THE

LAW OF INCOME-TAX
IN INDIA

BEING

A DETAILED COMMENTARY ON
THE INDIAN INCOME-TAX ACT XI OF 1922

AS AMENDED

BY
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SECOND EDITION

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IN MEMORY OF MY PARENTS.

PREFACE TO THE SECOND EDITION.

The exhaustion of the first edition and the passing of two Amending Acts have necessitated the bringing out of a second edition, and I have taken the opportunity not only to bring the book up-to-date but to revise parts here and there with the very limited time at my disposal. This edition also has had to be passed through the Press in a hurry and I can hardly exaggerate my gratefulness to Mr. R. Narayanaswamy Iyer for the assistance rendered by him.

1st July, 1928. V. S. Sundaram.

EXTRACT FROM PREFACE TO THE FIRST EDITION.

In view of my official position I must make it clear that this book represents my personal views only and not those of the Central Board of Revenue or the Government of India.

2. The proverbial obscurity of Income-tax Law is largely due to the vagueness of some of its principal cardinal concepts. This vagueness not only renders the enunciation of general principles difficult, but often reduces the problems that arise to mere problems of degree, the solution of which has to be sought in the facts of each case, and, when found, has to be largely a matter of opinion. Also, if the problems are not problems of degree they are very often problems on the borderland between 'fact' and 'law.' The rulings of Courts have therefore to be studied with special reference to the facts of each case; hence the advantage of a book like Dowell which gives in some detail the facts of each case and the relevant extracts from the judgments.

3. In yielding, perhaps too readily, to the temptation to compile a similar book, I must confess that I had underrated the difficulties. If the existence of an official Income-tax Manual in India, on the one hand,—with its official interpretation of the law and its extra-legal concessions—and the absence, on the other, of a large body of Case Law in the country—with the consequent necessity for comparing at each stage the English law with the Indian—made the task of compiling the book one of far greater

difficulty than that of compiling a similar book on English Income-tax Law, the attempt to write a book of this kind, while attending to the daily duties of an office, in which Income-tax is only one of several subjects dealt with and an uninterrupted eight-hour day is the rule, has well-nigh been one of despair. That I have somehow compiled it is due to the valuable and ungrudging help that I have received from others.

* * *

6. As already mentioned, I could not have compiled the book at all but for the assistance that I have received. I have obtained help from so many persons and so many books and publications that it is not possible to mention them all. But I must specially mention Mr. C. V. Krishnaswamy Aiyar, formerly Secretary to the Civil Justice Committee, and now Draftsman to the Madras Government but for whose guidance and encouragement in the early stages I should not have persisted in the attempt to compile the book at all; Mr. P. R. Srinivasan, the Editor of the Reports of Income-tax Cases, who very kindly read through the manuscript and made some valuable suggestions; and Mr. D. D. Chopra, of the Office of the Central Board of Revenue, who assisted me at every stage from the beginning to the end and of the value of whose help I cannot speak in too high terms. None of these gentlemen, however, is responsible for the views in this book, nor for its shortcomings, for both of which I take the full responsibility.

NEW DELHI,
1st March, 1927.

V. S. SUNDARAM.

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" . . . satisfies the most exacting standards that an expert lawyer might lay down . . . arrangement makes for lucidity, while the exposition is clear, elaborate and at places strikingly illuminating . . . a storehouse of perfectly ordered information, presented moreover in attractive language . . . "—*Calcutta Weekly Notes.*

" . . . marked by a thorough and discriminating analysis of the case-law both in India and in England. . . We have no doubt that the book will long remain the leading Indian treatise on Income-tax law . . . "—*Madras Law Journal.*

" . . . an exhaustive treatise . . . commentaries . . . are lucid . . . will prove an indispensable *vade mecum* to the Bench and the Bar . . . "—*Patna Law Times.*

" . . . We have no doubt that this treatise which reveals a keen insight and high merit will find its way into all the libraries of all lawyers and officers who have to deal with this important branch of law . . . "—*The Law Weekly* (Madras).

" . . . remarkable for its exhaustiveness, and clearness of exposition . . . "—*The Law College Journal, Lahore.*

" The danger of indiscriminate reliance upon English authorities is counteracted by pointing out the distinctions "—*All India Reporter.*

" . . . has handled a dry and difficult subject in a masterly manner and the book will be found to be of the very greatest assistance by all those who have occasion to consult it, the tax-payer, the Revenue officer and the lawyer . . . "—*Times of India.*

" . . . the amount of work put into this very compendious volume demands admiration . . . annotations, very well done . . . the book will surely rank as a standard work . . . "—*Pioneer.*

" . . . an authoritative and up-to-date guide . . . a detailed commentary illuminated by all the relevant English and Indian decisions . . . "—*Statesman.*

" . . . possesses all the qualities that make a legal commentary, a valuable work of reference . . . "—*Englishman.*

" . . . critical and thorough . . . contains a mass of valuable information . . . a creditable production . . . "—*Hindu.*

" . . . a publication of outstanding merit . . . "—*Indian Daily Mail.*

" . . . easily the most exhaustive book on the subject published so far . . . "—*Capital.*

" . . . very well done . . . we congratulate the Author . . . "—*Madras Mail.*

" . . . exhaustive . . . a kind of encyclopædia . . . worth several times its prize . . . "—*Civil & Military Gazette.*

" . . . the treatment is quite thorough and the book contains an astonishing wealth of material . . . "—*Leader.*

" . . . a reliable and exhaustive book of reference . . . "—*Indian Daily Telegraph.*

" . . . the first thing that strikes one is its exhaustiveness . . . "—*Searchlight.*

" . . . will occupy the position of a standard treatise . . . a notable and valuable acquisition to Anglo-Indian legal literature . . . "—*Hindustan Review*

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ADDENDA

Section 3—*Mutual concerns—Club—Shareholders different from members.*

A company limited by shares maintained a club. The club was managed by seven members, of whom at least five had to be shareholders in the company. The shareholders were not eligible as such for membership of the club, which was regulated by ballot, the voters being the already existing members. The company issued 445 shares, of which 74 were held by non-members of the club. The number of members of the club was 289, of whom 220 were not shareholders of the company. *Held*, that the company was not a mutual concern. The fact of incorporation could not be neglected, and the fact that some of the shareholders were members of the club was immaterial.[1]

Sections 3 and 4 (3) (vii)—*Capital and Income—Casual receipts—Detention of ships by Government—Compensation for.*

The compensation paid for the detention of ships during the coal strike by the Customs under orders of the Ministry of Shipping for a period of 15 days was considered to be taxable even though there was no formal chartering or requisitioning of ships by Government. The assessee claimed that the compensation was in the shape of damages for personal injury to a professional man. The ratio-decidendi was that the compensation was really in the nature of payment for the time and profit lost by the vessels during their detention. The Glenboig case was distinguished on the ground that in that case the compensation was for the sterlisation of the source of income. (Court of Appeal).

Sections 3 and 4 (3) (vii)—*Capital and Income—Casual receipts—Patents—Sales of.*

In the House of Lords followed the California Copper Syndicate and Melbourne Trust cases and reaffirmed the principle that "a gain made in an operation of

(1) *Dibrugarh Club, Ltd.* v. *Commissioner of Income-tax* (Calcutta High Court).
(2) *Ensign Shipping Co.* v. *Commissioners of Inland Revenue*, 7 A.T.C. 130.

business in carrying out a scheme of profit making" was taxable. The point in issue was whether in this particular case there was a solitary or accidental disposal of a capital asset or whether the company sold its patents as a regular and systematic business. The question was one of fact and there was no mis-direction on the part of the Commissioners. Though the line was one which the company did not intend to develop extensively there was evidence to show that it intended to sell and make profits on them. The House of Lords therefore declined to interfere[1].

Sections 4, 40, 42 and 43—*Non-resident—Business—Business connection—Agent should be in receipt of profits.*

The Hongkong Trust Corporation, Limited, a non-resident company lent money to the Bombay Trust Corporation, (a company in Bombay) large sums of money from time to time. About 15 to 20 crores of rupees was lent in 1924-25 and interest at 5½ per cent. was charged. The Bombay Trust Corporation paid the interest through E. D. Sassoon & Co., Ltd., Bombay, who passed on the credit to the Hongkong Corporation through Sassoon's Office at Shanghai. Though various members of the Sassoon family were interested in one or other of the three companies, it was not suggested by the Revenue Authorities that any of the companies was only a creature of the others or a sham. *Held* that (1) the Hongkong Trust Corporation carried on business in British India, since it lent money regularly and received interest; or alternatively received income from other sources in British India. (2) The Bombay Trust Corporation had a business connection with the Hongkong Trust Corporation; (3) The word 'through' as used in section 43 is not equivalent to the word 'from' and therefore under that section an agent cannot include a person who merely remits monies and (4) The agent should be in receipt of profits since otherwise there would be the anomaly that while an ordinary and undisputed agent was not liable under section 40 unless in receipt of profits a statutory agent deemed to be such under section 43 would be liable even if he received no income on behalf of the non-resident.[2]

The Remington Typewriter Company an English Company sold its Indian busines in 1914 to the Remington Typewriter Company (India), Ltd., the latter allotting 9,996 out of its 10,000 shares of Rs. 10 each to the New York Company as nominee of the English Company. In 1921 the Indian Company sold its Bombay and Madras

(1) *Ducker v. Rees Roturbo, Development Syndicate*, 7 A.T.C. 42.
(2) Bombay High Court (Unreported).

businesses to the New York Company which in its turn sold its business to the Remington Typewriter Company, Bombay, and the Remington Typewriter Company, Madras. The New York Company received dividends through the subsidiary companies. Taking the Bombay Company for example, the New York Company held all the shares in it except 3 out of 60,000, these 3 being held by employees in India. There was no obligation imposed on the New York Company not to sell typewriters to others in India. The Bombay Company purchased typewriters from the New York Company at the usual whole sale prices, *i.e.*, 40 per cent. below catalogue prices and retained profits on sales. The revenue authorities taxed the Bombay Company as agent of the New York Company on (*a*) dividends and (*b*) 5 per cent. of the sales from the New York Company to the Bombay Company. *Held* that (1) the relation between a shareholder and his Company is not business connection within the meaning of Section 42 (*i*); and that the Income-tax Officer should have used the provisions of section 57 in respect of the dividends in question and (2) that there was business connection between the New York and the Bombay Companies as regards sales; but that (3) the Bombay Company could not be taxed as agents since they were not in receipt of the profits. Sections 40 and 43 should be read together.[1]

As regards the receipt of profits by the agent—see notes on pp. 800 and 819.

Section 4 (3) (i)—*Charitable purposes—General Medical Council.*

The objects of the General Medical Council in England are to keep a register of Medical Practitioners and regulate their conduct, to supervise and control medical studies and examinations and to prepare and to revise from time to time the British Pharmacopoeia. It was held by the Court of Appeal that the purpose of the Council was not charitable.[2]

Section 10 (2) (ix)—*Capital expenditure—Foreclosure of lease.*

A company whose business was not to trade in mining licences but to win coal got rid of an onerous licence involving the payment of a dead rent and a minimum royalty by paying a lump sum to the lessor:

(1) *Remington Typewriter Co., Bombay* v. *Commissioner of Income-tax*, (unreported).

(2) *The General Medical Council* v. *Commissioners of Inland Revenue*, 7 A.T.C. 121.

Held that the payment was capital expenditure.[1]

Section 10 (2) (ix)—*Shares allotted with insufficient consideration.*

Though ordinarily a company may be presumed to get an adequate *quid pro quo* for its share capital which it allots, the shares are not really fully paid up if after making fair and reasonable allowance for conflicting views as to values there is a substantial discrepancy between the value of the shares allotted and the value of the consideration received in return. Therefore where a company allots its shares for a consideration much below its face value the consideration will for the purpose of calculating profit and loss for income-tax be estimated at its real value and not at the face value of the share exchanged for it; and the difference between the face value and the real value of the consideration cannot be claimed as a loss of the company.[2]

Section 13—*Stocks—Accounting of.*

At the same point of time the same stock could not belong both to the purchaser and to the seller. Till the property passes to the purchaser it is obviously the stock of the seller. To say that they had grain 'in hand' merely because by business arrangements which were in course of performance they had put themselves in a position to deal with purchasers in the security of being able to perform in their turn is merely a figure of speech like 'having 10 minutes in hand to catch a train' or finishing a race with several lengths in hand at the winning post, per *Lord Sumner*.[3]

Section 13—*Stock values—Rewriting—Retrospective—Additional assessment how to be made.*

The Bombay High Court have held that: when an assessee undervalues his stock for a series of years and the Income-tax Officer proposes to raise a supplementary assessment under section 34 such supplementary assessment should be based on a revaluation not only of the closing stock of the previous year but also of that of the opening stock of that year.[4]

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(1) *Staveley Coal Co.* v. *Commissioners of Inland Revenue*, (Court of Appeal) 7 A.T.C. 139.

(2) Civil Reference No. 8 of 1926 *Commissioners of Income-tax* v. *Trustees, Corporation (India), Ltd.*, following *In re Wragg, Ltd.*, (1897) 1 Ch. 796.

(3) *Benjamin Smith & Sons.* v. *The Commissioner of Inland Revenue* (House of Lords) 7 A.T.C. 135.

(4) *New Ahmedabad Spinning and Weaving Mills* v. *The Income-tax Commissioner* (unreported).

See in this connection notes on page 606.

The Draft of the revised rules necessitated by the recent amendment of Section 48 by Act III of 1928 (see foot-note on page 838) was published for criticism on 16th June 1928 and will be taken into consideration on or after the 1st August. The Draft rules are given below :

For rule 36 of the said Rules, the following Rule shall be *substituted,* namely :—

36. In the case of a person resident in British India, an application for a refund of income-tax under section 48 of the Act shall be made in the following form :—

Application for refund of income-tax.

I, of do hereby state that my total income computed in accordance with section 16 of the Indian Income-tax Act, XI of 1922, accruing or arising or received in British India, or deemed under the Act to accrue or arise or to be received in British India, during the year ending on the 31st March, 19 , amounted to Rs. only.

I therefore pray for a refund of

Rs.	under "Salaries"
Rs.	under "Securities"
Rs.	under "Dividends from companies".
Rs.	under "Share of profits of the registered firm"
known as	of which I am a partner.

[The portions not required should be scored out.].

Signature.

I hereby declare that I am resident in British India, and that what is stated in this application is correct.

Dated 19 .

Signature.

After rule 36 of the said Rules, the following new Rule shall be *inserted,* namely :—

36-A. In the case of a person not resident in British India, an application for a refund of income-tax under section 48 of the Act shall be made in the following form :—

Application for refund of income-tax.

I, of
residing at in (country)
do hereby state that my total income computed in accordance with section 48 (4) of the Indian Income-tax Act, 1922, amounted to Rs. only, as per return enclosed.

I therefore pray for a refund of

Rs. under "Salaries"
Rs. under "Securities"
Rs. under "Dividends from companies"
Rs. under "Share of profits of the registered firm"
known as of which I am a patner.

[The portions not required should be scored out.]

Signature.

I hereby declare that I am a $\frac{\text{British subject.}}{\text{subject of \quad State being a State in India.}}$

I also declare that what is stated in this application is correct.

Dated 19 .

Signature.

Sworn before me (Name)
Designation
Signature at on

Seal.

NOTE.—The above verification shall be sworn before a notary public or other functionary or official authorized to administer oaths.

After rule 37 of the said Rules, the following new Rule shall be *inserted*, namely :—

37-A. The application under Rule 36-A shall be accompanied by a return of total income in the following form the details of Part I of which but not the total may be omitted if the person has already submitted a return under section 22 (2) for the same year.

PART I.

Statement of total income accruing or arising or received in British India, or deemed under the Act to accrue or arise or to be received in British India, during the previous year.

[As in the form prescribed in Rule 19, p. 121].

Part II.

Statement of total income, profits and gains in the previous year, arising, accruing or received out of British India, which, if arising, accruing or received in British India, would be included in the computation of total income under section 16.

Name of Country.	Sources of income.	Amount of profits or gains or income during the previous year.
		Rs.
..	1. Salaries .. .. (see Note 10)	..
	*..............	
	....	
..	2. Securities .. .. .. (see Note 11)	..
	*..............	
	....	
..	3. Property .. .. (see Note 12)	..
	*..............	
	....	
..	4. Business .. .. (see Note 13)	..
	*..............	
	....	
..	5. Profession .. .. .. (see Note 14)	..
	*..............	
	....	
..	6 Dividents from companies .. (See Note 15)	..
	*..............	
	....	
..	7. Interest on securities other than in item 2 above mortgages, loans, fixed deposits current-accounts, etc., not being income from business .. (see Note 16)	..
	*..............	
	....	
..	8. Ground rent	..
	*..............	
	....	
..	9. Any source other than those mentioned above including any income earned in partnership with others .. .. (see Note 17)	..
	Total	
		Rs.
	Total as per Part I	..
	Total as per Part II	..
	Grand total	..

* The figures for each country should be separately shown.

Verification.

I declare that to the best of my knowledge and belief the information given in the above statement is correct and complete, that the amounts of income shown are truly stated and relate to the year ended and that no other income accrued or arose or was received by $\frac{\text{me}}{\text{the firm}}$ during the said year and that $\frac{\text{I}}{\text{the firm}}$ have no other sources of income.

Date *Signature.*

N.B.—(*a*) *Income accruing to you outside British India received in British India, should be entered in Part I and not in Part II.*

(*b*) *All income from whatever source derived must be entered in the form including income received by you as a partner of a firm.*

[*Notes* 1—9: As in the return under Rule 19.]

NOTE 10.—The gross amount of salary and not the net amount after deductions on account of income-tax provident fund, etc., should be shown.

NOTE 11.—Under this head should be shown interest on securities issued by the Government of India or a local Government or a local authority in India on which interest is paid or payable outside British India, and the interest on debentures of companies paid or payable outside British India. For this purpose " Company " means " a company as defined in the Indian Companies Act, 1913, or formed in pursuance of an Act of Parliament or of Royal Charter or Letters Patent, or of an Act of the Legislature of a British possession, and includes any foreign association carrying on business in British India whether incorporated or not, and whether its principal place of business is situate in British India or not, which the Central Board of Revenue may, by general or special order, declare to be a company for the purposes of this Act". Interest on all other securities should be shown under item 7—see Note 16. Interest should be shown gross if foreign tax is deducted therefrom after the assessee receives the interest; if the tax is deducted at source, the net interest received should be shown.

NOTE 12.—See instructions in Note 4.

NOTE 13.—The details should be given as explained in Note 5, but there will be no "deduct" entry on account of profits included in the amount already charged to Indian income-tax and the interest on securities of the Government of India or a local Government in India declared to be income-tax free.

NOTE 14.—This should show professional fees received outside India. Professional fees received in India, though outside British India, will be shown in Part I.

NOTE 15.—The figure to be shown here is the amount actually received by the shareholder irrespective of whether the dividends are declared free of tax or not.

NOTE 16.—This head will include *inter alia* interest on all securities other than those entered in item 2 see Note 11. Interest should be shown gross if foreign tax is deducted therefrom after the assessee receives the interest ; if the tax is deducted at source, the net interest received should be shown.

NOTE 17.—Agricultural income from land not included in Part I should be shown under this head.

Refunds—Indian States—Residents of.

The executive arrangements mentioned on the above page relating to the refund of income-tax under section 48 to residents in Indian States through Political Officers are now obsolete. Refunds are now made by the Income-tax Officer. Non-residents Refunds Circle, Bombay, who, however, allows the option to the recipient of receiving the payment in the British Indian Political Treasury in the State concerned.

INTRODUCTION.

INCOME AND CAPITAL.

INCOME-TAX, as its name implies, is a tax on Income. But what is Income? The law does not define it, though it sets out certain provisions as to particular kinds of income that should be excluded or included and as to the methods of computing income. As to the nature of income, we have to seek guidance from judicial pronouncements which again are based largely on commercial usage. Commercial usage unfortunately is not altogether a reliable guide; and in practice there is no more baffling problem that faces a Commercial Accountant than the allocation of items as between Capital and Revenue. The concepts of Capital and Income have been the subject of close analysis by successive generations of economic thinkers; and, as the following extracts from the classic book of Professor Fisher's[1] will show, the concepts have been elusive and have defied analysis.

"Capital is a fund and income a flow. . . . . Capital is wealth, and income is the service of wealth . . . . A stock of wealth existing at an instant of time is called Capital. A flow of services through a period of time is called income . . From the time of Adam Smith it has been asserted by economists, though not usually by business-men, that only particular kinds of wealth could be capital, and the burning question has been, what kinds? But the failure to agree on any dividing line between wealth which is and wealth which is not capital, after a century and a half of discussion, certainly suggests the suspicion that no such line exists. What Senior wrote seven decades ago is true to-day; "Capital has been so variously defined, that it may be doubtful whether it has any generally received meaning." In consequence, "almost every year there appears some new attempt to settle the disputed conception, but, unfortunately, no authoritative result has as yet followed these attempts. On the contrary, many of

1 "The Nature of Capital and Income" by Professor Irving Fisher--MacMillan & Co., a study of this book is strongly recommended.

them only served to put more combatants in the field and furnish more matter to the dispute." Many authors express dissatisfaction with their own treatment of capital, and even recast it in successive editions.

Adam Smith's concept of capital is wealth which yields "revenue." He would therefore exclude a dwelling occupied by the owner. Hermann, on the other hand, includes dwellings, on the ground that they are durable goods. But a fruiterer's stock in trade, which is capital according to Smith, because used for profit, according to Hermann does not seem to be capital, because it is perishable. Knies calls capital any wealth, whether durable or not, so long as it is reserved for future use. Walras attempts to settle the question of durability or futurity by counting the uses. Any wealth which serves more than one use is capital. A can of preserved fruits is therefore capital to Knies if stored away for the future, but is not capital to Walras because it will perish by a single use. To Kleinwachter, capital consists only of "tools" of production, such as railways. He excludes food, for instance, as passive. Jevons, on the contrary, makes food the most typical capital of all, and excludes railways except as representing the food and sustenance of the labourers who built them.

While most authors make the distinction between capital and non-capital depend on the kind of wealth, objectively considered, Mill makes it depend on the intention in the mind of the capitalist as to how he shall use his wealth. Marx makes it depend on the effect of the wealth on the labourer, and Tuttle, upon the amount of wealth possessed. Again, while most authors confine the concept of capital to material goods, MacLeod extends it to all immaterial goods which produce profit, including workmen's labour, credit, and what he styles "incorporeal estates," such as the Law, the Church, Literature, Art, Education, an author's Mind. Clark takes what he styles "pure" capital out of the material realm entirely, making it consist, not of things, but of their utility. Most authors leave no place, in their concept of capital, for the value of goods as distinct from the concrete goods themselves, whereas Fetter, in his definition, leaves place for nothing else. Some definitions are framed with especial reference to particular problems of capital; many, for instance, have reference to the problem of capital and labour, but they fail to agree as to the relation of capital to that problem. MacCulloch regards it as a means of supporting labourers by a wage fund; Marx, as a means of humiliating and exploiting them; Ricardo, as a labour saver; MacLeod, as including labour itself as a special form of capital.

Many definitions have reference to the problem of production, but in no less discordant ways. According to Senior, Mill, and many others, capital must be itself a product. Walras, MacLeod, and others admit land and all natural agents under capital. Bohm-Bawerk, while agreeing that it must be a product, insists that it must not apply to a finished product. Marx denies that capital is productive. Bohm-Bawerk admits that it is not " independently " productive, but denies the Marxian corollary that it should not receive interest. Other writers make it co-ordinate with land and labour as a productive element.

As to what it is that capital produces there is further disagreement. Adam Smith affirms that capital produces " revenue," Senior, that it produces " wealth." Others vaguely imply that it produces value, services, or utility.

Most of the definitions involve some reference to time, but in many different ways. Hermann has in mind the time the wealth will last; Clark, the permanency of the fund capital as contrasted with the transitoriness of its elements, " capital goods "; Knies, the futurity of satisfactions; Jevons and Landry, specifically the time between the " investment " of the capital and its return.

It is idle to attempt any reconciliation between concepts of capital so conflicting, and yet there are elements of truth in all. Though generally wrongly and narrowly interpreted, there are certain recurrent ideas which are entirely correct. The definitions concur in striving to express the important facts that capital is productive, that is, is antithetical to income, that it is a provision for the future, or that it is a reserve. But they assume that only a part of all wealth can conform to these conditions. To the authors of the definitions quoted, it would seem absurd to include all wealth as capital, as there would be nothing left with which to contrast it and by which to define it. And yet, as Professor Marshall says, when one attempts to draw a hard-and-fast line between wealth which is capital and wealth which is not capital, he finds himself " on an inclined plane," constantly tending, by being more liberal in his interpretation of terms, to include more and more in the term capital, until there is little or nothing left outside of it. We are told, for instance, that capital is wealth for future use. But "future" is an elastic term. As was shown in Chapter II, all wealth is, strictly speaking, for future use. It is impossible to push back its use into the past, neither is it possible to confine it to the present. The present is but an instant of time, and all use of wealth requires some duration of time. A plateful of food, however hurriedly it is being eaten, is still for future use, though the future is but the next few seconds; and if by "future" we mean to exclude the "immediate future," where is the line to be drawn? Are we to say, for instance, that capital is that wealth whose use extends beyond seventeen days?

And as all wealth is for future use it is also, by the same token, all a "reserve." To call capital a reserve does not, therefore, in strictness, delimit it from other wealth. Even a beggar's crust in his pocket will tide him over a few hours.

Equally futile is any attempt definitely to mark off capital as that wealth which is "productive." We have seen that all wealth is productive in the sense that it yields services. There was a time when the question was hotly debated what labour was productive and what unproductive. The distinction was barren and came to be so recognized. No one now objects to calling all labour productive. And if this productivity is common to all labour, it is equally common to all wealth. If we admit that a private coachman is a productive worker, how can we deny that the horse and carriage are also productive, especially as the three merely co-operate in rendering the very same service, transportation?

Finally, we cannot distinguish capital as that wealth which bears income. All wealth bears income, for income consists simply of the services of wealth. But the idea, that some wealth bears income and some not, has been persistent from the time of Adam Smith, who meaning by income only money income, conceived capital as the wealth, which produces income in this sense, as distinguished from the wealth such as dwellings, equipages, clothing, and food, which dissipates that income. A home, according to him, is not a source of income, but of expense, and therefore cannot be capital.

In these and other ways have economists introduced, in place of the fundamental distinctions between fund and flow, and between wealth and services, the merely relative distinction between one kind of wealth and another. As a consequence, their studies of the problems of capital have been full of confusion. Among the many confusions which have come from overlooking the time distinction between a stock and a flow was the famous "wage fund" theory, that the rate of wages varies inversely with the amount of capital in the supposed "wage fund" . . . .

A little attention to business book-keeping would have saved economists from such errors; for the keeping of records in business involves a practical if unconscious recognition of the time principle here propounded. The "capital account" of a railway, for instance, gives the condition of the railway at a particular instant of time, and the "income account" gives its operation through a period of time. . . . .

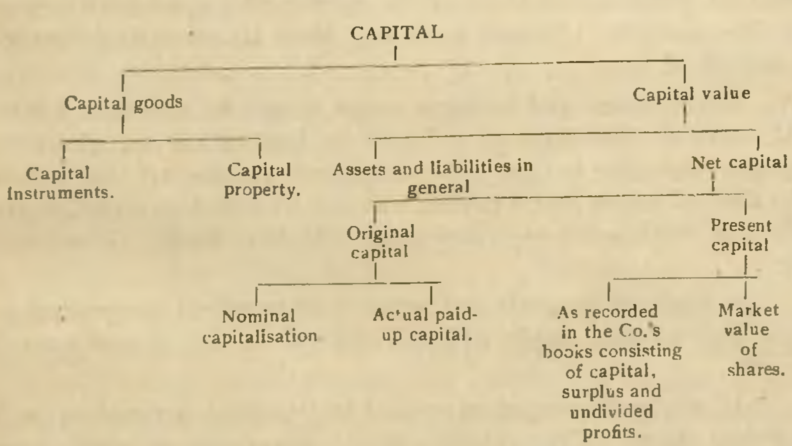
As to popular and business usage, it may be said that a careful study of this usage as reflected by lexicographers, who have sought from time to time to record it, reveals the fact that before the time of Adam Smith capital was not regarded as a part of the stock of wealth, but as synonymous with that stock. . . . .

. . .

In business manuals and articles on practical accounting we find that capital is employed in the sense of the net value of a man's wealth.

As one business-man expressed it, "Capital is simply a book-keeping term." Consequently the business-man naturally associates the term with his shop and not his home, for he keeps a balance sheet in the former and not in the latter; but, once given a balance sheet, it does not matter what purpose is behind it. A social club, an art gallery, or a hospital may have a capital. In one year a joint stock company with capital stock was proposed for the purpose of building the yacht for defending the America Cup. If a private family should call itself a joint stock company and draw up a balance sheet, entering all its property, house, furniture, provisions, etc., on one side, with the debts on the other, no business-man, we imagine, would hesitate to call the balance of assets over liabilities, which is the total wealth—value of the family, by the name "capital." As a business-man said to the writer, "Capital is not a part of wealth, but all a man has got, including his automobile." "Is that cigar in your mouth capital? he was asked. "No," he said, hesitatingly; but this opinion he quickly reversed as inconsistent with his former statement, and admitted that a box of cigars and each cigar in it, or out of it, for that matter, were a part of his stock or reserve . . . . . .

"We see, then, that the 'capital' of a person or firm has four separate meanings—the nominal 'capitalisation'; the actual original 'paid-in-capital'; the present accumulated capital or 'capital, surplus and undivided profits' as given by the bookkeeper; and the market estimate of the same, *i.e.*, the value of the shares. These and the other senses of capital are given in the following scheme which displays the various uses of the term 'capital.'



. . . . Were it not for an instinctive feeling that there exists a definite 'income' concept the repeated failure to formulate it might lead one to conclude that it is not susceptible of any exact and rigorous definition and that the best course is to abandon its search as futile. . . . . Income (or outgo) always implies (1) capital as the source, and (2) an owner of capital as the beneficiary. . . . . It will be observed that the cost of reconstructing the house was entered in the accounts in exactly the same way as repairs or other 'current' costs. There may seem to be objection to such a proceeding in the thought that reconstruction appears to be not a part of "running expense" but a 'capital' cost and belongs not to income accounts but to capital accounts. It is true that the *value* of the new house must be entered on the capital balance sheet but the *cost of producing it* belongs properly to income accounts. The former represents *wealth*, the latter represents *disservices*. The former relates to an *instant* of time (which may be any instant from the time it is begun till the time when it ceases to exist), the latter relates to a *period* of time (which may be all or any part of the time during which the labour and other sacrifices occasioned by the house occur). A house is quite distinct from the series of sacrifices by which it was fashioned. And yet it is undoubtedly true that we instinctively object to entering the cost of building the house in its income and outgo account; and we express the objection by calling this last a 'capital' cost rather than a part of running expenses. By so classing it we mean that it does not recur or at any rate only at long intervals. . . . .

"And this procedure (of taxing 'realised' income) is very common in practice. It amounts to taxing not the *income* actually flowing from capital but its 'earnings' or the interest upon the capital. It is familiar in the 'general property tax' in the United States. . . . . To some extent also the British income-tax is an instance of the same fallacy. . . . . The general principle connecting 'realised' and 'earned' income is that they differ by the appreciation or depreciation of capital."

However logical some of these theories and distinctions might be, and Professor Fisher's own theory is undoubtedly logical, they do not easily solve the practical difficulty of distinguishing whether particular items in a concrete case constitute 'Capital' or 'Income'. Judicial decisions on the other hand have had to solve this problem and necessarily rest on a less logical footing. Business usage and company law, the nature of the business, distinctions between 'fixed' and 'circulating' capital, the motives of persons, the degree of control a person has over the receipt, and similar considerations have been taken into account by the law courts, as will be seen from the decisions set out in the body of the book. The position is very obscure and it is almost impossible satisfactorily to lay down any general principles as to what constitutes the distinction between Capital and Income and the extent to which the question is one of law or one of fact.

The various rulings on the subject are set out under Sec. 2 (4)—Business, Sec. 3—Income and Capital, Sec. 4 (3) (vii)—Casual profits, and Sec. 10 (2) (ix)—Capital expenditure.

HISTORY OF INCOME-TAX LAW IN INDIA.

It would be scarcely relevant to the purpose of this book to detail the history of direct taxation in India in pre-British days. It hardly seems necessary therefore to refer to Manu or to Santi

Parva or to Kautilya; nor even to less distant periods like those of Akbar or Sher Shah.

Direct taxation is not a novelty in India introduced by the British as too commonly supposed, but a most ancient and well-known institution. Indian Governments have from time immemorial made the non-agricultural classes contribute their share of the expenses of the State. To the Indian mind in general this appeared only just, fitting, and to be contentedly borne. Between cultivators and traders, poor and rich, no sense of unequal treatment could subsist under the system which the predecessors of the British in the Empire for centuries pursued. But when the British superseded them, they gradually abolished the structure of direct taxation which their predecessors had laboriously raised. In the elder Provinces, that is, those that came under British rule first, this change was consummated by about the year 1844, in the newer ones it took place later, but the only survivals of the Indian system now are the 'capital' tax and the 'thathameda' in Burma. The last of them to be abolished was the 'Pandhari' tax in the Central Provinces in 1886. Where Indian States continued the taxation, they retained their old method of direct taxation till recently, when the force of circumstances has compelled them to copy British methods.

The British Government which had gradually abandoned direct taxation was obliged by financial necessities to revert to direct taxation in 1860. "But instead of an indigenous model, softened and adapted to local circumstances, the Government unfortunately set up that of the income-tax, as in force in England. To get direct taxation into good working order, even after a suitable model, would have been a work of time and care, in the absence of the long-standing record of the names and resources of householders which had been done away with in earlier days. But what, except failure, could attend a sudden call on relatively ignorant and unlettered millions, at short notice, to assess themselves, or prove right of exemption, to send in elaborate returns and calculations, and to understand and watch their own interests under the system of notices, surcharges, claims, abatements, instalments, penalties and what not, consequent thereon? Necessarily there followed a long train of evils. An army of tax assessors and collectors temporarily engaged could not be pure. They were aided by an army of informers, actuated by direct gain or private animosity. Frauds in assessment and collection went hand in hand with extortion in return for real or supposed exemption. Inquisition into private affairs, fabrication of false accounts where true ones did not exist or were inconvenient, acceptance of false returns, rejection of honest ones, unequal treatment of the similarly circumstanced, all these more or less prevailed. The tax reached numbers not really liable, for zamindars illegally recovered it from tenants and masters from servants, while underlings enriched themselves by the threat of a summons. Acts XXI of 1861 and XVI of 1862 while affording relief in some respects, practically stereotyped many inequalities and heart-burnings. In later years, the system of assessment by broad classes was an improvement on the earlier complications, but the advance of local officers towards equitable assessment was perpetually being cancelled by the alterations in rate and liability.

Renewed direct taxation in British India thus made a false start, from which it did not easily recover. Possibly, with time and care, a great improvement might have been effected, if the law had remained unaltered. But, unluckily, with its too English form, came the idea that the tax was to be, as in England a convenient means of rectifying Budget inequalities, and a great reserve in every financial or national emergency. In consequence of this idea, incomes between Rs. 200 and 500, which had been taxed at 2 per cent. in 1860, were exempted in 1862, the 4 per cent. rate was reduced to 3 per cent. in 1863, and the whole tax was dropped in 1865. In 1867 it re-appeared in the modified form of a license-tax, at the rate of only 2 per cent. at most, but reaching down again to incomes of Rs. 200. In 1868 it became a certificate-tax, at rates a fifth lower, and again commencing with a Rs. 500 limit. In 1869 it became once more a full-blown income-tax at 1 per cent. on all incomes and profits of Rs. 500 and upwards. In the middle of the same year it was suddenly nearly doubled. In 1870 a further rise to fully 3½ per cent. occurred; but with better times, the rate fell in 1871 to 1|24 per cent., with a limit of Rs. 750, and in 1872 the limit was further relaxed to Rs. 1,000 and upwards. In 1873 came a second period of total abolition, to be succeeded from 1877-78 by a new series of Acts. Along with the changes in rate and incidence just described, came changes in name, form, classification and procedure. With one object or another, twenty-three Acts on the subject were passed between 1860 and 1886.

Owing to the perpetual changes, the people, never certain who was liable or what was the sum due, were an easy prey for fraud and extortion, while the superior officials time after time found their labours thrown away, and a fresh battle with guess-work and deception to be begun. That both officials and people should in 1872 have united to condemn an impost hitherto associated only with such evils, is not to be wondered at. Our abandonment of the machinery of direct taxation inherited from our predecessors was one of the things in us which the mass of the people disliked without being able to understand. Our new-fangled and European attempts to retrace this policy seemed to them tyrannical, compared with the rude expedients familiar to their fathers. All things considered, the abolition of the income-tax in 1873 was probably the best thing that could then be done.

"But direct taxation could not long be dispensed with. A new start was made in 1877. This start was, I think decidedly well intentioned, made in considerable appreciation of past defects and desire to avoid them. It was wise to begin with trades and classification, but it seems to me that too much was made of supposed local differences, and too much importance attached to local action. Bengal, Madras and Bombay passed Acts of their own; Northern India was dealt with by the Imperial legislature. As a necessary consequence, further legislation was soon needed to remedy inequalities. Some good was thereby effected; more would have resulted, but for the, as I think, unfortunate abandonment of the Bill introduced in November, 1879.

Act VI of 1880, with the local Acts it amended, was in force till 1886. Their continuance for five years unaltered did a great deal to remove such evils as arose from frequent changes before. But there was still an unjust system of maximum everywhere, while the amount of maximum varied, and the classification essentially differed in different parts of India. The incidence differed with every class and the poor paid more in proportion than the rich, and the richer a man was, above a certain point, the less he had to pay. The measure was open to grave objections of principle and detail: and the legislation of 1886 was therefore welcome."[1]

The details of the provisions in the Acts that preceded the Act of 1886 have been summarised in the Appendix. They are

[1] Speech delivered by the Hon. Mr. Hope in 1886.

of little interest now as they do not throw any light either on the 1886 Act or its successors, the legislation of 1886 and again that of 1918 having made more or less a 'clean cut' with the past on each occasion. On both the occasions the law was altered so considerably that it is difficult to trace any historical continuity except to a very limited extent. Even the 1886 Act is of little except historical interest now.

The general structure of the 1886 Act was as below. Income was divided into four classes—(1) from salaries, (2) from securities, (3) Profits of Joint Stock Companies, (4) other income, which included income from house property. All income was taxed, except agricultural income and most of the incomes, now exempted under Sec. 4 (3), *e.g.*, income of charities, were exempt either by the Act or by notifications. No tax was levied on the shareholder in respect of profits of companies which had already paid tax; nor was tax levied on the share received by a member of a Hindu undivided family. The rate of tax was 5 pies in the rupee on incomes over Rs. 2,000; salaries between Rs. 500 and Rs. 2,000 per annum and interest on securities were taxed at 4 pies per rupee. Income from other sources was taxed at fixed rates varying with the income (but roughly corresponding to 4 to 5 pies in the rupee). In 1903 the taxable minimum was raised to Rs. 1,000.

The machinery of the Act was very simple. Except in very big cities, like Calcutta, Bombay and Madras, there were hardly any whole-time Income-tax Officers. The work was done by the Land Revenue Officers as a subsidiary activity. There was no obligation on individuals to furnish returns of income nor, consequently, any penalty for not doing so. Tax on salaries and interest on securities was collected at source without much difficulty. Nor was there much trouble about Joint Stock Companies, which, however, were compelled to send returns of profits. But the law did not lay down any rules as to how profits were to be calculated. In respect of (4)—" Other Income "—which was by far the most important, the Collector was allowed to assess summarily incomes below Rs. 2,000; and all that he had to do was to publish a list of such persons in his office, all of whom, unless they objected within 60 days, became *ipso facto* liable to the tax. In other cases the Collector merely notified each assessee what amount had been assessed as tax. There was also provision for the Collector calling for but not compelling the submission of returns of income. Any assessee could petition the Collector against the assessment; and assessees having to pay a tax of Rs. 250 or over, and Companies had a right to apply to the Divisional Commissioner (or the Board of Revenue in Madras) for revision; and the Commissioner had discretion to entertain such applications even if the amount of tax was less. Both the Collector and Commissioner had power to call for evidence, etc., but only at the instance of the petitioners or to verify facts alleged by them.

The Collector had power to compound the assessment with an assessee—whether an individual or a Company—for a number of years. It seems unnecessary to detail the various minor amendments that were made to this Act from time to time. This simple machinery provided by this Act worked smoothly enough so long as the rate of tax was low. The rates fixed in 1886 were fixed with close reference to the cesses on land that had been imposed in the seventies of that century. So long as these low rates were in force, slight inequalities in assessment did not very much matter—either to the taxpayers or to the Government. In 1916, the war necessitated the increase of taxation and income-tax had to make up its share. The graduation was made steeper and the rates increased substantially.

The increase in the rates coupled with the steeper graduation called for a radical change in the whole system of assessment. The first change made was to provide for the refund of income-tax to shareholders of Companies (small incomes relief). This was in 1916. Pending a general revision of the Act, the necessity for which was felt, the law was amended in 1917 so as to compel, in the case of assessees with an income of over Rs. 2,000, the production of returns on pain of a penalty both for false returns and for non-compliance. An assessee who failed to submit a return was also deprived of the right of appeal. These changes however were scarcely adequate, and far more drastic changes were required.

In the first place it was necessary to abandon the old system of assessing a person's income in separate compartments without reference to his income from the other compartments and to assess him with reference to his income from all sources together. In the second place higher rates of taxation required a greater degree of precision in arriving at taxable profits, etc., and it was therefore necessary to frame clear rules as to the calculation of profits, what expenses may be deducted from profits and what not. In the third place the machinery of assessment also required tightening up. The Collector was empowered to call for returns of income in all cases and for evidence in support of it, and if necessary to enforce the attendance of persons (including the assessees) who could give useful information in connection with the assessments. Compounding taxes for a series of years was given up and new assessments could be made only for each year at a time based on the income of that year. The assessee was assessed provisionally on the income of the previous year and the assessment was finally adjusted at the end of the year with reference to the income of the year, the necessary refund or supplementary demand being made. The Commissioner of Income-tax was vested with discretion to refer doubtful cases to the High Court, *suo motu* or at the instance of the assessee, and such references could cover points both of fact and of law. Provision was also made to tax non-residents through their agents when the non-resident principals and their income could not be got at directly. The Income-tax Act was amended accordingly in 1918. This Act of 1918 was much nearer to the present Act in its general features than to the Act of 1886 which it superseded. An attempt was also made by Government—though without success—to provide for the taxation of income of married women jointly with the income of their husbands and also to take agricultural income into account in determining the rate of tax payable by an assessee on his non-agricultural income.

Within a few years even the new Act showed that it required substantial revision. This however was not unexpected. The Government of India appointed Committees in each Province composed of both officials and non-officials to examine the questions that arose and make the necessary recommendations. When these Committees had reported an All-India Committee was appointed in 1921 and it is the recommendations of this Committee that formed the basis of the Act of 1922 which is in force now. This Committee's report has been printed as an Appendix.

