or management of the retail shop and not as income, profits or gains derived by the

firm from this business of the retail shop.

7. The second aspect in which this amount has been considered by the Tribunal also needs to be considered. The Tribunal have found that this amount was in excess of even the total expenses incurred during the chargeable accounting period on advertisement and salaries of travelling representatives for the entire business done by Messrs. L.N. Gadodia & Company in running the selling agency business as well as the retail shop. Obviously, therefore, the whole of this amount could not be reimbursement of the expenses incurred on costs of advertisement and salaries of travelling representatives in respect of this retail cloth shop. The amount required to reimburse the expenses would have to be taken into consideration in determining the income, profits or gains derived by the firm from the selling agency business but any amount received in excess of this reimbursement must be treated as salary received by Messrs. L.N. Gadodia & Company acting as servants of Messrs. British India Corporation, Limited, for managing this shop. The Tribunal have not given any finding of fact indicating the exact amount of expenses which were reimbursed out of this sum of Rs. 27,030-15-0. A determination of that amount is necessary and we have to hold that the income, profits or gains from the selling agency business must be increased to the extent of the amount out of Rs. 27,030-15-0, required to reimburse the expenses mentioned above, for the purpose of assessing the Excess Profits Tax payable by the firm.

8. Our answer to the question formulated by the Tribunal accordingly is that, in the circumstances of this case, for the chargeable accounting period 30-10-1940 to 19-10-1941 (a) the applicant firm is liable to be assessed to the Excess Profits Tax on the income, profits or gains derived by it from the selling agency business of the Cawnpore Cotton Mills Company; and (b) the applicant firm is not liable to be assessed to Excess Profits Tax on the income, profits or gains derived from the running or management of the retail cloth shop of the Cawnpore Cotton Mills Company, but the income, profits or gains derived by it from the selling agency business of the Cawnpore Cotton Mills Company are liable to be increased by the amount which was received by the firm for actual reimbursement of the expenses incurred by it on advertisement and salaries of travelling representatives. In the circumstances of this case, we make no order as to costs.