Super-tax.—A super-tax was first levied in India in 1917. The tax was levied on incomes over Rs. 50,000, the tax being graduated on a 'slab' basis. The same rates were levied on Companies as well as individuals and Hindu undivided families but, in the case of Companies, only the undistributed profits were taxed, the distributed profits being taxed in the hands of the shareholders if they were liable to the Super-tax. This arrangement which discouraged the accumulation of undistributed profits and encouraged the distribution of profits beyond the limits of prudence and safety was criticised by the commercial community. The Act was accordingly recast in 1920 and the tax on Companies was levied on the entire profits less Rs. 50,000 at a flat rate of one anna in the rupee instead of on a graduated basis. The shareholder was not credited with the tax paid by the Company and the Super-tax on Companies became all but in name a Corporation Profits Tax. But unlike the Corporation Profits Tax elsewhere it was not allowed to be deducted from taxable income for Income-tax purposes. In other respects the provisions of the 1917 Act remained unaltered. Both the 1917 and the 1920 Acts were small Acts of a few sections which had to be read in conjunction with the Income-tax Acts of 1886 and 1918 which were referred to as the 'principal' Acts. When the Income-tax Act of 1918 was amended in 1922, the Super-tax Act also was incorporated therein and the present Act XI of 1922 as amended from time to time deals both with Super-tax and with Income-tax.

Excess Profits Duty.—An E.P.D. was levied in India only in one year 1919-20—*see* Act X of 1919. This duty was of course connected with the war and the abnormal profits made by certain businesses in consequence of the war.

Act XI of 1922.

The important changes made by the 1922 Act are as below:—

(1) The adjustment system was abolished and the assessment made finally on the income of the previous year.

(2) Provision was made for cases in which there is a change in the ownership of a business, profession or vocation.

(3) It was made clear that no particular method of accounting need be adopted by the assessee and discretion was given to the Income-tax Officer to determine in doubtful cases on what basis income should be computed.

(4) The distinction between 'taxable income' and 'total income,' which was introduced in 1918, was abandoned.

(5) Provision was made for the setting off of a loss under one head of income against gains under another.

(6) The provision in the 1918 Act, which took into account the amount received by an individual member from an Hindu undivided family for determining the rate of tax payable by him on his other income, was abandoned.

(7) Provision was made for rebate on account of premia on Life Insurance Policies taken by male members of Hindu undivided families or the wives of such members.

(8) The departmental organisation was completely changed. A Board of Inland Revenue was created, which was entrusted with the duty of making rules and administering the tax.

(9) Under the Act of 1918 the Chief Revenue authority was not bound to make a reference to the High Court. Under the present Act the Commissioner is so bound and if he refused to make a reference an assessee may apply to the High Court for a mandamus requiring the Commissioner to state a case. No reference to the High Court lies until the applicant has exhausted his right of appeal under the Income-tax Act.

(10) The provisions against the disclosure of particulars regarding income-tax assessments were made more stringent.

(11) Private employers also were enjoined to collect income-tax on salaries at the time of payment.

(12) Wider powers were given to assessing officers to call for Returns, Documents, etc.; appellate rights were also widened and the procedure regarding refunds simplified.

Two features of the 1922 Act deserve special mention. In the first place it became a mere Act of machinery and procedure, and the rates of taxation were left to be decided every year by the Finance Act. In the second place it marks the first step in the disengagement of the Provincial Governments from administering central subjects. Both these features are due to the Constitutional Reforms which just preceded the revision of this Act.

Another important matter, though it is not a question affecting the law, is the improvements in departmental organisation since 1922. The All-India Committee of 1921 wrote:

"The non-official members . . . . desire to record their opinion that a matter of greater importance than the amendment of the Act is an increase in the number and efficiency of the staff, which should consist of officers of the highest training and integrity. They would emphasise that the Income-tax Department should include experts of high standing trained in accountancy whose remuneration should be such as . . . . to attract the best material available and all posts in the Department including the highest should be open to any officer of proved experience and capacity."

This policy has been given effect to whenever possible by the appointment of highly educated expert officers as Income-tax Officers who do nothing but Income-tax work.

The following amendments have been made since the Act was passed in 1922:—

I. XV of 1923—(*a*) making it clear that the value of a rent-free residence is a 'perquisite' liable to tax irrespective of whether it can be sub-let or not. Explanation to Sec. 7 (1).

(*b*) making it clear that the second proviso to Sec. 68 provided for the adjustment of assessments to super-tax made in 1921-22—of ephemeral interest only.

II. XXVII of 1923—Provision for taxing the profits of Tramp steamers—Sections 44-A to 44-C.

III. IV of 1924—The substitution for the Board of Inland Revenue of the Central Board of Revenue.

IV. XI of 1924—(*a*) the withdrawal of exemption in respect of Provident Insurance Societies governed by the Provident Insurance Societies Act, 1912—Sections 4 (3) (iv); 15 (1);

(*b*) the taxation of associations of individuals other than firms, companies and Hindu undivided families—Secs. 3, 55, 56 and 63 (2);

(*c*) amendment of Sec. 25 (1) and (3);

(*d*) the fixing of a time limit of 6 months in Sec. 66 (3);

(*e*) the insertion of 'any' after 'any other public body or' in Sec. 2 (12).

V. V of 1925—Proviso to Sec. 56—Super-tax—Levy of—When constitution of firm is altered.

VI. XVI of 1925—Taxation of sterling overseas pay received in the United Kingdom.

VII. III of 1926—Government Trading Taxation Act.

VIII. XXIV of 1926—

(*a*) levy of super-tax at source on dividends paid to non-residents—Secs. 19-A, 51 (*c*), 52, 57 and 58.

(*b*) High Courts for centrally administered areas—Sec. 66 (8).

(*c*) Appeals to the Privy Council—Sec. 66-A.

IX. XXVIII of 1927—The amendment of Section 59 so as to place beyond doubt the legality of certain Rules.

X. III of 1928—Containing miscellaneous amendments:

(*a*) allowing as deduction from profits the cost of animals used in a business and dead or discarded;

(*b*) prohibiting the deduction of local, etc., cesses based on profits;

(*c*) providing for the taxation of Hindu undivided families in the year of partition;

(*d*) re-draft of Section 26—relating to succession or change in partnership;

(*e*) rectification of obvious errors in appellate and revisional orders;

(*f*) taxation of profits from imports;

(*g*) the levy of progressive penalties;

(*h*) the restriction of refunds made to non-residents.

SUMMARY OF PRESENT LAW.

The body of the law is contained in Act XI of 1922 (as amended). The Act relates to both Income-tax and Super-tax. Sec. 58, sub-sec. (1) mentions the sections that do not apply to Super-tax. The rates of Income-tax and Super-tax are prescribed by the annual Finance Act.

The tax is levied for each financial year on the income of the 'previous year,' as defined in Sec. 2, sub-sec. 11, of the Act, that is, briefly, the previous financial year or a year ending on a date in the previous financial year for which the assessee has made up his accounts. The financial year ends on March 31st. Thus, the tax is levied in arrear on an ascertained income. The income of the previous year is actually the subject of taxation. It is not the case that the taxation is in respect of the income of the year in which the assessment is made, and that the income of the previous year is deemed by a statutory convention to be the income of the year of assessment. Hence, no assessment is made in the first year in which a business is started, but the first assessment is made, after the close of the assessee's first accounting period, on the profits of that period.

Similarly (subject to certain provisions in sub-sec. 3 of Sec. 25, relating to businesses that were taxed under the previous Income-tax Act, VII of 1918, and necessitated by the fact that under the Act of 1918, the assessment was on the income of the year of assessment, and tax was provisionally levied on the income of the previous year, subject to adjustment subsequently with reference to the ascertained income of the year of assessment) an assessment is made on a business after it has finally closed down on the profits of its last working account year. (Sub-section 1 of Sec. 25.)

The principal charging sections are Secs. 3 and 4 in regard to Income-tax, and Sec. 55 in regard to Super-tax. Income-tax is levied on incomes of Rs. 2,000 or over at rates graduated with reference to the amount of the income, except in the case of companies and registered firms, but " applicable to the total income " (Sec. 3.) Thus, if a man's income is not less than Rs. 2,000 but less than Rs. 5,000, the whole of it is under the present rates liable to Income-tax at the rate of 5 pies in the rupee; if it is not less than Rs. 5,000 but less than Rs. 10,000, the whole of it is liable to Income-tax at the rate of 6 pies in the rupee and so on. Income-tax is now levied at a flat rate of 1a. 6p. on the entire profits of companies and registered firms subject to no minimum. This is the present maximum rate of Income-tax. All these rates are prescribed by the Finance Act as already stated. The manner in which relief is given to partners or shareholders is described later.

Super-tax, on the other hand, is levied at different rates on different ' slabs ' of income except on Companies, and a deduction is made of Rs. 50,000 in the case of an individual, certain associations, a company or an 'unregistered firm' (a term that will be explained below) and Rs. 75,000 in the case of a Hindu undivided family. Thus, if the income of an individual be Rs. 1,50,000, he will pay Super-tax at the rate of one anna in the rupee on Rs. 50,000, and at the rate of one anna and a half in the rupee on Rs. 50,000. On companies, however, Super-tax is levied at a flat rate of one anna in the rupee on the entire income in excess of Rs. 50,000. The maximum rate of Super-tax is now 6 annas in the rupee. These rates also are prescribed by the annual Finance Act.

The rate of tax is determined by the ' total income ' of the assessee computed according to the provisions of Sec. 16. It will be observed from this section that the 'total income' and the ' taxable income ' (a term that is not to be found in the Act), that is, the income to which the rate is to be applied, in order to determine the actual amount of tax payable, may vary considerably.

An 'assessee' is defined in Sec. 2, sub-sec. 2, as a person by whom Income-tax is payable. The Act recognises the following classes of assessees :—Individuals, Hindu undivided families, firms (registered or unregistered), companies, and associations of individuals other than firms and companies. (Sec. 3.) The word 'person' is used in the Act with reference to all classes of assessees. It is specially declared to apply to a Hindu undivided family by Sec. 2, sub-section 9. The terms 'registered firm' and 'unregistered firm' have no reference to anything resembling the registration of companies under the Indian Companies Act. A "registered firm" is "a firm constituted under an instrument of partnership, specifying the individual shares of the partners, of which the prescribed particulars have been registered by the Income-tax Officer in the prescribed manner." (Sec. 2, sub-sec. 14.) An "unregistered firm" means any other firm. (Sec. 2, sub-sec. 16.) 'Prescribed' means prescribed by rules made under Sec. 59 of the Act by the Central Board of Revenue, subject to the control of the Governor-General in Council. Rules 2 to 6 of the Rules framed under the Act relate to the 'registration' of firms.

An unregistered firm is practically treated as an individual. It pays Income-tax, if its income is not less than Rs. 2,000 at the graduated rates. It also pays Super-tax at the graduated rates on its income in excess of Rs. 50,000. A partner in an unregistered firm is not liable to Super-tax individually on his share in the profits of the firm if the firm has paid Super-tax thereon. (Proviso to Sec. 55.) A registered firm pays Income-tax at the maximum rate of 1 a. 6 p. on all its profits, subject to no minimum. It is not, as such, liable to Super-tax, except under Sec. 57 (1) in respect of the share of a non-resident partner. In assessing a partner in a firm, registered or unregistered, to Income-tax, his share in the profits of the firm is included in his 'total income' *whether such share is actually distributed or not.* (Sec. 16.) The rate of tax to which he is personally liable is determined with reference to his 'total income.' If the firm has been assessed to Income-tax no tax is payable by him personally in respect of his share of its profits. [Sec. 14, sub-sec. 2 (*b*).] If it has not been assessed, he will be liable to pay Income-tax on his share of the profits, along with any other income that he may enjoy, at the rate applicable to his 'total income.' On the other hand, a partner in a registered firm is entitled (if the rate applicable to his total income is less than the maximum) to a refund of Income-tax on his share of the profits of the firm, if those profits have been assessed. This refund is calculated at the difference between the rate applicable to his total income and the maximum rate levied on the profits of the registered firm. (Sec. 48.) No such refund is allowed to a partner in an unregistered firm in respect of his share of the profits of the firm.

The partner in a registered firm thus ultimately 'suffers' Income-tax on his share of the profits of the firm at the rate applicable to his total income including his share of the profits of the firm. The partner in an unregistered firm suffers Income-tax on his share of the profits of the firm at the graduated rate applicable to the profits of the firm, which may be higher or lower than the rate applicable to his own total income. On the rest of his income he suffers Income-tax at the rate appropriate to his total income including his share of the profits of the firm.

The registered firm, as such, does not pay Super-tax except under Sec. 57 (1) as already mentioned. The partner in a registered firm pays Super-tax direct on the excess of his total income, including his share of the profits of the firm, over Rs. 50,000. The unregistered firm, on the other hand, pays Super-tax at the different rates applicable to the income of 'individuals' on so much of its profits as is in excess of Rs. 50,000; but in determining the liability of the partner in an unregistered firm to Super-tax his share of the profits of the unregistered firm is left out of account altogether if the firm has been assessed to Super-tax. (Sec. 55, Proviso.)

In assessing a member of a Hindu undivided family to Income-tax or Super-tax, his share of the income of the family is not taken into account at all; it is not even included in his 'total income' for the purpose of determining his personal rate of tax. [Sec. 14 (1) and Sec. 16 (1).]

The Act applies to six 'heads' of income, profits and gains:—(1) Salaries, (2) Interest on securities, (3) Property, *i.e.*, 'buildings or lands appurtenant thereto' of which the assessee is the 'owner,' and which he does not occupy for purposes of his business (Sec. 9, sub-sec. 1), (4) Business, (5) Professional earnings, and (6) Other sources. (Sec. 6.) All 'income, profits or gains' derived under any of these six heads are liable to the tax if 'accruing or arising or received in British India, or deemed under the provisions of this Act to accrue or arise or to be received in British India.' (Sub-sec. 1 of Sec. 4.)

Salaries include salaries paid by private as well as public employers. They also include fees, commissions and perquisites of all kinds, including the value of free quarters even though the quarters are not capable of conversion into money. [Sec. 7 (1).] Business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. [Sec. 2 (4)]. There is no definition of a 'profession' and for this we must seek guidance from rulings of courts.

The following are the instances in which income is deemed to accrue, etc., in British India:—

(1) Business profits received from abroad within three years [Sec. 4 (2).]

(2) Salaries of employees of Government and local authorities in India but outside British India. [Sec. 7 (2).]

(3) Professional fees received in India but outside British India by persons ordinarily resident in British India. [Sec. 12 (3).]

(4) Profits or income from property or a business connection in British India, to non-residents. [Sec. 42 (1).]

There is no definition of what constitutes 'accruing or arising.' The decisions in the United Kingdom or other countries are not very helpful, as the law in these countries is somewhat different in this respect; and the present position in India is somewhat obscure. The views have oscillated between the idea of receivability in British India on the one hand and the location of the source or origin of income in British India on the other. [*See* notes under Sec. 4 (1) and 42 (1).]

Secs. 7 to 13 describe how income shall be computed under each head. Salaries are income of the year in which they are received. The only deductions permissible are subscriptions to provident funds constituted by Government and insurance premia, the aggregate deductions being limited to 1|6th of the total income of the assessee. (Secs. 7, 15 and 16.) Sec. 8 deals with interest on securities, Sec. 9 deals with property—which is based on a notional income, *i.e.*, on the 'annual value' which is defined as the sum for which the property might reasonably be expected to be let from year to year. Deductions are allowed for repairs, insurance premia, interest on mortgages, land revenue, collection charges and vacancies. Also if the house is not let but occupied by the owner the annual value is limited to 10 per cent. of the total income of the owner. Sec. 10 deals with business carried on by the assessee. It allows for the following deductions, *viz.*, rent paid for business premises and repairs thereto, interest on borrowed capital, insurance premia, repairs of plant, machinery, etc., depreciation and obsolescence of plant, machinery, etc., land revenue and local rates, etc., on the premises and all expenditure (other than capital expenditure) incurred solely for the purpose of earning the profits or gains. Secs. 11 and 12 which deal with professional earnings and income from other sources allow for the deduction of all expenditure (other than capital expenditure) incurred solely for earning the profits or gains.

S. 13 deals with the method of accounting under Secs. 10 to 12. Under Secs. 7 to 9 the problem of the method of accounting does not arise. Under Secs. 7 and 8, the income is taken into account in the year of receipt. Under Sec. 9, it is a notional receipt and not the actual receipt that is taxed. It is only in respect of Secs. 10-12 therefore that the question of method of accounting has to be considered. Under S. 13, the income should be computed in accordance with the method of accounting regularly employed by the assessee, but if no method has been regularly employed or if the method employed obscures the real profits, the Income-tax Officer has absolute discretion to compute the income as he thinks best.

An assessee may set off the profits under one source against losses under another; even partners of registered firms are allowed this concession subject to some restrictions. (Sec. 24.)

Income-tax is deducted at the time of payment by every person paying salaries or interest on securities. This is collected in advance on behalf of the assessee who will be assessed the next year and meantime the deductions at source are held to his credit. (Sec. 18). 'Securities' means securities of the Government of India or a Local Government, and debentures or other securities for money issued by or on behalf of a local authority or a company. (Sec. 8.) It should be noted that interest on debentures issued by a company is allowed as a deduction from the taxable profits of the company. Tax on securities is deducted at the maximum rate, but under executive orders certificates are issued by Income-tax Officers authorizing the collection of tax at lower rates if the probable total income of the assessee justifies it. Owners of securities and persons in receipt of salaries are entitled to a refund if eligible with reference to their total income in the year. (Sec. 48.) The tax on dividends is recovered as follows. Every company is liable to Income-tax on its profits, subject to no minimum, at the maximum rate of 1 a. 6 p. per rupee. Every shareholder is entitled, if he is not liable on his personal 'total income,' including the dividends, to pay tax at the maximum rate, to a refund calculated on his dividends received from any company whose profits are liable to Indian Income-tax, at the difference between the rate applicable to his personal total income and the maximum rate borne by the company. (Sec. 48.) Super-tax is levied on the entire profits in excess of Rs. 50,000 of every company at a flat rate of one anna in the rupee. This Company Super-tax is regarded as a Corporation profits tax. It is not regarded as in any sense paid by the company on behalf of the shareholder. [See *Dinshaw* v. *Tata Iron and Steel Company* unreported and *Maharajadhiraj of Darbhanga* v. *Commissioner of Income-tax, Bihar and Orissa*, I. L. R. 3 Patna 470.] Sec. 48 does not apply to Company Super-tax, and consequently a shareholder cannot get any refund in respect of the Company Super-tax that he has indirectly suffered on his dividends. Further, if his income including his dividends exceeds Rs. 50,000 (or, in the case of a Hindu undivided family, Rs. 75,000) he is personally liable to pay the graduated Super-tax direct on so much of his income as is in excess of Rs. 50,000 or Rs. 75,000, as the case may be, irrespective of whether the company has paid the Company Super-tax on its profits or not. A company that holds shares in another company is liable to the Company Super-tax on so much of its profits (including dividends received from the 'held' company) as is in excess of Rs. 50,000 irrespective of whether the 'held' company has paid the Company Super-tax or not.

Under Sec. 57, sub-sections (2) and (3) (as amended by Act XXIV of 1926) the 'principal officer' of a company may, in certain circumstances, be required to deduct Super-tax from dividends payable to a non-resident shareholder. This, and the case of a non-resident partner in a registered firm [Sub-section (1) of Sec. 57] are the only exceptions to the rule that Super-tax is payable by the assessee direct and not by any form of deduction at source.

Assessments are made by 'Income-tax Officers'. They have power to require persons other than companies, whom they consider to have derived a taxable income, to make a return of their total income in the prescribed form. [Sec. 22, sub-section (2).] Every company is bound to make such a return. [*Ibid.*, sub-section (1).] Failure to make a return in either case renders the defaulter liable to prosecution. [Sec. 51 (*c*).] The Income-tax Officer can also call on an assessee to produce accounts or other evidence. [Secs. 23 (2), 23 (3), 22 (4) and 37.] To enforce the production of evidence, the Income-tax Officer has been given the powers of a Court (Sec. 37) and false evidence given before him is perjury under the Indian Penal Code, (Sec. 52.) The law also provides for the making of supplementary assessments in respect of 'escaped' income within one year (Sec. 34) and for the rectification of apparent mistakes within the same period. (Sec. 35.) Against the

Income-tax Officer's assessment an appeal lies to the Assistant Commissioner unless the assessee failed to make a return or to produce his accounts or evidence on which he relies when required by the Income-tax Officer to do so. (Sec. 30.) It is open to the assessee to move the Income-tax Officer to re-open such non-appealable assessments if he can show that his default was due to " sufficient cause "; and a right of appeal lies to the Assistant Commissioner against the order of the Income-tax Officer refusing to re-open such assessment. (Secs. 27 and 30.) There is a Commissioner of Income-tax for each Province, who exercises appellate powers in respect of appellate orders passed by Assistant Commissioners either levying a penalty (Sec. 28) or enhancing the demand (Sec. 32) and also possesses wide powers to review any order passed by any of his subordinates. (Sec. 33.) In any case in which there is a right of appeal under Sec. 30 or 32 and it has been exercised, the assessee may require the Commissioner to refer any question of law arising out of the appellate order to the High Court. [Sec. 66, sub-section (2).] If the Commissioner refuses to make a reference, the assessee may move the High Court direct to order the Commissioner to make a reference. The Commissioner may also refer to the High Court of his own motion any question of law arising out of any proceeding under the Act except a proceeding under Chapter VIII which relates to offences and penalties. [Sec. 66, sub-section (1).]

The functions of the Civil Courts are strictly limited to the disposal by the High Courts of these references on points of law. An appeal lies to the Privy Council from the decision of the High Court if the High Court certifies that the case is a fit one for appeal.

The Income-tax Officers, Assistant Commissioners, and Commissioners of Income-tax are all Government officials.

Tax is recovered either by the Income-tax Officer himself [Secs. 45 and 46 (1)] or by the Collector of the District as an arrear of land revenue [Sec. 46 (2)] or as an arrear of a Municipal tax or other local rate. [Sec. 46 (3).] No proceedings may be started for the recovery of any arrears after one year. [Sec. 46 (7).]

There are special provisions for the taxation of tramp ships. (Sec. 44 A. to C.), the taxation of incapacitated persons or *Cestui que trusts* and non-residents (Secs. 40 to 43) and for the transfer of businesses. (Sec. 26.)

Any notice or requisition under the Act can be served by registered post or as a summons under the Civil Procedure Code. (Sec. 63.) An assessee may appear in all income-tax proceedings either in person or by any duly authorised representative, not necessarily a lawyer or accountant as in the United Kingdom. (Sec. 61.) Every person deducting or paying tax in accordance with the Act on income belonging to another person is indemnified. (Sec. 65.)

All documents, accounts, etc., which officers of the Income-tax Department receive in connection with assessments, appeals, etc., are confidential and the disclosure of any of these, except for the purposes of the Act, is an offence punishable with imprisonment for six months and also a fine. No such prosecution may be made except at the instance of the Commissioner. (Sec. 54.)

The law exempts the following kinds of income from taxation [Sec. 4 (3)]—Income of charitable and religious trusts including voluntary contributions received by such institutions, income of local authorities, interest on securities held by certain Provident Funds, capital sums received on account of insurance policies, commuted pensions and accumulations in provident funds, casual and non-recurring receipts not arising from the exercise of a business, profession or vocation, agricultural income and special allowances given to meet expenditure incurred in connection with the performance of duties. Power is also given to the Governor-General in Council under Sec. 60 to exempt, or modify the tax in favour of, any class of persons or any class of income.

The law also provides for the refund of a part of the income-tax paid on income which has been taxed both in India and the United Kingdom. (Sec. 49.) Somewhat similar arrangements have been concluded with Indian States and relief is given on income taxed both in British India and the States. These reliefs are regulated by notification under Sec. 60.

The law provides for the levy of the following penalties by the Income-tax Officer—for not giving notice of discontinuance of business (Sec. 25), for concealment of income (Sec. 28) and for delay in paying tax. [Sec. 46 (1).] It also provides for the prosecution before a Magistrate of persons who fail to perform the duties with which they are charged under the Act, *e.g.*, failure to submit returns or accounts, failure to collect or pay the tax deducted at source, refusal to allow books to be seen. Such prosecutions can be made only at the instance of the Assistant Commissioner who can also compound the offence. (Secs. 51 to 53.)

CONSTRUCTION—RULES OF.

As regards the rules of construction of Statutes, the reader is referred to any standard text-book on the Interpretation of

Statutes. The general rules however are summarised below; and a few authorities have been cited, more especially those relating to Revenue cases.

Words—Construction of.—The rules about construction of words are as below: If a special definition of a word or words is given in the Act, it should be adopted if not repugnant to the context[1]; failing this, the definition, if any, in the General Clauses Act of the *same* legislature[2] and failing this the meaning should be ascertained by ordinary rules. If there are interpretation clauses referring to other Acts (like 'Public servants' in Sec. 2 (13) or 'judicial proceeding' in Sec. 37) it should not be assumed that the thing defined has annexed to it every incident attached to it in the other Act by the legislature.[3]

The first ordinary rule of interpretation of words is that words importing a popular meaning when employed in a statute ought to be construed in the popular sense, unless the legislature has defined the words in another sense.[4] "What we ought to do in this case, it not being free from difficulty, is to choose that which, I should say, is the natural meaning of a word used in a statute not specially relating at all to the technicalities of real property law or to conveyancing in particular but relating to a matter of business, for this is a Finance Act and therefore using language which is to be read from a business point of view."[5] But words of known legal import are to be considered to have been used in their technical sense or according to their strict acceptation unless there appear to be a manifest intention of using them in the popular sense.[6] Regard should therefore be given to any peculiar sense which words may have acquired in Indian law.[6] And in any case the words of a statute should be understood in the sense they bore when the statute was passed.[7] If, however, the context or the declared intention of the Act or provisions contained in other parts

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(1) *Reg* v. *Govind and others*, 16 Bom. 283.

(2) *Woomesh Chunder Bose* v. *Soorjee Kanto Roy Chowdhry*, 5 Cal. 713.

(3) *Uma Churn Bag* v. *Ajadunnissa Bibee*, 12 Cal. 430.

(4) *Reg* v. *Imam Ali, etc.*, 10 All. 150; *Yorkshire, etc., Co.* v. *Clayton*, 1 Tax Cases 485.

(5) *Per Kennedy, J.* (*in Commissioners, Inland Revenue* v. *Gribble*, (1913) 3 K. B. 212) *followed by Sankey, J. in Neville Reid & Co.* v. *Commissioners, Inland Revenue*, 1 A. T. C. 237.

(6) *Rhedoykrishna Ghose* v. *Koylash Chunder Bose*, 4 B. L. R. 82; *Collector of Trichinopoly* v. *Lekamani*, 14 B. L. R. 115; *Special Commissioners* v. *Pemsel*, 3 Tax Cases 53.

(7) *Yorkshire, etc., Co.* v. *Clayton*, 1 Tax Cases 483; *Girwar Singh* v. *Thakur Narain Singh*, 14 Cal. 730.

of the Act show that general words are not to be read in their understood sense, they must receive a more limited meaning.[1] In *Colquhoun* v. *Brooks*[2] in which the assessee resided in the United Kingdom and profits accrued or arose to him from business outside the United Kingdom it was contended on behalf of the assessee that on the analogy of certain decisions under the Legacy and Succession Duty Acts, which, without the limitations imposed by the decisions, would have applied even if neither the testator nor the legatee nor the property was within or had some relation to the United Kingdom, the Income-tax Act also should be limited in its application; the House of Lords held that the Acts were not analogous. In the Income-tax Act specific limits are laid down as to who is taxable and in respect of what part of his income, whereas the Legacy and Succession Duty Act imposed no such definite limits. At the same time, "I am far from denying that if it can be shown that a particular interpretation of a taxing statute would operate unreasonably in the case of a foreigner sojourning in this country, it would afford a reason for adopting some other interpretation if it were possible consistently with the ordinary canons of construction." (*Per* Lord Herschell.)

As regards territorial limitations on the Income-tax Acts, see *Whitney* v. *Commissioners of Inland Revenue*[3] set out under Sec. 22 (4), and *London & South American Trust* v. *British Tobacco Co.*[4] set out under Sec. 1.

If the construction of words in a technical sense produces inequality and in a popular sense equality, the latter may be chosen.[5]

In an enumeration of different subjects general words following specific words may be construed with reference to the antecedent matters and the construction restricted by treating them as applying to things of the same kind as previously mentioned[6] unless of course there be something to show that a wider sense was intended.[7] This is known as the doctrine of *ejusdem*

(1) *Shidlingapa* v. *Karisbasapa*, 11 Bom. 599; *Reg* v. *Ramchandra Narayan and another*, 22 Bom 152; *Colquhoun* v. *Brooks*, 2 Tax Cases 490.

(2) 2 Tax Cases 490.

(3) 10 Tax Cases 88; 1926 A. C. 37.

(4) 42 T. L. R. 771.

(5) *Special Commissioners* v. *Pemsel*, 3 Tax Cases 53.

(6) *Mr. John Poulson, etc.* v. *Madhusudan Paul Chowdhry*, 1 B. L. R. 101; *Trustees of Psalms and Hymns* v. *Whitwell*, 3 Tax Cases 7; *Ystradyfodwg, etc., Board* v. *Bensted*, 5 Tax Cases 230.

(7) *Maxwell on Statutes*, 6th edition, pp. 592-593.

generis. But this doctrine cannot apply when each of the words preceding the general word is generically distinct from the rest and is exhaustive of its own genus[1] or only one specific word precedes the general word.[2] Language is always used *secundum subjectam materiam* and it must therefore be understood in the sense which best harmonises with the subject-matter.[3] When considering what is of ambiguous import the whole context ought to be regarded.[4]

A word which occurs more than once in the same Act should be construed uniformly unless a definition in the Act or the context shows that the word has been used in varying senses.[5]

Unless there is anything repugnant in the subject or context, words importing the masculine gender include females; and words in the singular the plural and *vice versa*. (Sec. 13 of the General Clauses Act.)

The following words deserve special mention :

Include.—

" Shall include " is a phrase of extension, and not of restrictive definition; it is not equivalent to "shall mean".[6]

" ' Include ' is very generally used in Interpretation Clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is so used, these words or phrases must be construed as comprehending not only such things as they signify according to their natural import but also those things which the interpretation clause declares that they shall include. But ' include ' is susceptible of another construction which may become imperative if the context of the Act is sufficient to show that it was not merely employed for the purpose of adding to the natural significance of the words or expressions defined. It may be equivalent to ' mean and include,' and in that case it may afford an exhaustive explanation of the meaning which, for the purposes of the Act, must invariably be attached to these words or expressions."[7] (Stroud's Judicial Dictionary, Vol. II, pp. 945-46.)

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(1) *In re Purna Chunder Pal*, 27 Cal. 1023.

(2) *Rex* v. *Special Commissioners. Ex parte Shaftesbury Homes, etc.*, 8 Tax Cases 367.

(3) *Chartered, &c., Bank* v. *Wilson*, 1 Tax Cases 192.

(4) *Reith* v. *Westminster School*, 6 Tax Cases 486.

(5) *Baijnath* v. *Sital Singh*, 13 All. 224; *Mahomed Akil* v. *Assadunnissa Bibee*, B. L. R. Supp. Vol. 774.

(6) *R.* v. *Kershaw*, 6 E. & B. 1007; 26 L. J. M. C. 19; *R.* v. *Hermann*, 48 L. J. M. C. 106; 4 Q B. D. 284; 27 W. R. 475; 40 L. T. 263.

(7) *Per Lord Watson, Dilworth* v. *Commissioner of Stamps*, 1899 A. C. 105, 106; 68 L. J. P. C. 4.

See also R. v. *Gard and others*, 16 Bom. 283.

R. v. *Asutosh Chakravarthi*, 4 Cal. 483.

Vyankaji v. *Sarje Rao Appaji Rao*, 16 Bom. 536.

May.—

" Though dicta of eminent Judges may be cited to the contrary, it seems a plain conclusion that " may," " it shall be lawful," " it shall and may be lawful," " empowered," " shall hereby have power," " shall think proper," and such like phrases, give, in their ordinary meaning, an enabling and discretionary power. " They are potential and never (in themselves) significant of any obligation."[1] "They confer a faculty or power, and they do not of themselves do more than confer a faculty or power "; and therefore, where the point in question is not covered by authority, " it lies upon those who contend that an obligation exists to exercise this power, to show in the circumstances of the case something which according to the principles I have mentioned creates this obligation."[2] On that case Cotton, L. J., observed : ' May ' never can mean ' must,' so long as the English language retains its meaning; but it gives a power, and then it may be a question in what cases, where a Judge has a power given him by the word ' may,' it becomes his duty to exercise that power."[3]

Julius v. *Bishop of Oxford* (Sup.), may be regarded as the leading case on the principles therein referred to by Lord Cairns for construing as obligatory phrases which in their ordinary meaning are merely enabling. His Lordship in that case gathers those principles into the following proposition:—

" Where a power is deposited with a public officer for the purpose of being used for the benefit of persons (1) who are specifically pointed out, and (2) with regard to whom a definition is supplied by the Legislature of the conditions upon which they are entitled to call for its exercise, that power ought to be exercised, and the Court will require it to be exercised."[4]

And the following supplemental proposition may be gathered from the judgment of Lord Blackburn in the same case:—

Enabling words are construed as compulsory whenever the object of the power is to effectuate a legal right; and if the object of the power is to enable the donee to effectuate a legal right, then it is the duty of the donee of the power to exercise the power when those who have the right call upon him to do so.

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(1) *Per Lord Selborne, Julius* v. *Oxford*, (1880) 5 App. Cas. 214.

(2) *Per Lord Cairns*, (*ibid.*)

(3) *Re Baker, Nichols* v. *Baker*, 59 L. J. Ch. 661; 44 Ch. D. 262.

(4) 5 App. Ca. 214.

"May", and such enabling words as those above referred to, therefore group themselves into two classes according as they impose or give:—

I. An Obligatory Duty;

II. A Discretionary or Enabling Power.

(Strouds Jud. Dictionary—Vol. II, pp. 1173, 1174.)

See *Alcock Ashdown & Co.* v. *Chief Revenue Authority*,[1] where the Judicial Committee of the Privy Council applied the above principles in construing "may" in Sec. 51 of the Indian Income-tax Act of 1918.

Discretion.—

" Where something is left to be done according to the discretion of the authority on whom the power of doing it is conferred, the discretion must be exercised honestly and in the spirit of the statute, otherwise the act done would not fall within the statute. ' According to his discretion,' means, it is said, according to the rules of reason and justice, not private opinion[2] according to law and not humour; it is to be not arbitrary, vague, and fanciful, but legal and regular[3] to be exercised not capriciously, but on judicial grounds and for substantial reasons.[4] And it must be exercised within the limits to which an honest man competent to the discharge of his office ought to confine himself,[5] that is within the limits and for the objects intended by the legislature." (Maxwell, 147, 148, 150 to 151 for cases in illustration). V. May: Opinion.

You cannot lay down a hard and fast rule as to the exercise of Judicial Discretion, for the moment you do that " the discretion of the Judge is fettered.'"[6] (Strouds Jud. Dictionary, p. 542.)

Year.—

The word ' year ' is used in varying senses in the Act. But it will be seen from the following that the Act uses it in the sense

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(1) 1 I. T. C. 221.

(2) *Rooke's Case*, 5 Rep. 100-A; *Keighley's Case*, 10 Rep. 140-B; *Eastwick* v. *City of London, Style*, 42-43; *Per Willes, J., Lee* v. *Bude Ry.*, L. R. 6 C. P. 576; 40 L. J. C. P. 288.

(3) *Per Lord Mansfield, R* v. *Wilkes*, 4 Bur. 2839

(4) *Per Jessel M. R., Re Taylor*, 4 Ch. D. 160; 46 L. J. Ch. 400; and *per Lord Blackburn, Doherty* v. *Allman*, 3 App. Ca. 728.

(5) *Per Lord Kenyon, Wilson* v. *Rastall* 4 T. R. 757.

(6) *Per Brett, M. R., In re Friedeberg*, 54 L. J. P. D. & A. 75; 10 P. D. 112; *Vf, per Bowen, L. J., Jones* v. *Curling*, 53 L. J. Q. B. 373; 13 Q. B. D. 262.

of the financial year [or the accounting period (the ' previous year ') relating to the financial year] except where it is clear from the context that the year contemplated is something else:—

" Previous year " is defined in the Act—See Sec. 2 (11).

" The year " clearly means " financial year " in Sec. 2 (11) (*a*) (line 2); so does " any year " (Sec. 3), ' that year ' (*ibid* and Sec. 4 (2)), " the year " (twice) and " that year " in Sec. 4 (2). The year " (line 7) and " a year " in Sec. 2 (11) (*a*) evidently mean any recognised period, such as the calendar year, the Samvat year, and so on. " Three years " in Sec. 4 (2) must mean three periods of 365 days, while in Sec. 22 (4) proviso it seems to mean " three accounting periods ". " From year to year " in S. 9 (2) presents no difficulty. The following refer to the financial year:—

"That year" (three times), 'the following year', 'succeeding years' and 'in any year' (Sec. 10 (2) (vi) Proviso), 'the following year' (Sec. 18 (5)), 'each year' (Sec. 21 and Sec. 22 (1)), 'any year', and 'that year' (Sec. 25 (1)). In Sec. 34 'any year' refers to the financial year, and so does 'that year', while 'one year' means 'a period of 365 days.' In Sec. 35 (1) 'one year' has the latter meaning. The financial year is also referred to in the following cases:—'in any year', and 'the following year' (Sec. 44-A) and 'in any year' (Sec. 44-C). 'The year' in Sec. 48 (1) must mean the period that the shareholder has adopted as his accounting period. This is clear from the general tenor of the section, and because ' total income ' is the income of the ' previous year' in the technical sense. "Any year," "that year" and 'the year' in Sec. 24 must also have the same meaning. "The year " in Sec. 46 (7) clearly means ' the financial year ', while 'one year' means "one period of 365 days." 'That year' in Sec. 48 (2) refers back to 'previous year'. The same is true in Sec. 48 (3). In Sec. 49 'any year' refers to the financial year, so does 'that year'. In Sec. 50, 'one year' means as usual 'a period of 365 days' while 'the year' means 'the financial year'. (But a more equitable construction is necessary in order to avoid anomalous results in certain cases—*see* notes under Sec. 50). In Sec. 55 'any year' and 'that year' (twice) refer to a financial year. So do 'any year' and 'same year' (Sec. 56), while 'that year' in the Proviso to Sec. 56 refers back to the previous year. It will thus be seen that 'year', etc., practically always refer to the 'financial year' except in a few cases where it is reasonably clear from the context that they do not.

Title and Preamble.—

In England it appears to have been a matter of dispute at one time whether the *title* of an Act should be taken into account in interpreting a statute. The title and preamble however were considered in the Pemsel case about charities.[1] In India it appears to be the accepted practice to refer to the title in construing the meaning of doubtful portions of the Act.[2] Although the *preamble* is not a part of the enactment but only a recital,[3] it furnishes the key to the construction of the Statute.[4] But it can be quoted only when the substantive part of the enactment is ambiguous; if not,[5] the substantive portion prevails and the preamble cannot override it.[5] The preamble may also be resorted to in restraint of the generality of the enacting clause when it would be inconvenient if not restrained.[6]

Title of Chapter.—

If the words of an enacting section admit of any reasonable doubt, the title or bearing of the *chapter* may be looked to in interpreting the section,[7] but these words cannot be taken to restrict the plain terms of the enacting section if they do not admit of reasonable doubt.[8]

Punctuation and Marginal Notes.—

In England, punctuation and marginal notes cannot be referred to for the purpose of construing a statute.[9] In India the position is not so clear. While there seems to be unanimity that, where the meaning of the enactment is clear, the punctuation and marginal notes cannot be referred to, there have been cases in which, as the text of the section was ambiguous, punctuation marks have been referred to in order to remove the

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(1) *Special Commissioners* v. *Pemsel*, 3 Tax Cases 53. See also *Fielding* v. *Morley Corporation*, (1899) 1 Ch. 3 and *Attorney-General* v. *Margate Pier Co.*, (1900) 1 Ch. 749.

(2) *Mahomed Akil* v. *Assadunnissa Bibee*, Supp. Vol. B.L.R. 774.

(3) *Brindaban Chunder Sircar Chowdhry* v. *Brindaban Chandra Dey Chowdhry*, 13 B.L.R. 408; *Collector of Trichinopoly* v. *Lukkamani*, L.R. 1 I.A. 268.

(4) *Nga Hoong* v. *The Queen*, 7 Moore's I.A. 72.

(5) *Ganesh Krishnaji* v. *Krishnaji*, 14 Bom. 387; *Nga Hoong* v. *The Queen*, 7 Moore's I.A. 72; *Chinna Aiyan* v. *Mahomed Fakiruddin Saib*, 2 Mad. 322.

(6) *Karunakar Mahati* v. *Niladhro Chowdhry*, 5 B.L.R. 652.

(7) *Sah Makhun Lall* v. *Sah Koondun Lall*, 15 B.L.R. 228; *Reg.* v. *Krishna Parashram*, 5 Bom. 69 (Cr.).

(8) *R.* v. *Ayyakkannu*, 21 Mad. 293; *Kishori Singh* v. *Sabdal Singh and another*, 12 All. 553.

(9) *London Library* v. *Carter*, 2 Tax Cases 597.

ambiguity.[1] It has been held that marginal notes cannot be referred to,[2] but even these have sometimes been referred to.[3]

Schedules and Forms.—

Schedules and forms are part of the Act but if the schedule conflicts with the main enacting part, the latter prevails.[4] This problem does not arise in the Income-tax Act as the only schedule is one of repealed enactments and there are no forms appended to the Act.

But there are forms and schedules in the Rules to which presumably the same principles will apply. Reference was made to the form of return of income prescribed under the Act in order to construe one of the sections of the Act.[5] The question whether the form of notice of demand under Sec. 29 of the Act by intendment prescribed a period of limitation of one year for the issue thereof has been considered,[6] and it has been held that the forms issued under the Act could be altered by the Revenue authorities in case of necessity and that such necessary alterations would be valid.

Proceedings of the Legislature.—

The proceedings of the legislature which precede the passing of an Act, including the statement of objects and reasons, cannot be referred to as legitimate aids to the *construction of a particular section or sections of the Act.*[7] But they may be referred to for the purpose of ascertaining the *object* of an Act.[8] In certain circumstances it may be admissible to look at a later Act for assistance in the construction of an earlier Act,[9] but general and ambiguous words of a later statute should not be relied upon to abrogate the clear intention of an earlier Act.[10]

(1) *Commissioner of Income-tax* v. *Nirmal Kumar Singh Nowlakshya*, 2 I.T.C. 20; *Board of Revenue* v. *S. R. M. A. R. Ramanathan Chettiar*, 1 I.T.C. 244.

(2) *Punardeo* v. *Ramsarup*, 25 Cal. 858; *Balraj Kunwar* v. *Jagathpal Singh*, 26 All. 393.

(3) *Bushell* v. *Hammond*, (1904) 73 L.J.K.B. 1005; *Administrator-General of Bengal* v. *Prem Lal Mullick*, 21 Cal. 732; *Kameshar Prasad* v. *Bhikhan Narain Singh*, 20 Cal. 609.

(4) *Attorney-General* v. *Lamplugh*, (1878) L.R. 3 Ex. D. 214.

(5) *Commissioner of Income-tax* v. *Arunachalam Chetti*, 44 Mad. 65; 1 I. T. C. 75. *See* Krishnan, J.'s judgment.

(6) *Rajendra Narayan* v. *Commissioner of Income-tax*, 2 I. T. C. 82.

(7) *Administrator-General of Bengal* v. *Prem Lall Mullick*, 22 Cal. 788.

(8) *Shaik Moosa* v. *Shaik Essa*, 8 Bom. 241.

(9) *Investors Mortgage Security Co.* v. *Sinton*, (1924) Sc. L. R., *Cape Brandy Syndicate* v. *Inland Revenue*, (1921) 2 K. B. 403 and *Smith* v. *Greenwood*, 8 Tax Cases 193.

(10) *Attorney-General* v. *Exeter Corporation*, 5 Tax Cases 629.

Literal Construction.—

A statute should be construed literally, *i.e.*, Courts of law can discover the intention of the legislature only from the terms used and are not at liberty to speculate upon the existence of an intention, inconsistent with the plain and obvious meaning of such terms and derived merely by inference from the general nature of the objects dealt with by the statute.[1] If the words of a statute are clear it is not the function of a Court to criticise the words and struggle to find some other way of construing them, because the words of the Legislature are the text of the law which must be obeyed and not criticised.[2] It is not for the Courts to decline to give effect to a clearly expressed statute because it may lead to apparent hardship.[3] "It is far better that we should abide by the words of a statute than seek to reform it according to the supposed intention."[4]

The Legislature must be assumed to have intended what it has said. A Court of Law cannot assume that it has made a mistake.[5] But literal construction may be departed from in favour of a liberal or beneficial construction if the literal construction would create a hardship which it cannot be supposed that the Legislature contemplated having regard to the language and tenor of the rest of the Act.[6] When the main object and intention of a statute are clear it must not be reduced to a nullity by the draftsman's unskilfulness or ignorance of law except in case of necessity or absolute intractability of the words.[7] But if the language is ambiguous, the construction should be made not only with reference to the literal and grammatical sense of the words,[8] but with reference to the other passages in the Act,[6] the object of the legislation,[9] its history,[10] and policy,[11] and scheme,[12] and also

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(1) *Skerry* v. *Lord Muskery quoted in Mahomed Akil* v. *Assadunnissa Bibee*, Supp. Vol. B. L. R. 774.

(2) *Attorney-General* v. *Exeter Corporation*, 5 Tax Cases 629.

(3) *Young & Co.* v. *Mayor of Leamington*, 8 A. C. 517; *Haji Abdul Rahiman* v. *Khoja Khaki Aruth*, 11 Bom. 6; *Balkaran Rai* v. *Gobind Nath Tiwari*, 12 All. 129.

(4) *Coe.* v. *Lawrence*, 1 E. & B. 516; *Rangaswami Naickan* v. *Varadappa Naickan*, 27 Mad. 462.

(5) *Special Commissioners* v. *Pemsel*, 3 Tax Cases 53.

(6) *Mahomed Ewaz* v. *Brij Lal and another*, 1 All. 465 (P. C.).

(7) *Salmon* v. *Duncombe*, 11 A. C. 627 (P. C.).

(8) *Tulsidas Dhunji* v. *Virbussapa*. 4 Bom. 624.

(9) *R.* v. *Gangaram*, 16 All. 136.

(10) *Administrator-General of Bengal* v. *Prem Lal Mullick*, 22 Cal. 788.

(11) *Sreenath Bhattacharjee* v. *Ramcomul Gangopadya*, 10 Moore's I. A. 220.

(12) *Gould* v. *Curtis*, 6 Tax Cases 293.

the consequences[1] of the construction. Even if the words are plain one is entitled and bound to have regard not to the mere language only but to the subject matter with which the Legislature is dealing and to the history of that subject matter at any rate in so far as it is embodied in statutes.[2] Generally speaking, ambiguous words must be construed with reference to the Act in which they occur and the purpose for which the words are used.[3]

Construction as a whole.—

It is a cardinal principle of construction that one should look at the whole of an Act and not merely a particular section or part of a section,[4] and this is necessary even when the words are quite plain.

"It is beyond doubt too that we are entitled and indeed bound, when construing the terms of any provisions found in a statute, to consider any other parts of the Act which throw light upon the intention of the Legislature, and which may serve to show that the particular provision ought not to be construed as it would be if considered alone and apart from the rest of the Act."[5]

At the same time it is not usual to construe a clause in an Act as if controlled by a previous clause.[6] It is the later clause if anything that should control the earlier clause.

A statute ought to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous,[7] void or insignificant.[8] But surplusage and tautology are not unknown.[b] At the same time words are sometimes inserted in an Act *ex abundante cautela* and the Act must be interpreted accordingly.[9] A provision put in possibly *ex major cautela* in one section does not affect the interpretation to be put on a subsequent section if the language of the latter in itself is clear.[10]

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(1) *Datto Dudheshvar* v. *Vithu*, 20 Bom. 408.
(2) *Attorney-General* v. *Exeter Corporation*, 5 Tax Cases 629.
(3) *Trustees of Mary Clark Home* v. *Anderson*, 5 Tax Cases 48.
(4) In re *Ratansi Kalyanji*, 2 Bom. 148.
(5) Per Lord Herschell in *Colquhoun* v. *Brooks*, 2 Tax Cases 490. See also *Queen* v. *Special Commissioners* (ex parte *Cape Copper Mining Co.*), 2 Tax Cases 332, on Appeal 2 Tax Cases 347 and *Special Commissioners* v. *Pemsel*, 3 Tax Cases 53.
(6) *Lord Advocate* v. *Hugh Gibb*, 5 Tax Cases 194.
(7) *Yorkshire, &c., Co.* v. *Clayton*, 1 Tax Cases 482.
(8) *R.* v. *Bishop of Oxford*, 4 Q. B. D. 245.
(9) *Special Commissioners for Income-tax* v. *Pemsel*, 3 Tax Cases 53.
(10) *Furtado* v. *City of London Brewery*, 6 Tax Cases 882.

In certain circumstances the principle of 'contemporary exposition' may be invoked.[1]

Also every attempt should be made to avoid inconstistency of meaning,[2] but if this is impossible the latter passage in the Act must be held to override the earlier.[3]

Proviso.—

A proviso or saving clause or exception prevails over the substantive part which it follows.[4] A proviso should be interpreted as though it were a substantive rule and not as an exception to the general proposition enunciated in a section.[5] If a proviso is unnecessarily inserted in order to except a case which does not fall within the enactment and only in order to remove misapprehension, it cannot be inferred from this that cases otherwise outside the enactment would fall within it as they have not been specifically excepted.[6]

If a section specifically grants exemption to certain persons or bodies of persons, it does not necessarily follow that every other person is brought within the scope of the impost; other persons not specifically referred to may also be exempt. This is not a case to which the principle *expressio unius est exclusio alterius* can be applied as a matter of course.[7]

Uniformity of Construction.—

A universal law, like Income-tax, cannot receive different interpretations with reference to different localities. In *Special Commissioners* v. *Pemsel*[7] it was held that if statutes apply to more than one country (*e.g.*, England and Scotland) "you must reason by analogy, you must take the meaning of legal expressions from the law of the country to which they properly belong, and in any case arising in the sister country, you must apply the statute in an analogous and corresponding sense, so as to make its operation and effect the same in both the countries."

Consolidating Statutes.—

A codifying, *i.e.*, consolidating measure, like the Income-tax Act, should be construed as far as possible with reference to its

(1) *Emperor* v. *Probhat Chandra Barua*, 1 I. T. C. 284; 51 Cal. 504 and *Maharajadhiraj of Darbhanga* v. *Commissioner of Income-tax*, 1 I. T. C. 303; 3 Patna 470.

(2) *Sugden* v. *Leeds Corporation*, 6 Tax Cases 211; *Colquhoun* v. *Heddon*, 2 Tax Cases 621; *Sutton's Hospital* v. *Elliott*, 8 Tax Cases 155; *Grant* v. *Langston*, 4 Tax Cases 217.

(3) *Ajudhia Prasad* v. *Balmukand*, 8 All. 354

(4) *Attorney-General* v. *Chelsea Waterworks*, *Fitzgibbon*, p. 195.

(5) *Mullins* v. *Treasurer of Surrey*, (1880) 5 Q. B. D. 173

(6) *West Derby Union* v. *Metropolitan Life Assurance Co.*, (1897) A. C. 647.

(7) *Special Commissioners of Income-tax* v. *Pemsel*, 3 Tax Cases 53.

natural meaning, as it stands, without reference to the previous state of the law[1]; otherwise the very object of the codification, *viz.*, the avoidance of reference to previous enactments would be defeated.[1] But a reference to the previous law would be justified if the new measure is ambiguous.[1] If the same words are used in the consolidating Acts as in the original Acts and if the words in the original Acts have been judicially interpreted that interpretation should be followed in construing the consolidating Act also.[2] "Since that decision the rule has been re-enacted in the same terms, and I should hesitate long before overruling a decision which has stood for 38 years and upon which subsequent legislation may have been based."[3]

As regards alterations in law or language, the Legislature must not be taken to intend any change beyond what it explicitly declares in express terms or by unmistakable implication.[4] "If the language used in the amending Act is reasonably capable of being construed so as to leave the procedure substantially as it was, we ought, in my opinion, so to construe it."[5] But the presumption that a change of language necessarily indicates a change of intention ought not to have too great weight attached to it.[6] There are such things as attempts at a more graceful style and the elimination of superfluous words. It should however be assumed that in re-enacting a particular clause or section the Legislature was aware of the construction put by Courts on it,[7] and the amendments must be construed with reference to the state of the law that it was proposed to amend.[8]

Remedial sections—Construction of.—

A remedial enactment or section should be construed liberally[9] and a penal one strictly.[10] In construing an exemption clause no word which would extend the exemption may be left out nor is generalisation permissible for the purpose of holding

(1) *Rogers Pyat Shellac Co.* v. *Secretary of State*, 1 I. T. C. 363; *Administrator-General* v. *Premlall Mullick*, 22 Cal. 788 (P. C.); *Bank of England* v. *Vagliano Bros.*, (1891) A. C. 107; *Norendranath Sircar* v. *Kamal Basini Dasi*, 23 Cal. 563 (P. C.).

(2) *Stewart* v. *Conservators of Thames*, 5 Tax Cases 297.

(3) Per Cave, L. C. in *Ricketts* v. *Colquhoun*, 10 Tax Cases 118.

(4) *Chief Commissioner of Income-tax* v. *Zemindar of Singampatti*, 1 I. T. C. 181; 45 Mad. 518.

(5) *R.* v. *Bloomsbury Commissioners*, (1905) 3 K. B. 768; 7 Tax Cases 59.

(6) *Emperor* v. *Probhat Chandra Barua*, 1 I. T. C. 284; 51 Cal. 504.

(7) *Stewart* v. *Conservators of Thames*, 5 Tax Cases 297.

(8) *Attorney-General* v. *London County Council*, 4 Tax Cases 265.

(9) *Farmer* v. *Cotton's Trustees*, 6 Tax Cases 604.

(10) *Perumal* v. *Municipal Commissioners of Madras*, 23 Mad. 164.

one word to be synonymous with another, if in fair construction it is capable of receiving an independent signification.[1] An act by which the jurisdiction of the ordinary courts is taken away should be construed strictly.[2] Limitation should also be construed strictly, *i.e.*, in favour of the right to proceed.[3] Though appeals are the creation of statutory enactment and must be affirmatively given and not presumed,[4] a party should not be deprived of the right of appeal except by express words or necessary implication,[5] and if the words of a section giving a right of appeal are ambiguous they ought to receive a liberal construction, *i.e.*, so far as possible so as to give an appeal.[6]

Rules.—

The rules made in pursuance of a delegated authority must be consistent with the statute under which the rules are made. The authority is given to the end that the provisions of a statute may be the better carried into effect, and not with the view of neutralising or contradicting these provisions.[7] Delegated power may not be further delegated without express provision to that effect.[8]

If there is a conflict between two rules or between a rule and a section of the Act, the position must be dealt with exactly as in the case of a conflict between two sections; and if no reconciliation is possible the rule would ordinarily be treated as the subordinate provision and made to give way to the section.

In rules, forms and notifications issued under the Act, words shall have the same meaning as in the Act unless there is something repugnant in the subject or context (Sec. 20, General Clauses Act.)

Under Sec. 21 of the General Clauses Act the power to make rules includes the power to add to, amend, vary or rescind orders, rules and notifications.

Practice.—

Special importance is attached to practice—*i.e.*, the interpretation placed by the Revenue authorities—in respect of fiscal

(1) *Muat* v. *Stewart*, 2 Tax Cases 607.

(3) *Prosunno Coomar Paul Chowdhry* v. *Koylash Chunder Paul Chowdhry*, B. L. R. Supp. Vol. 759.

(3) *Manckji* v. *Rustomji*, 14 Bom. 269.

(4) *Reg.* v. *Vajiram*, 16 Bom. 429.

(5) *Rance Shurno Mayee* v. *Lachmeeput Doogur*, B. L. R. Supp. Vol. 694.

(6) *Zain-ul-Abdin Khan* v. *Ahmad Raza Khan*, 2 All. 67.

(7) *Rajam Chetti* v. *Seshayya*, 18 Mad. 236.

(8) *Reg.* v. *Morian Chetti*, 17 Mad. 118.

law[1] but this is done usually when the practice is in favour of the subject. But there is no obligation to pay a tax—not clearly and expressly imposed by the law—even though the tax may have been paid by mistake for a long time.[2] Nor is the practice of the Revenue authorities binding on the Courts one way or the other.[3] Nor could a Court give effect to a practice not warranted by the provisions of the Statute.[4] No weight will be given unless the practice is of long standing.[5]

Miscellaneous.—

Affirmative words without a negative, expressed or implied, do not take away an existing right,[6] and an enactment conferring a narrow and limited right does not take away a larger right if it exists apart from the enactment.[7]

The following general principles also should be followed: General provisions do not derogate from special provisions, but the latter derogate from the former. In the absence of express legislative directions the Courts should be guided by justice, equity and good conscience. Every statute should be interpreted so as not to conflict with the comity of nations and accepted principles of international law.

Besides these there are various well-known maxims of interpretation, *e.g.*, *expressio unis est exclusio alterius*, *stare decisis*, *contemporanea expositio*, etc., of varying degrees of importance in practical application; and for an exposition of these principles the reader is referred to any treatise on the Interpretation of Statutes.

TAXING ACT—CONSTRUCTION OF.

The accepted rules of construction of Taxing Acts are set out in the following leading cases:—

" As I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the case he might otherwise appear to be. In other words, if there be admissible, in any statute, what

(1) *Special Commissioners* v. *Pemsel*, 3 Tax Cases 53; *Commissioner of Income-tax* v. *Ramanathan Chetti*, 43 Mad. 75; 1 I. T. C. 37.

(2) *Pole Carew* v. *Craddock*, 7 Tax Cases 488.

(3) *Killing Valley Tea Co.* v. *Secretary of State*, 1 I. T. C. 54; 48 Cal. 161; *Associated Newspapers* v. *City of London Corporation*, 1916 (2) A. C. 429.

(4) *Glenaloy Co.* v. *Lethem*, 6 Tax Cases 453.

(5) *Bhikanpur Sugar Concern Case*, 1 I. T. C. 29.

(6) *Collector of Trichinopoly* v. *Lekamani*, 14 B. L. R. 115.

(7) *Hinu Ram Das* v. *Mozaffer Hosain Shaha*, 14 Cal. 809.

is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.''[1]

" I quite agree we ought not to put a strained construction upon that section in order to make liable to taxation that which would not otherwise be liable, but I think it is now settled that in construing these Revenue Acts, as well as other Acts, we ought to give a fair and reasonable constuction, and not to lean in favour of one side or the other, on the ground that it is a tax imposed upon the subject, and therefore, ought not to be forced unless it comes clearly within the words. That is the rule which has been laid down by the House of Lords in regard to the Succession Duty Acts, and I think it is a correct rule.''[2]

" No tax can be imposed on the subject without words in an Act of Parliament clearly showing an intention to lay a burden on him. But when that intention is sufficiently shown, it is, I think, vain to speculate on what would be the fairest and most equitable mode of levying that tax. The object of those framing a Taxing Act is to grant to Her Majesty a revenue; no doubt they would prefer, if it were possible, to raise that revenue equally from all, and, as that cannot be done, to raise it from those on whom the tax falls with as little trouble and annoyance and as equally as can be contrived; and when any enactments for the purpose can bear two interpretations, it is reasonable to put that construction on them which will produce these effects. But the object is to grant a revenue at all events, even though a possible nearer approximation to equality may be sacrificed in order more easily and certainly to raise that revenue, and I think the only safe rule is to look at the words of the enactments and see what is the intention expressed by those words.''[3]

" This is an Income-tax Act, and what is intended to be taxed is income. And when I say ' what is intended to be taxed,' I mean what is the intention of the Act as expressed in its provisions, because in a Taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act, to do more than take such tax as the statute imposes. In various cases the principle of construction of a Taxing Act has been referred to in various forms but I believe they may be all reduced to this, that inasmuch as you have no right to assume that there is any governing object which a Taxing Act is intended to attain other than that which it has expressed by making such and such objects the intended subject for taxation, you must see whether a tax is expressly imposed. Cases, therefore, under the Taxing Acts always resolve themselves into a question whether or not the words of the Act have reached the alleged subject of taxation.''[4]

(1) Per Lord Cairns, *Partington* v. *Attorney-General*, (1869) L. R. 4 E. & I. App. H. L. 100, p. 122.

(2) Per Cotton, L. J., *Gilbertson* v. *Fergusson*, (1881) 7 Q. B. D. 562, p. 572 (1 Tax Cases 501).

(3) Per Lord Blackburn, *Clotness Iron Co.* v. *Black*, (1881) 6 App. Cases 315, p. 330 (1 Tax Cases 287).

(4) Per Lord Wensleydale in *In re Micklethwait*, 11 Ex. 452 at p. 456.

"It is a well-established rule that the subject is not to be taxed without clear words for that purpose; and also, that every Act of Parliament must be read according to the natural construction of its words."[1]

"I am rather disposed to repudiate the notion of there being any artificial distinction between the rules to be applied to a taxing Act and the rules to be applied to any other Act. With regard to all Acts and all documents you have to apply your best mind to it to look at the question all round, get all the light that you can throw on it and see what seems to be the meaning of the expressions used. It would not be satisfactory to say that, if this Act applies to anything else than taxation, you might require a less degree of certainty or an inferior exercise of the process of reasoning to attempt to arrive at its meaning than you should apply in respect to a Tax Act."[2]

"I see no reason why special canons of construction should be applied to any Act of Parliament and I know of no authority for saying that a taxing Act is to be construed differently from any other Act. The duty of the Court is, in my opinion, in all cases the same, whether the Act to be construed relates to taxation or any other subject, *viz.*, to give effect to the intention of the Legislature, as the intention is to be gathered from the language employed having regard to the context in connection with which it is employed. The Court must no doubt ascertain the subject-matter to which the particular tax is by the statute intended to be applied but when once this is ascertained it is not open to the Court to narrow or whittle down the operation of the Act by seeming considerations of hardship or of business convenience or the like. Courts have to give effect to what the Legislature has said."[3]

No tax can be imposed except by words which are clear; and the benefit of the doubt is the right of the subject.[4]

"I know of no law which prevents a man from avoiding a duty which has not attached to the property. . . . A man is perfectly entitled, if he can, to avoid the payment of duty by disposing of his property in any way not forbidden by the Act. The argument that his motive is to escape duty appears to me wholly irrelevant, because a man is perfectly justified in avoiding and escaping the duty which will arise in the future but which has not yet attached to any property which he possesses."[5]

"The Crown however must make out its right to the duty, and if there be a means of evading the stamp duty, so much the better for those

(1) Per Lord Halsbury, L. C. in *Tennant* v. *Smith*, (1892) A. C. 150 p. 154 (3 Tax Cases 158).

(2) Per Wills J. in *Styles* v. *Middle Temple*, 4 Tax Cases 123.

(3) Per Lord Russel C. J. in *Attorney-General* v. *Carlton Bank*, (1899) 2 Q. B. 158.

(4) Per Fitzgibbon L. J. in *In re Finance Act*, 1894 *and Studdert*, (1900) 2 Ir. R., p. 400.

(5) Per Farwell L. J. in *Attorney-General* v. *Richmond & Gordon*, (1908) 2 K. B. 729.

who can evade it. It is no fraud upon the Crown, it is a thing which they are perfectly entitled to do.'"[1]

Arguments based upon the ground of injustice have but little weight in determining the true meaning of an Act of Parliament unless indeed its provisions are so ambiguous that the hardship inflicted by one construction can be based to show that such a purpose could not be properly attributed to the Legislature.[2]

I think however that considerations of justice and injustice have not much to do with modern direct taxation; they belong to a different order of ideas. Taxation is concerned with expediency or inexpediency. It regularly results in one person being burdened for another's benefit in the sense that the subject who pays the tax may be the last person to benefit by the expenditure of it.[3]

Equity and Income-tax are strangers.[4]

I agree that this case was not contemplated but when one gets cases under the taxing law which cannot be contemplated it does not do to make assumptions as to what they would have said had they contemplated the case. I think you have simply to look and see what they have said—per Rowlatt J. in *Commissioner of Inland Revenue* v. *Ryde Pier Co.*[5]

Statutory language cannot be construed by asking which construction will most benefit the Revenue—per Lord Sumner in *National Provident Institution v. Brown.*[6]

But even in a Taxing Statute it is legitimate to consider which of two possible constructions is most in accordance with the spirit and intention of the Act—per Lord Salvesen in *Scottish Shire Line* v. *Lethem.*[7]

Substance is to be looked at in Revenue matters, not machinery and form. *St. Louis Breweries* v. *Apthorpe.*[8]

See also the following cases : *Oriental Bank Corporation* v. *Wright,*[9] *Cox* v. *Rabbits,*[10] *Lord Advocate* v. *Fleming,*[11] *Pryce* v. *Monmouthshire, &c., Companies,*[12] *Simms* v. *Registrar of Probates,*[13] *Stockton Railway Co.* v. *Barrette.*[14]

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(1) Per Lord Esher M. R. in *Commissioners, Inland Revenue* v. *Angus*, 23 Q. B. 579.

(2) Per Lord Buckmaster in *Wankie Colliery* v. *Commissioners, Inland Revenue*, 1 A. T. C. 125.

(3) Per Lord Sumner, *ibid.*

(4) Per Lord Sands in *Commissioners of Inland Revenue* v. *Granite City Steamship. Co.*, 6 A. T. C. 678.

(5) 4 A. T. C. 513.

(6) 8 Tax Cases 57.

(7) 6 Tax Cases 91.

(8) 4 Tax Cases 111.

(9) (1880) 5 A. C. 842.

(10) (1878) 3 A. C. 473.

(11) (1897) A. C. 145.

(12) (1879) 4 A. C. 197.

(13) (1900) A. C. 323.

(14) (1844) 11 Cl. & Fin. 590.

See also the following cases in India : *Killing Valley Tea Co* v. *Secretary of State*,[1] *Rowe & Co.* v. *Secretary of State*,[2] *Imperial Tobacco Co.* v. *Secretary of State*,[3] *Sundardas* v. *Collector of Gujrat*,[4] *Commissioner of Income-tax* v. *Ramanathan Chetti*.[5]

Where it is desired to impose a new burden by way of taxation, it is essential that this intention should be stated in plain terms. The Courts cannot assent to the view that if a section in a taxing statute is of doubtful and ambiguous meaning, it is possible out of the ambiguity to extract a new and added obligation not formerly cast upon the tax-payer.[6]

In construing a fiscal statute the Court has no concern with disputable questions of distributive justice—this upon the plainest ground, that by very strong presumption the Legislature has not intended that questions of equality or fairness in taxation should be left to any decision save its own.[7]

Manifest mistakes.—

Although, in construing fiscal enactments, Judges should ordinarily insist upon the subject taxed being clearly within the words of the law and decline to extend its scope when there is any ambiguity they cannot exclude from their consideration the fact that the context discloses a manifest inaccuracy. In such cases the sound rule of construction is to eliminate the inaccuracy and to execute the true intention of the Legislature.[8]

Double taxation—Presumption against.—

In the United Kingdom it is now a well-recognized principle that the various taxing Acts do not authorize the Crown to take income tax twice over in respect of the same source for the same period of time and that this can be done only under specific statutory authority. As Lord Sumner said in *Bradbury* v. *English Sewing Co.*,[9] " Though the Acts nowhere say so, this principle has long been assumed. Whether the contention may ever be raised that the Crown is not bound by mere conventions of fair play current from time to time hitherto, at any rate, the

(1) 1 I. T. C. 54; 48 Cal. 161.
(2) 1 I. T. C. 16.
(3) 1 I. T. C. 169; 48 Cal. 721.
(4) 1 I. T. C. 189; 3 Lah. 349.
(5) 1 I. T. C. 37; 43 Mad. 75.
(6) Per Lord Buckmaster in *Smidth* v. *Greenwood*, 8 Tax Cases 193 cited by Chatterjee, J., in *Rogers Pyatt Shellac Company* v. *Secretary of State* 1 I. T. C. 363.
(7) Per Rankin J. in *Emperor* v. *Probhat Chandra Barua*, 1 I.T.C. 284; 51 Cal. 504.
(8) *Jennings* v. *President, Municipal Commission*, 11 Mad. 253.
(9) 8 Tax Cases 481.

binding force of this principle has not been questioned." See also *Manindra Chandra Nandi* v. *Secretary of State*;[1] *Emperor* v. *Probhat Chandra Barua*[2] in both of which it was observed that the Indian Income-tax Acts specifically authorized the levy of tax on incomes that may have already borne some other tax.

Precedents—Use of.—

Observations as to the use of decided cases:—In *Quinn* v. *Leatham*,[3] Halsbury, L. C., said:—

"There are two observations which I wish to make: one is that every judgment must be read as applicable to the particular facts proved, or assumed to be proved, since the generality of the expressions which may be found there are not intended to be expositions of the whole law, but governed and qualified by the particular facts of the case in which such expressions are to be found; the other is that a case is an authority for what it actually decides. I entirely deny that it can be quoted for a proposition that may seem to follow logically from it."

At the same time precedents are not to be lightly departed from—

"We have not however succeeded in laying down a rule which would be consistent with the existing legislation and decisions on the subject, and would at the same time be capable of being satisfactorily worked, and we are strongly impressed with the importance of not unsettling the law as established by past decisions when we cannot lay down a rule that is not open to exceptions."—Per Blackburn J. in 12 Q. B. D. quoted with approval by Lord Macnaghten in *The General Accident, &c., Corporation* v. *Mcgowan*.[4]

English decisions—Applicability of.—

Though Income-tax has been in force in India for quite a long time it is only in recent years that the tax has been sufficiently heavy or administered with sufficient strictness to result in disputes and as a consequence in the accumulation of much case law on the subject. In deciding most problems, therefore, one has perforce to rely to a great extent on English precedents. Though in *North Anantapur Gold Mines* v. *Chief Commissioner of Income-tax*,[5] and in other cases High Courts have held that English Income-tax law may be usefully followed, the precedents have to be applied with great caution in view of the wide differences between English and Indian law. It is only in respect of fundamental

(1) 34 Cal. 257.
(2) 1 I. T. C. 284; 51 Cal. 504.
(3) (1901) Appeal Cases 495 (506).
(4) 5 Tax Cases 308.
(5) 1 I. T. C. 133; 44 Mad. 718.

concepts, *e.g.*, the distinction between income and capital, the test of what constitutes a business or a profession, the general principle of taxing at source and indemnifying the person actually collecting the tax, the criterion of what constitutes expenditure necessary for earning the income, ignoring the destination of the income, etc., that the English law furnishes really useful guidance. Even in respect of such general concepts there is in some important features a fundamental difference between English and Indian law, *e.g.*, in regard to the relevancy of the locality where income accrues or arises as a basis of liability to tax. In India, for instance, all income that accrues or arises in India or is received in India is taxed irrespective of the residence or domicile of the persons, whereas in England not only all income that accrues or arises in the country is taxed but also all income belonging to residents wherever arising or accruing (subject, however, to certain exceptions). This difference, of course, is due to the fact that England is a creditor country with much capital invested abroad and the ignoring of foreign income of residents would result in a considerable portion of the taxable capacity of the residents being overlooked. However that may be, it will be seen for example from the decision of the Madras High Court in the *Madras Export Company Case*,[1] and the decisions of the Calcutta High Court in the *Rogers Pyatt Shellac Case*,[2] and of the Rangoon High Court in *Steel Bros. Case*,[3] that there is considerable difficulty in following English precedents. Then there is the difference in the method of graduating the tax, England giving a system of allowances, whereas India has different rates of taxes; and again married women are taxed jointly with their husbands in the United Kingdom.

The machinery of assessment and collection is also quite different in England and India. In the United Kingdom the law attempts to utilise non-official agencies to a considerable extent in assessments, but this is almost a formality as will be seen from the following extract from the Report of the Royal Commission on Income-tax in 1920:—

"This smooth working of the machine has been rendered possible only by considerable deviations from the scheme. . . . originally conceived . . . . little by little (the) plan has been departed from . . . . and every change has been in the direction of making over to the Inspector of Taxes the exercise of powers that theoretically belong to the Local

(1) 1 I. T. C. 194.
(2) 1 I. T. C. 363.
(3) I. L. R. 3 Rang. 614.

Commissioners and their officials. Many of the recommendations that we have to make . . . . are directed towards recognising and giving legal sanction to these . . . developments. . . ."

The Commission recommended that appeals against assessments should be heard only by Special Commissioners appointed by the Treasury but consisting only of practising Barristers, Solicitors or Accountants of not less than ten years' standing and experienced officials (not exceeding one-half of the Special Commissioners) of the Inland Revenue Department. This recommendation however has not yet been given effect to.

It will be seen from the above that there is considerable danger in following English decisions in the matter of procedure also. Notwithstanding all this difference, however, it will be seen from the body of the book that the bulk of the cases cited are English cases. As already stated a sufficient volume of case-law has not yet grown up in India though it is growing rapidly and we have to go to English cases for whatever guidance we require. The detailed differences between the English and the Indian law are explained as far as possible in the notes under each section.

English Income-tax Laws—Obscure.

But there is one important difference between the United Kingdom and the Indian law which cannot be passed over. The United Kingdom laws have always been obscure. "In these Acts," says Lord Wrenbury, in *Kensington Commissioners* v. *Aramayo*,[1] speaking of the Acts of 1842 and 1880, "it is not possible to rest any conclusion upon a particular word. The same word is in one section used in one sense, and in another, in a different sense. . . From a change of language, I should in the absence of other considerations infer a change of meaning. But I cannot do so in this case. . . . The change of language is attributed only to the very indifferent drafting which is found throughout this most complicated and ill-digested Act;" and the Earl Loreburn adds in the same case, "I regret to say that in this respect the language of the different Acts is not coherent. You may strain the language to mean either one thing or the other. You must strain it to arrive at any conclusion." Such extracts from judgments could be indefinitely multiplied. The 1918 Income-tax Act in England is supposed to have consolidated the previous law, but this is what Lord Sumner said of it : "It is a most wholesome rule that in taxing the subject the Crown must

(1) (1916) 1 A. C. 227; 6 Tax Cases 613.

show that clear powers to tax were given by the legislature. Applied to income-tax, however, this is an ironical proposition. Most of the operative clauses are unintelligible to those who have to pay the taxes, and in any case derive such clarity as they possess from the Judges who have interpreted them.'"[1]

Per Lord Buckmaster—. . . . I do not pretend that the opinion I hold rests on any firm logical foundations. Logic is out of place in these questions, and the embarrassment that I feel is increased with the knowledge that my views are not shared by other Members of the House, but this fact is not surprising. It is not easy to penetrate the tangled confusion of these Acts of Parliament, and though we have entered the labyrinth together we have unfortunately found exits by different paths.—In *G. W. Railway* v. *Bater.*[2]

The Income-tax Law in the United Kingdom is at the present moment distributed between nearly a dozen enactments, the most important of these being the Act of 1918.

In India we are far more fortunate. We have a brief Act which is fairly clear and precise. No Act, of course, can be perfect, but many of the lacunae and defects have been filled up in the last few years since the Act was passed, and it is without doubt a remarkably good Act compared with those in other countries.

U. S. A.—INCOME-TAX LAW IN.

While, in the United Kingdom, income-tax is of very long standing, in the United States of America the Federal Income-tax is of quite recent development. The States have been levying the tax for quite a long time and there is, as is only to be expected, no uniformity. Federal Income-taxes were levied during the Civil War as a temporary measure. A tax was again imposed in 1894 but the Supreme Court held a year later in *Pollock* v. *Farmer's Loan and Trust Company,*[3] that such a tax was unconstitutional as it was a direct tax and could be imposed only on the basis of apportionment according to population in each State. The necessary amendment was made to the constitution after 18 years and it is only since 1913 that the Federal Income-tax has been in force.

But a Corporation Profits Tax—called Corporation Special Excise Tax—came into force in 1909. This was really an indirect

(1) *Brown* v. *National Provident Institution,* (1921) 2 A. C. at p. 257; 8 Tax Cases 57.

(2) 8 Tax Cases 244.

(3) 157 W. S. 429, 158 W. S. 601.

income-tax levied so as to circumvent the constitutional difficulty. The Supreme Court declared it to be constitutional in *Flint v. Stone Tracy Co.*[1]

Under the 1913 law—which was the first general income-tax law—the English law was closely followed. Collection at source was resorted to as much as possible; and deductions were allowed only of losses in ' trade '. But it was more liberal in one respect, *viz.*, it permitted a deduction for depletion of mines and similar capital assets. In 1916 the war brought in higher rates of tax and also a Surtax. But the " set-off " provision was made wider as well as that for the depletion of wasting assets. The year 1917 saw a still further rise in rates but the system of collection at source was virtually abandoned and a plan of ' information at source ' substituted. Deductions were allowed (up to 15 per cent. of net taxable income) on account of gifts to charitable, religious or educational purposes. Then came the Excess Profits Duty in 1917, and the Act was recast in 1918—most of the provisions being made more liberal. The tax is levied on " gains, profits and income derived from any source whatever " subject to certain specific deductions, etc., but the law expressly provides for the taxation of appreciation in capital values actually realised. But capital itself—or property—may not be taxed according to the constitution unless apportioned according to population. The question, therefore, as to what is the dividing line between Capital and Income is one of special interest in the United States of America.

Most English colonies and many foreign States have income-tax of one kind or another and it hardly seems necessary to set out the details of those systems here. It should also be noted that the law in the United States of America is rapidly changing from year to year.

PREVIOUS STATUTES—EFFECT OF—EXEMPTIONS.

The question how far the Indian Income-tax Act overrides exemptions from taxation conferred by previous statutes has been the subject of considerable difference of opinion. The principal class of cases that we have to consider is that of permanently settled estates. The revenue payable by these estates was settled permanently about 1800 in accordance with the policy that then prevailed. These estates are mostly in Bengal, Behar and parts of Assam, and the Northern Circars of Madras; and there are

(1) 220 W. S. 107.

also some 'islands' of permanently settled tracts—some of them fairly extensive—in the ryotwari parts of Madras. Later on the policy of the East India Company changed and permanent settlements were not extended elsewhere. The question has often been raised how far the permanent settlement precluded the levy of further taxation. In some of the Income-tax Acts that preceded the Act of 1886, permanently settled estates were taxed. All agricultural income was taxed and no distinction was made between permanently and temporarily settled estates. From 1877 however agricultural income was not taxed and both classes of estates escaped taxation. But additional cesses and imposts for various purposes, road cess, education cess, embankment and drainage cess, cost of settlements between landlords and tenants, etc., have been levied on the permanently settled estates; and though all these levies have evoked protests, the legislature has never admitted that the permanent settlement gave absolute immunity from future taxation. In *Manindra Chandra Nandi* v. *Secretary of State for India*[1] it was contended before the High Court of Calcutta that income from royalties on coal in permanently settled lands should be exempted both from local cesses and from income-tax. Curiously however the objection then taken to the levy of the latter was not that it contravened the permanent settlement but that royalties were of the nature of capital receipts and that in any case the same income should not be taxed twice over, once to local cesses and once to income-tax. The levy of income-tax on the non-agricultural income of permanently settled estates was *not* objected to as a breach of the terms of the permanent settlement.

In recent years, however, the question has come to the forefront.

In *Chief Commissioner of Income-tax* v. *Zemindar of Singampatti*,[2] a Full Bench of the Madras High Court (Ayling, Coutts-Trotter and Ramesam, JJ.) decided that the non-agricultural income of permanently settled estates was not taxable. In *Emperor* v. *Probhat Chandra Barua*,[3] a Divisional Bench of the Calcutta High Court (Rankin and Page, JJ.) decided that it was. There was a difference of opinion between the two judges and the view of the senior judge (Rankin, J.) prevailed. In *Maharajadhiraj of Darbhanga* v. *Commissioner of Income-tax*,[4] the Patna High Court (Dawson Miller, C. J. and Mullick, J.) held that

(1) (1907) 34 Cal. 257.
(2) 1 I. T. C. 181.
(3) 1 I. T. C. 284.
(4) 1 I. T. C. 303.

the income was not taxable. Here again the judges differed and the view of the Chief Justice prevailed. In *Indu Bhushan Sarkar* v. *Commissioner of Income-tax,*[1] a Divisional Bench of the Calcutta High Court (Cuming and Page, JJ.) differed from the ruling in the *Barua* case and held that the income was not taxable. In *Emperor* v. *Probhat Chandra Barua,*[2] a Full Bench of five judges of the Calcutta High Court considered the question and (by a majority of 3 judges, Ghose, Buckland and Panton, JJ., to 2, Mukherjee and Suhrawardy, JJ.) decided that the income was taxable. An appeal against this judgment is now pending before the Privy Council.

It is common ground in all the judgments that the Legislature could take away the exemption once granted, and the question for decision has therefore been narrowed down to one merely of construction of the Permanent Settlement Regulations and the Sanad where available and of the Income-tax Acts. The only points for consideration have been (1) whether the immunity from increase in demand given by the Permanent Settlement was absolute or only from future enhancement of land revenue, and (2) whether such immunity, if absolute, has been taken away by the Income-tax Acts.

The case for the owners of the permanently settled lands would, of course, have been stronger and quite conclusive if the permanent settlement had succeeded the levy of a general income-tax by the Legislature instead of preceding it. Then the later Act would have prevailed without question.[3]

There is no analogy, however, between the position of a proprietor of a permanently settled estate who has entered into a permanent agreement with Government and that of a conquered Raja who is deposed and reduced to the position of a tenure holder.[4]

INCOME-TAX LEGISLATION—THEORY OF— INTERNATIONAL ASPECTS.

" It is the principle of domicile that regulates the levy of income-tax. . . . This is certainly the rule in most of the systems and that it should be so is perhaps to some extent accounted for by the fact that attempts to levy and to collect income-tax in a foreign country would very frequently encounter insurmountable difficulties "—, Bar's International Law quoted by Seshagiri

(1) 2 I. T. C. 221.

(2) 54 Cal. 863.

(3) See *Duke of Argyll* v. *Commrs. of Inland Revenue*, 109 L. T. 893; 7 Tax Cases 225.

(4) 48 Mad. 75.

Iyer, J. in *Commissioner of Income-tax* v. *Ramanathan Chetti*.[1] The 'domicile' refers to persons as well as property or business; otherwise it is difficult to see how the above extract represents the same view as in the following extract:—

"The power of taxation of any State is, of necessity, limited to persons, property or business within its territorial jurisdiction. . . the principle is so fundamental that it has been declared that an act of State legislature in violation thereof would be as much a nullity as if in conflict with the most explicit constitutional inhibition."

(Wharton's Conflict of Laws, Vol. I, which also the learned Judge quoted as stating the same view.)

It is obvious that a tax cannot be enforced unless either the country is the place of 'origin' of the income, *i.e.*, there is a source of income there, whether tangible or not, or the country is the place of 'domicile' of the 'taxee,' *i.e.*, the taxee resides in the country. ('Domicile' is not used in a legal but in an economic sense.) Otherwise the country has no means of imposing taxation. The principles of 'domicile' and 'origin' are applied in varying degrees by different countries. Though the principles are clear enough when stated in the abstract, they are exceedingly difficult of application in practice, as it is not easy to state what is the cause of the income. The result is acute conflict between the fiscal interests of countries on the one hand and a heavy burden in the shape of double taxation on the tax-payer on the other. Political as well as economic considerations stand in the way of any really satisfactory arrangements being made between different countries. The problem is far more difficult and obscure than jurists have generally assumed it to be. Possibly the most notable contributions to the subject recently are the Reports made to the League of Nations by the four Professors of Economics and by the Administrative Experts. The following extract from the former report will show the difficulty of the problem. The Professors suggested certain possible lines on which conflicting interests of countries could be reconciled but these lines were shown to be impracticable by the Administrators who after prolonged discussion recommended an admittedly illogical, arbitrary and complicated formula in the shape of a Draft Bilateral Convention for relief from double taxation.

"The older theory of taxation was the exchange theory, which was related directly to the philosophical basis of society in the 'social contract,' according to which the reason and measure of taxation are in accordance with the principles of an exchange as between the government and the individual. This took two forms : the cost theory and the benefit

(1) *Radha Mohan* v. *Commissioner of Income-tax*, [illegible] . 841.

theory. The cost theory was that taxes ought to be paid in accordance with the cost of the service performed by the Government. The benefit theory was that taxes ought to be paid in accordance with the particular benefits conferred upon the individual. Neither the cost nor the benefit theory was able to avoid or to solve the problem of international double taxation. For the services conferred by a given government affect not only the person of the tax-payer resident within that government's area (his personal safety, health and welfare) but also the property that he possesses within the limits of that area (not, of course, the property outside it), the services by which property benefits being its physical defence from spoliation, its protection from various kinds of physical deterioration and the maintenance of a system of legal rights surrounding it. Where the property was in one State and the person in another State, the complications were obvious. There was, moreover, no satisfactory method of apportioning either the cost or the benefit.

There is, however, no need to enter into the details of these methods, as the entire exchange theory has been supplanted in modern times by the faculty theory or theory of ability to pay. This theory is more comprehensive than the preceding theory, because it includes what there is of value in the benefit theory. So far as the benefits connected with the acquisition of wealth increase individual faculty, they constitute an element not to be neglected. The same is true of the benefits connected with the consumption side of faculty, where there is room even for a consideration of the cost to the government in providing a proper environment which renders the consumption of wealth possible or agreeable. The faculty theory is the more comprehensive theory.

The objection may be made that faculty does not attach to things, and that many taxes are imposed upon things or objects. This is true of the so-called real or impersonal taxes as opposed to personal taxes. This distinction, however, must not prevent the recognition of the fact that all taxes are ultimately paid by persons. So-called real or impersonal taxes —taxes *in rem,* as the English-speaking countries term them—which are often chosen for reasons of administrative convenience, are ultimately defrayed by persons and, through the process of economic adjustment, ultimately affect the economic situation of the individual.

When we deal with the question of personality, we are confronted by the original idea of personal political allegiance or nationality. It is first of all necessary to consider briefly the issues that arise upon political allegiance. A citizen of a country living abroad is frequently held responsible to his own country, though he may have no other ties than that of citizenship there. His is a political fealty which may involve political duties and may also confer political rights. It may well be that the political rights are such as to imply a political obligation or duty to pay taxes.

In modern times, however, the force of political allegiance has been considerably weakened. The political ties of a non-resident to the mother-country may often be merely nominal. His life may be spent abroad, and his real interests may be indissolubly bound up with his new home, while his loyalty to the old country may have almost completely disappeared. In many cases, ind[illegible] he new home will also become the place of a new political allegiance. But it is well known that in some countries the political bond cannot be dissolved even by permanent emigration; while it frequently happens that the immigrant has no desire to ally himself politically with what is socially and commercially his real home. In the modern age of the international migration of persons as well as of capital, political allegiance no longer forms an adequate test of individual fiscal obligation. It is fast breaking down in practice, and it is clearly insufficient in theory.

A second possible principle which may be followed is that of mere temporary residence; every one who happens to be in the town or State may be taxable there. This, however, is also inadequate. If a traveller chances to spend a week in a town when the tax-collector comes around, there is no good reason why he should be assessed on his entire wealth by this particular town; the relations between him and the government are too slight. Moreover, as he goes from place to place, he may be taxable in each place or in none. Temporary residence is plainly inadmissible as a test.

A third possible principle is that of domicile or permanent residence. This is a more defensible basis, and has many arguments in its favour. It is obviously getting further away from the idea of mere political allegiance and closer to that of economic obligation. Those who are permanently or habitually resident in a place ought undoubtedly to contribute to its expenses. But the principle is not completely satisfactory. For, in the first place, a large part of the property in the country may be owned by outsiders : if the government were to depend only on the permanent residents, it might have an insufficient revenue even for the mere protection of property. In the second place, most of the revenues of the resident population may be derived from outside sources, as from business conducted in other States : in this case, the home government would be gaining at the expense of its neighbour. Thirdly, property-owners like the absentee landlords of Ireland or the stockholders of railways in the western States of America cannot be declared devoid of all obligations to the place whence their profits are derived. Domicile, it is obvious, cannot be the exclusive consideration.

A fourth possible principle is that of the location of the wealth. This again is undoubtedly to a certain extent legitimate. For a man who owns property has always been considered to have such a close relation with the government of the town or country where his property is situated as to be under a clear obligation to support it.

While the principle of location or situs seemed to be adequate as long as we were dealing with the older taxes on property owned by the living or passing on death, the term became inadequate under the more modern systems of the taxation of income or earnings. It has become customary, therefore, to speak of the principle of location in the case of property, and the principle of origin in the case of income. Further consideration makes us realise that these two principles are not exactly conterminous; because, even though the income may be earned in a certain place, after it has been earned it becomes property, and is therefore susceptible of a different situs. Tangible, corporeal property is more difficult of movement, and in some cases, when it consists of immovables, cannot be moved at all; but certain forms of incorporeal property can be easily moved. The legal writers and the courts attempt to surmount certain of the resulting difficulties by distinguishing between the actual and the constructive location of property. We thus have the possibility of income originating in country A by trading within that country or physically arising from crops, property, etc., in that country, being actually found, so far as it consists, for instance, of securities in a strong box in country B; so that in one sense the property, or the rights to it, may be said to exist in country B. It may, however, well be that the whole apparatus for producing the income that is non-physical, namely:—the brains and control and direction, without which the physical adjuncts would be sterile and ineffective, are in country C; and therefore it may be said in another sense that the origin of the income is where the intellectual element among the assets is to be found. Finally, it may be said that the location of the property is in country D, where the owner of the property has his residence. There is thus a possible difference between the theory of origin and the theory of location, if one examines the legal view of the matter.

Apart from these considerations, however, and chiefly for reasons which are just the reverse of those mentioned in the preceding case, the location or origin of the wealth cannot be the only test. Permanent residents owe some duty to the place where they live, even if their property is situated or their income derived elsewhere.

Practically, therefore, apart from the question of nationality, which still plays a minor role, the choice lies between the principle of domicile and that of location or origin. Taking the field of taxation as a whole, the reason why tax authorities waver between these two principles is that each may be considered as a part of the still broader principle of economic interest or economic allegiance, as against the original doctrine of political allegiance. A part of the total sum paid according to the ability of a person ought to reach the competing authorities according to his economic interest under each authority. The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that the liability should be divided among the tax districts according to his relative interests in each. The individual has certain economic interests in the place of his permanent residence or domicile, as well as in the place or places where his property is situated or from which his income is derived. If he makes money in one place he generally spends it in another."

This long extract has been quoted largely in order to show how empirical and inconclusive must be any general theory of legislation as to Income-tax. The diversity of continental European tax systems is well known. Of the law in the United Kingdom which, being a creditor country with a large volume of capital invested abroad, taxes not only all income arising in the country but, with certain exceptions, all income arising to residents wherever such income might arise and whether received in the United Kingdom or not, Sir Josiah Stamp expressively remarks that he sees in the law only one principle, *viz.*, that of Donnybrook Fair, *i.e.*, " See a head, hit it."

THE POSITION OF THE CROWN.

It is a maxim in English law that the Crown is not bound by an Act of Parliament unless by express enactment referring to the Crown in unambiguous terms. The Crown therefore is not ordinarily within the scope of a Taxing Act. In India on the other hand the position is somewhat different. See *Bell* v. *Municipal Commissioners for the City of Madras*[1] in which Bell, the Superintendent of the Government Gun Carriage Factory, was successfully prosecuted to conviction for failure to pay Municipal licence fees on account of timber belonging to Government.

Per Benson, J.—It would, no doubt, seem to be the case that in England, owing to historical causes, the Legislature has proceeded on the view that the Crown is not bound by a Statute unless named in it, and we, therefore, find that the Crown is in many Statutes expressly stated to be bound, but it is impossible to say broadly that in India the Crown is not bound by a Statute, or the taxing provisions of a Statute, unless expressly named in it. Such express inclusion is altogether exceptional. It would be more correct to say that, as a general rule, the Indian Legislatures have proceeded on the assumption that the Government will be bound by the Statute unless expressly or by necessary implication excluded from its operation. Government, when a party to litigation, pays Court-fees just as other suitors do because there is no special exemption in favour of Government in the Court-fees Act. On the other hand, Government is specially exempted from the payment of stamp duties under the General Stamp Act, 1899, section 3, proviso 1, " in cases where but for this exemption the Government would be liable to pay the duty chargeable in respect of such instrument." This amounts to a statutory declaration that Government would be liable to pay the duty but for the special exemption. In like manner goods belonging to Government are specially exempted from duty under the Sea Customs Act and the Indian Tariff Act, and it would be easy to enumerate many other Acts in which exemptions are made in favour of Government on the evident assumption that but for such exemption the Government would be bound.

Per Bhashyam Aiyangar, J.—But it is unduly stretching the language of the rule, to bring within its scope general words of a Statute imposing a tax and claim exemption for the Crown on the ground that the Crown is divested of any prerogative right, title or interest, by giving full effect to the general words.

(1) 25 Mad. 457.

So far as exemption from any tax imposed by a Statute is concerned, the question for determination is whether according to the right construction of the Statute, the Crown is or is not made liable to pay the tax. In the former case, it is bound to pay; in the latter, it is not; in neither case is there any question of prerogative. The rule of construction above adverted to cannot itself be regarded as a prerogative of the Crown. A Statute imposing a tax upon Crown property, which tax will be payable out of the public revenue, cannot reasonably be regarded as divesting the Crown of any right, title or interest, within the meaning of the above rules—especially when such tax is levied for purposes connected with the good government of the country, for which purpose, such revenues are, in India, vested in trust in the Crown, by section 39 of 21 and 22 Vict., cap. 106.

The conclusions that I reach are—(i) The canon of interpretation of Statutes that the prerogative or rights of the Crown cannot be taken away except by express words or necessary implication, is as applicable to the Statutes passed by the Indian Legislatures as to Parliamentary and Colonial Statutes; and this is really concluded by the authority of the Privy Council in more appeals than one from the Colonies;

(ii) When in an Indian Act the Crown is not expressly included and the question is whether it is bound by necessary implication, the course of Indian Legislation and Acts *in pari materia* with the Act in question will have an important bearing upon the construction of the Act;

(iii) Notwithstanding that in several Indian enactments the Crown has been specially exempted, the above rule of interpretation will nevertheless hold good in construing the provisions of an enactment from the operation of which the Crown is not expressly exempted, when a question is raised as to whether such provisions take away a right, or prerogative of the Crown;

(iv) The said rule, based like other cognate rules of construction upon the maxim *generalia specialibus non derogant* is not really a prerogative of the Crown, though such rule as well as the rule relating to the construction of Crown-grants are dealt with in treatises under the head of "Prerogatives of the Crown" and also loosely referred to as such in some English decisions;

(v) The English law as to the exemption of the Crown and Crown property from payment of tolls, poor-rates and other taxes, local or imperial, imposed by Statutes rests partly upon historical reasons and principally upon judicial decisions which do not proceed upon a course of reasoning or principle which will be binding on Indian Courts;

(vi) Exemption from payment of tolls, rates and taxes is not in reality a prerogative of the Crown, but depends solely upon the right construction to be put upon the Crown-grant or the Statute in question;

(ix) According to the uniform course of Indian Legislation, Statutes imposing duties or taxes bind Government as much as its subjects, unless the very nature of the duty or tax is such as to be inapplicable to Government, and whenever it is the intention of the Legislature to exempt

Government from any duty or tax which in its nature is not inapplicable to Government, the Government is specially exempted.

(It may be mentioned incidentally that the exemption of Government goods from customs duties was repealed on 1st April, 1924, and that all Government goods now pay duty just like private goods.)

Similarly in Australia it has been held by the High Court[1] that the exemption of the Crown from taxation in the absence of express provision to that effect applies to the Crown only in its capacity as the Executive Government of the country whose statutes are in question. In that case accordingly it was held that the Federal Customs Act applied to the Crown in its character as the Executive Government of New South Wales and that goods imported by the Government of New South Wales were liable accordingly to customs duties imposed by the Federal Government.

The question then is whether there is anything inherently in the income-tax which makes it inapplicable to Government. In the first place, it seems absurd to tax taxes, for after all Government receipts are mostly taxes; exceptions of course would be the (notional) income from property and profits, if any, from State trading. In the second place, how is a Government department to be taxed? Is it as an individual or as a firm or a company or an association of individuals?—*See* Secs. 3 and 55.—In the third place, so far as the Central Government in India is concerned, it would only be transferring the tax from one pocket to another. This argument, of course, applies to almost any kind of taxation but usually there is an object in taxing a Government department, *e.g.*, customs duties may be levied in order to protect local trade but there would be no object in levying an income-tax on Government departments raising taxes. And as regards Provincial Governments, considering the exemptions accorded to the income of local authorities (the position is different in the United Kingdom in this respect) and the basis of the financial settlements between the Provincial and Central Governments, there is little doubt that the income of Provincial Governments will be formally exempted if it is ever considered that the law as it stands renders the income of Provincial Governments liable to tax. The question therefore is only academic and of no practical importance.

Under the Government Trading Taxation Act III of 1926, every trade or business carried on by or on behalf of the Govern-

(1) *King* v. *Sutton*, (1908) 5 C. L. R. 789.

ment of any part of His Majesty's Dominions exclusive of British India can be taxed in British India as though the business were that of a 'Company'. Similarly the other Dominions are entitled to tax the profits of any business carried on in these Dominions by or on behalf of the Government of India. This arrangement was the outcome of a Resolution of the Imperial Economic Conference in 1923 and designed to remove the handicaps against private trade that the exemption from taxation of State undertakings created. Under the above Act 'His Majesty's Dominions' include territories under His Majesty's protection or in respect of which a mandate is being exercised by the Government of any part of His Majesty's Dominions. Therefore under the above Act the profits of business carried on by Indian States in British India are taxable. The above Act does not, of course, apply to States outside the British Empire.

As regards other income accruing to Indian States in British India, under the law as it stands, tax has to be deducted at source from interest on securities irrespective of who owns the securities unless a specific exemption has been sanctioned by Government as in the case of non-transferable Government Promissory Notes held by Indian States.

FOREIGN STATES—LIABILITY OF.

The Government Trading Taxation Act above referred to applies only to Dominions in the British Empire. The liability of a foreign State, that is to say, a State outside the British Empire, is therefore to be determined by other considerations. Broadly speaking, the liability to taxation depends largely on the same considerations as determine the liability of a foreign State to be sued in the Municipal Courts of the country. This is a difficult question of international law on which there appears to be considerable difference of opinion. One school of jurists appear to think that if a foreign Government trades in this country it is certainly liable to tax, though it will not be possible to enforce the liability if the foreign State refuses voluntarily to discharge the liability; while another school seem to think that there is no liability to taxation at all. But from the fact that in regard to the British Dominions themselves the Legislature has found it necessary to make an express provision as to the liability in the share of the Government Trading Taxation Act, it must apparently be presumed that in the absence of such legislation no liability would have attached to the British Dominions carrying on trade in India. In the same way it would seem that we should assume that there is no liability in respect of trading carried on by foreign States either. If it is intended to impose such a liability what will presumably be done is for the Government of India to enter into an agreement with the foreign State concerned and then make the necessary legislation.

In either view—whether a foreign State is liable or not—it would seem that a foreign Government cannot be assessed at all, inasmuch as Sec. 3 of the Income-tax Act refers only to 'individuals', 'firms', 'companies' and 'associations of individuals', and presumably a foreign Government is none of these. It also does not seem possible to make the local agent or agents of the foreign Government liable for the tax under Sections 42 and 43 of the Act, inasmuch as these agents are presumably entitled to the same immunity from processes as the foreign Governments whom they represent.

STAMPS AND COURT-FEES.

Affidavits.—

An affidavit is not exempt from stamp duty on the ground that it is required for the immediate purpose of being filed or used in any Income-tax proceedings or before the Income-tax Officer or the Assistant Commissioner or the Commissioner, as none of these officers is a 'Court' except to the extent specified in Section 37 of the Income-tax Act (*See* Exemption (*b*) Article 4, Schedule I, Indian Stamp Act).

Copies or Extracts.—

Under Article 24, Schedule I, *ibid*, all copies or extracts issued by officers in the Income-tax Department are liable to pay stamp duty if under the law they are not chargeable with Court-fees.

Authorisation letters.—

A letter authorising a clerk or some one else to appear before an officer of the Income-tax Department on behalf of the assessee is evidently a 'power of attorney'. Such a person cannot appear without 'acting', *i.e.*, doing something which will bind the assessee; and the power of attorney should evidently be stamped as an authority to act in a single transaction (Article 48 (*c*) of Schedule I). There is however nothing to prevent an Income-tax Officer permitting a representative to appear without acting on behalf of an assessee, *i.e.*, merely to produce or explain accounts, etc. In such cases somewhat difficult questions may arise as to how far the assessee is bound by the explanations of the representative, but presumably no Civil Court can interfere so long as the proceedings of the Revenue authority are not in conflict with justice and equity.

Orders—Copies of.—

Under Schedule I, Article 6, of the Court-fees Act, every copy of an order passed by an officer in the Income-tax Department in respect of any proceedings under the Act is chargeable with Court-fees.

Under Article 9 of the same schedule, every copy of an Income-tax proceeding or order (not otherwise provided for by the Court-fees Act) or copy of any account, statement, report or the like taken out of an office in the Income-tax Department is liable to pay Court-fees.

Article 6 of Schedule I of the Court-fees Act applies to quasi-judicial orders, *e.g.*, assessment orders including orders enhancing assessments, orders under Sec. 27, orders imposing penalties under Sec. 25 (2) and Sec. 28 (1) and all appellate and revisional orders generally; and Article 9 to other orders.

Petitions—Applications.—

Under Article 1 of Schedule II every application or petition presented to "any executive officer" (which presumably includes any officer in the Income-tax Department) for the purpose of obtaining a copy or translation of any order passed by such officer or any other document on record in such office is chargeable with Court-fees.

Under Article 1 (*b*) of the same schedule, Court-fee is chargeable on every application or petition when presented to a Collector or any Revenue Officer having jurisdiction equal or subordinate to a Collector and not otherwise provided for by the Court-fees Act. It is doubtful, however, whether this Article will apply to applications presented to officers in the Income-tax Department.

Under Article 1 (*c*) of the same schedule, an application or petition presented to the Central Board of Revenue is chargeable with Court-fee.

Wakalatnama.—

Under Article 10 (*a*) and (*c*) of the same schedule, a Mukhtarnama or Wakalatnama presented for the conduct of any one case to an officer in the Income-tax Department or the Central Board of Revenue is chargeable with Court-fee.

Appeal—Memorandum of.—

Under Article 11 (*a*) and (*b*) a memorandum of appeal presented to an officer in the Income-tax Department or the Central Board of Revenue is chargeable with Court-fee.

It should be remembered, however, that no appeal lies to the Central Board of Revenue and that except under certain specific sections, *e.g.*, Sec. 64, Sec. 2 (11) (*b*), Sec. 2 (6), Sec. 59, the Central Board of Revenue has no functions to discharge.

Refunds.—

Applications for refunds under Sec. 48 of the Indian Income-tax Act are exempt from payment of Court-fees. *See* clause (xx) of Sec. 19 of the Court-fees Act, under which all applications for payment of money due by Government are exempt from Court-fees.

Court-fees—Computation of.—

In all those cases where the Court-fee is *ad valorem*, the monetary value for the purpose of determining the Court-fee is the amount of tax or penalty levied by the Income-tax Officer.

Copies for assessee's information—Gratis.—

For his own information, however, the assessee can have copies of any of the orders free but they may not be used for any purpose except on payment of Court-fees. An assessment order for instance cannot be used for appeal unless stamped with Court-fees but the assessee can have a copy for his own private use gratis.

Rates of duties.—

Stamp duties and Court-fees vary from Province to Province, and no attempt has therefore been made to detail the actual rates of fees payble in respect of each class of petitions or orders. As regards the details of the rates, reference is invited to the various Stamps and Court-fees Amendment Acts in the different Provinces which have been passed in recent years.

THE INDIAN INCOME-TAX ACT (XI OF 1922).

AS MODIFIED UP TO THE 1st APRIL 1928.

STATEMENT OF REPEALS AND AMENDMENTS.

S. 2, Amended	Act IV of 1924. Act XI of 1924.
S. 3, Amended	Act XI of 1924.
S. 4, Amended	Act XXVII of 1923. Act XI of 1924.
S. 5, Amended	Act IV of 1924.
S. 7, Amended	Act XV of 1923.
S. 10, Amended	Act III of 1928.
S. 14, Amended	Act III of 1928.
S. 15, Amended	Act XI of 1924.
S. 18, Amended	Act IV of 1924. Act XVI of 1925.
S. 19-A, Added	Act XXIV of 1926.
S. 25, Amended	Act XI of 1924.
S. 25-A, Added	Act III of 1928.
S. 26, Amended	Act III of 1928.
Chapter V-A, Added	Act XXVII of 1923.
S. 35, Amended	Act III of 1928.
S. 42, Amended	Act III of 1928.
S. 46, Amended	Act IV of 1924. Act III of 1928.
S. 48, Amended	Act III of 1928.
S. 51, Amended	Act XXIV of 1926.

S. 52, Amended..	Act XXIV of 1926.
S. 55, Amended..	Act XI of 1924.
S. 56, Amended..	Act XI of 1924.
	Act V of 1925.
	Act III of 1928.
S. 57, Amended..	Act XXIV of 1926.
S. 58, Amended..	Act XXIV of 1926.
S. 59, Amended..	Act IV of 1924.
	Act XXVIII of 1927.
S. 63, Amended..	Act VII of 1924.
	Act XI of 1924.
S. 64, Amended..	Act IV of 1924.
S. 66, Amended..	Act XI of 1924.
	Act XXIV of 1926.
	Act III of 1928.
S. 66-A, Added	Act XXIV of 1926.
S. 68, Amended..	Act XV of 1923.
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ACT XI OF 1922.[1]

[*5th March*, 1922.]

AN ACT TO CONSOLIDATE AND AMEND THE LAW RELATING TO INCOME-TAX AND SUPER-TAX.

[*As modified up to* 1st *April*, 1928.]

WHEREAS it is expedient to consolidate and amend the law relating to Income-tax and Super-tax; it is hereby enacted as follows:—

Short title, extent and commencement.

1. (1) This Act may be called THE INDIAN INCOME-TAX ACT, 1922.

(2) It extends to the whole of British India, including British Baluchistan and the Sonthal Parganas, and applies also, within the dominions of Princes and Chiefs in India in alliance with His Majesty, to British subjects in those dominions who are in the service of the Government of India or of a local authority established in the exercise of the powers of the Governor-General in Council in that behalf, and to all other servants of His Majesty in those dominions.

(3) It shall come into force on the first day of April, 1922.

Definitions.

2. In this Act, unless there is anything repugnant in the subject or context,—

(1) "agricultural income" means—

(*a*) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land-revenue in British India or subject to a local rate assessed and collected by officers of Government as such;

(*b*) any income derived from such land by—

(*i*) agriculture, or

(*ii*) the performance by a cultivator or receiver of rent-in kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market, or

(1) For Statement of Objects and Reasons, see *Gazette of India*, 1921, Pt. V, p. 159 and for Report of Joint Committee, see *ibid*, 1922, Pt. V, p. 31.

(*iii*) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in sub-clause (*ii*);

(*c*) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator, or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any operation mentioned in sub-clauses (*ii*) and (*iii*) of clause (*b*) is carried on:

Provided that the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator or the receiver of the rent-in-kind by reason of his connection with the land, requires as a dwelling-house, or as a store-house, or other out-building;

(2) "assessee" means a person by whom income-tax is payable;

(3) "Assistant Commissioner" means a person appointed to be an Assistant Commissioner of Income-tax under section 5;

(4) "business" includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture;

[(4-A) "the Central Board of Revenue" means the Central Board of Revenue constituted under the Central Board of Revenue Act, 1924.][1]

(5) "Commissioner" means a person appointed to be a Commissioner of Income-tax under section 5;

(6) "company" means a company as defined in the Indian Companies Act, 1913,[2] or formed in pursuance of an Act of Parliament or of Royal Charter or Letters Patent, or of an Act of the Legislature of a British possession, and includes any foreign association carrying on business in British India whether incorporated or not, and whether its principal place of busines is situate in British India or not, which the [Central Board of Revenue][3] may, by general or special order, declare to be a company for the purposes of this Act;

(7) "Income-tax Officer" means a person appointed to be an Income-tax Officer under section 5;

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(1) This clause was inserted by S. 4 and Sch. of Act IV of 1924.
(2) VII of 1913.
(3) These words were substituted for the words "Board of Inland Revenue" by S. 4 and Sch. of Act IV of 1924.

(8) "Magistrate" means a Presidency Magistrate or a Magistrate of the first class, or a Magistrate of the second class specially empowered by the Local Government to try offences against this Act;

(9) "person" includes a Hindu undivided family;

(10) "prescribed" means prescribed by rules made under this Act;

(11) "previous year" means—

(*a*) the twelve months ending on the 31st day of March next preceding the year for which the assessment is to be made, or, if the accounts of the assessee have been made up to a date within the said twelve months in respect of a year ending on any date other than the said 31st day of March, then at the option of the assessee the year ending on the day to which his accounts have so been made up:

Provided that, if this option has once been exercised by the assessee, it shall not again be exercised so as to vary the meaning of the expression "previous year" as then applicable to such assessee except with the consent of the Income-tax Officer and upon such conditions as he may think fit; or

(*b*) in the case of any person, business or company or class of person, business or company, such period as may be determined by the [Central Board of Revenue][1], or by such authority as the Board may authorize in this behalf;

(12) "principal officer," used with reference to a local authority or a company or any other public body or [any][2] association, means—

(*a*) the secretary, treasurer, manager or agent of the authority, company, body or association, or

(*b*) any person connected with the authority, company, body or association upon whom the Income-tax Officer has served a notice of his intention of treating him as the principal officer thereof;

(13) "public servant" has the same meaning as in the Indian Penal Code[3];

(14) "registered firm" means a firm constituted under an instrument of partnership specifying the individual shares of the

(1) These words were substituted for the words "Board of Inland Revenue" by S. 4 and Sch. of Act IV of 1924.

(2) This word was inserted by S. 2 of Act XI of 1924.

(3) XLV of 1860.

partners of which the prescribed particulars have been registered with the Income-tax Officer in the prescribed manner;

(15) "total income" means total amount of income, profits and gains from all sources to which this Act applies computed in the manner laid down in section 16; and

(16) "unregistered firm" means a firm which is not a registered firm.

CHAPTER I.

Charge of Income-tax.

Charge of income-tax.

3. Where any Act of the Indian Legislature enacts that income-tax shall be charged for any year at any rate or rates applicable to the total income of an assessee, tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions of, this Act in respect of all income, profits and gains of the previous year of every [individual, Hindu undivided family, company, firm and other association of individuals].[1]

Application of Act.

4. (1) Save as hereinafter provided, this Act shall apply to all income, profits or gains, as described or comprised in section 6, from whatever source derived, accruing, or arising or received in British India, or deemed under the provisions of this Act to accrue, or arise, or to be received in British India.

(2) Profits and gains of a business accruing or arising without British India to a person resident in British India [shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be profits and gains of the year in which they are so received or brought][2] notwithstanding the fact that they did not so accrue or arise in that year, provided that they are so received or brought in within three years of the end of the year in which they accrued or arose.

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(1) These words were substituted for the words "individual, company, firm and Hindu undivided family" with effect from 1st April 1923, by Ss. 3 and 11 of Act XI of 1924.

(2) These words were substituted for the words "shall be deemed to be profits and gains of the year in which are received or brought into British India" by S. 2 of Act XXVII of 1923, Genl. Acts, Vol. IX.

Explanation.—Profits or gains accruing or arising without British India shall not be deemed to be received or brought into British India within the meaning of this sub-section by reason only of the fact that they are taken into account in the balance sheet prepared in British India.

(3) This Act shall not apply to the following classes of income:—

(*i*) Any income derived from property held under trust or other legal obligation wholly for religious or charitable purposes, and in the case of property so held in part only for such purposes, the income applied, or finally set apart for application, thereto.

(*ii*) Any income of a religious or charitable institution derived from voluntary contributions and applicable solely to religious or charitable purposes.

(*iii*) The income of local authorities.

(*iv*) Interest on securities which are held by, or are the property of, any Provident Fund to which the[1] Provident Funds Act, 1897, applies, * * * *.[2]

(*v*) Any capital sum received in commutation of the whole or a portion of a pension, or in the nature of consolidated compensation for death or injuries, or in payment of any insurance policy, or as the accumulated balance at the credit of a subscriber to any such Provident Fund.

(*vi*) Any special allowance, benefit or perquisite specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit.

(*vii*) Any receipts not being receipts arising from business or the exercise of a profession, vocation or occupation, which are of a casual and non-recurring nature, or are not by way of addition to the remuneration of an employee.

(*viii*) Agricultural income.

In this sub-section "charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility.

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(1) IX of 1897; *see* now Act XIX of 1925.

(2) The words "or any Provident Insurance Society to which the Provident Insurance Societies Act, 1912, is, or, but for an exemption under that Act, would be applicable" were omitted by S. 4 of Act XI of 1924.

CHAPTER II.

INCOME-TAX AUTHORITIES.

Income-tax authorities.

5. (1) There shall be the following classes of Income-tax authorities for the purposes of this Act, namely:—

(a) [The Central Board of Revenue,][1]

(b) Commissioners of Income-tax,

(c) Assistant Commissioners of Income-tax, and

(d) Income-tax Officers.

* * * * *[2]

(3) There shall be a Commissioner of Income-tax for each province who shall be appointed by the Governor-General in Council after consideration of any recommendation made by the Local Government in this behalf.

(4) Assistant Commissioners of Income-tax and Income-tax Officers shall, subject to the control of the Governor-General in Council, be appointed by the Commissioner of Income-tax by order in writing. They shall perform their functions in respect of such classes of persons and such classes of income and in respect of such areas as the Commissioner of Income-tax may direct. The Commissioner may, by general or special order in writing, direct that the powers conferred on the Income-tax Officer and the Assistant Commissioner by or under this Act shall, in respect of any specified case or class of cases, be exercised by the Assistant Commissioner and the Commissioner, respectively, and, for the purposes of any case in respect of which such order applies, references in this Act or in any rules made hereunder to the Income-tax Officer and the Assistant Commissioner shall be deemed to be references to the Assistant Commissioner, and the Commissioner, respectively.

(5) The [Central Board of Revenue][3] may, by notification in the Gazette of India, appoint Commissioners of Income-tax, Assistant Commissioners of Income-tax and Income-tax Officers to perform such functions in respect of such classes of persons or such classes of income, and for such area, as may be specified in the notification, and thereupon the functions so specified shall cease, within the specified area, to be performed, in respect of the

(1) These words were substituted for the words "a Board of Inland Revenue" by S. 4 and Sch. of Act IV of 1924.

(2) Sub-section (2) was omitted by *ibid.*

(3) *Ibid.*

specified classes of persons or classes of income, by the authorities appointed under sub-sections (3) and (4).

(6) Assistant Commissioners of Income-tax and Income-tax Officers appointed under sub-section (4) shall, for the purposes of this Act, be subordinate to the Commissioner of Income-tax appointed under sub-section (3) for the province in which they perform their functions.

CHAPTER III.

Taxable Income.

Heads of income chargeable to income-tax.

6. Save as otherwise provided by this Act, the following heads of income, profits and gains, shall be chargeable to income-tax in the manner hereinafter appearing, namely:—

(*i*) Salaries.
(*ii*) Interest on securities.
(*iii*) Property.
(*iv*) Business.
(*v*) Professional earnings.
(*vi*) Other sources.

Salaries.

7. (1) 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 received by him in lieu of, or in addition to, any salary or wages, which are paid by or on behalf of Government, a local authority, a company, or any other public body or association, or by or on behalf of any private employer:

[1]['*Explanation.*—The right of a person to occupy free of rent as a place of residence any premises provided by his employer is a perquisite for the purposes of this sub-section.']

Provided that the tax shall not be payable in respect of any sum deducted under the authority of Government from the salary of any individual for the purpose of securing to him a deferred annuity or of making provision for his wife or children, provided that the sum so deducted shall not exceed one-sixth of the salary.

(2) Any income which would be chargeable under this head if paid in British India shall be deemed to be so chargeable if paid to a British subject or any servant of His Majesty in any part

(1) This explanation was added by S. 2 of Act XV of 1923, Genl. Acts, Vol. IX.

of India by Government or by a local authority established by the Governor-General in Council.

Interest on securities.

8. The tax shall be payable by an assessee under the head "Interest on securities" in respect of the interest receivable by him on any security of the Government of India or of a Local Government, or on debentures or other securities for money issued by or on behalf of a local authority or a company:

Provided that no income-tax shall be payable on the interest receivable on any security of the Government of India issued or declared to be income-tax free:

Provided, further, that the income-tax payable on the interest receivable on any security of a Local Government issued income-tax free shall be payable by the Local Government.

Property.

9. (1) The tax shall be payable by an assessee under the head "Property" in respect of the *bona fide* annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of his business, subject to the following allowances, namely:—

(*i*) Where the property is in the occupation of the owner, or where it is let to a tenant and the owner has undertaken to bear the cost of repairs, a sum equal to one-sixth of such value;

(*ii*) where the property is in the occupation of a tenant who has undertaken to bear the cost of repairs, the difference between such value and the rent paid by the tenant up to but not exceeding one-sixth of such value;

(*iii*) the amount of any annual premium paid to insure the property against risk of damage or destruction;

(*iv*) where the property is subject to a mortgage or charge or to a ground-rent, the amount of any interest on such mortgage or charge or of any such ground-rent;

(*v*) any sums paid on account of land-revenue in respect of the property;

(*vi*) in respect of collection charges, a sum not exceeding the prescribed maximum;

(*vii*) in respect of vacancies, such sum as the Income-tax Officer may determine having regard to the circumstances of the case:

Provided that the aggregate of the allowances made under this sub-section shall in no case exceed the annual value.

(2) For the purposes of this section, the expression "annual value" shall be deemed to mean the sum for which the property might reasonably be expected to let from year to year:

Provided that, where the property is in the occupation of the owner for the purposes of his own residence, such sum shall, for the purposes of this section, be deemed not to exceed ten per cent. of the total income of the owner.

Business

10. (1) The tax shall be payable by an assessee under the head "Business" in respect of the profits or gains of any business carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely:—

(*i*) any rent paid for the premises in which such business is carried on, provided that, when any substantial part of the premises is used as a dwelling-house by the assessee, the allowance under this clause shall be such sum as the Income-tax Officer may determine having regard to the proportional part so used;

(*ii*) in respect of repairs, where the assessee is the tenant only of the premises, and has undertaken to bear the cost of such repairs, the amount paid on account thereof, provided that, if any substantial part of the premises is used by the assessee as a dwelling-house, a proportional part only of such amount shall be allowed;

(*iii*) in respect of capital borrowed for the purposes of the business, where the payment of interest thereon is not in any way dependent on the earning of profits, the amount of the interest paid;

Explanation.—Recurring subscriptions paid periodically by shareholders or subscribers in such Mutual Benefit Societies as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause;

(*iv*) in respect of insurance against risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores, used for the purposes of the business, the amount of any premium paid;

(*v*) in respect of current repairs to such buildings, machinery, plant, or furniture, the amount paid on account thereof;

(*vi*) in respect of depreciation of such buildings, machinery, plant, or furniture being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed:

Provided that—

(*a*) the prescribed particulars have been duly furnished;

(*b*) where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or, if there is no such allowance for that year, be deemed to be allowance for that year, and so on for succeeding years; and

(*c*) the aggregate of all such allowances made under this Act or any Act repealed hereby, or under the Indian Income-tax Act, 1886,[1] shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant, or furniture, as the case may be;

(*vii*) in respect of any machinery or plant which, in consequence of its having become obsolete, has been sold or discarded, the difference between the original cost to the assessee of the machinery or plant as reduced by the aggregate of the allowances made in respect of depreciation under clause (*vi*), or any Act repealed hereby, or the Indian Income-tax Act, 1886,[1] and the amount for which the machinery or plant is actually sold, or its scrap value;

[2](*vii-a*) in respect of animals which have been used for the purposes of the business otherwise than as stock in trade and have died or become permanently useless for such purposes, the difference between the original cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals;

(*viii*) any sums paid on account of land-revenue, local rates or municipal taxes in respect of such part of the premises as is used for the purposes of the business;

(*ix*) any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains:

[3]Provided that nothing in clause (*viii*) or clause (*ix*) shall be deemed to authorise the allowance of any sum paid on account of any cess, rate or tax levied on the profits or gains of any business

(1) II of 1886.
(2) The clause was inserted by Section 2 (*a*) of Act III of 1928.
(3) The proviso was inserted by section 2 (*b*) of Act III of 1928.

or assessed at a proportion of or otherwise on the basis of any such profits or gains.

(3) In sub-section (2), the word "paid" means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section.

Professional earnings.

11. (1) The tax shall be payable by an assessee under the head "Professional earnings" in respect of the profits or gains of any profession or vocation followed by him.

(2) Such profits or gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred solely for the purposes of such profession or vocation, provided that no allowance shall be made on account of any personal expenses of the assessee.

(3) Professional fees paid in any part of India to a person ordinarily resident in British India shall be deemed to be profits or gains chargeable under this head.

Other sources.

12. (1) The tax shall be payable by an assessee under the head "Other sources" in respect of income, profits and gains of every kind and from every source to which this Act applies (if not included under any of the preceding heads).

(2) Such income, profits and gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains, provided that no allowance shall be made on account of any personal expenses of the assessee.

Method of accounting.

13. Income, profits and gains shall be computed, for the purposes of sections 10, 11 and 12, in accordance with the method of accounting regularly employed by the assessee:

Provided that, if no method of accounting has been regularly employed, or if the method employed is such that, in the opinion of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Income-tax Officer may determine.

Exemptions of a general nature.

14. (1) The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family.

(2) The tax shall not be payable by an assessee in respect of—

(*a*) any sum which he receives by way of dividend as a share-holder in a company where the profits or gains of the company have been assessed to income-tax; or

(*b*) such an amount of the profits or gains of any firm which have been assessed to income-tax as is proportionate to his share in the firm, at the time of such assessment.[1]

Exemption in the case of life insurances.

15. (1) The tax shall not be payable by an assessee in respect of any sums paid by him to effect an insurance on his own life or on the life of his wife, or in respect of a contract for a deferred annuity on his own life or on the life of his wife, or as a contribution to any Provident Fund to which the Provident Funds Act,[2] 1897, applies [* * * * * *][3].

(2) Where the assessee is a Hindu undivided family, there shall be exempted under sub-section (1) any sums paid to effect an insurance on the life of any male member of the family or of the wife of any such member.

(3) The aggregate of any sums exempted under this section shall not, together with any sums exempted under the proviso to sub-section (1) of section 7, exceed one-sixth of the total income of the assessee.

Exemptions and exclusions in determining the total income.

16. (1) In computing the total income of an assessee sums exempted under the proviso to sub-section (1) of section 7, the provisos to section 8, sub-section (2) of section 14 and section 15, shall be included.

(2) For the purposes of sub-section (1), any sum mentioned in clause (*a*) of sub-section (2) of section 14 shall be increased by the amount of income-tax payable by the company in respect of the dividend received.

Reduction of tax when margin above a certain limit is small.

17. Where, owing to the fact that the total income of any assessee has reached or exceeded a certain limit, he is liable to pay income-tax or to pay income-tax at a higher rate, the amount of

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(1) The words "at the time of such assessment" were inserted by Section 3 of Act III of 1928.

(2) IX of 1897. *See* now Act XIX of 1925.

(3) The words "or to any Provident Fund which complies with the provisions of the Provident Insurance Societies Act, 1912, or has been exempted from the provisions of that Act" were omitted by S. 5 of Act XI of 1924.

income-tax payable by him shall, where necessary, be reduced so as not to exceed the aggregate of the following amounts, namely:—

(*a*) the amount which would have been payable if his total income had been a sum less by one rupee than that limit, and

(*b*) the amount by which his total income exceeds that sum.

CHAPTER IV.

Deductions and Assessment.

Payment by deduction at source.

18. (1) Income-tax shall, unless otherwise prescribed in the case of any security of the Government of India, be leviable in advance by deduction at the time of payment in respect of income chargeable under the following heads:—

(*i*) "Salaries"; and

(*ii*) "Interest on securities."

(2) Any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the rate applicable to the estimated income of the assessee under this head:

Provided that such person may, at the time of making any deduction, increase or reduce the amount to be deducted under this sub-section for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct.

[1] [(2-A.) Notwithstanding anything hereinbefore contained, for the purpose of making the deduction under sub-section (2), there shall be included in the amount payable any income chargeable under the head 'Salaries' which is payable to the assessee out of India by or on behalf of Government, and the value in rupees of such income shall be calculated at the prescribed rate of exchange.]

(3) The person responsible for paying any income chargeabe under the head "Interest on securities" shall, at the time of payment, deduct income-tax on the amount of the interest payable at the maximum rate.

(4) All sums deducted in accordance with the provisions of this section shall, for the purpose of computing the income of an assessee, be deemed to be income received.

(5) Any deduction made in accordance with the provisions of this section shall be treated as a payment of income-tax on

(1) This sub-section was added by S. 2 of Act XVI of 1925.

behalf of the person from whose income the deduction was made, or of the owner of the security, as the case may be, and credit shall be given to him therefor in the assessment, if any, made for the following year under this Act:

Provided that, if such person or such owner obtains, in accordance with the provisions of this Act, a refund of any portion of the tax so deducted, no credit shall be given for the amount of such refund.

(6) All sums deducted in accordance with the provisions of this section shall be paid within the prescribed time by the person making the deduction to the credit of the Government of India, or as the [Central Board of Revenue][1] directs.

(7) If any such person does not deduct and pay the tax as required by this section, he shall, without prejudice to any other consequences which he may incur, be deemed to be personally in default in respect of the tax.

(8) The power to levy by deduction under this section shall be without prejudice to any other mode of recovery.

(9) Every person deducting income-tax in accordance with the provisions of sub-section (3) shall, at the time of payment of interest, furnish to the person to whom the interest is paid a certificate to the effect that income-tax has been deducted, and specifying the amount so deducted, the rate at which the tax has been deducted, and such other particulars as may be prescribed.

Payment in other cases.

19. In the case of income chargeable under any other heads than those mentioned in sub-section (1) of section 18, and in any case where income-tax has not been deducted in accordance with the provisions of that section, the tax shall be payable by the assessee direct.

Supply of information regarding dividends.

[2]19-A The principal officer of every company shall, on or before the 15th day of June in each year, furnish to the prescribed officer a return in the prescribed form and verified in the prescribed manner of the names and of the addresses, as entered in the register of shareholders maintained by the company, of the shareholders to whom a dividend or aggregate dividends exceeding such amount as may be prescribed in this behalf has or have

(1) These words were substituted for the words "Board of Inland Revenue" by S. 4 and Schedule of Act IV of 1924.

(2) This section was inserted by S. 2 of Act XXIV of 1926.

been distributed during the preceding year and of the amount so distributed to each such shareholder.]

Certificate by Company to shareholders receiving dividends.

20. The principal officer of every company shall, at the time of distribution of dividends, furnish to every person receiving a dividend a certificate to the effect that the company has paid or will pay income-tax on the profits which are being distributed, and specifying such other particulars as may be prescribed.

Annual return.

21. The prescribed person in the case of every Government office, and the principal officer or the prescribed person in the case of every local authority, company or other public body or association, and every private employer shall prepare, and, within thirty days from the 31st day of March in each year, deliver or cause to be delivered to the Income-tax Officer in the prescribed form, a return in writing showing—

(*a*) the name and, so far as it is known, the address, of every person who was receiving on the said 31st day of March, or has received during the year ending on that date, from the authority, company, body, association or private employer, as the case may be, any income chargeable under the head "Salaries" of such amount as may be prescribed;

(*b*) the amount of the income so received by each such person, and the time or times at which the same was paid;

(*c*) the amount deducted in respect of income-tax from the income of each such person.

Return of income.

22. (1) The principal officer of every company shall prepare and, on or before the fifteenth day of June in each year, furnish to the Income-tax Officer a return, in the prescribed form and verified in the prescribed manner, of the total income of the company during the previous year:

Provided that the Income-tax Officer may, in his discretion, extend the date for the delivery of the return in the case of any company or class of companies.

(2) In the case of any person other than a company whose total income is, in the Income-tax Officer's opinion, of such an amount as to render such person liable to income-tax, the Income-tax Officer shall serve a notice upon him requiring him to furnish, within such period, not being less than thirty days, as may be specified in the notice, a return in the prescribed form and veri-

fied in the prescribed manner setting forth (along with such other particulars as may be provided for in the notice) his total income during the previous year.

(3) If any person has not furnished a return within the time allowed by or under sub-section (1) or sub-section (2), or, having furnished a return under either of those sub-sections, discovers any omission or wrong statement therein, he may furnish a return or a revised return, as the case may be, at any time before the assessment is made, and any return so made shall be deemed to be a return made in due time under this section.

(4) The Income-tax Officer may serve on the principal officer of any company or on any person upon whom a notice has been served under sub-section (2) a notice requiring him, on a date to be therein specified, to produce, or cause to be produced, such accounts or documents as the Income-tax Officer may require.

Provided that the Income-tax Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

Assessment.

23. (1) If the Income-tax Officer is satisfied that a return made under section 22 is correct and complete, he shall assess the total income of the assessee, and shall determine the sum payable by him on the basis of such return.

(2) If the Income-tax Officer has reason to believe that a return made under section 22 is incorrect or incomplete, he shall serve on the person who made the return a notice requiring him, on a date to be therein specified, either to attend at the Income-tax Officer's office or to produce, or to cause to be there produced, any evidence on which such person may rely in support of the return.

(3) On the day specified in the notice issued under sub-section (2), or as soon afterwards as may be, the Income-tax Officer, after hearing such evidence as such person may produce and such other evidence as the Income-tax Officer may require, on specified points, shall, by an order in writing, assess the total income of the assessee, and determine the sum payable by him on the basis of such assessment.

(4) If the principal officer of any company or any other person fails to make a return under sub-section (1) or sub-section (2) of section 22, as the case may be, or fails to comply with all the terms of a notice issued under sub-section (4) of the same section or, having made a return, fails to comply with all

the terms of a notice issued under sub-section (2) of this section, the Income-tax Officer shall make the assessment to the best of his judgment.

Set-off of loss in computing aggregate income.

24. (1) Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in section 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year.

(2) Where the assessee is a registered firm, and the loss sustained cannot wholly be set off under sub-section (1), any member of such firm shall be entitled to have set off against any income, profits or gains of the year in which the loss was sustained in respect of which the tax is payable by him such amount of the loss not already set off as is proportionate to his share in the firm.

Assessment in case of discontinued business

25. (1) Where any business, profession or vocation [on which income-tax was not at any time charged under the provisions of the Indian Income-tax Act, 1918][1] is discontinued in any year, an assessment may be made in that year on the basis of the income, profits or gains of the period between the end of the previous year and the date of such discontinuance in addition to the assessment, if any, made on the basis of the income, profits or gains of the previous year.

(2) Any person discontinuing any such business, profession or vocation shall give to the Income-tax Officer notice of such discontinuance within fifteen days thereof, and, where any person fails to give the notice required by this sub-section, the Income-tax Officer may direct that a sum shall be recovered from him by way of penalty not exceeding the amount of tax subsequently assessed on him in respect of any income, profits or gains of the business, profession or vocation up to the date of its discontinuance.

(3) Where any business, profession or vocation * * *[2] on which tax was at any time charged under the provisions of the Indian Income-tax Act, 1918, is discontinued, no tax shall be payable in respect of the income, profits and gains of the period between the end of the previous year and the date of such discontinu-

(1) These words were substituted for the words and figures "commenced after the 31st day of March, 1922," by S. 6 of Act XI of 1924.

(2) The words "which was in existence at the commencement of this Act, and" were omitted by *ibid*.

ance, and the assessee may further claim that the income, profits and gains of the previous year shall be deemed to have been the income, profits and gains of the said period. Where any such claim is made, an assessment shall be made on the basis of the income, profits and gains of the said period, and if an amount of tax has already been paid in respect of the income, profits and gains of the previous year exceeding the amount payable on the basis of such assessment, a refund shall be given of the difference.

(4) Where an assessment is to be made under sub-section (1) or sub-section(3), the Income-tax Officer may serve on the person whose income, profits and gains are to be assessed, or, in the case of a firm, on any person who was a member of such firm at the time of its discontinuance, or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of section 22, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section.

Assessment after partition of a Hindu undivided family.

[1]**25-A.** (1) Where, at the time of making an assessment under section 23, it is claimed by or on behalf of any member of a Hindu family hitherto undivided that a partition has taken place among the members of such family, the Income-tax Officer shall make such inquiry thereinto as he may think fit, and if he is satisfied that a separation of the members of the family has taken place and that the joint family property has been partitioned among the various members or groups of members in definite portions before the end of the previous year, he shall record an order to that effect:

Provided that no such order shall be recorded until notices of the inquiry have been served on all the members of the family.

(2) Where such an order has been passed, the Income-tax Officer shall make an assessment of the total income received by or on behalf of the joint family as such, as if no separation or partition had taken place, and each member or group of members shall, in addition to any income-tax for which he or it may be separately liable and notwithstanding anything contained in sub-section (1) of section 14, be liable for a share of the tax on the income so assessed according to the portion of the joint family property allotted to him or it;

(1) Section 25-A was inserted by section 4 of Act III of 1928.

and the Income-tax Officer shall make assessments accordingly on the various members and groups of members in accordance with the provisions of section 23:

Provided that all the separated members and groups of members shall be liable jointly and severally for the tax assessed on the total income received by or on behalf of the joint family as such.

Change in constitution of firm

[1]26. (1) Where, at the time of making an assessment under section 23, it is found that a change has occurred in the constitution of a firm or that a firm has been newly constituted, the assessments on the firm and on the members thereof shall, subject to the provisions of this Act, be made as if the firm had been constituted throughout the previous year as it is constituted at the time of making the assessment, and as if each member had received a share of the profits of that year proportionate to his interest in the firm at the time of making the assessment.

Change of ownership of business.

(2) Where, at the time of making an assessment under section 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year.

Cancellation of assessment when cause is shown.

27. Where an assessee or, in the case of a company, the principal officer thereof, within one month from the service of a notice of demand issued as hereinafter provided, satisfies the Income-tax Officer that he was prevented by sufficient cause from making the return required by section 22, or that he did not receive the notice issued under sub-section (4) of section 22, or sub-section (2) of section 23, or that he had not a reasonable opportunity to comply, or was prevented by sufficient cause from complying, with the terms of the last-mentioned notices, the Income-tax Officer shall cancel the assessment and proceed to make a fresh assessment in accordance with the provisions of section 23.

Penalty for concealment of income.

28. (1) If the Income-tax Officer, the Assistant Commissioner or the Commissioner in the course of any proceedings under this Act, is satisfied that

(1) Section 26 was substituted for the old section of the same number by section 5 of Act III of 1928.

an assessee has concealed the particulars of his income, or has deliberately furnished inaccurate particulars of such income, and has thereby returned it below its real amount, he may direct that the assessee shall, in addition to the income-tax payable by him, pay by way of penalty a sum not exceeding the amount of income-tax which would have been avoided if the income so returned by the assessee had been accepted as the correct income:

Provided that no such order shall be made unless the assessee has been heard, or has been given a reasonable opportunity of being heard:

Provided, further, that no prosecution for an offence against this Act shall be instituted in respect of the same facts on which a penalty has been imposed under this section.

(2) An Assistant Commissioner or a Commissioner who has made an order under sub-section (1) shall forthwith send a copy of the same to the Income-tax Officer.

Notice of demand.

29. When the Income-tax Officer has determined a sum to be payable by an assessee under section 23, or when an order has been passed under sub-section (2) of section 25 or section 28 for the payment of a penalty, the Income-tax Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum so payable.

Appeal against assessment under this Act.

30. (1) Any assessee objecting to the amount or rate at which he is assessed under section 23 or section 27, or denying his liability to be assessed under this Act, or objecting to a refusal of an Income-tax Officer to make a fresh assessment under section 27, or to any order against him under sub-section (2) of section 25 or section 28, made by an Income-tax Officer, may appeal to the Assistant Commissioner against the assessment or against such refusal or order:

Provided that no appeal shall lie in respect of an assessment made under sub-section (4) of section 23, or under that sub-section read with section 27.

(2) The appeal shall ordinarily be presented within thirty days of receipt of the notice of demand relating to the assessment or penalty objected to, or of the date of the refusal to make a fresh assessment under section 27, as the case may be; but the Assistant Commissioner may admit an appeal after the expiration of the period if he is satisfied that the appellant had sufficient cause for not presenting it within that period.

(3) The appeal shall be in the prescribed form and shall be verified in the prescribed manner.

Hearing of appeal

31. (1) The Assistant Commissioner shall fix a day and place for the hearing of the appeal, and may from time to time adjourn the hearing.

(2) The Assistant Commissioner may, before disposing of any appeal, make such further inquiry as he thinks fit, or cause further inquiry to be made by the Income-tax Officer.

(3) In disposing of an appeal the Assistant Commissioner may, in the case of an order of assessment,—

(*a*) confirm, reduce, enhance or annul the assessment, or

(*b*) set aside the assessment and direct the Income-tax Officer to make a fresh assessment after making such further inquiry as the Income-tax Officer thinks fit or the Assistant Commissioner may direct, and the Income-tax Officer shall thereupon proceed to make such fresh assessment,

or, in the cases of an order under sub-section (2) of section 25 or section 28,

(*c*) confirm, cancel or vary such order:

Provided that the Assistant Commissioner shall not enhance an assessment unless the appellant has had a reasonable opportunity of showing cause against such enhancement.

Appeals against orders of Assistant Commissioner.

32. (1) Any assessee objecting to an order passed by an Assistant Commissioner under section 28 or to an order enhancing his assessment under sub-section (3) of section 31, may appeal to the Commissioner within thirty days of the making of such order.

(2) The appeal shall be in the prescribed form and shall be verified in the prescribed manner.

(3) In disposing of the appeal the Commissioner may, after giving the appellant an opportunity of being heard, pass such orders thereon as he thinks fit.

Power of review.

33. (1) The Commissioner may of his own motion call for the record of any proceeding under this Act which has been taken by any authority subordinate to him or by himself when exercising the powers of an Assistant Commissioner under sub-section (4) of section 5.

(2) On receipt of the record the Commissioner may make such inquiry or cause such inquiry to be made and, subject to the

provisions of this Act, may pass such orders thereon as he thinks fit:

Provided that he shall not pass any order prejudicial to an assessee without hearing him or giving him a reasonable opportunity of being heard.

Income escaping assessment

34. If for any reason income, profits or gains chargeable to income-tax has escaped assessment in any year, or has been assessed at too low a rate, the Income-tax Officer may, at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains, or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of section 22, and may proceed to assess or re-assess such income, profits or gains, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section:

Provided that the tax shall be charged at the rate at which it would have been charged had the income, profits or gains not escaped assessment or full assessment, as the case may be.

Rectification of mistake

35. (1)[1] *The Commissioner or Assistant Commissioner may, at any time within one year from the date of any order passed by him in appeal or, in the case of the Commissioner, in revision under section* 33 *and* the Income-tax Officer may, at any time within one year from the date of any demand made upon an assessee, on his own motion rectify any mistake apparent from the record of the *appeal, revision or* assessment, *as the case may be,* and shall within the like period rectify any such mistake which has been brought to his notice by the[2] assessee.

Provided that no such rectification shall be made, having the effect of enhancing an assessment unless *the Commissioner, the Assistant Commissioner or* the Income-tax Officer, *as the case may be,* has given notice to the assessee of his intention so to do and has allowed him a reasonable opportunity of being heard.

(2) Where any such rectification has the effect of reducing the assessment, the Income-tax Officer shall make any refund which may be due to such assessee.

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(1) The words in italics were inserted by section 6 of Act III of 1928.

(2) The word 'the' was substituted for the word 'such' by section 6 of Act III of 1928.

(3) Where any such rectification has the effect of enhancing the assessment, the Income-tax Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable, and such notice of demand shall be deemed to be issued under section 29, and the provisions of this Act shall apply accordingly.

Tax to be calculated to nearest anna.

36. In the determination of the amount of tax or of a refund payable under this Act, fractions of an anna less than six pies shall be disregarded, and fractions of an anna equal to or exceeding six pies shall be regarded as one anna.

Power to take evidence on oath, etc.

37. The Income-tax Officer, Assistant Commissioner and Commissioner shall, for the purposes of this Chapter, have the same powers as are vested in a Court under the Code of Civil Procedure, 1908,[1] when trying a suit in respect of the following matters, namely:—

(*a*) enforcing the attendance of any person and examining him on oath or affirmation;

(*b*) compelling the production of documents; and

(*c*) issuing commissions for the examination of witnesses;

and any proceeding before an Income-tax Officer, Assistant Commissioner or Commissioner under this Chapter shall be deemed to be a "judicial proceeding" within the meaning of sections 193 and 228 of the Indian Penal Code.[2]

Power to call for information.

38. The Income-tax Officer or Assistant Commissioner may, for the purposes of this Act,—

(1) require any firm, or Hindu undivided family to furnish him with a return of the members of the firm, or of the manager or adult male members of the family, as the case may be, and of their addresses;

(2) require any person whom he has reason to believe to be a trustee, guardian, or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian, or agent, and of their addresses.

Power to inspect the register of members of any company.

39. The Income-tax Officer or Assistant Commissioner, or any person authorized in writing in this behalf by the Income-tax Officer or Assistant Commissioner, may inspect and, if necessary, take copies, or cause copies to be taken, of any register of

(1) V of 1908.

(2) XLV of 1860.

the members, debenture-holders or mortgagees of any company or of any entry in such register.

CHAPTER V.

Liability in Special Cases.

Guardians, trustees and agents.

40. In the case of any guardian, trustee or agent of any person being a minor, lunatic or idiot or residing out of British India (all of which persons are hereinafter in this section included in the term beneficiary) being in receipt on behalf of such beneficiary of any income, profits or gains chargeable under this Act, the tax shall be levied upon and recoverable from such guardian, trustee or agent, as the case may be, in like manner and to the same amount as it would be leviable upon and recoverable from any such beneficiary if of full age, sound mind, or resident in British India, and in direct receipt of such income, profits or gains, and all the provisions of this Act shall apply accordingly.

Courts of Wards etc.

41. In the case of income, profits or gains chargeable under this Act which are received by the Courts of Wards, the Administrators-General, the Official Trustees or by any receiver or manager (including any person whatever his designation who in fact manages property on behalf of another) appointed by or under any order of a Court, the tax shall be levied upon and recoverable from such Court of Wards, Administrator-General, Official Trustee, receiver or manager in the like manner and to the same amount as it would be leviable upon and recoverable from any person on whose behalf such income, profits or gains are received, and all the provisions of this Act shall apply accordingly.

Non residents.

42. (1) In the case of any person residing out of British India, all profits or gains accruing or arising, to such person, whether directly or indirectly, through or from any business connection or property in British India, shall be deemed to be income accruing or arising within British India, and shall be chargeable to income-tax in the name of the agent of any such person, and such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax:

Provided that any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non-resident person which are, or may at any time come, within British India

(2) Where a person not resident in British India, and not being a British subject or a firm or company constituted within His Majesty's dominions or a branch thereof, carries on business with a person resident in British India, and it appears to the Income-tax Officer or the Assistant Commissioner, as the case may be, that owing to the close connection between the resident and the non-resident person and to the substantial control exercised by the non-resident over the resident, the course of business between those persons is so arranged, that the business done by the resident in pursuance of his connection with the non-resident produces to the resident either no profits or less than the ordinary profits which might be expected to arise in that business, the profits derived therefrom or which may reasonably be deemed to have been derived therefrom, shall be chargeable to income-tax in the name of the resident person who shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax.

(3) Where any profits or gains have accrued or arisen to any person directly or indirectly from the sale in British India by him or by any agency or branch on his behalf of any merchandise exported to British India by him or any agency or branch on his behalf from any place outside British India, the profits or gains shall be deemed to have accrued and arisen and to have been received in British India, and no allowance shall be made under sub-section (2) of section 10 in respect of any buying or other commission whatsoever not actually paid, or of any other amounts not actually spent, for the purpose of earning such profits or gains.[1]

Agents to include persons treated as such.

43. Any person employed by or on behalf of a person residing out of British India, or having any business connection with such person, or through whom such person is in the receipt of any income, profits or gains upon whom the Income-tax Officer has caused a notice to be served of his intention of treating him as the agent of the non-resident person shall, for all the purposes of this Act, be deemed to be such agent:

Provided that no person shall be deemed to be the agent of a non-resident person, unless he has had an opportunity of being heard by the Income-tax Officer as to his liability.

Liability in case of a discontinued firm or partnership

44. Where any business, profession or vocation carried on by a firm has been discontinued, every person who was at the time of such discontinuance a member of such firm shall be jointly and seve-

(1) Sub-section (3) was inserted by Sec. 7 of Act III of 1928

rally liable for the amount of the tax payable in respect of the income, profits and gains of the firm.

[1][CHAPTER V-A.]

SPECIAL PROVISIONS RELATING TO CERTAIN CLASSES OF SHIPPING.

Liability to tax of occasional shipping.

44-A. The provisions of this Chapter shall, notwithstanding anything contained in the other provisions of this Act, apply for the purpose of the levy and recovery of tax in the case of any person who resides out of British India and carries on business in British India in any year as the owner or charterer of a ship (such person hereinafter in this Chapter being referred to as the principal), unless the Income-tax Officer is satisfied that there is an agent of such principal from whom the tax will be recoverable in the following year under the other provisions of this Act.

Return of profits and gains.

44-B. (1) Before the departure from any port in British India of any ship in respect of which the provisions of this Chapter apply, the master of the ship shall prepare and furnish to the Income-tax Officer a return of the full amount paid or payable to the principal, or to any person on his behalf, on account of the carriage of all passengers, live-stock or goods shipped at that port since the last arrival of the ship thereat.

(2) On receipt of the return, the Income-tax Officer shall assess the amount referred to in sub-section (1), and for this purpose may call for such accounts or documents as he may require, and one-twentieth of the amount so assessed shall be deemed to be the amount of the profits and gains accruing to the principal on account of the carriage of the passengers, live-stock and goods shipped at the port.

(3) When the profits and gains have been assessed as aforesaid, the Income-tax Officer shall determine the sum payable as tax thereon at the rate for the time being applicable to the total income of a company, and such sum shall be payable by the master of the ship, and a port-clearance shall not be granted to the ship until the Customs-collector, or other officer duly authorized to grant the same, is satisfied that the tax has been duly paid.

Adjustment.

44-C. Nothing in this Chapter shall be deemed to prevent a principal from claiming, in any year following that in which any payment has been made on his behalf under this Chapter, that an assessment be made of his

(1) Chapter V-A was inserted by S. 3 of Act XXVII of 1923. Genl. Acts, Vol. IX.

total income in the previous year, and that the tax payable on the basis thereof be determined in accordance with the other provisions of this Act, and, if he so claims, any such payment as aforesaid shall be treated as a payment in advance of the tax and the difference between the sum so paid, and the amount of tax found payable by him shall be paid by him or refunded to him, as the case may be.

CHAPTER VI.

RECOVERY OF TAX AND PENALTIES.

Tax when payable.

45. Any amount specified as payable in a notice of demand under section 29 or an order under section 31 or section 32 or section 33, shall be paid within the time, at the place and to the person mentioned in the notice or order, or if a time is not so mentioned, then on or before the first day of the second month following the date of the service of the notice or order, and any assessee failing so to pay shall be deemed to be in default, provided that, when an assessee has presented an appeal under section 30, the Income-tax Officer may in his discretion treat the assessee as not being in default as long as such appeal is undisposed of.

Mode and time of recovery.

46. (1) When an assessee is in default in making a payment of income-tax, the Income-tax Officer may in his discretion direct that, in addition to the amount of the arrears, a sum not exceeding that amount shall be recovered from the assessee by way of penalty.

(1-A) For the purposes of sub-section (1) the Income-tax Officer may direct the recovery of any sum less than the amount of the arrears and may enhance the sum so directed to be recovered from time to time in the case of a continuing default, so however that the total sum so directed to be recovered shall not exceed the amount of the arrears payable.[1]

(2) The Income-tax Officer may forward to the Collector a certificate under his signature specifying the amount of arrears due from an assessee, and the Collector, on receipt of such certificate, shall proceed to recover from such assessee the amount specified therein as if it were an arrear of land revenue.

(3) In any area with respect to which the Commissioner has directed that any arrears may be recovered by any process

(1) Sub-section (1-A) was inserted by Sec. 8 of Act III of 1928.

enforceable for the recovery of an arrear of any municipal tax or local rate imposed under any enactment for the time being in force in any part of the province, the Income-tax Officer may proceed to recover the amount due by such process.

(4) The Commissioner may direct by what authority any powers or duties incident under any such enactment as aforesaid to the enforcement of any process for the recovery of a municipal tax or local rate shall be exercised or performed when that process is employed under sub-section (3).

(5) If any assessee is in receipt of any income chargeable under the head "Salaries," the Income-tax Officer may require any person paying the same to deduct from any payment subsequent to the date of such requisition any arrears due from such assessee, and such person shall comply with any such requisition, and shall pay the sums so deducted to the credit of the Government of India, or as the [Central Board of Revenue][1] directs.

(6) The Local Government may direct, with respect to any specified area, that income-tax shall be recovered therein, with, and as an addition to, any municipal tax or local rate by the same person and in the same manner as the municipal tax or local rate is recovered.

(7) Save in accordance with the provisions of sub-section (1) of section 42, no proceedings for the recovery of any sum payable under this Act shall be commenced after the expiration of one year from the last day of the year in which any demand is made under this Act.

Recovery of penalties.

47. Any sum imposed by way of penalty under the provisions of sub-section (2) of section 25, section 28 or sub-section (1) of section 46, shall be recoverable in the manner provided in this Chapter for the recovery of arrear of tax.

CHAPTER VII.

REFUNDS.

Refunds.

48. (1) If a shareholder in a company who has received any dividend therefrom satisfies the Income-tax Officer that the rate of income-tax applicable to the profits or gains of the company at the time of the declaration of such dividend is greater than the rate applicable to his

(1) These words were substituted for the words "Board of Inland Revenue" by S. 4 and Sch. of Act IV of 1924.

total income of the year in which such dividend was declared, he shall, on production of the certificate received by him under the provisions of section 20, be entitled to a refund on the amount of such dividend (including the amount of the tax thereon) calculated at the difference between those rates.

(2) If a member of a registered firm satisfies the Income-tax Officer that the rate of income-tax applicable to his total income of the previous year was less than the rate at which income-tax has been levied on the profits or gains of the firm of that year, he shall be entitled to a refund on his share of those profits or gains calculated at the difference between those rates.

(3) If the owner of a security from the interest on which, or any person from whose salary, income-tax has been deducted in accordance with the provisions of section 18, satisfies the Income-tax Officer that the rate of income-tax applicable to his total income, profits and gains wherever arising, accruing or received, come-tax has been charged in making such deduction in that year, he shall be entitled to a refund on the amount of interest or salary from which such deduction has been made calculated at the difference between those rates.

(4) For the purposes of this section, 'total income' includes, in the case of any person not resident in British India, all income, profits and gains wherever arising, accruing or received, which, if arising, accruing or received in British India, would be included in the computation of total income under section 16.[1]

(5) Nothing in this section shall entitle to any refund any person not resident in British India who is neither a British subject as defined in section 27 of the British Nationality and Status of Aliens Act, 1914,[2] nor a subject of a State in India.[1]

Relief in respect of United Kingdom income-tax.

49. (1) If any person who has paid Indian income-tax for any year on any part of his income proves to the satisfaction of the Income-tax Officer that he has paid United Kingdom income-tax for that year in respect of the same part of his income, and that the rate at which he was entitled to, and has obtained, relief under the provisions of section 27 of the Finance Act, 1920,[3] is less than the Indian rate of tax charged in respect of that part of his income, he shall be entitled to a refund of a sum calculated on that part of his income at a rate equal to the difference between the Indian rate of tax and the rate at which he was entitled to, and obtained, relief under that section:

(1) Sub-sections (4) and (5) were inserted by Sec. 9 of Act III of 1928

(2) 4 and 5 Geo. V. Ch. 17.

(3) 10 & 11 Geo. V, Ch. 18.

Provided that the rate at which the refund is to be given shall not exceed one-half of the Indian rate of tax.

(2) In sub-section (1)—

(*a*) the expression "Indian Income-tax" means income-tax and super-tax charged in accordance with the provisions of this Act;

(*b*) the expression "Indian rate of tax" means the amount of the Indian income-tax divided by the income on which it was charged;

(*c*) the expression "United Kingdom income-tax" means income-tax and super-tax chargeable in accordance with the provisions of the Income-tax Acts.

Limitation of claims for refund.

50. No claim to any refund of income-tax under this Chapter shall be allowed, unless it is made within one year from the last day of the year in which the tax was recovered.

CHAPTER VIII.

Offences and Penalties.

Failure to make payment or deliver returns or statements or allow inspection.

51. If a person fails without reasonable cause or excuse—

(*a*) to deduct and pay any tax as required by section 18 or under sub-section (5) of section 46;

(*b*) to furnish a certificate required by sub-section (9) of section 18 or by section 20 to be furnished;

(*c*) to furnish in due time any of the returns mentioned in [1][section 19-A], section 21, section 22, or section 38;

(*d*) to produce, or cause to be produced, on or before the date mentioned in any notice under sub-section (4) of section 22, such accounts and documents as are referred to in the notice;

(*e*) to grant inspection or allow copies to be taken in accordance with the provisions of section 39,

he shall, on conviction before a Magistrate, be punishable with fine which may extend to ten rupees for every day during which the default continues.

False statement in declaration.

52. If a person makes a statement in a verification mentioned in [2][section 19-A or] section 22, or sub-section (3) of section 30, or sub-section (2) of section 32 which is false, and which he either

(1) These words and figures were inserted by S. 3 of Act XXIV of 1926.
(2) These words and figures were inserted by S. 4 of *ibid.*

knows or believes to be false, or does not believe to be true, he shall be deemed to have committed the offence described in section 177 of the Indian Penal Code.[1]

Prosecution to be at instance of Assistant Commissioner.

53. (1) A person shall not be proceeded against for an offence under section 51 or section 52 except at the instance of the Assistant Commissioner.

(2) The Assistant Commissioner may stay any such proceeding or compound any such offence.

Disclosure of information by a public servant.

54. (1) All particulars contained in any statement made, return furnished or accounts or documents produced under the provisions of this Act, or in any evidence given, or affidavit or deposition made, in the course of any proceedings under this Act other than proceedings under this Chapter, or in any record of any assessment proceeding, or any proceeding relating to the recovery of a demand, prepared for the purposes of this Act, shall be treated as confidential, and notwithstanding anything contained in the Indian Evidence Act, 1872,[2] no Court shall, save as provided in this Act, be entitled to require any public servant to produce before it any such return, accounts, documents or record or any part of any such record, or to give evidence before it in respect thereof.

(2) If a public servant discloses any particulars contained in any such statement, return, accounts, documents, evidence, affidavit, deposition or record, he shall be punishable with imprisonment which may extend to six months, and shall also be liable to fine:

Provided that nothing in this section shall apply to the disclosure—

(*a*) of any such particulars for the purposes of a prosecution under section 193 of the Indian Penal Code[1] in respect of any such statement, return, accounts, documents, evidence, affidavit or deposition, or for the purposes of a prosecution under this Act, or

(*b*) of any such particulars to any person acting in the execution of this Act where it is necessary to disclose the same to him for the purposes of this Act, or

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(1) XLV of 1860.

(2) I of 1872.

(c) of any such particulars occasioned by the lawful employment under this Act of any process for the service of any notice or the recovery of any demand, or

(d) of such facts, to an authorized officer of the United Kingdom, as may be necessary to enable relief to be given under section 27 of the Finance Act, 1920,[1] or a refund to be given under section 49 of this Act:

Provided, further, that no prosecution shall be instituted under this section except with the previous sanction of the Commissioner.

CHAPTER IX.

SUPER TAX.

Charge of super tax.

55. In addition to the income-tax charged for any year, there shall be charged, levied and paid for that year in respect of the total income of the previous year of any [2][individual, Hindu undivided family, company, unregistered firm or other association of individuals, not being a registered firm], an additional duty of income-tax (in this Act referred to as super-tax) at the rate or rates laid down for that year by Act[3] of the Indian Legislature:

Provided that, where the profits and gains of an unregistered firm have been assessed to super-tax, super-tax shall not be payable by an individual having a share in the firm in respect of the amount of such profits and gains which is proportionate to his share.

To a income for purposes of super-tax.

56. Subject to the provisions of this Chapter, the total income of any [4][individual, Hindu undivided family, company, unregistered firm or other association of individuals] shall, for the purposes of super-tax, be the total income as assessed for the purposes of income-tax, and where an assessment of total income has become final and conclusive for the purposes of income-tax

(1) 10 & 11 Geo. V, Ch. 18.

(2) These words were substituted for the words "individual, unregistered firm, Hindu undivided family or company" with effect from 1st April 1923, by S. 7 of Act XI of 1924.

(3) See Finance Acts and Schedule relating to Super tax.

(4) These words were substituted for the words "individual, unregistered firm, Hindu undivided family or company" by S. 8 of Act XI of 1924 with effect from 1st April 1923.

for any year, the assessment shall also be final and conclusive for the purposes of super-tax for the same year.

* * * * * * * * *[1]

Non-resident partners and shareholders.

57. (1) In the case of any [2][person] residing out of British India who is a member of a registered firm, and whose share of the profits from such firm is liable to super-tax, the remaining members of such firm who are resident in British India shall be jointly and severally liable to pay the super-tax due from the non-resident member in respect of such share.

[3][(2) Where the Income-tax Officer has reason to believe that any person, who is a shareholder in a company, is resident out of British India and that the total income of such person will in any year exceed the maximum amount which is not chargeable to super-tax under the law for the time being in force, he may, by order in writing, require the principal officer of the company to deduct at the time of payment of any dividend from the company to the shareholder in that year super-tax at such rate as the Income-tax Officer may determine as being the rate applicable in respect of the income of the shareholder in that year.

(3) If in any year the amount of any dividend or the aggregate amount of any dividends paid to any shareholder by a company (together with the amount of any income-tax payable by the company in respect thereof) exceeds the maximum amount of the total income of a person which is not chargeable to super-tax under the law for the time being in force, and the principal officer of the company has not reason to believe that the shareholder is resident in British India, and no order under sub-section (2) has been received in respect of such shareholder by the principal officer from the Income-tax Officer, the principal officer shall at the time of payment deduct super-tax on the amount of such excess at the rate which would be applicable under the law for the time being in force if the amount of such dividend or dividends (together with the amount of such income-tax as aforesaid) constituted the whole total income of the shareholder.]

(1) The proviso which was added by S. 2 of Act V of 1925, was omitted by Sec. 10 of Act III of 1928.

(2) This word was substituted for the word 'assessee' by S. 5 of Act XXIV of 1926.

(3) Sub-sections (2) and (3) were substituted for the original sub-section (2) by S. 5 of Act XXIV of 1926.

[1][(4)] Where any person pays any tax under the provisions of this section on account of [1][another person] who is residing out of British India, credit shall be given therefor in determining the amount of the tax to be payable by any agent of such non-resident [1][person] under the provisions of sections 42 and 43.

Application of Act to super-tax.

58. (1) All the provisions of this Act, except section 3, the proviso to sub-section (1) of section 7, the provisos to section 8, sub-section (2) of section 14, and sections 15, 17, 18, 19, 20, 21 and 48 shall apply, so far as may be, to the charge, assessment, collection and recovery of super-tax.

[2][Provided that sub-sections (4) to (9) of section 18 shall apply, so far as may be, to the assessment, collection and recovery of super-tax under sub-section (2) or sub-section (3) of section 57.]

(2) Save as provided in section 57, super-tax shall be payable by the assessee direct.

CHAPTER X.

Miscellaneous.

Power to make rules.

59. (1) The [3][Central Board of Revenue] may, subject to the control of the Governor-General in Council, make rules for carrying out the purposes of this Act and for the ascertainment and determination of any class of income. Such rules may be made for the whole of British India or for such part thereof as may be specified.

(2) Without prejudice to the generality of the foregoing power, such rules may—

(*a*) prescribe the manner in which, and the procedure by which, the income, profits and gains shall be arrived at in the case of—

(*i*) incomes derived in part from agriculture and in part from business;

(*ii*) insurance companies;

(*iii*) persons residing out of British India;

(*b*) prescribe the procedure to be followed on applications for refunds;

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(1) Original sub-section (2) was re-numbered (4) and the words "another person" and "person" were substituted for the words "an assessee" and "assessee" respectively by S. 5 of Act XXIV of 1926.

(2) This proviso was added by S. 6 of Act XXIV of 1926.

(3) These words were substituted for the words "Board of Inland Revenue" by S. 4 and Sch. of Act IV of 1924.

(c) provide for such arrangements with His Majesty's Government as may be necessary to enable the appropriate relief to be granted under section 27 of the Finance Act, 1920,[1] or under section 49 of this Act;

(d) prescribe the year which, for the purpose of relief under section 49, is to be taken as corresponding to the year of assessment for the purposes of section 27 of the Finance Act, 1920; [1]and

(e) provide for any matter which by this Act is to be prescribed.

[2][(3) In cases coming under clause (a) of sub-section (2), where the income, profits and gains liable to tax cannot be definitely ascertained, or can be ascertained only with an amount of trouble and expense to the assessee which, in the opinion of the Central Board of Revenue, is unreasonable, the rules made under that sub-section may—

(a) prescribe methods by which an estimate of such income, profits and gains may be made, and

(b) in cases coming under sub-clause (i) of clause (a) of sub-section (2), prescribe the proportion of the income which shall be deemed to be income, profits and gains liable to tax,

and an assessment based on such estimate or proportion shall be deemed to be duly made in accordance with the provisions of this Act.]

(4) The power to make rules conferred by this section shall, except on the first occasion of the exercise thereof, be subject to the condition of previous publication.

(5) Rules made under this section shall be published in the Gazette of India, and shall thereupon have effect as if enacted in this Act.

Power to make exemptions, etc.

60. The Governor-General in Council may, by notification in the Gazette of India, make an exemption, reduction in rate or other modification, in respect of income-tax in favour of any class of income, or in regard to the whole or any part of the income of any class of persons.

Appearance by authorised representative

61. Any assessee, who is entitled or required to attend before any income-tax authority in connection with any proceedings under this Act, may attend either in person or by any person authorised by him in writing in this behalf.

(1) 10 & 11 Geo. V, Ch. 18.
(2) Inserted by the Income-tax (Amendment) Act, 1927 (XXVIII of 1927).

Receipts to be given.

62. A receipt shall be given for any money paid or recovered under this Act.

Service of notices.

63. (1) A notice or requisition under this Act may be served on the person therein named either by post or, as if it were a summons issued by a Court, under the Code of Civil Procedure, 1908.[1]

(2) Any such notice or requisition may, in the case of a firm or a Hindu undivided family, be addressed to any member of the firm or [2][to the] manager, or any adult male member of the family [3][and, in the case of any other association of individuals, be addressed to the principal officer thereof].

Place of assessment.

64. (1) Where an assessee carries on business at any place, he shall be assessed by the Income-tax Officer of the area in which that place is situate or, where the business is carried on in more places than one, by the Income-tax Officer of the area in which his principal place of business is situate.

(2) In all other cases, an assessee shall be assessed by the Income-tax Officer of the area in which he resides.

(3) Where any question arises under this section as to the place of assessment, such question shall be determined by the Commissioner, or, where the question is between places in more provinces than one, by the Commissioners concerned, or, if they are not in agreement, by the [Central Board of Revenue][4]:

Provided that, before any such question is determined, the assessee shall have had an opportunity of representing his views.

(4) Notwithstanding anything contained in this section, every Income-tax Officer shall have all the powers conferred by or under this Act on an Income-tax Officer in respect of any income, profits or gains accruing, or arising or received within the area for which he is appointed.

Indemnity.

65. Every person deducting, retaining or paying any tax in pursuance of this Act in respect of income belonging to another person is hereby indemnified for the deduction, retention or payment thereof.

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(1) V of 1908.

(2) These words were substituted for the words "on the" by S. 2 and Sch. I of Act VII of 1924.

(3) These words were inserted by S. 9 of Act XI of 1924.

(4) These words were substituted for the words "Board of Inland Revenue" by S. 4 and Sch. of Act IV of 1924.

Statement of case by Commissioner to High Court.

66. (1) If, in the course of any assessment under this Act or any proceeding in connection therewith other than a proceeding under Chapter VIII, a question of law arises, the Commissioner may, either on his own motion or on reference from any Income-tax authority subordinate to him, draw up a statement of the case and refer it with his own opinion thereon to the High Court.

(2) Within one month of the passing of an order under section 31 or section 32, the assessee in respect of whom the order was passed may, by application accompanied by a fee of one hundred rupees or such lesser sum as may be prescribed, require the Commissioner to refer to the High Court any question of law arising out of such order and the Commissioner shall, within one month of the receipt of such application, draw up a statement of the case and refer it with his own opinion thereon to the High Court :

Provided that, if, in exercise of his power of revision[1] under section 33, the Commissioner decides the question, the assessee may withdraw his application, and if he does so, the fee paid shall be refunded.

(3) If, on any application being made under sub-section (2), the Commissioner refuses to state the case on the ground that no question of law arises, the assessee may [2][within six months from the date on which he is served with notice of the refusal] apply to the High Court, and the High Court, if it is not satisfied of the correctness of the Commissioner's decision, may require the Commissioner to state the case and to refer it, and, on receipt of any such requisition, the Commissioner shall state and refer the case accordingly.

(4) If the High Court is not satisfied that the statements in a case referred under this section are sufficient to enable it to determine the question raised thereby, the Court may refer the case back to the Commissioner by whom it was stated to make such additions thereto or alterations therein as the Court may direct in that behalf.

(5) The High Court upon the hearing of any such case shall decide the questions of law raised thereby, and shall deliver its judgment thereon containing the grounds on which such decision is founded, and shall send to the Commissioner by whom

(1) The word "revision" was substituted for the word "review" by S. 11 of Act III of 1928.

(2) These words were inserted by S. 10 of Act XI of 1924.

the case was stated a copy of such judgment under the seal of the Court and the signature of the Registrar, and the Commissioner shall dispose of the case accordingly, or, if the case arose on a reference from any Income-tax authority subordinate to him, shall forward a copy of such judgment to such authority who shall dispose of the case conformably to such judgment.

(6) Where a reference is made to the High Court on the application of an assessee, the costs shall be in the discretion of the Court.

(7) Notwithstanding that a reference has been made under this section to the High Court, income-tax shall be payable in accordance with the assessment made in the case :

Provided that, if the amount of an assessment is reduced as a result of such reference, the amount overpaid shall be refunded with such interest as the Commissioner may allow.

[1][(8) For the purposes of this section "the High Court" means—

(*a*) in relation to the North-West Frontier Province and British Baluchistan, the High Court of Judicature at Lahore;

(*b*) in relation to the province of Ajmer-Merwara, the High Court of Judicature at Allahabad; and

(*c*) in relation to the province of Coorg, the High Court of Judicature at Madras.]

References to be heard by Benches of High Courts, and appeal to lie in certain cases to Privy Council.

[2][**66-A**. (1) When any case has been referred to the High Court under section 66, it shall be heard by a Bench of not less than two Judges of the High Court, and in respect of such case the provisions of section 98 of the Code of Civil Procedure, 1908,[3] shall, so far as may be, apply notwithstanding anything contained in the Letters Patent of any High Court established by Letters Patent or in any other law for the time being in force.

(2) An appeal shall lie to His Majesty in Council from any judgment of the High Court delivered on a reference made under section 66 in any case which the High Court certifies to be a fit one for appeal to His Majesty in Council.

(1) This sub-section was added by S. 7 of Act XXIV of 1926.
(2) This section was inserted by S. 8 of *ibid*.
(3) V of 1908.

(3) The provisions of the Code of Civil Proceduce, 1908,[1] relating to appeals to His Majesty in Council shall, so far as may be, apply in the case of appeals under this section in like manner as they apply in the case of appeals from decrees of a High Court :

Provided that nothing in this sub-section shall be deemed to affect the provisions of sub-section (5) or sub-section (7) of section 66 :

Provided, further, that the High Court may, on petition made for the execution of the order of His Majesty in Council in respect of any costs awarded thereby, transmit the order for execution to any Court subordinate to the High Court.

(4) Where the judgment of the High Court is varied or reversed in appeal under this section, effect shall be given to the order of His Majesty in Council in the manner provided in sub-sections (5) and (7) of section 66 in the case of a judgment of the High Court.

(5) Nothing in this section shall be deemed—

(*a*) to bar the full and unqualified exercise of His Majesty's pleasure in receiving or rejecting appeals to His Majesty in Council, or otherwise howsoever, or

(*b*) to interfere with any rules made by the Judicial Committee of the Privy Council, and for the time being in force, for the presentation of appeals to His Majesty in Council, or their conduct before the said Judicial Committee.]

Bar of suits in Civil Court.

67. No suit shall be brought in any Civil Court to set aside or modify any assessment made under this Act, and no prosecution, suit or other proceeding shall lie against any Government officer for anything in good faith done or intended to be done under this Act.

Repeals.

68. [2]The enactments mentioned in the Schedule are hereby repealed to the extent specified in the fourth column thereof :

Provided that such repeal shall not affect the liability of any person to pay any sum due from him or any existing right of refund under any of the said enactments :

(1) V of 1908.

(2) Sec. 68 has been repealed by the Repealing and Amending Act, 1927 (XII of 1927).

Provided, further, that the provisions of section 19 of the Indian Income-tax Act, 1918,[1] shall apply, so far as may be, [2][to income-tax leviable under that Act in respect of the year beginning on the first day of April, 1921, and to super-tax chargeable under the Super-tax Act, 1920, in that year;] and where an adjustment shall be made under the provisions of [3][that section], the provisions of this Act regarding the procedure for the assessment and recovery of income-tax shall apply as if such adjustment were an assessment made under this Act.

THE SCHEDULE.[4]

ENACTMENTS REPEALED.

(*See section* 68.)

Year.	No.	Short title.	Extent of repeal.
1	2	3	4
1918	VII	The Indian Income-tax Act, 1918.	The whole.
1919	IV	The Indian Income-tax (Amendment) Act, 1919.	The whole.
,,	XVIII	The Repealing and Amending Act, 1919.	So much of the First Schedule as relates to the Indian Income-tax Act, 1918.
1920	XVII	The Indian Income-tax (Amendment) Act, 1920.	The whole.
,,	XIX	The Super-tax Act, 1920.	The whole.
,,	XXXI	The Repealing and Amending Act, 1920.	So much of the First Schedule as relates to the Super-tax Act, 1920.
,,	XLIV	The Indian Income-tax (Amendment No. 2) Act, 1920.	The whole.

(1) VII of 1918.

(2) These words and figures were substituted for the words and figures "to all assessments made under that Act in the year ending on the 31st day of March, 1922," by S. 3 of Act XV of 1923, Genl. Acts, Vol. IX.

(3) These words were substituted for the words and figures "section 19 of the said Act" by S. 3 Act XV of 1923.

(4) The Schedule was repealed by the Repealing and Amending Act, 1927 (XII of 1927).

EXTRACT FROM THE INDIAN FINANCE ACT, 1928.

* * * * * *

1. (1) This Act may be called THE INDIAN FINANCE ACT, 1928.

* * * * * *

5. (1) Income-tax for the year beginning on the 1st day of April, 1928, shall be charged at the rates specified in Part I of the Second Schedule.

(2) The rates of super-tax for the year beginning on the 1st day of April, 1928, shall, for the purposes of section 55 of the Indian Income-tax Act, 1922, be those specified in Part II of the Second Schedule.

(3) For the purposes of the Second Schedule, "total income" means total income as determined, for the purposes of income-tax or super-tax, as the case may be, in accordance with the provisions of the Indian Income-tax Act, 1922.

* * * * * *

SCHEDULE II.

(*See Section* 5.)

PART I.

RATES OF INCOME-TAX.

	Rate.
A. In the case of every individual, Hindu undivided family, unregistered firm an other association of individuals not being a registered firm or a company.—	
(1) When the total income is less than Rs. 2,000.	*Nil.*
(2) When the total income is Rs. 2,000 or upwards, but is less than Rs. 5,000.	Five pies in the rupee.
(3) When the total income is Rs. 5,000 or upwards, but is less than Rs. 10,000.	Six pies in the rupee.
(4) When the total income is Rs. 10,000 or upwards, but is less than Rs. 20,000.	Nine pies in the rupee.
(5) When the total income is Rs. 20,000 or upwards, but is less than Rs. 30,000.	One anna in the rupee.
(6) When the total income is Rs. 30,000 or upwards, but is less than Rs. 4, 000.	One anna and three pies in the rupee.
(7) When the total income is Rs. 40,000 or upwards.	One anna and six pies in the rupee.
B. In the case of every company, and every registered firm whatever its total income.	One anna and six pies in the rupee.

PART II.

Rates of Super-tax.

In respect of the excess over fifty thousand rupees of total income :—

	Rate.
(1) in the case of every company.	One anna in the rupee
(2) (*a*) in the case of every Hindu undivided family—	
(*i*) in respect of the first twenty-five thousand rupees of the excess.	*Nil.*
(*ii*) for every rupee of the next twenty five thousand rupees of such excess.	One anna in the rupee
(*b*) in the case of every individual, unregistered firm and other association of individuals not being a registered firm or a company for every rupee of the first fifty thousand rupees of such excess.	Do. do.
(*c*) in the case of every individual, Hindu undivided family, unregistered firm and other association of individuals not being a registered firm or a company—	
(*i*) for every rupee of the second fifty thousand rupees of such excess.	One and a half annas in the rupee.
(*ii*) for every rupee of the next fifty thousand rupees of such excess.	Two annas in the rupee.
(*iii*) for every rupee of the next fifty thousand rupees of such excess.	Two and a half annas in the rupee.
(*iv*) for every rupee of the next fifty thousand rupees of such excess.	Three annas in the rupee.
(*v*) for every rupee of the next fifty thousand rupees of such excess.	Three and a half annas in the rupee.
(*vi*) for every rupee of the next fifty thousand rupees of such excess.	Four annas in the rupee.
(*vii*) for every rupee of the next fifty thousand rupees of such excess.	Four and a half annas in the rupee.
(*viii*) for every rupee of the next fifty thousand rupees of such excess.	Five annas in the rupee.
(*ix*) for every rupee of the next fifty thousand rupees of such excess.	Five and a half annas in the rupee.
(*x*) for every rupee of the remainder of the excess.	Six annas in the rupee.

THE INDIAN INCOME-TAX RULES, 1922.

Board of Inland Revenue Notification No.3-I.T., dated the 1st April 1922 as subsequently amended.

In exercise of the powers conferred by section 59 of the Indian Income-tax Act, 1922 (XI of 1922), the Board of Inland Revenue has made the following rules, namely :—

1. These rules may be called THE INDIAN INCOME-TAX RULES, 1922.

2. Any firm constituted under an instrument of partnership specifying the individual shares of the partners may, for the purposes of clause (14) of section 2 of the Indian Income-tax Act, 1922 (hereinafter in these rules referred to as the Act), register with the Income-tax Officer the particulars contained in the said instrument on application in this behalf made by the partners or by any of them. Such application shall be made—

(*a*) before the income of the firm is assessed for any year under section 23, or

(*b*) if no part of the income of the firm has been assessed for any year under section 23, before the income of the firm is assessed under section 34, or

(*c*) with the permission of the Assistant Commissioner hearing an appeal under section 30, before the assessment is confirmed, reduced, enhanced or annulled, or, if the Assistant Commissioner sets aside the assessment and directs the Income-tax Officer to make a fresh assessment, before such fresh assessment is made.

3. The application referred to in rule 2 shall be made in the form annexed to this rule and shall be accompanied by the original instrument of partnership under which the firm is constituted together with a copy thereof : provided that if the Income-tax Officer is satisfied that for some sufficient reason the original instrument cannot conveniently be produced, he may accept a copy of it certified in writing by one of the partners to be a correct copy, and in such a case the application shall be accompanied by a duplicate copy.

FORM I.

Form of application for registration of a firm under section 2 (14) of the Indian Income-tax Act, 1922.

To
THE INCOME-TAX OFFICER,

Dated 19

$\frac{\text{I}}{\text{We}}$ ——————————————beg to apply for the registration of $\frac{\text{my}}{\text{our}}$ firm under section 2 (14) of the Indian Income-tax Act, 1922.

2. $\frac{\text{The original}}{\text{A certified copy}}$ of the instrument of partnership under which the firm is constituted specifying the individual shares of the partners together with $\frac{\text{a copy}}{\text{duplicate copy}}$ is enclosed. The prescribed particulars are given below.

3. $\frac{\text{I}}{\text{We}}$ do hereby certify that the profits for the year ending have been or will be actually divided or credited in accordance with the shares shown in this partnership deed.

Signature————————

Address————————

Name and address of the firm.	Names of the partners in the firm with the share of each in the business.	Date on which the instrument of partnership was executed.	Date, if any, on which the instrument of partnership was last registered in the Income-tax Officer's office.	REMARKS.

$\frac{\text{I}}{\text{We}}$ do hereby certify that the information given above is correct.

Signature (*s*)————————

4. (1) On the production of the original instrument of partnership or on the acceptance by the Income-tax Office of a certified copy thereof, the Income-tax Officer shall enter in writing at the foot of the instrument or copy, as the case may be, the following certificate, namely :—

"This instrument of partnership (or this certified copy of an instrument of partnership) has this day been registered with me, the Income-tax Officer for in the province of under clause (14) of section 2 of the Indian Income-tax Act, 1922. This certificate of registration has effect from the day of April 19 up to the 31st day of March 19 ."

(2) The certificate shall be signed and dated by the Income-tax Officer who shall thereupon return to the applicant the instrument of partnership or the certified copy thereof, as the case may be, and shall retain the copy or duplicate copy thereof.

5. The certificate of registration granted under rule 4 shall have effect from the date of registration.

6. A certificate of registration granted under rule 4 shall have effect up to the end of the financial year in which it is granted, but shall be renewed by the Income-tax Officer from year to year on application made to him in that behalf at any time before the assessment of the income of the firm is made, and accompanied by a certificate signed by one of the partners of the firm that the constitution of the firm as specified in the instrument of partnership remains unaltered.

7. Under section 9 (1) (*vi*) of the Act, the sum to be allowed in respect of collection charges shall not exceed 6 per cent. of the annual value of the property.

8. An allowance under section 10 (2) (*vi*) of the Act in respect of depreciation of buildings, machinery, plant or furniture shall be made in accordance with the following statement :—

Class of buildings, machinery, plant or furniture.	Rate.	REMARKS.
	Percentage on prime cost	
1. *Buildings** :—		* Double these rates may be allowed for buildings used in industries which cause special deterioration, such as chemical works, soap and candle works paper mills and tanneries.
(1) First class substantial buildings of selected materials.	2½	
(2) Buildings of less substantial construction ..	5	
(3) Purely temporary erections such as wooden structures.	10	
2. *Machinery Plant or Furniture*† :—		† The special rates for electrical machinery given below may be adopted, at firm's option, for that portion of their machinery.
General rate ..	5	
Rates sanctioned for special industries :—		
Flour Mills, Rice Mills, Bone Mills. Sugar Works, Distilleries, Ice Factories, Aerating Gas Factories, Match Factories.	6¼	
Paper Mills, Ship Building and Engineering Works, Iron and Brass Foundries, Aluminium Factories, Electrical Engineering Works, Motor Car Repairing Works, Galvanizing Works. Patent Stone Works, Oil Extraction Factories, Chemical Works, Soap and Candle Works, Lime Works, Saw Mills, Dyeing and Bleaching Works, Furniture and Plant in hotels and boarding houses, Cement Works using rotary kilns.	7½	
Plant used in connection with Brick Manufacture, Tile-making Machinery, Optical Machinery, Glass Factories, Telephone Companies, Mines and Quarries,	10	
Sewing machines for canvas or leather ..	12½	
Motor cars used solely for the purpose of business, indigenous sugar-cane crushers (Kohlus or Belnas). ..	15	
Motor taxis, motor lorries and motor buses	20	
3. *Electrical Machinery*—		
(*a*) Batteries ..	15	
(*b*) Other electrical machinery, including electrical generators, motors (other than tramway motors), switch gear and instruments, transformers and other stationary plant and wiring and fittings of electric light and fan installations.	7½	
(*c*) Underground cables and wires ..	6	
(*d*) Overhead cables and wires ..	2½	

Class of buildings, machinery, plant or furniture.	Rate.	REMARKS,
	Percentage on prime cost,	
4. *Hydro Electric concerns*—		
Hydraulic works, pipe lines, sluices, and all other items not otherwise provided for in this statement.	2½	
5. *Electric tramways*—		
Permanent way— (*a*) Not exceeding 50,000 car miles per mile of track per annum.	6¼	
(*b*) Exceeding 50 000 and not exceeding 75,000 car miles per mile of track per annum.	7 1/7	
(*c*) Exceeding 75,000 and not exceeding 125,000 car miles per mile of track per annum.	8⅓	
Cars—car trucks, car bodies, electrical equipment and motors.	7	
General plant, machinery and tools ..	5	
6. *Mineral Oil Companies*—		
A. Refineries--		
(1) Boilers ..	10	
(2) Prime movers ..	5	
(3) Process plant ..	10	
B. Field operations—		
(1) Boilers ..	10	
(2) Prime movers ..	5	
(3) Process plant ..	7½	
Except for the following items :—		
(1) Below ground—All to be charged to revenue ..	..	
(2) Above ground—		
(*a*) Portable boilers, drilling tools, well head tank, rigs, etc. ..	25	
(*b*) Storage tanks ..	10	
(*c*) Pipe lines—		
(*i*) Fixed boilers ..	10	
(*ii*) Prime movers ..	7½	
(*iii*) Pipe line ..	10	

Class of buildings, machinery, plant or furniture.	Rate.	REMARKS.
	Percentage on prime cost	
7 *Ships*—		
(1) Ocean—		
(*a*) Steam ..	5	
(*b*) Sail or tug ..	4	
(2) Inland—		
(*a*) Steamers (over 120 ft. in length) ..	5	
(*b*) Steamers including cargo launches (120 ft. in length and under)	6	
(*c*) Tug boats ..	7½	
(*d*) Iron or Steel flats for cargo, etc. ..	5	
(*e*) Wooden cargo boats up to 50 tons capacity..	10	
(*f*) Wooden cargo boats over 50 tons capacity ..	7½	
8. *Mines and Quarries*—		
(1) Railway sidings* (excluding rails) ..	5	* Depreciation on rails used for tramways and sidings, and in inclines where the rails are the property of the assessee, is allowed at 10 per cent. under item 2 above (plant used in connection with Mines and Quarries) in addition to any depreciation allowance on the cost of constructing the tramways sidings or inclines.
(2) Shafts ..	5	
(3) Inclines* ..	5	
(4) Tramways on the surface* (excluding rails) ..	10	

9. For the purpose of obtaining an allowance for depreciation under proviso (*a*) to section 10 (2) (*vi*) of the Act, the assessee shall furnish particulars to the Income-tax Officer in the following form :—

Description of buildings machinery, plant, or furniture.	Original cost.	Capital expenditure during the year for additions, alterations, improvements and extensions.	Date from which used for the purposes of the business.	Particulars (including original cost, depreciation allowed and value realised by sale or scrap value) of obsolete machinery, plant or furniture sold or discarded during the year, with dates on which first brought into use and sold or discarded.	REMARKS.
1	1-A	2	3	4	5

I——————————declare that to the best of my information and belief the buildings, machinery, plant and furniture described in column 1 of the above statement were the property of—————— during the year ended——————————and that the particulars entered in the statement are correct and complete.

Place—————————— *Signature*——————————

Date—————————— *Designation*——————————

10. All sums deducted in accordance with the provisions of section 18 of the Act shall be paid by the person making the deduction to the credit of the Government of India on the same day as the deduction is made in the case of deduction by or on behalf of Government, and within one week from the date of such deduction in all other cases :

Provided that the Income-tax Officer may, in special cases, and with the approval of the Assistant Commissioner, permit a local authority, company, public body or association, or a private employer to pay the income-tax deducted from salaries quarterly on June 15th, September 15th, December 15th, and March 15th.

11. In the case of income chargeable under the head ' Salaries,' where deduction is not made by or on behalf of Government, the person paying the salary shall pay to the credit of the Government of India by remitting the amount to the Income-tax Officer concerned or to such officer as he may direct and shall send therewith a statement showing the name of the employee from whose salary the tax has been deducted, the period for which the salary has been paid, the gross amount of the salary, the deduction for a provident fund or insurance premia, and the amount of tax deducted.

11-A. The prescribed rate of exchange for the calculation of the value in rupees of any income chargeable under the head ' Salaries ' which is payable to the assessee out of India by or on behalf of Government shall be the rate notified by the Controller of the Currency in respect of the recovery of contributions to the Indian Civil Service Fund for the month in which such income is payable.

12. In the case of income chargeable under the head 'Interest on securities,' where the deduction is not made by or on behalf of Government, the person responsible for paying the interest shall pay to the credit of the Government of India by remitting the amount to the Income-tax Officer concerned or to such officer as he may direct with a statement showing the following particulars :—

(*i*) Description of securities.
(*ii*) Numbers of securities.
(*iii*) Dates of securities.
(*iv*) Amounts of securities.
(*v*) Period for which interest is drawn.
(*vi*) Amount of interest, and
(*vii*) Amount of tax.

13. The certificate to be furnished under section 18 (9) of the Act by any person paying interest chargeable to income-tax on any security of the Government of India or of a local Government shall be in the following form :—

Draft No.[1] ——————————

Certified that Rs.——————being income-tax at the rate of—pies per rupee has been deducted by draft of this date from Rs.——————being the amount of interest

for Rs.
on[2]——————for Rs.——————standing in the name
for Rs.

of ——————————

——————192 . *Superintendent or Principal Officer.*

To be signed by claimant.

I hereby declare that the securities on which interest as above specified has been received were my own property and were in the possession of——

——————————

at the time when income-tax was deducted.

Signature——————

Date——————

(*N.B.*—The securities to be produced when required in support of any claim.)

13-A. The certificate to be furnished under section 18 (9) of the Act by the person paying any interest on debentures or other securities for money issued by or on behalf of a local authority or a company shall be in the following form :——

" Name of ~~Local Authority~~ Company ——————

Address ——————

To ——————

I/We hereby certify that Rs. being income-tax at the rate of pies per rupee has been deducted from Rs. being the amount of interest at the rate of per cent. per annum due[1] on debentures

(1) This number also appears in the interest cages on the back of the securities.
(2) Name of security.

Nos. of Rs. each of the[2] and that it has been or will, within the prescribed period, be paid by me/us to the Government of India, at

Principal Officer or Managing Agents.

——————192 .

(To be signed by claimant.)

I hereby declare that the securities on which interest as above specified has been received were my own property and were in the possession of at the time when income-tax was deducted.

Signature——————

Date——————

(*N.B.*—The securities to be produced when required in support of any claim.)

14. The certificate to be furnished by the principal officer of a company under section 20 shall be in the following form:—

(Name of Company)——————

(Address of Company)——————

Date——————

Warrant for Rs. being dividend[3] of per cent. for the[4] ending on the day of 19 ,[5] on[6] shares in this company, registered in the name of

This dividend was declared at the[7] meeting held on the[8] 192 .

I/We hereby certify that income-tax on the entire / on such part, as is liable to be charged to Indian income tax of the profits and gains of the company, of which this dividend forms a part, has been, or will be, duly paid by me/us to the Government of India.

Signature——————

Office——————

(To be signed by the claimant.)

I hereby certify that the dividend above-mentioned relates to shares which were my own property at the time when the dividend was declared and were in the possession of

Signature——————

Date——————

15. The returns for Government officers under section 21 of the Act shall be prepared and submitted to the Income-tax Officer by:—

(1) The date interest is payable.
(2) Here enter the name of the local authority or the company.
(3) Or dividend and bonus.
(4) Year or half year, as the case may be.
(5) Here enter whether free of income-tax or not.
(6) Here enter number and description of shares.
(7) Here specify number and nature of meeting.
(8) Here enter date.

(*a*) Civil Audit Officers for all gazetted officers and others who draw their pay from audit offices on separate bills; and also for all pensioners who draw their pensions from audit offices.

(*b*) Treasury officers for all gazetted officers and others who draw their pay from treasuries on separate bills without countersignature; and also for all pensioners who draw their pensions from treasuries.

(*c*) Heads of Civil or Military offices for all non-gazetted officers whose pay is drawn on establishment bills or on bills countersigned by the head of office.

(*d*) Forest Disbursing Officers and Public Works Department Disbursing Officers in cases where direct payment from treasuries is not made, for themselves and their establishments.

(*e*) Head postmasters for (*i*) themselves, their gazetted subordinates and the establishments of which the establishment pay bills are prepared by them and (*ii*) gazetted supervising and controlling officers of whose head-quarters post office they are in charge; Head Record Clerks, Railway Mail Service, for themselves and all the staff whose pay is drawn in their establishment pay bills; the Disbursing Officers in the case of the Administrative and the Audit offices.

(*f*) Controllers of Military Accounts (including Divisional Military Supply, Marine, Field and War Controllers) for all gazetted military officers under their audit.

(*g*) Disbursing officers in the Military Works Department for themselves and their establishments.

(*h*) Chief Examiners of Accounts or Chief Auditors of Railways concerned for all railway employees under their audit.

16. The minimum income under the head "Salaries" referred to in section 21 (*a*), shall be Rs. 2,000 per annum.

17. The return to be delivered to the Income-tax Officer under section 21 of the Act shall be in the following form:—

Serial number.	Name of persons.	Postal address of residence.	Appointment or nature of employment.	Total amount of salary, wages, annuity or pension paid during the year ending on the 31st March, 19 .	House allowance or value of rent-free quarters	Amount of bonus, gratuity, fees, commissions, perquisites or allowances (other than those shown in column 6), or profits in lieu of or in addition to salary or wages (each to be shown separately).	Total of columns 5, 6 and 6-A.	Deductions on account of Provident and other funds [Proviso to sec. 7 (1)]	Deductions on account of Life Insurance Premia (section 15).	Net amount chargeable.	Amount of tax payable.	Reduction under section 17.	Amount of tax deducted.	REMARKS.
1	2	3	4	5	6	6-A	7	8	8 A	9	10	11	12	13

I certify that the above statement contains a complete list of the total amounts paid by——————to all persons who were receiving income on the 31st day of March, 19 —at the rate of Rs. 2,000 per annum, or have received during the year ended on that day not less than Rs. 2,000 in respect of salary, wages, annuity, pension, gratuity, fees, commissions, perquisites, or profit in lieu of or in addition to salary or wages, and that all the particulars stated are correct.

Signature of person by whom the return is delivered.

Date

18. The return of total income of companies required under section 22 (1) shall be in the following form and shall be accompanied by a copy of the profit and loss account referred to therein :—

Income, profits or gains from business, trade, commerce.

	RS. A. P.
Income, profits, or gains as per profit and loss account for the year ended —————— 192 ..	
Add any amount debited in the accounts in respect of—	
1. Reserve for bad debts ..	
2. Sums carried to reserve for provident or other funds ..	
3. Expenditure of the nature of charity or presents ..	
4. Expenditure of the nature of capital ..	
5. Income-tax or Super-tax ..	
6. Rental value of property owned and occupied ..	
7. Cost of additions to, or alterations, extensions, improvements of, any of the assets of the business ..	
8. Interest on reserve or other funds ..	
9. Losses sustained in former years ..	
10. Losses recoverable under an insurance or contract of indemnity ..	
11. Depreciation of any of the assets of the business ..	
12. Expenses not incurred solely for the purpose of earning the profits ..	
TOTAL ..	
Deduct—Any profits included in the accounts already charged to Indian income tax and the interest on securities of the Government of India or of local Governments declared to be income-tax free ..	
BALANCE ..	

If the company owns any property not occupied for the purposes of the business a statement in the form prescribed in Schedule A to rule 19 should be attached with particulars of the credit and debit on account of such property entered in the accounts.

Declaration.

I, the———————————————————— [Secretary, etc., (see section 2 (12) of the Act)] of the———————————— ——————————(name of Company) declare that the information against each head in this return is correctly given as shown in the books of the Company as also in the accounts which have been duly audited by the auditors of the Company and which have been adopted by the shareholders of the Company.

(*Signature*)————————————

(*Designation*)————————————

Dated——————19 .

19. The return of total income for individuals, firms and Hindu undivided families required under section 22 (2) shall be in the following form:—

Statement of total income during the previous year.

1	2	3
Sources of Income.	Amount of profits or gains or income during the previous year.	Tax already charged on the income.
	Rs.	Rs
1, Salaries (including wages, annuity, pension, gratuity, fees, commission, allowances, perquisites, including rent-free quarters) or profits received in lieu of, or in addition to, salary or wages ..[*See* note (1)]		
2 Interest on Securities (including debentures) already taxed .. ,, (2)		
3. Interest on Securities of the Government of India or of local Governments declared to be income-tax free .. ,, (3)		
4. Property as shown in detail in Schedule A. .. ,, (4)		
5. Business, trade, commerce, manufacture, or dealings in property, shares or securities (details as in note 5) .. ,, (5)		
6. Profession .. ,, (6)		
7. Dividends from Companies .. .. (7)		

1	2	3
Sources of Income.	Amount of profits or gains or income during the previous year.	Tax already charged on the income.
	RS.	RS.
8. Interest on mortgages, loans, fixed deposits, current account, etc., not being income from business		
9. Ground Rent ..		
10. Any source other than those mentioned above including any income earned in partnership with others .. (*See* note 8)		
Total ..		
Deductions claimed on account of contributions to provident fund, etc., or insurance premia (*See* note 9).		

I declare that to the best of my knowledge and belief the information given in the above statement is correct and complete, that the amounts of income shown are truly stated and relate to the year ended—————— and that no other income accrued or arose or was received by me / the firm during the said year and that I / the firm have no other sources of income.

Signature——————————

Date——————————

N.B.—(*a*) *Income accruing to you outside British India received in British India is liable to taxation, and must be entered by you in the form.*

(*b*) *All income from whatever source derived must be entered in the form, including income received by you as a partner of a firm.*

Note 1.—In column 2 should be shown the gross amount of salary and not the net amount after deduction on account of income-tax, provident funds, etc.

Note 2.—"Interest on securities" means the interest on promissory notes or bonds issued by the Government of India or a Local Government, or the interest on debentures or other securities for money issued by or on behalf of a local authority or Company. Where income-tax has been deducted from the interest, or where the interest has been paid income-tax free, the amount of tax so deducted or paid should be added to the amount of interest actually received, and the gross amount so arrived at should be entered in column 2 of the statement. The term "interest on securities" does not include interest on fixed deposits or mortgages or other loans, which have to be shown under heading 8.

The interest on securities of the Government of India or of Local Governments declared to be income-tax free should be shown under head 3. Those which are not declared to be income-tax free should be included under this head.

Entries under this head must be supported by the certificate issued by the person or Company paying the interest under section 18 (9) of the Act.

Note 3.—(*a*) The income-tax payable on the interest receivable on a security of a Local Government issued income-tax free is payable by the Local Government and not by the holder of the security.

(*b*) Only the interest on securities of the Government of India or of a Local Government declared to be income-tax free should be entered against this head. Such interest will not be charged to income-tax, but it must be included in the statement of total income in order to ascertain the rate of income-tax chargeable on other income. *It is chargeable to super-tax.*

(*c*) Particulars of any interest on securities issued by other authorities and stated to be free of income-tax should be entered against head 2, as income-tax on such interest is actually paid by these authorities on behalf of the recipients.

Note 4.—The tax is payable under this head in respect of the *bona fide* annual value of any building or lands appurtenant thereto of which you are the owner, other than such portions of such buildings and lands as you may occupy for the purpose of your business.

SCHEDULE A.

Serial number.	Name of village or town where the property is situated.	Name of mohalla or street and number of property if any.	In the case of Municipalities the name of the person in whose name the property stands in the municipal registers.	Whether the property is occupied by owner or is let.	Annual letting value of the property.	Period during which the property remained vacant.	Amount of rent actually received for the property if let.	DEDUCTIONS. Of one-sixth of the annual letting value shown in column 6.	Premium paid to insure the property against damage or destruction.	Interest paid on a mortgage or charge on the property.	Ground rent paid for the property.	Land revenue paid for the property.	Collection charges paid.	Amount claimed on account of property remaining vacant.	Total of columns 8 to 13-A.	Net amount to be carried over to the front of the form.
1	2	3	4	5	6	6-A	7	8	9	10	11	12	13	13-A	14	15

Note 5.—(*a*) Where you keep your accounts on the mercantile accountancy or book profits system, you must file return in the following form:—

Income, profits or gains from business, trade, commerce.

	Rs
Income, profits or gains as per Profit and Loss Account for the year ended ———— ————192	..
Add any amount debited in the accounts in respect of—	..
1 Reserve for bad debts ..	..
2. Sums carried to reserve for provident or other funds ..	..
3. Expenditure of the nature of charity or presents ..	..
4. Expenditure of the nature of capital ..	..
5. Income-tax or Super-tax ..	..
6. Drawings or Salary of proprietor or partners ..	..
7. Rental value of property owned and occupied ..	..
8. Cost of additions to. or alterations, extensions, improvements of any of the assets of the business.	..
9. Interest on the proprietor's or partner's capital including interest on reserve or other funds.	..
10. Losses sustained in former years ..	..
11. Losses recoverable under an insurance or contract of indemnity	..
12. Depreciation of any of the assets of the business ..	..
13 Private or personal expenses and expenses not incurred solely for the purpose of earning the profits.	
TOTAL ..	..
Deduct any profits included in the account already charged to Indian income-tax and the interest on securities of the Government of India or of local Governments declared to be income-tax free.	..
Balance ..	..

(Signature of the person making the return).————————

(Date)————————192 .

(*b*) Where you do not keep your accounts in such a form, you must file a statement showing how you arrive at the taxable profits, *i.e.*, showing details of the gross receipts and of the expenditure you propose to set against those receipts. No deductions are permissible on account of—

(*i*) Property owned and occupied by the owner of a business for the purposes of a business;

(*ii*) Additions to or alterations, extensions, or improvements of any of the assets of the business;

(*iii*) Interest on the capital of the proprietors or partners of the business;

(*iv*) Bad debts not actually written off in the accounts;

(*v*) Losses sustained in previous years;

(*vi*) Reserves of any kind;

(*vii*) Sums paid on account of the income-tax or super-tax or any tax levied by a local authority other than local rates or municipal taxes in respect of the portion of the premises used for the purpose of the business;

(*viii*) Any expenditure of the nature of charity or a present;

(*ix*) Any expenditure of the nature of capital;

(*x*) Any loss recoverable under an insurance or a contract of indemnity;

(*xi*) Depreciation of any kind other than that specified in the Act;

(*xii*) Drawings or salaries of the proprietors or the partners;

(*xiii*) Private or personal expenses of the assessee;

(*xiv*) Any expenditure of any kind which is not incurred solely for the purpose of earning the profits.

If you have included any such sums in your expenditure in your books, you must exclude them from the expenditure permissible for the purpose of arriving at your taxable profits.

Note 6.—The income, profits or gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred *solely* for the purpose of such profession or vocation, provided that no allowance is made on account of any of your personal expenses. Professional fees received by you in any part of India (whether within British India or not) must be included by you in your receipts.

Note 7.—Income-tax chargeable on the profits of companies is paid by the companies, so that the dividends which shareholders receive represent the net amount remaining after income-tax has been paid. The amount of income-tax paid upon these dividends, even if the dividends are stated to be income-tax free, should be added to the amount of the dividends actually received, and the gross amount arrived at should be entered in column 2 of the statement.

If the rate of tax applicable to your total income is less than the rate at which tax has been paid upon your dividends, you may, by attaching the company's certificate received with the dividends, have the excess collected on your dividends from the company set against the tax payable by you on your other income instead of having to apply separately for a refund.

Note 8.—Agricultural income from land not paying land revenue or local rates to an authority in British India should be included under this head.

Note 9.—Deductions from total income can only be made for insurance premia in respect of insurance on your own life or on the life of your wife, or in respect of a contract for a deferred annuity on your own life or on the life of your wife. No deduction is permissible in the case of any other form of insurance except in the case of Hindu undivided families where deductions are permissible on account of premia paid in respect of insurance on the life of any male member of the family or of his wife. The original receipt or the certificate of the insurance company to which the premium was paid must be attached to the return.

20. The Notice of Demand under section 29 shall be in the following form:—

Notice of Demand under Section 29 of the Income-tax Act, 1922.

To

____

____

____

1. You have been assessed for the year to income-tax amounting to Rs. [in addition to which a penalty of Rs. has been imposed], as shown in the copy of the Assessment form sent herewith.

2. You have also been assessed to super-tax amounting to Rs.

3. You are required to pay the amount of Rs. on or before the to at when you will be granted a receipt.

4. If you do not pay the tax on or before the date specified above, you will be liable to a penalty which may be as great as the tax due from you.

5. If you are dissatisfied with your assessment you may present an appeal under sub-section (1) of section 30 of the Indian Income-tax Act, 1922, to the Assistant Commissioner of Income-tax at within 30 days from the receipt of this notice, on a petition duly stamped in the form prescribed under sub-section (3) of section 30 and verified as laid down in that form.

Or

The assessment has been made under sub-section (4) of section 23 of the Indian Income-tax Act, 1922, because you failed
- to make a return of your income under section 22,
- to comply with a notice under sub section (4) of section 22,
- to comply with a notice under sub section (2) of section 23,

and no appeal lies.

But if you were prevented by sufficient cause from making the return or did not receive the notice(s) aforesaid, or had not a reasonable opportunity to comply, or were prevented by sufficient cause from complying, with the terms of the notice(s), you may apply to me, within one month from the receipt of this notice, under section 27, to cancel the assessment and proceed to make a fresh assessment.

6. The appropriate chalan should be sent along with the amount paid. Should you lose the chalans attached to this notice of demand, it will be necessary for you to apply to the Income-tax Officer for copies of fresh chalans.

Dated————————— 19 .

Income-tax Officer.

(Place)—————————

Note.—The superfluous words in paragraph 5 should be deleted.

ACT XI OF 1922.

ASSESSMENT FORM.

ASSESSMENT FOR 192 -2 .

District.

Name of assessee

Address

Serial number.	Detailed sources of income.	Amount of income.	Tax deducted at source.		REMARKS.
		RS.	RS.	A.	
1	Salaries ..				
2	Interest on securities ..				
3	Property ..				
4	Business ..				
5	Profession ..				
6	Other sources ..				

	RS.	A.	RS.	A.
(i) Total income				
(ii) Deduction on account of provident fund, insurance premia, etc.				
(iii) Deduct sums received as dividends or from a firm the profits of which have been assessed to tax.				
(iv) Deduct amount of interest from tax-free securities of the Government of India, or of a Local Government.				
(v) Income now to be taxed				
(vi) Rate applicable—pies per rupee				
(vii) Amount of tax				
(viii) Reduction under section 17				
(ix) Amount of deductions at source from salary or interest on securities for which credit is given under section 18 (5)				
(x) Abatement on account of dividends (at pies per rupee).				
(xi) Abatement on account of income from a registered firm (at pies per rupee).				
(xii) Net amount of tax (or refund)				
(xiii) Penalty under section 28 [or section 25 (2)]				
(xiv) Total sum payable (or to be refunded) (in figures as well as in words). Rupees Annas				

* * * * * * *

21. An appeal under section 30 shall, in the case of an appeal against a refusal of an Income-tax Officer to make a fresh assessment under section 27, be in Form A; in the case of an appeal against an order of an Income-tax Officer under section 25 (2) in Form C; in the case of an appeal against an order of an Income-tax Officer under section 28 in Form D and in other cases in Form B.

FORM A.

Form of appeal against an order refusing to re-open an assessment under section 27.

To

The Assistant Commissioner of

The day of 19 .

The petition of sheweth as follows:—

1. Under the Indian Income-tax Act, 1922, your petitioner has been assessed on the sum of Rs. for the year commencing the 1st day of April 19 .

2. Your petitioner was prevented by sufficient cause from making the return required by section 22 or did not receive the notice issued under sub-section (4) of section 22, or sub-section (2) of section 23, or had not a reasonable opportunity to comply or was prevented by sufficient cause from complying with the terms of the notice under sub-section (4) of section 22 or sub-section (2) of section 23, as more particularly specified in the statement attached.

3. Your petitioner therefore presented a petition to the Income-tax Officer under section 27, requesting him to cancel the assessment. This petition, the Income-tax Officer, by his order dated of which a copy is attached, has rejected.

4. Your petitioner therefore requests that the order of the Income-tax Officer may be set aside and that he may be directed to make a fresh assessment in accordance with the law.

(Signed)——————————

STATEMENT OF FACTS.

Form of verification.

I , the petitioner, named in the above petition, do declare that what is stated therein and in the above statement of facts is true to the best of my information and belief.

(Signed)——————————

FORM B.

Form of appeal against assessment to Income-tax.

To

The Assistant Commissioner of

The day of 19 .

The petition of of sheweth as follows:—

1. Under the Indian Income-tax Act, 1922, your petitioner has been assessed on the sum of Rs. for the year commencing the 1st day of April 19 . The notice of demand attached hereto was served upon him on .

2. Your petitioner's income accruing or arising or received or deemed under the provisions of the Act to accrue or arise or to be received in British India for the year ending the day of 19 amounted to Rs.

3. Such income and profits actually accrued or arose or were received during the period of months and days.

4. During the said year your petitioner had no other income or profits.

5. Your petitioner has made a return of his income to the Income-tax Officer under section 22, sub-section (2) of the Act and has complied with all the terms of the notice served on him by the Income-tax Officer under section 23 (2) and|or [section 22 (4)].

Your petitioner therefore prays that he may be assessed accordingly (or that he may be declared not to be chargeable under the Act).

(Signed)————————

GROUNDS OF APPEAL.

Form of verification.

I, , the petitioner, named in the above petition, do declare that what is stated therein is true to the best of my information and belief.

(Signed)————————

FORM C.

Form of appeal against an order under section 25 (2).

To

The Assistant Commissioner of Income-tax,

The day of 19 .

The petition of of sheweth as follows:—

1. Under section 25 (2) of the Indian Income-tax Act, 1922, a penalty of Rs. has been imposed on your petitioner. The notice of demand attached hereto was served upon him on .

2. Your petitioner was prevented by sufficient cause as more particularly explained below from giving notice within the time prescribed by section 25 (2) to the Income-tax Officer of the discontinuance of his business, profession or vocation.

3. Your petitioner therefore requests that the order of the Income-tax Officer imposing a penalty of Rs. upon your petitioner may be set aside.

(Signed)————————

STATEMENT OF FACTS.

Form of verification.

I, , the petitioner, named in the above petition, do declare that what is stated therein and in the above statement of facts is true to the best of my information and belief.

(Signed)————————————

FORM D.

Form of appeal against an order under section 28.

To

The Commissioner of Income-tax.
The Assistant Commissioner of Income-tax,

The day of 19 .

The petition of of sheweth as follows:—

1. Under section 28 of the Indian Income-tax Act, 1922, a penalty of Rs. has been imposed on your petitioner by the $\frac{\text{Income-tax Officer}}{\text{Assistant Commissioner}}$ The notice of demand attached hereto was served upon him on .

2. Your petitioner did not conceal the particulars of his income or deliberately furnish inaccurate particulars thereof but as will be seen from the statement of facts attached returned it at its real amount to the best of his knowledge and belief.

3. Your petitioner therefore requests that the order of the $\frac{\text{Income-tax Officer}}{\text{Assistant Commissioner}}$ imposing a penalty of Rs. upon your petitioner may be set aside.

(Signed)————————————

STATEMENT OF FACTS.

Form of verification.

I, , the petitioner, named in the above petition, do declare that what is stated therein is true to the best of my information and belief.

(Signed)————————————

22. An appeal under section 32 (2) shall in the case of an appeal against an order of an Assistant Commissioner under section 28 be in Form C attached to Rule 21 and in other cases in Form E.

FORM E.

To

The Commissioner of Income-tax.

The day of 19 .

The petition of sheweth as follows:—

1. Under section 31 (3) of the Indian Income-tax Act, 1922, the Assistant Commissioner of————————has increased the tax payable by your petitioner from Rs.————————to Rs.————————.

2. Your petitioner prays that the enhancement may be set aside or reduced to Rs.————————for the reasons stated below :

(Signed)————————

Grounds of appeal.

Form of verification.

I, . the petitioner, named in the above petition, do declare that what is stated therein is true to the best of my information and belief.

(Signed)————————

23. (1) In the case of income derived in part from agriculture and in part from business an assessee shall be entitled to deduct from such income the market value of any agricultural produce raised by him or received by him as rent-in-kind which he has utilized as raw material for the purposes of his business or the sale receipts of which are included in the accounts of his business. The balance of such income shall be deemed to be income derived from the business and no further deduction shall be made therefrom in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent-in-kind.

(2) For the purposes of sub-rule (1) "market value" shall be deemed to be:—

(*a*) where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the year previous to that in which the assessment is made.

(*b*) where agricultural produce is not ordinarily sold in the market in its raw state, the aggregate of—

(*i*) the expenses of cultivation:

(*ii*) the land revenue or rent paid for the area in which it was grown: and

(*iii*) such amount as the Income-tax Officer finds, having regard to all the circumstances in each case, to represent a reasonable rate of profit on the sale of the produce in question as agricultural produce.

24. Income derived from the sale of tea grown and manufactured by the seller shall be computed as if it were income derived from business and 40 per cent. of such income shall be deemed to be income, profits and gains liable to tax.

25. In the case of Life Assurance Companies incorporated in British India whose profits are periodically ascertained by actuarial valua-

tion, the income, profits and gains of the Life Assurance Business shall be the average annual net profits disclosed by the last preceding valuation, provided that any deductions made from the gross income in arriving at the actuarial valuation which are not admissible for the purpose of income-tax assessment, and any Indian Income-tax deducted from or paid on income derived from investments before such income is received, shall be added to the net profits disclosed by the valuation.

26. Rule 25 shall apply also to the determination of the income, profits and gains derived from the annuity and capital redemption business of life assurance companies, the profits of which can be ascertained from the results of an actuarial valuation.

27. If the Indian income-tax deducted from interest on the investments of a company exceeds the tax on the income, profits and gains thus calculated, a refund may be permitted of the amount by which the deduction from interest on investments exceeds the tax payable on such income, profits and gains.

28. In the case of other classes of insurance business (fire, marine, motor-car, burglary, etc.,) of a company incorporated in British India, the income, profits or gains shall be determined in accordance with the provisions of the Act, subject to the allowance specified in the rule next following.

29. If in the ordinary accounts of any insurance business other than Life Assurance, Annuity, or Capital Redemption Business carried on by an Insurance Company any amount is actually charged against the receipts for the sole purpose of forming a reserve to meet outstanding liabilities or unexpired risk in respect of policies which have been issued (including risk of exceptional losses) and is not used for any other purpose such amount may be treated as expenditure incurred solely for the purpose of earning the profits of the business.

30. Any amount either written off in the accounts or through the Actuarial Valuation Balance Sheet to meet depreciation of, or loss on, securities or other assets, or which is carried to a reserve fund formed for that sole purpose and not used for any other purpose, may be treated as expenditure incurred solely for the purpose of earning the profits of the business. Any sums taken credit for in the accounts or Actuarial Valuation Balance Sheet on account of appreciation of or gains on the securities or other assets shall be deemed to be income chargeable to tax, subject always to deduction of such portion thereof as has been otherwise taken into account in calculating the income, profits or gains.

31. The income, profits and gains of companies carrying on Dividing Society or Assessment business shall be taken at 15 per cent. of the premium income in the previous year and, in the case of non-resident companies, at 15 per cent. of the Indian premium income in the previous year.

32. Notwithstanding anything contained in rules 25 to 31, the total income, however, of an insurance company carrying on more than

one class of business shall be determined by its aggregate income from all classes of businesses.

33. In any case in which the Income-tax Officer is of opinion that the actual amount of the income, profits or gains accruing or arising to any person residing out of British India whether directly or indirectly through or from any business connection in British India cannot be ascertained, the amount of such income, profits or gains for the purposes of assessment to income-tax may be calculated on such percentage of the turnover so accruing or arising as the Income-tax Officer may consider to be reasonable, or on an amount which bears the same proportion to the total profits of the business of such person (such profits being computed in accordance with the provisions of the Indian Income-tax Act) as the receipts so accruing or arising bear to the total receipts of the business, or in such other manner as the Income-tax Officer may deem suitable.

34. The profits derived from any business carried on in the manner referred to in section 42 (2) of the Act may be determined for the purposes of assessment to income-tax according to the preceding rule.

35. The total income of the Indian branches of non-resident insurance companies (Life, Marine, Fire, Accident, Burglary, Fidelity Guarantee, etc.), in the absence of more reliable data, may be deemed to be the proportion of the total income, profits or gains, of the companies, corresponding to the proportion which their Indian premium income bears to their total premium income.

36. An application for a refund of income-tax under section 48 of the Act shall be made in the following form:—

Application for refund of Income-tax.

I,——————————————of——————————————

——————————————————————————————

do hereby state that my income from all sources to which the Act applies during the year ending——————————on the 31st March 19 , amounted to Rs.——————————only.

I therefore pray for a refund of

Rs.—————————— under " Salaries "
Rs.—————————— under " Securities "
Rs.—————————— under " Dividends from companies "
Rs.—————————— under "Share of profits of the registered firm "

known as ——————————————————of which I am a partner.

Signature——————————————

(The portions not required should be scored out.)

I hereby declare that what is stated herein is correct.

Signature——————————————

Dated——————————19 .

37. The application under rule 36 shall be accompanied by a return of total income in the form prescribed under section 22 unless the applicant has already made such a return to the Income-tax Officer.

38. Where the application under rule 36 is made in respect of interest on securities or dividends from companies, the application shall be accompanied by the certificate prescribed under section 18 (9) or section 20, as the case may be.

39. The application under rule 36 shall be made as follows:—

(*a*) If the applicant is resident in British India, to the Income-tax Officer of the district in which the applicant is chargeable directly to income-tax or, if he is not chargeable directly to income-tax, to the Income-tax Officer of the district in which he ordinarily resides;

(*b*) If the applicant is resident outside British India, to the Income-tax Officer appointed by the Central Board of Revenue.

40. An application for refund of income-tax under section 49 of the Act shall be made in the following form:—

Application for relief from double income-tax under section 49 *of the Indian Income-tax Act,* 1922.

I,———— of————————, do hereby state that I have paid United Kingdom income-tax and super-tax amounting to £——— for the year ending 19 on an income of £———— and that Indian income tax / income tax and super-tax of Rs.———has also been paid on the same income. / income from the same source amounting to Rs. ———— I have obtained relief under the provisions of section 27 of the English Finance Act, 1920, at the rate of————see attached certificate from the Inspector of Taxes,————. I now pray for a further relief at the rate of———amounting to Rs.————under section 49 of the Indian Income-tax Act, 1922, to which I am entitled. My income from all sources to which this Act applies during the "previous year" ending on the ————19 amounted to Rs.————only—see Return of income attached. / already submitted.

Signature————————

I hereby declare that what is stated herein is correct.

Signature————————

Dated————————19 .

41. The application under rule 36 or rule 40 may be presented by the applicant in person or through a duly authorized agent or may be sent by post.

42. A return shall be furnished by the principal officer of a company under section 19-A in respect of a dividend or aggregate dividends if the amount thereof exceeds Rs. 10,000.

43. The return by the principal officer of a company under section 19-A shall be in the following form and shall be delivered to the Income-tax Officer who assesses the company :—

Return under section 19-*A of the Indian Income-tax Act*, 1922, *for the year* 1st *April* 19 —31*st March* 19 .

Name of Company——————————————————

Address of Company——————————————————

(1) Resident Shareholders ——————————————————
Non-Resident Shareholders

Serial number	Name of share holder.	Address of shareholder.	Date of declaration of dividends.	(2) Amount of dividends.	
				Net.	Gross.
1	2	3	4	5	6
				Rs.	Rs.

I,——————————, the principal officer of the—————————— company, hereby certify that the above statement contains a complete list of the resident / non-resident shareholders of the company to whom a dividend or aggregate dividends exceeding Rs. 10,000 was or were distributed in the period from the 1st April 19 to the 31st March 19 .

Signature——————————

Dated——————————19 .

44. All sums deducted in accordance with sub-sections (2) and (3) of section 57 shall be paid by the person making the deduction to the credit of the Government of India within one week from the date of such deduction by remitting the amount to the Income-tax Officer concerned or to such Government Treasury or branch of the Imperial Bank of India as he may direct. The person making the deduction shall send at the same time to the Income-tax Officer a statement showing the name of the non-resident person on whose behalf the tax has been deducted, the amount of the tax deducted, the gross amount of dividend in respect of which the deduction has been made and the period for which the dividend has been paid.

Note.—(1) Separate forms should be used for resident and non-resident shareholders.

(2) Where dividends are issued "free of income-tax", the figure to be entered in column 5 is the sum actually paid, and the figure to be entered in column 6 is the aggregate of the sum so paid and the amount of income-tax payable by the company in respect of the dividends.

GOVERNMENT TRADING TAXATION ACT
(ACT NO. III of 1926).

An Act to determine the liability of certain Governments to taxation in British India in respect of trading operations.

Whereas it is expedient to determine the liability to taxation for the time being in force in British India of the Government of any part of His Majesty's Dominions, exclusive of British India, in respect of any trade or business carried on by or on behalf of such Government; it is hereby enacted as follows:—

Short title and commencement.

1. (1) This Act may be called The Government Trading Taxation Act, 1926.

(2) It shall come into force on such date as the Governor-General in Council may, by notification in the Gazette of India, appoint.[1]

Liability of certain Governments to taxation in respect of trading operations.

2. (1) Where a trade or business of any kind is carried on by or on behalf of the Government of any part of His Majesty's Dominions, exclusive of British India, that Government shall, in respect of the trade or business and of all operations connected therewith, all property occupied in British India and all goods owned in British India for the purposes thereof, and all income arising in connection therewith, be liable—

(*a*) to taxation under the Indian Income-tax Act, 1922,[2] in the same manner and to the same extent as in the like case a company would be liable;

(*b*) to all other taxation for the time being in force in British India in the same manner as in the like case any other person would be liable.

(2) For the purposes of the levy and collection of income-tax under the Indian Income-tax Act, 1922, in accordance with the provisions of sub-section (1), any Government to which that sub-section applies shall be deemed to be a company within the meaning of that Act, and the provisions of that Act shall apply accordingly.

(3) In this section the expression "His Majesty's Dominions" includes any territory which is under His Majesty's protection or in respect of which a mandate is being exercised by the Government of any part of His Majesty's Dominions.

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(1) The Act came into force with effect from the 1st April, 1926—*Vide* Notification No. 13, dated 30th March 1926.

(2) XI of 1922.

THE
INDIAN INCOME-TAX ACT (XI OF 1922.)

An Act to consolidate and amend the law relating to Income-tax and Super-tax.

WHEREAS it is expedient to consolidate and amend the law relating to Income-tax and Super-tax ; it is hereby enacted as follows :—

Short title, extent and commencement.

1. (1) This Act may be called THE INDIAN INCOME-TAX ACT, 1922.

(2) It extends to the whole of British India, including British Baluchistan and the Sonthal Pargannas, and applies also, within the dominions of Princes and Chiefs in India in alliance with His Majesty, to British subjects in those dominions who are in the service of the Government of India or of a local authority established in the exercise of the powers of the Governor-General in Council in that behalf, and to all other servants of His Majesty in those dominions.

(3) It shall come into force on the first day of April, 1922.

Preamble—

As regards the construction of titles, preambles, etc., *see* Rules of Construction in the Introduction. The present Act consolidates the previous Income-tax and Super-tax Acts and amends them in the light of experience. The amendments were largely based on the recommendations of the All-India Income-tax Committee of 1921, a copy of whose report is printed as an Appendix.

British India—

Under section 3 (7) of the General Clauses Act (X of 1897), 'British India' means "all territories and places within

Her Majesty's dominions which are for the time being governed by Her Majesty through the Governor-General of India or through any Governor or other officer subordinate to the Governor-General of India."

India—

Under section 3 (27) *ibid* 'India' means 'British India together with any territories of any Native Prince or Chief under the suzerainty of Her Majesty exercised through the Governor-General of India through any Governor or other Officer subordinate to the Governor-General of India'.

Local authority—

Under section 3 (28) *ibid* 'Local authority' means 'a Municipal Committee, District Board, body of Port Commissioners or other authority legally entitled to, or entrusted by the Government with, the control or management of a municipal or local fund'.

Scope of Act—

The Act applies *locally* to the whole of British India and only *personally* to the specified class of persons outside British India but within India. The *personal* and *local* jurisdiction of the Indian legislature is determined by section 65 of the Government of India Act.

Sub-section (2) governs the whole Act. The jurisdiction of the Act cannot extend beyond the areas mentioned herein. The jurisdiction however has primary reference to the liability to tax, and if there is liability, the Act gives jurisdiction to give effect to the objects of the Act. The liability does not depend on the effectiveness of the machinery to enforce liability.[1] Thus there is nothing to prevent an Income-tax Officer acting under section 64 (4) assessing an assessee residing out of India. Whether he can enforce the assessment is a different matter which would depend on what property the assessee has in India, etc.

The jurisdiction of the Indian Legislature is regulated under section 65, Government of India Act, which runs as below :—

"The Indian Legislature has power to make laws :—

(*a*) For all persons, for all courts and for all places and things within British India; and

(*b*) For all subjects of His Majesty and servants of the Crown within other parts of India; and

(*c*) For all native Indian subjects of His Majesty without and beyond as well as within British India: and

(1) *Crown* v. *Commissioners of Inland Revenue*, 7 Tax Cases 316; *Whitney* v. *Commissioners of Inland Revenue*, 10 Tax Cases 88.

(*d*) For the government officers, soldiers (airmen) and followers in His Majesty's Indian forces, wherever they are serving, in so far as they are not subject to the Army Act (or the Air Force Act); and

(*e*) For all persons employed or serving in or belonging to the Royal Indian Marine Service; and . . . . . "

' Income, profits and gains ' arising or accruing or received in British India are included in ' things ' in clause (*a*) above; otherwise no non-resident could be made liable to tax—even through an agent—unless the non-resident fell under one of the clauses (*c*), (*d*) or (*e*).

Section 7 (2) applies only to the particular class of income mentioned therein, namely, ' salaries '; and sets out the extent to which income not accruing, arising, or received in British India may be *deemed* to be chargeable within the meaning of section 4. Section 1 governs section 7 (2) also, and the latter, it will be seen, does not—as indeed it cannot—go beyond the scope of section 1, which in its turn is really determined by section 65 of the Government of India Act.

There is nothing to prevent, for instance, the Government of India so amending the Income-tax Act as to appoint (say) the High Commissioner for India in England as an Income-tax Officer under the Act in respect of incomes accruing in India but paid in the United Kingdom or (say) in respect of refunds of Indian Income-tax to persons in the United Kingdom. The point is that so long as there is liability to tax the Government adopt the necessary machinery at their risk. Thus an Income-tax Officer acting outside British India cannot obviously have the same powers as in British India; nor would it be possible to visit the same penalties in cases of default; but to the extent that the assessee or the person called on obeys the Income-tax Officer or complies with his direction, or the Income-tax Officer is able to get at the assessee's income or property, there would be nothing *ultra vires* in the acts of the Income-tax Officer.

See also notes under sections 22 (serving notices on non-residents); 29 (issuing notice of demand); 64 (4) (Jurisdiction of the Income-tax Officer); and 65 (indemnity).

History—

The words " and to all other servants of His Majesty in those dominions " were added in 1918. Formerly only British subjects serving outside British India were liable. Now even subjects of Indian States who are in the service of the Government of India but serve outside British India and within India are liable. The fact that these persons pay Income-tax to the

Government of India does not absolve them from liability to taxation by the States which have powers to tax them—*see* however notes under section 60 regarding relief from Double Income-tax.

The words "Sonthal Perganmas" were added in 1918. Previously the Act had been extended by the Sonthal Pergannas Settlement Regulations (III of 1872) and (III of 1899).

The words "including British Baluchistan" were added in 1922. Formerly, the Act was applied by notification only to salaries and pensions paid by Government or local authorities. The conditions after the war justified the extension of the whole Act to British Baluchistan. Besides, traders and contractors from other Provinces made substantial profits in this Province and brought it to India without paying Income-tax—*see* the case of *Rai Bahadur Sundar Das*[1] cited under section 4.

The whole of the Act has been applied to Berar, the Civil and Military Station of Bangalore, and the districts of Abu and Angul. The Act applies only to salaries and pensions paid by Government and local authorities in the cantonment of Baroda, the British Administered areas in Central India and the British Administered areas (excluding Railway land) in Bombay Presidency.

Administered areas—Income arising, etc., in—Double taxation of

Where the Act has been extended to territories which are not British India, strictly speaking profits accruing or arising or received in British India or deemed to accrue or arise or to be received in British India are liable to tax even if they have already been taxed in those territories, except, of course, in those cases in which the doctrine of "no second receipt in the hands of the same person" saves such income from double taxation. The point is that these territories are, so to speak, duplicates of British India and not part of British India. In practice, however, by executive orders, the following concessions have been given, saving such income from double taxation. Berar is practically treated as part of British India for purposes of assessment and no question of double taxation arises. When the same profits are taxed both in British India and in the Civil and Military Station of Bangalore, a deduction or refund is given in British India equal to the tax levied on such profits in the Civil and Military Station if the headquarters of the firm or company, etc., are in

(1) [1] I. T. C. 189.

British India, and a similar refund or deduction is given at Bangalore if the headquarters of the firm or company are at Bangalore.

Salaries of persons outside India—

The position resulting from this section and section 7 (2) is that the salaries of Government officers serving outside *India* (*i.e.*, accruing or arising out of India, *e.g.* in the Persian Gulf) are not taxable unless *received* in India.

Salaries in Indian States—

In Indian States, all persons in the service of Government, of whatever nationality, are liable to tax, but only those servants of local authorities who are British subjects are taxable. If a Government servant is lent to a "local authority" in an Indian State, he will be taxable whether he is a British Subject or not because he does not cease to be a servant of His Majesty owing to his being lent to a "local authority"; but a Government servant lent to an Indian State for service in that State is not taxable as he ceases to be a servant of His Majesty—*see* section 7 (2). Other British subjects are not taxable, *e.g.*, British subjects travelling in Indian States or receiving salaries from sources other than Government or local authorities, *e.g.*, an Englishman or British Indian employed as a State servant.

Frontier Agency Tracts and Ceded Areas are included in the term "Dominions of Princes and Chiefs in India in alliance with His Majesty".

United Kingdom Law—

The English Income-tax Acts do not contain any section similar to this section. The scope of the Acts there is defined by the various charging sections (by no means very clear) and the interpretations placed on them by the Courts. In this connection see the remarks of Lord Herschell in *Colquhoun* v. *Brooks*,[1] quoted in the Introduction. *See* also *Whitney* v. *Commissioners of Inland Revenue*,[2] cited under section 22 as regards the taxation of non-residents, and the remarks of Tomlin, J. regarding the scope of the Australian Income-tax laws in *London & South American Investment Trust* v. *British Tobacco Co. Ltd.*[3]

Definitions. **2.** In this Act, unless there is anything repugnant in the subject or context,—

(1) 2 Tax Cases 490.
(2) (1926) A. C. 37; 10 Tax Cases 88.
(3) 42 T. L. R. 771; (1927) 1 Ch. 107.

'Unless there is anything repugnant in the subject or context':—Examples of words not used in the strict sense of the definitions in this section are "assessee" in sections 24 and 64.

The definitions should be followed in construing not only the Act proper but also the Rules and Notifications. These definitions are supplementary to those in the General Clauses Act except where they definitely override them.

(1) "agricultural income" means—

(*a*) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land revenue in British India or subject to a local rate assessed and collected by officers of Government as such;

(*b*) any income derived from such land by—

(*i*) agriculture, or

(*ii*) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market, or

(*iii*) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in sub-clause (*ii*);

(*c*) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator, or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any operation mentioned in sub-clauses (*ii*) and (*iii*) of clause (*b*) is carried on:

Provided that the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator or the receiver of the rent-in-kind by reason of his connection with the land, requires as a dwelling house, or as a storehouse, or other out-building.

History—

In the Income-tax Act of 1860 agricultural income was taxed. This was given up in 1865. In the Act of 1867 the tax was levied only as a license tax on professions and trades, and agriculture was neither a 'profession' nor a 'trade'. In 1869, an income-tax was levied upon all incomes, including agricultural income, and in 1873-74 this was given up. In 1877 a license tax was levied upon traders and artisans but not upon agriculturists on whom a cess on land was levied. In 1886 a regular Income-tax Act was passed but exempting agricutural income and the exemption is still in force. The principal reason for exempting agricultural income from 1877 onwards appears to have been, not the fact that landlords paid revenue to Government (which of course was in return for the use of land) but that they paid a cess on land corresponding to income-tax. This cess was not inconsiderable having regard to the low rates of income-tax then prevalent; and it was considered that landlords should not be asked to contribute to the general exchequer more than once (apart from the payment of land revenue which, as already stated, was held to be not a contribution to the public revenues but a payment for the use of land). In those days when the Cess Acts were passed and an income-tax levied on agricultural income, the owners of permanently settled estates carried on a powerful agitation against these imposts on the ground that the new taxes constituted a breach of the Permanent Settlement. As will be seen the policy of the Government of India was vacillating. They met these complaints, not by exempting permanently settled estates as such from income-tax, but by exempting all agricultural income whether the lands were permanently settled or not. The omission of the 1886 Act to refer expressly to permanently settled estates has, as will be seen from the Introduction, led to considerable difference of opinion about the liability to income-tax of non-agricultural income from permanently settled estates.

Circumstances have, of course, since changed, especially since 1916-17 with the introduction of a graduated system of income-tax and the levy of super-tax—*see* for instance para. 60 of Sir William Meyer's Budget speech for 1917-18. In 1918 when the Income-tax Act was amended and consolidated, Government intended to take into account agricultural income for the purpose of fixing the *rate* at which an assessee should pay tax—a clearly logical step with the advent of a real system of graduation—but this was opposed by the Legislative Council and the proposal was dropped. In 1922, when the Act was again revised, Government desired to exclude 'forestry' from agricultural income, but this also was opposed by the Assembly and the proposal was dropped. Agricultural income, as now defined in the Act, is not only exempt from income-tax but may not even be taken into account in considering the 'rate' at which the assessee should be taxed on his non-agricultural income. Nor can it be taken into account even for super-tax, however large the income. The existence of agricultural income is completely ignored by the Income-tax Officer for all purposes. Government, however, have never given a specific undertaking that they will not tax agricultural income in future, nor can there be any doubt that the Legislature has powers to tax agricultural income as well as income from permanently settled estates. Recent political developments are bringing the question to the forefront, and the Taxation Enquiry Committee have written on the subject at length in their report.

Under the previous Acts profits from the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him were included under "agricultural income" only if he did not keep a shop or stall for the sale of such produce. Under the present Act such profits are exempt from taxation if the produce is sold in a raw state or after it is subjected only to such processes as an ordinary cultivator would employ. The present Act, it will be seen, makes the law more lenient. The change was made in 1922.

The drafting of the corresponding portion of the previous Acts was defective. The words 'in British India' in clause (*a*) and 'such land by' in clauses (*b*) and (*c*) did not occur therein. The result, therefore, was that the income from lands outside British India, *viz.*, in Indian States—whether falling under clause (*a*) any rent or revenue or (*b*) income derived from cultivation, etc., or (*c*) from occupied buildings—escaped taxation. This defect has been remedied in the present Act under which only income from such land as is either assessed to land revenue *in British India* or subject to a local rate assessed and collected *by officers of Government as such* is exempt from income-tax.

Conditions to be satisfied by the land.—

It will be seen that the definition imposes several conditions. The land must first of all be used for an agricultural purpose. As to what constitutes such purpose, *see* below. The land should also be (1) either assessed to land revenue in British India or (2) subject to a local rate assessed and collected by officers of

Government as such. In practice there is hardly any land which is not assessed to land revenue or local rates, *i.e.*, which escapes both. Even waste lands which are settled are assessed to revenue though up to a certain stage the revenue is remitted. Lands like those of *Col. Malik Sir Umar Hayat Khan* in Shahpur District, Punjab (cited *infra*) are very rare. All that the law requires is, that land revenue should be assessed and not that it should be actually levied and collected, though there is not much practical significance in this distinction.

Local Rates —

The Act does not define 'local rates' and there is no general definition in other statutes in India. There are definitions in English statutes but they are clearly inapplicable to India. A 'rate' as distinguished from a 'tax' is sometimes used to denote a payment for services rendered, but such a distinction is not relevant to the present context. The expression 'local rates' presumably means taxes for the benefit of local authorities, *i.e.*, District Boards, Municipalities, etc., but there is no authority to justify one's defining 'local rates' as meaning rates on account of 'local authorities' as defined in the General Clauses Act. It was argued in the case of *Malik Umar Hayat Khan*[1] that, if a land is not assessed to land revenue but pays irrigation rates to Government, 'local rates' should be construed to include such irrigation rates as well; but the Court did not give a ruling on this point as they threw out the case on different grounds.

The further condition is that such local rates should be assessed and collected by officers of Government as such. A tax, therefore, levied by a municipality which is assessed and collected by its own officers, would not come within the definition. Such land could not escape income-tax unless it was assessed to Land Revenue. On the other hand Road and Educational cesses and cesses for District Boards and District Committees are almost invariably assessed and collected by officers of Government.

What constitutes Agriculture?

There is no definition in the Act of the term 'agriculture,' nor is a simple definition of such a common and comprehensive word possible. The word should, therefore, be interpreted with reference to common usage as well as the general spirit and the tendency of the Act. A provision exempting certain specified items from taxation should, like all remedial legislation, be con-

(1) 2 I. T. C. 52.

strued in as liberal a spirit as possible and income from 'agriculture' should therefore be construed liberally in cases of doubt. It is evidently in this spirit that some of the judicial pronouncements on this point have been made. The ordinary dictionary meanings of agriculture are as below:—

"Farming, horticulture, forestry, butter and cheese making, etc." (Webster.)

"The tillage of the land, the art of cultivating the soil, including the allied pursuits of gathering of the crops and rearing live-stock, also husbandry—farming, in the widest sense." (Murray's Oxford Dictionary.)

There are various definitions of the word in enactments of the United Kingdom as well as in Indian enactments, *e.g.*, Rent Recovery Acts, Estates Tenancy Acts, Agriculturists' Relief Acts; but these definitions are of no help inasmuch as these enactments are not *in pari materia* with the Indian Income-tax Act. In the Agricultural Rates Act (59 and 60 Vict., cap. 16) passed in 1896 for the purpose of exempting the occupiers of agricultural lands in England from paying as high rates on such lands as those levied on buildings and other hereditaments, 'agricultural land' is defined in section 9 as follows :—

The expression "agricultural land" means any land used as arable, meadow or pasture ground only, cottage gardens exceeding one-quarter of an acre, market gardens, nursery grounds, orchards, or allotments, but does not include land occupied together with a house as a park, gardens other than as aforesaid, pleasure grounds or any land kept or preserved mainly or exclusively for purpose of sport or recreation or land used as a race course.

The definitions and rulings in the United Kingdom Income-tax Acts are not of much help. The position in the two countries regarding the taxation of agricultural income is somewhat different. In India the income is exempt from taxation whereas in England it is liable to taxation though under a particular schedule instead of another—with certain incidental differences in favour of agricultural income. In a case under the United Kingdom Excess Profits Duty Acts, *Inland Revenue* v. *Ransom,*[1] Sankey J., said :

"The contention for the Crown is that 'husbandry' means farming. . . . . 'husbandry' is a term of very wide signification and, though I am not prepared to hold that a man who tills and cultivates the soil is, in all circumstances, a husbandman or a man engaged in 'husbandry', I can see no distinction between a man who does so in order to produce food for human consumption and a man who does so in order to produce medicines and herbs, also for human consumption."

(1) (1918) 2 K. B. 709; 12 Tax Cases 21.

In *Duncan Keir* v. *Thomas Gillespie*[1] it was held that the term "husbandry" was not restricted to tillage or cultivation of the soil but included the use of lands for the purpose of grazing sheep.

Per the Lord President.—Confessedly no light is thrown by the Statutes on the meaning of the word " husbandry ". It has no technical or secondary meaning. It must be taken in its ordinary acceptation. What is that? Is it confined to tillage or cultivation . . . . or does it embrace " all farming operations " . . . . For the answer. . . . I rather think we must turn to the dictionary and having regard to the object and the purpose of the statutes we are construing take the widest meaning which is there first put upon the expression. (In) Stormonth's Dictionary . . . . I find ' husbandry ' defined first as " the business of a farmer " and ' husbandman ' as the "man who manages the concerns of the soil" . . . . According to the New English Dictionary ' husbandry ' signifies " the business or occupation of a husbandman or farmer including also the raising of live-stock and poultry." In Murray's Dictionary a like meaning is given to the term. The attempt to confine ' husbandry ' to the ' tillage ' of the soil fails. For ' tillage ' is defined as " the act or practice of preparing land for seed and raising crops." To adopt it . . . . would be to confine husbandry to the raising of crops which are artificial and not natural. ' Husbandry ' has in these days come to have a much more extended meaning than that; but even if turning over the soil to enable a crop to be grown were essential we have it in the cutting of the drains on the sheep farm. ' Husbandry ' as Mr. Justice Kenny. . . .said *In re the Covan Co-operative Society,*[2] " presupposes a connection with land and production of crops or food in some shape " but let me add it shall not pre-suppose the use of artificial means to prepare the land for raising the crops. . . Neither judicial decision nor statutory enactment nor practice throws any light upon it. All that one can say about it is that in common parlance lands devoted to grazing sheep are occupied " for the purposes of husbandry " and that a sheep farmer is in the ordinary acceptation of the term a ' husbandman.'

Per Lord Mackenzie.—It may be that in its origin the word ' husbandman ' meant the man who ploughed and planted as distinguished from the man who owned flocks and herds. No such limited meaning can now be attached to the word.

Per Lord Skerrington.—I think at the present day the primary and natural meaning of the word ' husbandry ' as applied to land includes all those uses of the land which are common to what at the present day we describe as farmers. In short the rearing of sheep and cattle and the production of milk are a familiar and daily duty of the husbandman.

' Husbandry ' is practically the same as ' agriculture ' and the interpretation of the English and Scottish Courts could appa-

(1) 7 Tax Cases 473.
(2) (1917) 2 I. R. 608.

rently be extended to the Indian Income-tax Act without modifications, in so far as the interpretation does not conflict with the definition in the Indian Income-tax Act.

There are various definitions in Indian Tenancy Acts also but they are clearly inapplicable to income-tax because the subject-matter of these Acts is so entirely different from that of the Income-tax Act. The object of these Acts is to secure certain rights for tenants as against the landlords or rather to limit the powers of the landlords as against the tenants, and in many cases the most natural interpretation is to construe words strictly, inasmuch as any other construction would create new rights as against the landlords. Thus in a case under the Madras Estates Lands Act[1] it was decided by the High Court that 'agriculture' does not include pasturage, but it would be obviously improper to apply this interpretation for the purposes of the Income-tax Act also. In fact such an application would, apart from offending against all accepted rules of interpretation, be in such total conflict with the general purport of the Income-tax Act, inasmuch as it would result in inferior pasture lands being subjected to double taxation, *i.e.*, to the payment both of land revenue and of income-tax, while leaving superior lands bearing cereal and other crops to pay only land revenue and nothing else.

In fact, in a case under the Madras District Municipalities Act,[2] the High Court held that pasture land was agricultural and therefore exempt from enhanced rates.

Per Davies and Moore, JJ.—. . . . We have no hesitation in holding that land on which potatoes, grain, vegetables, etc., are grown are lands used solely for agricultural purposes. We do not consider that any distinction can be drawn between large and small plots of lands on which roots or grain are cultivated. All such land must be held to be land used solely for agricultural purposes . . . .

Turning again to the definition of the word "agricultural" which we have accepted we find that agricultural lands include lands set apart as pasture ground only and also lands used for rearing live-stock. If, therefore, it could be shown that these so-called waste lands were in reality pasture grounds or lands used for rearing live-stock, we should certainly decide that they were lands used solely for agricultural purposes. . . .

This decision was evidently given on the principle of liberally construing remedial legislation and is of greater applicability to the Income-tax Act than a decision under the Estates Lands Act.

"The primary meaning of 'agriculture' is the cultivation of the ground; and in its general sense, it is the cultivation of the ground for

(1) *Raja of Venkatagiri v. Ayyappa Reddi*, 38 Mad. 738.
(2) *Emperor v. Alexander Allan*, 25 Mad. 627.

the purpose of procuring vegetables and fruits for the use of man and beast including gardening or horticulture and the raising or feeding of cattle and other stock. Its less general and more ordinary signification is the cultivation with the plough and in large areas in order to raise food for man and beast; or in other words that species of cultivation which is intended to raise grain and other field crops for man and beast. Horticulture, which denotes the cultivation of gardens or orchards, is a species of agriculture in its primary and more general sense—per Bhashyam Aiyangar, J., in *Murugesa Chetti* v. *Chinnathambi Goundan*[1] (in which the question was whether a lease was agricultural).

In *Panadai Pathan* v. *Ramasami*,[2] in which again the same question was raised, the denotation of the word was made wider.

Spencer, J.—" With due deference, while accepting that the case was rightly decided, I am unable to follow the opinion of Bhashyam Aiyangar, J., in *Murugesa Chetti* v. *Chinnathambi Goundan*[1] that the word ' agriculture ' in its more general sense comprehends the raising of vegetables, fruits and other garden products as food for man and beast, if the learned Judge intended thereby to limit it to the raising of food products. For to so restrict the word would be to exclude flower, indigo, cotton, jute, flax, tobacco and other such cultivation. For the purposes of that particular case, which related to a lease of betel gardens, considering the policy of favouring agriculture, upon finding that they produced a form of food, the connection between agriculture and the production of food may have seemed important, but such a limitation is not supported by the definition of agriculture in the Oxford Dictionary which is : ' the science and art of cultivating the soil, tillage, husbandry, farming (in the widest sense).' This dictionary notes that a meaning restricted to tillage is rare. In Bouvier's Law Dictionary ' agriculture ' is defined as the cultivation of the soil for food products or any other useful or valuable growths of the field or garden.

Shephard, J., who sat with Bhashyam Aiyangar, J., conceded that the earlier decision, *Kunhayan Haji* v. *Mayan*,[3] to which he was a party which decided that the lease of a coffee garden was not an agricultural lease, was wrong.

I am equally unable, with respect, to agree with the narrow definition of Sadasiva Ayyar, J., in *Seshayya* v. *Rajah of Pitapur*,[4] and *Rajah of Venkatagiri* v. *Ayyappareddi*,[5] that agriculture means the raising of annual or periodical grain crop through the operation of ploughing, sowing, etc., though the decision may be perfectly sound so far as they excluded pasture lands from ' ryoti land ' for the purpose of the Madras Estates Land Act.

The learned Judge's definition would exclude sugarcane, indigo, tea, flower, tobacco and betel cultivation from agriculture.

(1) (1901) I. L. R. 24 Mad. 421.
(2) 45 M. 710.
(3) (1894) I. L. R. 17 Mad. 98.
(4) (1916) 3 L. W. 485.
(5) (1915) I. L. R. 38 Mad. 738.

In my opinion agriculture connotes the raising of useful or valuable products which derive nutriment from the soil with the aid of human skill and labour and thus it will include horticulture, arboriculture and sylviculture in all cases where the growth of trees is effected by the expenditure of human care and attention in such operations as those of ploughing, sowing, planting, pruning, manuring, watering, protecting, etc. . . . ."

Obviously ' agriculture ' is not necessarily confined to the cultivation of cereals. While it is not difficult to raise cases on the borderland which could be considered to be both agricultural and not agricultural, it is not so easy to exhaust, by enumeration, the possible agricultural uses to which land can be put. Obviously they must include dairying, poultrying, rearing of live-stock, gathering of wool, etc.; but all such uses could be non-agricultural as well in certain circumstances. Thus dairying with stall-fed cattle in urban areas or poultrying in similar areas cannot be agricultural. But these instances would also be excluded by the very definition of ' agricultural income ' in the Act, which presupposes that the income is derived from *land assessed to Land Revenue*, etc. The profits of a milk-seller who merely purchases from cattle owners and sells the milk, etc., to others are presumably profits from trade as they cannot be brought under any of the clauses in the definitions of ' agricultural income.'

A co-operative society buying milk from its members and selling the butter in the open market, returning the skimmed milk to its members, does not carry on ' husbandry ', though the making of butter by an ordinary farmer on his farm would be ' husbandry '.[1]

Rule 4 of Case III of Schedule D in the United Kingdom Income-tax Act provides for cases of milk and cattle dealers who are charged supplementarily to the charge under Schedule B in certain cases. These conditions give a clue as to when in such cases agriculture becomes trade. The conditions are (1) the man must be a dealer in cattle or a dealer in or a seller of milk; (2) the lands must be insufficient for the keep of the cattle brought on to the lands; and (3) the lands must be so insufficient that the assessable value of the lands affords no just estimate of the profits. All these are ordinarily questions of fact. Condition (3) cannot be applied by analogy in India in face of the definition of agricultural income, but conditions (1) and (2) seem to be applicable.

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(1) *Commissioners of Inland Revenue* v. *Cavan Central Co-operative Society*, 12 Tax Cases 1; (1917) 2 I. R. 594 and 622.

It is fairly clear that income from fisheries,[1 & 3] markets,[1] moorings,[1] ferries,[1] stone quarries,[2] coal, manganese, mica, etc., is not agricultural. The profits from a mela (fair) held on land admittedly agricultural are not agricultural income.[4] Profits from trade in milk are as already stated not 'agricultural income'. Profits from sea fisheries, including pearl and 'chank', and fisheries in public ponds, lakes, etc.,, are not entitled to the exemption at all (even assuming that by any possible straining of words they could be considered 'agricultural') because the 'land' is not assessed to land revenue in British India.

The income derived from honey, whether the deposit is spontaneous or derived from the rearing of bees, is undoubtedly agricultural; and if the land is assessed to land revenue or a local rate, exempt from income-tax.

Grazing Lands—Leased—

The position of income derived from land leased out and used for grazing cattle of other persons than the lessee is not clear. In the United Kingdom it has been decided that such profits constitute profits of 'trade' and not income from 'husbandry.'[5]

In *Donald* v. *Thompson*,[6] the assessee rented certain grass parks outside his farm and utilized them for the grazing of young dairy cattle with which to replenish his farm stock. It was held that the profits from the seasonal occupation of the grazings outside the farm were assessable to income-tax under Schedule D, *i.e.*, as profits from business; and not as agricultural income. The assessee had been assessed in the usual course under Schedule B, *i.e.*, occupation of agricultural land.

Land—Leased or mortgaged—

The land need not be cultivated by the owner himself. It can be leased, in which case the income would still be income from agriculture both to the lessor and to the lessee. If the land is mortgaged, the income will be agricultural income in the hands of the mortgagee if it is a usufructuary mortgage, but not if it is a simple mortgage. In the latter case, of course, the owner

(1) *Maharajadhiraj of Darbhanga* v. *Commissioner of Income-tax* 1 I. T. C. 355 & 410.

(2) *Shiblal Gangaram* v. *Commissioner of Income-tax*, 50 All. 98.

(3) *Emperor* v. *Raja P. C. Barua*, 1 I. T. C. 284.

(4) *Umed Rasul* v. *Anath Bandu*, 28 Cal. 637.

(5) *McKenna* v. *Herlihy*, 7 Tax Cases 620.

(6) 8 Tax Cases 277.

would receive the agricultural income himself while the mortgagee would be merely in receipt of income from money-lending, which would not be differentiated in any way merely because he had a right to attach the property in case the debt was not paid. Where there are intermediary lessees or tenure holders—whatever the nature of interest and whatever the local tenure, zamindary or ryotwari or anything else—the income of all these holders and lessees is clearly agricultural.

Usufructuary mortgages—

In *Commissioner of Income-tax* v. *Subramania Sastrigal,*[1] the Madras High Court held that when a person carrying on money-lending business lends money in the course of such business on the security of lands of which he takes usufructuary mortgage and immediately leases these lands back to the borrowers, the rent of the lands being a definite percentage of the loans given, such rent is not agricultural income. The Allahabad High Court in the cases of *Mukand Sarup and Banwarilal*[2] questioned this view. The scheme of the Act does not distinguish between agricultural income on the one hand and business income on the other, and even if the income was admittedly from business there was nothing to prevent that part of the income which was derived from agriculture being exempt under section 4 (3) (*viii*). The court considered therefore that unless the mortgage was a sham (the consequences of such a mortgage they did not examine) the income was clearly agricultural. In a later case[3] the Madras High Court also have receded from the view originally taken by them, and adopted the line of reasoning adopted by the Allahabad High Court and their conclusion.

Toddy—

Income received from toddy is agricultural when it is received by the actual cultivator, whether owner or lessee, of the land on which the trees grow. If the income is obtained by a person who has not produced the trees from which the toddy is tapped or has not done any agricultural operation whereby the trees have been raised, it is not agricultural income within the meaning of the Act.[4] The *ratio decidendi* was that there can be no lease of trees apart from the land, and in this case the assessee admitted that he had no interest in the land.

(1) 2 I. T. C. 152.
(2) Unreported.
(3) *Ibrahim, etc., Rowther* v. *Commissioner of Income-tax*, unreported.
(4) *Commissioner of Income-tax* v. *Yagappa Nadar*, 105 I. C. 489.

Forest produce—

In the Bill of 1922 it was proposed to tax income from forestry but the Select Committee threw out the proposal and the Government acquiesced in the Committee's recommendation. It is arguable whether the expression 'agriculture' includes forestry. Growing and felling timber on one's own land may be considered agriculture, but no amount of straining can make the felling and marketing of timber grown on another man's land agriculture. In the *Chief Commissioner of Income-tax, Madras* v. *The Zemindar of Singampatti*,[1] the Madras High Court appeared to incline to the view that income from forestry was agricultural. This was, however, *obiter* and not part of the decision. In *Emperor* v. *Raja P. C. Barua*,[2] the Calcutta High Court held that income derived from payments for stacking timber in forest land is not 'agricultural income.' In *Har Prasad* v. *Emperor*,[3] the Lahore High Court held that income derived from land let out for the purpose of stacking timber was not agricultural income. Para. 2 of the Income-tax Manual says "if a land-owner grows on his own land, which is assessed to land revenue, forests or trees and derives income therefrom, he is not liable to income-tax on such income. Persons, however, who take contracts in forests for the cutting down of trees and selling of timber are liable to tax on the profits from such transactions." There is no clear authority in the law for this but it is fair and in accordance with common sense and not inconsistent with the Act. An extract from the Honourable Sir Malcolm Hailey's speech in this connection when the Bill was discussed in the Assembly is reproduced below :—

Sir, I admit the Honourable Member's main point that forests are indispensable to the country, but I am under the necessity of asking him, when he puts forward this amendment, what exactly he means by forestry. We had ourselves in the original Bill intended to include the word 'forestry' but when we came to discuss it, we found it very difficult indeed to arrive at any definite interpretation. If it is intended that a man who grows trees or forests on his own land should not be taxed for any income that he derives from them, then, I say, it is already sufficiently provided for, in section 2 (1) (*a*), which exempts:

'Any rent or revenue derived from land which is used for agricultural purposes.'

We tried, but could not improve on that definition. If, on the other hand, he means that a man who takes a contract in a forest, say in a Native State, and earns an income thereby, should escape from income-tax, then

(1) 1 I. T. C. 181; 45 Mad. 518.
(2) 1 I. T. C. 284.
(3) 1 I. T. C. 417.

I, for one, am not with him. I would point out that if the House accepts his amendment, all such persons, *viz.*, those who take contracts in forests for cutting down and selling the timber would escape assessment. It is for that reason that we ourselves have made no such amendment as he himself has now put forward and we have left the matter to the ordinary operation of the Act. I would add that if this point is not sufficiently clear from the Act, I am prepared to make it perfectly clear by executive instructions that if a land-owner grows on his own land, which is assessed to land revenue, forests or trees and derives income therefrom, he will not be assessed on such income.

Lac, Silk, etc.—

The same principles should presumably apply to *lac* cultivation which is semi-agricultural. Income from *lac* is really a species of income from forestry. The owner of a forest assessed to land revenue would not be taxable in respect of income from the cultivation or collection of *lac* on the trees in the forest. If the forest is let out to an ordinary agriculturist, neither the owner nor the tenant would be taxable. If, on the other hand, the forest is let out to a commercial contractor (as distinguished from a tenant) the owner would not be taxable but the contractor would be. If the owner himself or the tenant introduces processes not ordinarily followed by the cultivator, he would clearly be taxable. Merchants who buy *lac* and manufacture it into *shellac*, etc., are clearly taxable, as such manufacture cannot be considered an agricultural process.

The same principles would apply *mutatis mutandis* to sericulture and other similar pursuits.

Water—Income from—Whether Agricultural—

In *Malik Umar Hayat Khan and others* v. *Commissioner of Income-tax*,[1] a case probably *sui generis*, the assessees who owned certain canals purchased water from Government for which they paid irrigation rates and sold it to certain agriculturists who paid for it in kind by a share of the produce. It was contended on behalf of the assessee (1) that the income was derived from land—either from the land constituting the water-courses or the land of those using the water, the latter giving a share of the produce as rent for the water and (2) that if the income was derived from the land forming the water-courses, that land paid ‘ irrigation ’ rates which, it was contended, should be included in ‘ local rates ’ (the latter not having been defined) and that if the income was held to be derived from the lands of those using the

(1) 2 I. T. C. 52.

water, the latter was assessed to land revenue; (3) that the land constituting the water-courses should be held to be subservient or appurtenant to the lands cultivated with the water purchased and (4) that as the income was dependent upon the crop of the lands cultivated by the purchasers, it should be considered to be income from these lands. The Court held that the income was not derived from land at all but simply from the sale of water and that the fact that the price was paid in kind and not in cash made no difference whatever. They therefore considered that the income was not 'agricultural income,' and the other points raised by the assessee were therefore not considered.

Rent and Revenue—

What the framers of the Act meant by the distinction between 'rent' and 'revenue' is not clear. The words have come in the same form from 1886 and from a practical point of view the distinction is not of importance as both are equally entitled to the exemption.

'Rent' is defined in section 105 of the Transfer of Property Act as 'money, share of the crops, service, or any other thing of value to be rendered periodically or on specified occasions by the tenant to the landlord in consideration of the enjoyment of immoveable property'. The same idea pervades most of the definitions in Indian Tenancy Legislation. Rent implies the idea of a lessor and lessee or landlord and tenant. Revenue on the other hand is a different concept. The definitions in English Acts and in judicial pronouncements in that country hardly help us in distinguishing between the two concepts in this country with its different land revenue history and its totally different framework of land tenures.

The dictionary meaning of 'revenue' is as below:

"the return, yield or profit of any lands, property or other important source of income; that which comes to one as a return from property or possessions, specially of an extensive kind; income from any source specially of an extensive kind; income from any source but specially when large and not directly earned."—Oxford Dictionary.

'Revenue' is ordinarily a word with a wider denotation than 'rent.' The distinction however in the mind of the framers of the Act is probably that 'revenue' is income due to the State and 'rent' the income on account of the user of land due to the landlord. This is the usual distinction which is observed in many land revenue and agrarian enactments in India. The landlord receives 'rent' from his tenants and pays 'revenue' to Government. A person other than Government also can receive revenue but in such cases the Government must have relinquished it in his favour. A jagirdar, for instance, who receives an assignment of revenue from specified lands—whether in ryotwari or zamindary tracts—is evidently the kind of person contemplated by the Act. The Income-tax Manual makes it clear that payment of land revenue to a jagirdar is not assessable to income-tax in the hands of the jagirdar.

Rent or Revenue—What may be included in—

As to what may or may not be included in rent or revenue it was decided by the Calcutta High Court in *Maharaja Birendra Kishore Manikya Bahadur* v. *Secretary of State for India in Council*[1] that: (1) the premium paid for the settlement of waste lands or abandoned holdings may reasonably be regarded as 'rent or revenue' derived from land within the meaning of section 2 (1) (*a*). The argument was that the premium represented the capitalised value of a portion of the rent; and (2) illegal cesses exacted by landlords are not agricultural income and therefore not rent or revenue. The above ruling also decided that premium paid for recognition of a transfer of holding from one tenant to another was not to be considered rent and therefore not 'agricultural income', but the same High Court took a contrary view in a Full Bench decision—*Nawabzadi Meher Bano Khanum and others* v. *Secretary of State*,[2] and this Full Bench ruling was followed in *Maharajadhiraj of Darbhanga* v. *Commissioner of Income-tax*[3] by the Patna High Court.

The following are not agricultural income: (1) Income derived from the use of land for storing purchases of crops by merchants; (2) *Nazar* paid by tenants at the beginning of the Zemindari year known as *punyaha nazar*—a voluntary payment paid on an auspicious day (the Full Bench ruling in *Meher Bano Khanum's* case[2] was distinguished on the ground that fees paid for the recognition of transfer of holidays were virtually commuted payments of rent); (3) *Nazars* paid for the recognition of succession, inheritance, etc., not in connection with the land or tenure held by the tenant.[4]

Rent—Interest on arrears of—

Interest on arrears of rent of land used for agricultural purposes is part of the rent derived from the land and is therefore not liable to income-tax. If, however, the arrears are secured by a bond and are therefore recoverable by a civil suit, such interest is taxable (*vide* paragraph 2, Income-tax Manual).

(1) 1 I. T. C. 67; 48 Cal. 766.
(2) 2 I. T. C. 99; 58 Cal. 34.
(3) Unreported.
(4) *Emperor* v. *Probhat Chandra Barua*, 106 I. C. 353.

Mixed occupations—

There is nothing to prevent an assessee (including of course a corporation) practising more than one trade or having more than one source of income[1] and one of such business might be agricultural. Thus a Tea Company may not only cultivate and raise tea but manufacture it into a state fit for the market by applying processes not applied by the ordinary cultivator. Similarly a sugar refinery may not only have its own sugar plantations but also buy cane as well as crude sugar from other persons and with the assistance of up-to-date machinery on a large scale prepare refined sugar. In the case of the *Bhikanpur Sugar concern*[2] the Patna High Court (Dawson Miller, C. J.) wrote as below :—

"I would answer in the affirmative the question whether the Bhikanpur concern is liable to income-tax in respect to that portion of its produce which is derived from sugarcane grown by its servants and its own land, and in the negative the question whether it is exempted by reason of the provisions contained in section 2 (1) (*b*) (ii) of the Act.... The truth is, in my opinion, that the concern was really acting in a dual capacity. In so far as they were cultivators of sugarcane their operations ceased when they handed over the raw material to their factory branch. In so far as they were manufacturers of refined sugar, they were carrying on a business which required the adoption of manufacturing processes not ordinarily used by cultivators before disposing of their produce in the market...."

In the *Killing Valley Tea Company's* case[3] the Calcutta High Court found as below :—

"The earlier part of the operation when the tea bush is planted and the young green leaf is selected and plucked may well be deemed to be agriculure. But the later part of the process (*i.e.*, the processes in an up-to-date large scale Tea Factory) is really manufacture of tea, and cannot, without violence to language, be described as agriculture."

The taxing of such mixed occupations has always been contemplated. The Act of 1886 provided for such taxation and so did the Act of 1918, but no rules were framed by the Government of India to cover such cases. Tea estates had escaped taxation for a long time on the assumption that the entire operations of tea manufacture were agricultural. It was only after the decision of the Calcutta High Court in the Killing Valley Tea Company, which was a test case put forward by Government, that rules were made for taxing income from Tea Companies.

(1) *Egyptian Hotels, Ltd.* v. *Mitchell*, A. C. 1022 (1915); *I. R.* v. *Ransom*, (1918) 2 K. B. 709; *I. R.* v. *Maxse*, (1919) 1 K. B. 647 (C. A.).

(2) 1 I. T. C. 29.

(3) 1 I. T. C. 54.

Rules 23 and 24 of the Income-tax Rules set out below prescribe the manner in which and the procedure by which profits and gains shall be arrived at in the case of incomes derived in part from agriculture and in part from business and provide for the separation of industrial from agricultural profits in cases where the agricultural raw produce is worked up for the market. *See* also section 59 (2) (*a*) (*i*).

Rule 23. (1) [* * *] In the case of income derived in part from agriculture and in part from business an assessee shall be entitled to deduct from such income the market value of any agricultural produce raised by him or received by him as rent in kind which he has utilized as raw material for the purposes of his business or the sale of receipts of which are included in the accounts of his business. The balance of such income shall be deemed to be income derived from the business and no further deduction shall be made therefrom in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

(2) For the purposes of sub-rule (1) "market value" shall be deemed to be :—

(*a*) where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent in kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the year previous to that in which the assessment is made.

(*b*) where agricultural produce is not ordinarily sold in the market in its raw state, the aggregate of—

(1) the expenses of cultivation;

(2) the land revenue or rent paid for the area in which it was grown; and

(3) such amount as the Income-tax officer finds, having regard to all the circumstances in each case, to represent a reasonable rate of profit on the sale of the produce in question as agricultural produce.

Rule 24. Income derived from the sale of tea grown and manufactured by the seller shall be computed as if it were income derived from business, and 40 per cent. of such income shall be deemed to be income, profits and gains liable to tax.

Rule 23 (1)—

The words "subject to the provisions of rule 24" at the beginning of this rule were cancelled in 1927.

Rule 23 (2)—

Clause (*a*)—The 'average' price may be either the average of the prices at which the produce was sold by the cultivator or of those of the market generally. Presumably it means the latter for *ex hypothesi* the assessee must have used the whole or the greater part of his produce in the manufacture.

Whether the produce is ordinarily sold in the market in its raw state or not, and what is the price at which it is sold are obviously questions of fact. On what basis the price is to be calculated is, however, a question of law.

'Market' is a vague expression, and all that the rule means here is that if, in practice, the produce has a sale value apart from the demand for the business of the assessee in question Rule 23 (2) (*a*) should be applied; otherwise Rule 23 (2) (*b*).

Clause (*b*) of Rule 23 (2) can come into operation only if clause (*a*) cannot be applied. Formerly clause (*b*) (3) was as below :

"such percentage of the aggregate of (1) and (2) as the Board of Inland Revenue may from time to time fix for the class of produce concerned;"

but it had been inoperative as no percentage had been prescribed by the Central Board of Revenue. The change in the form of the rule was made in 1927.

Rule 24—

As regards tea, when the person growing, manufacturing and selling tea has separate purely agricultural income, *e.g.*, from rent or cultivation of land on which tea is not grown, it cannot be taken as his income in calculating the profits of the business. If a tea company grows tea seed for its own use, the growing of tea seed must be included in the general business and 40 per cent. of the profits taxed; but if separate accounts are kept of receipts and expenditure for the growing of seed, the income from so much of the seed as is sold to third parties may be treated as agricultural. Till 1927 only 25 per cent. of the profits of Tea Companies was taxed.

Expenses of Cultivation—Deductibility of—

The Income-tax Manual (para. 2) says :

"Although under section 10 (2) (ix) of the Act the only expenditure that can be allowed to be set against profits is expenditure incurred solely for the purpose of earning the profits or gains taxable in that year, it will only be fair in the case of tea concerns to allow as a charge against profits the whole of the cost of the upkeep, *e.g.*, weeding and draining and the extension of the estates which are not in bearing: no allowance can be made on account of any capital expenditure in connection with the extensions, such as acquisition, clearing and draining of the land, the making of roads or the erection of buildings before the cultivation begins. But when once the cultivation has begun with the completion of the planting, only the cost of the upkeep of such extension should be allowed as a business expense, even although the extension is not in bearing."

Provisions in the English law which are substantially and for this purpose almost identically—the same as in the Indian law have however been differently interpreted.

Estate of a Rubber Company—Upkeep of trees not yielding rubber—Expenditure on—Admissible deduction—

A Rubber Company had an estate, of which in the year in question one-seventh only actually produced rubber, the other six-sevenths being in process of cultivation for the production of rubber, rubber trees not yielding rubber until they are about six years old. Expenditure for superintendence, weeding, etc., was incurred by the company in respect of the whole estate. *Held*, that in arriving at their assessable profits the company were entitled to deduct the expenditure for superintendence, weeding, etc., on the whole estate and not one-seventh of such expenditure only.

Per Lord President.—I think the proposition only needs to be stated to be upset by its own absurdity. Because what does it come to? It would mean this, that if your business is connected with a fruit which is not always ready precisely within the year of assessment you would never be allowed to deduct the necessary expenses without which you could not raise that fruit. This very case, which deals with a class of thing that takes six years to mature before you pluck or tap it, is a very good illustration, but of course without any ingenuity one could multiply cases by the score. Supposing a man conducted a milk business, it really comes to the limits of absurdity to suppose that he would not be allowed to charge for the keep of one of his cows because at a particular time of the year, towards the end of the year of assessment, that cow was not in milk, and therefore the profit which he was going to get from the cow would be outside the year of assessment . . . . the real point is, what are the profits and gains of the business? Now, it is quite true that in arriving at the profits or gains of business you are not entitled, simply because—for what are likely quite prudent reasons—you either consolidate your business by not paying the profit away or enter into new speculations or increase your plant and so on—you are not entitled on that account to say that what was a profit is a profit no more. The most obvious illustration of that is a sum carried to a reserve fund. It would be a perfectly prudent thing to do, but none the less if that sum is carried to a reserve fund out of profit it is still profit, and on that income-tax must be paid. But when you come to think of the expense in this particular case that is incurred for instance in the weeding which is necessary in order that a particular tree should bear rubber, how can it possibly be said that that is not a necessary expense for the rearing of the tree from which alone the profit eventually comes? And the Crown will not really be prejudiced by this, because when the tree comes to bear the whole produce will go to the credit side of the profit and loss account. . . . . *Vallambrosa Rubber Co., Ltd.* v. *Farmer.*[1]

Rubber—

Income from rubber cultivation is now treated as agricultural income even though in some cases it is possible that the methods adopted in preparing the raw material for the market are not exactly those ordinarily employed by a cultivator. But the general position in all such cases of mixed occupations is that it is a question of fact how much of the income is agriculture and therefore exempt from income-tax and how much from business. In the absence of a rule specifying a percentage of profits to be taxed as in the case of tea, the profits should be worked out in each case in accordance with Rule 23. See the *Bhikanpur Sugar Concern*[2] and the *Killing Valley Tea Cases*[3] *already* cited.

Salt Pans—

In *Commissioner of Income-tax v. Lingareddi*,[4] the Madras High Court held that the process of flooding land by letting in sea water, and then extracting sodium chloride by the elimination of other constituents, was not an agricultural purpose.

Sporting rights—

In India this is not of consequence but such income from sporting rights as may exist will presumably not be considered to be ' agricultural income '. In the United Kingdom the value of sporting rights is charged on lands under Schedules A and B but it seems fairly clear that ' husbandry ' does not include the leasing of ' sporting rights '. The charge in the United Kingdom under these two schedules is not on agricultural lands only.

Stallion—

In the United Kingdom fees derived from a stallion kept on a farm by serving *outside* mares were considered to be separate source of income from the farm.[5] The principle of this decision will presumably apply to India also.

(1) 5 Tax Cases 535.
(2) 1 I. T. C. 29.
(3) 1 I. T. C. 54.
(4) 50 Mad. 763.
(5) *Malcolm* v. *Lockhart*, 7 Tax Cases 90; *McLaughlin* v. *Mrs. Blanche Bailey*, 7 Tax Cases 508.

Horse-breeding—Racing—Stallion—Letting out of—Whether separate enterprises or one—

The assessee owned a racing establishment and a breeding stud at which he raised and trained a number of mares. He also bred several stallions which were first tested in the race course and then sent to the stud where they served the assessee's mares and were also let out to serve other mares. In order to prevent interbreeding the assessee also sometimes hired other stallions to serve his mares. The Commissioners found that the letting out of the stallions was a separate business and chargeable as a 'Trade.' *Held*, that there was evidence on which the Commissioners could arrive at the finding. In this case the assessee paid tax under Schedule B for the lands occupied by the stud.[1]

Poultry farming—

A poultry farm occupied 33 acres of land on which poultry were raised and a few sheep grazed. Most of the food for the poultry was brought from outside. Only half an acre of the land was cultivated for green food for winter feeding. The farm buildings served as incubating rooms and for storing food. *Held*, that having regard to the facts in this case the poultry farming was 'husbandry.'

Per the Lord President.—"I think it may be extracted from (the previous decisions) that lands are properly said to be occupied for 'husbandry' if the trade or business carried on by the occupier depends to a material extent on the industrial or commercial use of the fruits (natural or artificial) of the lands so occupied. I say 'to a material extent' because it is notorious that there are many agricultural farms in this country which depend to a large extent upon imported foodstuffs which are not and could not be produced on the lands of such farms."

Per Lord Cullen.—"The case is not one of a space having the character of a mere poultry yard used for housing and for artificial feeding and affording exercise to poultry but is one where the poultry derive sustenance to a material extent from the produce of the ground."[2]

A poultry farmer occupied three acres of grass land on which he raised the poultry and grazed a couple of cows in summer and four sheep in winter. No part of the land was cultivated and the entire food for the poultry was brought from outside. It was argued by the Crown that the profits from the sale of the poultry and eggs were derived from a trade or business. *Held* by Rowlatt J. that the grass land on which the poultry were kept was used for husbandry. *Lean and Dickson* v. *Ball*[2] *followed*.

(1) *Earl of Derby* v. *Bassom*, 5 A. T. C. 260; 42 T. L. R. 380.

(2) *Lean and Dickson* v. *Ball*, 5 A. T. C. 7.

"It seems to me that he is using the land as land.... The stock is not all kept in the same place in a yard and the mess cleared away; he moves them from place to place; they live to some extent upon the herbage and upon insects and other produce of the soil. He moves them about, the herbage springs up and the cow comes and eats it and so he works this little bit of land...."[1]

Processes applied ordinarily by cultivators—

The test is whether the process employed to render the produce fit to be taken to the market is a process ordinarily employed by a cultivator or receiver of rent-in-kind. This is essentially a question of fact, depending on the locality, the crop, the magnitude of the holding, the organisation adopted, etc. Like all questions of degree this question is beset with baffling border-land cases. Thus the husking of paddy is an agricultural operation, so is the preparation of *gur* or brown sugar, but not sugar refining or the milling of paddy. (See *In re Bhikanpur Sugar Concern*[2] already cited). Similarly the cultivation and plucking of the tea plant is an agricultural operation but the manufacture of the leaves into a state fit for consumption, with the aid of up-to-date appliances on a large scale is not such an operation. *In re Killing Valley Tea Company*[3] already cited).

The word 'cultivator' means the person who 'cultivates,' *i.e.*, applies the process of agriculture. He need not cultivate with his own hands, but may hire others to do so, and the expression includes a firm or company. (See *Killing Valley Company and Bhikanpur cases* cited above).

Buildings—

Agricultural buildings are exempt from taxation only if (1) they are on or in the immediate vicinity of the land and (2) the receiver of rent or revenue or the cultivator, etc., requires as a dwelling house, store house or other out-building and (3) so requires it because of his connection with the land. All these three conditions should be satisfied.

Immediate Vicinity—

There are no decisions as to what constitutes "immediate vicinity." The expression obviously means such reasonably close vicinity that the building may be taken as a part of the land. Thus a Zemindar's house in the middle of the village would perhaps be excluded while the ryot's hut close to the land would be included.

(1) *Jones* v. *Nuttall*, 5 A. T. C. 229.
(2) 1 I. T. C. 29.
(3) 1 I. T. C. 54.

Connection with land—

Nor is there any decision as to what is "connection with the land." A Zemindar's house in the immediate vicinity of the land would presumably not be taxable if he lived there and supervised the cultivation or held his cutchery, but not if, say, he was an absentee nor had a cutchery. The test is whether the house is necessary for the earning of the exempt income. Note the word 'requires.'

In Maharajadhiraj of Darbhanga v. *Commissioner of Income-tax*,[1] the Patna High Court ruled that a guest house which was really part of the landlord's dwelling house but built separately owing to custom was not taxable, the dwelling house itself being exempt from tax.

(2) "assessee" means a person by whom Income-tax is payable ;

Assessee—

Income-tax can become *payable* only after the liability to pay has been determined by the Income-tax Officer under section 23. Before such assessment, the person is not an assessee. The fact that the Income-tax Officer had wrongly determined the liability would not make the person any the less an 'assessee.' See section 30. Every person as defined in section 2 (2) and General Clauses Act, section 3 (39), can be an 'assessee.' Under the latter 'person' includes any company or association or body of individuals whether incorporated or not.

In some sections, *e. g.*, section 24, section 64, the word has not been used in the strict sense of the definition. Even in sections 7 to 16, the word is not used in the strict sense. It is only after computing a person's income that his liability to tax can be determined.

A person declared not liable to tax is not an 'assessee'—see notes under section 30. In *Govind Saran* v. *Commissioner of Income-tax*[2], the Chief Court of Lucknow suggested that if the representative of a deceased person's estate was an assessee for the purpose of liability to pay, he was also an assessee for the purpose of claiming a refund.

Income-tax includes super-tax. See section 55, which defines super-tax as an 'additional duty of income-tax' and also section 58 which lays down which sections of the Act do not apply to super-tax.

(1) Unreported.
(2) Set out under section 66.

History—

In the 1886 Act there was no definition of 'assessee.' In the 1918 Act the definition of 'assessee' was "a person by whom income-tax is payable and includes a firm and a Hindu undivided family." In the 1922 Act it was proposed to expand this so as to include a partnership also but the Select Committee considered that the proper place to lay down liability, etc., was the charging section (section 3) and dropped the latter part of the definition altogether.

Liability to tax of different kinds of assessees—

As regards the liability to tax see sections 3 and 55—the charging sections for Income-tax and Super-tax respectively. Under section 3 income-tax is payable by every individual, Hindu undivided family, company, firm and other association of individuals. Under section 55 super-tax is payable by every individual, Hindu undivided family, company, unregistered firm or other association of individuals not being a registered firm. The only distinction between the two sections is in regard to 'firm.' All firms whether registered or not are liable to pay income-tax, but unregistered firms alone are liable to super-tax. The profits of registered firms are charged to super-tax in the hands of the partners if they are personally liable. As regards the distinction between a registered firm and an unregistered firm, see section 2 (14).

Firms—Partners of—

As to how far a firm is a separate assessee from its partners see the remarks of Schwabe, C. J., in *Commissioner of Income-tax v. M. Ar. Arunachalam Chetti*[1] in which he discussed the position of partners of firms with reference to claims to 'set-off' under section 24.

(3) "Assistant Commissioner" means a person appointed to be an Assistant Commissioner of Income-tax under section 5;

See notes under section 5 as to how Assistant Commissioners are appointed, their duties and powers under the Act, etc.

(4) "business" includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture;

The definition of 'Business' was first introduced in the Act of 1918. In the Act of 1886 incomes from this head fell under

(1) 1 I. T. C. 278.

Part III—profits of Joint Stock Companies or Part IV—other income as the case may be.

The definition of 'business' in the Indian law is a little wider than the corresponding definition of 'trade' in the English law, in which the word 'business' has not been used. 'Trade' has been defined in the English Income-tax Act, 1918, as "*including* every trade, manufacture, adventure or concern in the nature of trade."

'Includes'—The question whether this word means merely 'includes' or "means and includes" has been discussed but not decided. In the *Royal Calcutta Turf Club* v. *Secretary of State*[1] it was argued on behalf of the Crown that the definition was *not* exhaustive but the point was not decided. Attention was drawn to other definitions in the Act in which the word "means" was used when an exhaustive definition was contemplated. The case was one under the Excess Profits Duty Act but the definition of 'business' in that Act was identical with the definition in the present Income-tax Act.

'Business' has a more extensive meaning than the word 'trade;'[2] but ordinarily speaking 'business' is synonymous with 'trade.'[3] In *Smith* v. *Anderson*,[4] Jessel M. R. after citing definitions of 'business' from several dictionaries said "anything which occupies the time and attention and labour of a man *for the purpose of profit* is business." Further on he remarks:—

"There are many things which in common colloquial English would not be called a business when carried on by a single person, which would be so called when carried on by a number of persons. For instance a man, who is the owner of a house divided into several floors, if used for commercial purposes, *e.g.*, offices, would not be said to carry on a business because he let the offices as such. But suppose a company was formed for the purpose of buying a building or leasing a house to be divided into offices and to be let out—should we not say if that was the object of the company that the company was carrying on business for the purpose of letting offices? The same observation may be made as regards a single individual buying or selling land with this additon that he may make it a business and then it is a question of continuity. When you come to an association or company formed for a purpose, you will say at once that it is a business because there you have that from which you would infer continuity. So in the ordinary case of investments a man who has money to invest, the object being to obtain his income, invests his money and he may occasionally sell the investments and buy others but he is not carrying on a business." (Stroud)

(1) 1 I. T. C. 108; 48 Cal 844.
(2) *Harris* v. *Amery*, 35 L. J. C. P. 92; L. R. 1 C. P. 148.
(3) *Delany* v. *Delany*, 15 L. R. I. V. 67.
(4) 50 L. J. Ch. 43; 15 Ch. D. 258.

(This portion of the decision was not affected though it was reversed on appeal; but the above decision was given with reference to the English Companies Act and not for income-tax purposes). But there may be a business without pecuniary profit being at all contemplated. In this sense 'business' is a much larger word than 'trade.'[1] The keeping of a lodging house, for instance, would be a 'business.' A covenant not to permit the carrying on of any 'trade' or 'business' was held to be broken by allowing the premises to be used as an out-patients branch of a hospital.[2] In interpreting a restrictive covenant it was held that a Boys' school[3] constituted a 'business.' But this aspect of the definition does not very much affect Income-tax law which is concerned only with such 'business' as yields profits. A Council of Law Reporting, for instance, carried on if not 'trade' certainly 'business.'[4] On the other hand there may be a sequence of acts from which profit is anticipated without a 'business' being constituted. Thus, where a Barrister occupying a house and 79 acres of land as a private residence, which he had originally taken for pleasure, used some of the land for breeding cattle and horses and raising vegetables, fruits and flowers which he sold and he also occasionally bought and sold cattle and horses it was held on the evidence that he did not carry on 'business.'[5] (This decision, however, was given under the Bankruptcy Act). But there may be a business without any sequence of acts for "if an isolated transaction, which if repeated would be a transaction in a business, is proved to have been undertaken with the intent that it should be the part of several transactions in the carrying on of a business, then it is a first transaction in an existing business."[6] (This again was decided under the Bankruptcy Act). *In re Kaladan Suratee Bazaar*[7] a decision under the Excess Profits Duty Act, the Rangoon Chief Court held that a registered limited company owning house property consisting of stalls and tenements let out for rents and distributing the rents collected as dividends to its shareholders was not carrying on a business within the meaning of section 2 of the Excess Profits Duty Act.

But an important point to be remembered in distinguishing 'business' for income-tax purposes from 'business' for other purposes, *e.g.*, under the Partnership or Bankruptcy Acts, is that

(1) *Rolls* v. *Miller*, 53 L. J. Ch. 101.
(2) *Bramwell* v. *Lacy*, 10 Ch. D. 591.
(3) *Kemp* v. *Sober*, 20 L. J. Ch. 602.
(4) 58 L. J. Q. B. 90.
(5) Re *Wallis Exp. Sully*, 14 Q. B. D. 950.
(6) Re *Giffin*, 60 L. J. Q. B. 235.
(7) 1 I. T. C. 50.

under the Income-tax Act 'business' does not include a profession; a partnership is possible between two or more professional persons but such a partnership would not be treated as a 'business' under the Income-tax Act, though under the Contract Act such partnership would be a 'business.'

Trade—

'Trade' in its largest sense is the business of selling, with a view to profit, goods which the trader has either manufactured or himself purchased.—Per Lord Davey in *Grainger* v. *Gough.*[1]

Buying in itself does not constitute a 'trade.' Unless the selling also is taken into account there are no profits.—See *per Lord Watson, ibid.*

"I do not think there is any principle of law which lays down what carrying on trade is. There are a multitude of things which together make up the carrying on of a trade but I know of no one distinguishing incident which makes a practice a carrying on of trade and another practice not a carrying on a trade. If I may use the expression, it is a compound fact made up of a variety of incidents."—Per the M. of R. Jessel in *Erichsen* v. *Last.*[2]

"When a person habitually does and contracts to do a thing capable of producing profit and for the purpose of producing profit he carries on a trade or 'business.'"—Per Cotton L. J., *ibid*, quoted with approval by Esher M. R. in *Werle* v. *Colquhoun.*[3]

Obviously no man can trade with himself and it follows therefore that several persons whose interest in a transaction are identical cannot be held to 'trade' among themselves, *e.g.*, members of mutual societies, etc., in respect of transactions among themselves.[4]

'*Commerce*' is "traffic, trade or merchandise in buying and selling of goods." (Stroud.)

'*Manufacture*'—No mere philosophical or abstract principle can answer to the word 'manufacture.' Something of a corporal and substantial nature, something that can be made by man from the matters subject to his art and skill, or at the least some new mode of employing practically his art and skill, is required to satisfy the word.[5] (Stroud.)

"To work up (material) into forms suitable for use"—(Murray's New English Dictionary). "The operation of reducing raw materials into a form suitable for use by more or less complicated processes"—(Annandale's Concise English Dictionary). "To make from raw materials by any means into a form suitable for use"—(Chamber's Twentieth Century Dictionary).

(1) (1896) A. C. 345; 3 Tax Cases 462.
(2) 4 Tax Cases 422.
(3) 2 Tax Cases 402.
(4) *Dublin Corporation* v. *McAdam*, 2 Tax Cases 387.
(5) *Vf. Gibson* v. *Brand*, 4 M. & G. 109; 11 L. J. C. P. 177.

Manufacture can perhaps be easily distinguished from Trade and Commerce, but it is difficult to distinguish *inter se* between the latter. But the distinction is of no consequence as the definition of ' business ' includes both and there is no provision in the Act under which it is necessary to distinguish between the two. It is absolutely immaterial whether a business is 'trade' or ' commerce.'

'Adventure or concern in the nature of trade, commerce or manufacture'—

These words are used to bring into the net transactions of a somewhat doubtful nature. The word ' adventure ' connotes the idea or ' risk ', however remote, which almost every transaction made for profit bears. The word ' concern ' implies a certain element of continuity. The essential features *in the nature* of trade, commerce or manufacture are (1) an element of profit—involving buying and selling, (2) such profit ordinarily being the purpose of the transaction, and (3) a certain degree of continuity—actual or possible. These are the criteria by which income from business is ordinarily distinguished from casual receipts. See notes under section 3 (distinction between Capital and Income) and under section 4 (3) (vii) (casual receipts not arising from a business). But all the features need not exist in every case.

"In the nature of Trade, etc."—

In *Liverpool* and *London and Globe Insurance Company* v. *Bennet*[1] it was held that the word ' in the nature of trade ' used in the definition qualified only ' concern ' and not ' adventure '; therefore the entire business of an Insurance Company was its ' adventure ', though a part of its business was that of making investments as an ancillary to its main business. This question arose with reference to the question whether the company should be taxed in the United Kingdom on the whole of its profits wherever arising. The same question cannot arise under the Indian law but the principle of the above decision is evidently applicable to India also. In the case of Insurance Companies special rules have been made in this country—*see* Rules 25 to 35, but in the case of other businesses the question may arise for the purpose of determining the liability to tax of profits when brought into the country under section 4 (2), whether interest from investments abroad is profits from ' business '.

(1) (1913) A. C. 610.

Destination of profits—Not relevant—

Whether an adventure or concern is a business or not is not affected by how its profits are ultimately disposed of. See *Trustees of Psalms and Hymns* v. *Whitwell*[1]; *Religious Tract and Book Society* v. *Forbes*[2]; *Grove* v. *Y. M. C. A.*[3]; *Mersey Docks* v. *Lucas*[4]; *Coman* v. *Governors of Rotunda Hospital and others*,[5] set out under section 3 which show that the destination of profits or the motive with which the profits are made is immaterial.

Trade or no trade—Difficulty of defining—

It is not possible to lay down definite lines to mark out what is a business or trade or adventure and to define the distinctive characteristics of each; nor is it necessary or wise to do so. The facts in each case may be very different and it is the facts that establish the nature of the enterprise embarked upon.—Per the M. of R. Pollock in *Martin* v. *Lowry*.[6]

Taking into account the ordinary occupation of the appellant, the subject-matter of his purchase and sale, the method adopted for disposal, the number of operations and the period occupied, there is ample evidence to support the findings of the Commissioners that the appellant carried on a trade.—*Per Atkin, L. J., ibid.*

A series of retail purchases followed by one bulk sale or a single bulk purchase followed by a series of retail sales may well constitute a trade.—*Per Sargant, L. J., ibid.*

It is possible that, while each independent transaction may not by itself constitute a trade, *i.e.*, other persons sharing in the profits will not be liable to tax on the ground that the profits were casual, the transactions taken together may constitute a trade. Thus a person, who bought, liquidated and reconstructed a number of companies, the persons working with him and sharing the profits being different in each transaction, was held to carry on a trade, though the other persons were not so held.[7]

See also the decisions set out under section 3 (capital receipts) and section 4 (3) (vii) (casual profits).

Advances—In course of business, trade or investment—

A company in the course of a wool-broking business, granted temporary advances on the security of second mortgages, or on wool and produce. The advances fluctuated in amount as the produce was realised. *Held*, that the interest from the advances was profits of a trade and not interest from investments even though some of them were secured by real property.

(1) 3 Tax Cases 7.
(2) 3 Tax Cases 415.
(3) 4 Tax Cases 613.
(4) 1 Tax Cases 385; 2 Tax Cases 25.
(5) 7 Tax Cases 517.
(6) 5 A. T. C. 11.
(7) *Pickford* v. *Quirke*, 6 A. T. C. 525.

Per the Lord President.—" It appears to me that the sort of trade in which they are engaged is partly the trade of a broker, and partly the trade of a banker . . . . it seems to me to be not at all of the nature of investments of money. On the contrary, the advances are of the most irregular and fluctuating description. . . . . I think this is proper trading and nothing else, and not investment of money upon securities."

Scottish Mortgage Company v. McKelvie[1] and *Smiles* v. *Northern Investment Company*,[2] distinguished. *Smiles* v. *Australasian Mortgage and Agency Company, Limited.*[3]

The importance of the above decision lies in the fact that under the English law profits of a trade carried on by a resident are taxed in the United Kingdom wherever the profits may accrue or arise, whereas interest from investments is taxed only to the extent that such profits are brought into England. This question of course will not arise under the Indian law, but the principle of the above decision will equally apply when, for instance, it has to be determined with reference to section 4 (2) whether the profits brought into British India are profits from business or not.

Liquidator—Steam power—Supply of—By—

A trustee liquidating an insolvent firm of spinners continued to supply steam power at a profit to the lessees and others. It was contended that as he did not carry on any other part of the firm's business and that as the supply of power was being made in order to assist in the realisation of the assets to the best advantage, the profits were not from a ' trade ' but an accidental result from the liquidation of a previously existing loss. *Held*, that the supply of power was a ' trade ' and the profit therefrom taxable. *Armitage* v. *Moore.*[4]

House Property—Profits from—

A company invested its capital in house property and kept an office and a staff of collectors for the collection of rents and for letting out the property. *Held*, that it was not carrying on ' business '. A company holding house property and distributing rents as dividends to its shareholders is not carrying on ' business ' for though it is an association for acquiring gain, its method is passive by owning property and not active by carrying on business. *In re Kaiadan Suratee Bazaar Coy.*[5] The above decision was given under the Excess Profits Duty Act, section 2, of which defined ' business ' in exactly the same way as the present

(1) 2 Tax Cases 165.
(2) 2 Tax Cases 177.
(3) 2 Tax Cases 367.
(4) 4 Tax Cases 199.
(5) 1 I. T. C. 50.

Income-tax Act. But under the Income-tax Act the profits are taxable as income from 'property'—*see* notes under section 9.

Inventor—Director—Company promoter—Whether carrying on business—

An assessee had for many years been an inventor and had been granted nearly four hundred patents. Of these he had only sold one, and that was twenty-five years before the period of assessment in question. He was managing director of a company which worked some of his patents and paid him a fixed salary and commission dependent on results; and he was also managing director of, and principal shareholder in, another company of which he was the promoter and which paid him royalties on non-exclusive licences in respect of some of his patents granted by him to the company. He was also a director of several other manufacturing companies. *Held*, that he was not carrying on a trade or business (a case under the Excess Profits Duty Act).

Per Rowlatt, J.—. . . . The (assessee) is managing director of a company : that is not, nor is being a shareholder, carrying on a business. He is also an owner of royalties. That again is not carrying on business. But those are the whole sources of his income. It is true that he is adding to his royalties, and he is performing his duties of managing director of the company and it may be very advantageous that he has those positions —that he has that particular form of property and is creating more, but I do not think those matters can be added together and that it can be said, in what I cannot help describing as a loose way, "Look at the general position". I think the (assessee's) position must be dissected and what his income is really derived from must be ascertained. In my judgment it is derived from those three distinct sources, and he is not, in respect of each or all of them put together, deriving this royalty income from a business. . . .

It is said that if a person habitually invents, or habitually paints pictures or habitually writes books, with a view to gain from the patents when he has taken them out, the books which he has written and the pictures which he has painted, that is carrying on a business, and I feel a little difficulty about it. Very possibly if a person habitually paints a number of pictures year after year and sells them, it would be said that he was carrying on a business. He might be a professional man, but that is another matter. If he was writing books habitually year after year and carrying on a business, I suppose he would be assessable under Schedule D in respect of it. If he was inventing patentable devices year after year and selling them and gaining an income, it would be difficult perhaps to say that he was not carrying on a business—I do not know whether that could be said—and if he kept on developing land and selling year after year he would be carrying on a business. On the other hand (Counsel for assessee) asks, "Supposing he has land and keeps on building on it and never sells it at all but has rent from the houses that he builds, is he carrying on a business?" One cannot help feeling that the answer to that question must be "No," because he is merely investing his money in new property and keeping it; he is not dealing with it in any way.

Now the (assessee) does not sell his patents. He sold one twenty-five years ago, but it is quite clear that that is not the way in which he deals with the produce of his inventive ability. He simply keeps on inventing things and keeping the patent in his own hands, making what he can out of it by granting licences, just as a man builds a house and makes something out of it by letting it. Of course a painter cannot, as things are, do otherwise than sell his pictures. An author is more like an inventor, because he can grant licences under royalties.

It seems to me that the true position is that, unless it can be shown that the property called into existence by the invention, or by the painting, is sold so as to obtain a money return against it, no evidence is produced that the inventor or the artist is carrying on a business. If the artist or the inventor sells the product of his ability, in many cases inquiry would have to be made whether he does so habitually as to bring him within the category of persons who carry on a business, but if he does not sell at all I do not think there is any evidence in support of the contention that he carries on a business.

It is said, for the Crown, that by granting these licences the (assessee) is putting his patent on the market. So he is, but so is the man who builds a house and lets it. It seems to me that carrying on a business involves, in a case like this, the disposal of the article which is produced as opposed to retaining it as a valuable thing in itself which can be treated as an investment, just as anything bought with the money obtained for it if it had been sold could be treated as an investment. On those grounds I think that the (assessee) cannot be regarded as carrying on a business.

I think it better not to say anything upon the question whether if I had held he was carrying on a business, I should have held that his business was a profession. . . . . *Inland Revenue Commissioners* v. *Sangster.*[1]

Business—Motive of—Immaterial—

Per Lord Coleridge, C. J.—"It is not essential to the carrying on of a trade that the persons engaged in it should make, or desire to make, a profit by it."

Per Manisty, J.—"If the Council in the present case make a profit, they are liable to pay income-tax upon it." *Commissioners of Inland Revenue* v. *Incorporated Council of Law Reporting.*[2]

Business—One or many—Fact—

Whether a business is one or many is a question of fact.[3] On this may depend important issues, *e.g.*, whether particular

(1) (1920) 1 K. B. 587; 12 Tax Cases 208.

(2) 3 Tax Cases 105.

(3) *Birt, Potter and Hughes* v. *Commissioners of Inland Revenue*, 6 A. T. C. 237; 12 Tax Cases 976.

profits arise from business or otherwise (very important when profits arise from isolated transactions of a speculative nature or from mere appreciation of capital) questions of succession and discontinuance, all of which are questions of fact. As to the multiplicity of businesses being a question of fact, see *Gloucester Railway Carriage Coy.* v. *Commissioners of Inland Revenue.*[1]

In *Farrell* v. *Sunderland Steamship Company*[2] it was held that ordinarily a whole ship was a separate trade from that of another ship in which the company owned only a share. As already stated, however, such questions are primarily questions of fact.

Business—Question of fact—

As to the extent to which the existence of a ' business ' is a question of fact and how the Income-tax Officers should give their findings, see per *Justice Rowlatt in Mellor* v. *Commissioners of Inland Revenue,*[3] quoted below :

" The question is whether the profits made by the financial operation in regard to these two mills and the stock was a profit of his stock-broker's business. Now, it does not appear that he is found to be a stock dealer. That is the first difficulty. In paragraph 2 it is stated that he bought shares sometimes not knowing whether he would sell them again, and not having an immediate purchaser for them, and that he sometimes resold them if he found a purchaser, and he kept them if he did not, and so on. It does not state whether he was doing that as a stock dealer or whether he was doing that as any person with a fancy for playing with investments might do. It does not appear that he sold them as a stock-broker to his clients, or that he sold them in any market where he operated as a stock dealer. It is quite vague. It is only thrown in as a sort of argument; it is thrown in argumentatively, and I do not find that there is any finding in this case that he really was a stock dealer. That question is not faced.

" Then, further, I do not think there is any finding that these profits or gains were the profits or gains of the business assessed, which is called stock-broking. One of the contentions set out is that the business ought to be dissected, and these profits ought to be separated from the stock-broker's business. That is certainly an argument. How is it dealt with? There are really only three findings in the case. One is that it is not an isolated transaction; the second is that it is not an investment; and, third, that it is done for the purpose of gain.

"Now the Attorney-General says that reading that with the form of the assessment and the contentions, the result is that the Commissioners have found that the profits were those of a stock-broking business. But I do not think so. It seems to me that the tribunal in a case like

(1) (1925) A. C. 469; 12 Tax Cases 720.
(2) 4 Tax Cases 605.
(3) 3 A. T. C. 659.

this must be made to find the very fact in dispute; they must find that it is part of the stock-broker's business.

"Now, if this gentleman had dealt in furniture or in pigs or in horses outside his business, all these questions would have been answered in precisely the same way. The argument would have been that it is not part of the stock-broker's business and ought to be dissected. That argument is stated here. The Commissioners find that it is not an isolated transaction. That would be also true in the other case. They also find that it is done for the purpose of gain. That is also true. They also find that it is not an investment. That is also true. But that is all that is found in this case.

"It seems to me it would be very dangerous indeed to allow tribunals, whether they are Income-tax Commissioners or juries or anybody else, not to face the real issue, but to find a person liable upon a series of conclusions upon matters of argument which throw light upon the question, and then, merely because they have found for one side, to say that they necessarily must have found all the things to which they ought to have addressed their minds, the question being whether they did do so or not.

"I think the case must go back to the Commissioners to say whether or not in terms these profits were the profits of the stock-broking business. . . . ."

"The question of what is the business of the company is, apparently, a pure question of fact and the matter is one which is for the revenue authorities and the revenue authorities alone.—Per Robinson, C. J. in *Ahlone Land Company* v. *Secretary of State for India.*[1]"

In the above case it was conceded on behalf of the Assessee Company that the whole question turned upon what was the business of the company and that if it was the buying and selling of land, the company would be liable to tax.[2]

The most extreme exposition of this principle that the carrying on of a business is a question of fact was in *Edwards* v. *Old Bushmills Distillery Coy.*[3] In this case a company went into liquidation in August, 1920. In order to sell the business as a going concern the liquidator continued distilling but on a reduced scale. The distillery was put up for sale in March, 1921, but was not sold as no purchasers offered. For the year ending 5th April, 1921, the liquidator, *i.e.*, the company, was assessed to income-tax. The Special Commissioners upheld the assessment but the Recorder of Belfast cancelled it on the ground that the receipts were capital received in the course of winding up. For the year

(1) 1 I. T. C. 167.

(2) See also *Currie* v. *Inland Revenue Commissioners*, (1921) 2 K. B. 332 and *Cape Brandy Syndicate* v. *Inland Revenue Commissioners*, 1 A. T. C. 298, which were followed in the above case and are set out under sections 66 and 4 (3) (vii), *infra*.

(3) 10 Tax Cases 285.

ending 5th April, 1922, the company was again assessed to income-tax. The company appealed and the Special Commissioners cancelled the assessment as they felt bound by the decision of the Recorder. The Crown appealed and it was finally decided by the House of Lords (approving the decisions of the Court of Appeal and the K. B. Division for Northern Ireland) that the case should be sent back to the Commissioners to find on the facts, independently of the Recorder's decision for 1920-21, whether a business had been carried on in 1921-22. It is somewhat difficult to understand why the Recorder's decision was considered not to involve a point of law. The position would of course have been totally different if the liquidator had abandoned his idea of selling the distillery as a going concern. In that case all that he would have been doing would have been the beneficial disposal of the assets in the course of closing the business down; and his receipts would undoubtedly have been capital receipts.

Person—More than one business—Carrying on—

There is nothing to prevent a person carrying on more than one business or exercising more than one profession.[1] See also the cases under Mixed Occupations under Agricultural Income, *supra*, section 2 (1).

Consulting Engineer—Fees—When treated as income from business —

The assessee was a skilled engineer who acted both as consulting engineer and as an inventor. As a consulting engineer he advised his clients to instal new machinery the orders for which were placed through him. In supplying his clients with the machinery he charged them an inclusive price which covered three items, *viz.*, (1) a merchant's profit to himself for getting the machinery, (2) an engineer's fee for his advice, and (3) he also arranged that machinery under his patents was to some extent provided. He claimed that deductions should be made on account of item (2) in assessing him to Excess Profits Duty on the ground that they were not profits from business. *Held* by the Court of Appeal that the assessee was not carrying on a profession but was carrying on a merchant's business in which he brought his professional skill to bear. *Commissioners of Inland Revenue* v. *Marx.*[2]

Though this was an Excess Profits Duty case, the principle of the decision is of general application. Income in such cases should be assessed as income from business (section 10) and not as professional earnings (section 11).

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(1) *Commissioners of Inland Revenue* v. *Maxse* (Magazine Editor and Proprietor), (1919) 1 K. B. 647; *Inland Revenue* v. *Ransom* (growing herbs and manufacturing chemicals), (1918) 2 K. B. 709; *Egyptian Hotels, Ltd.* v. *Mitchell*, (1915) A. C. 1022.

(2) 4 A. T. C. 467.

See also following Excess Profits Duty cases as to what is ' business '.

Barker & Sons v. *Inland Revenue* (Stock-broker);[1] *Burt* v. *Inland Revenue* (Commission Agent);[2] *Wm. Espleen, Ltd.* v. *Inland Revenue* (Company working as naval-Architects);[3] *Smeeton* v. *A. G.* (Advising Enginner);[4] *Robbins* v. *Inland Revenue* (General Sales Manager);[5] *Currie* v. *Inland Revenue* (Income-tax Repayment Agent).[6]

A company cannot exercise a profession—See *Wm. Espleen, Ltd.* v. *Inland Revenue* cited above, and *Commissioners of Inland Revenue* v. *Peter McIntyre, Ltd.*[7]

Executors—Carrying on business—Whether taxable—

Executors may not trade as a general rule but

"....They may do certain things which are, from other points of view, trading without offending against the prohibition that they may not trade; that is to say, they may trade to the extent of winding up the business they find left to them by the testator."—*Per Rowlatt, J.*[8]

But it was held by the Court of Appeal on the particular facts of the case that there was no trade.

Per the M. of R. :—" It seems to me that the evidence shows that the executors only dealt with the business, only handled the business for the purpose of securing the proper advantage to the estate of the testator. . . . . . Of course it is largely a question of degree as to whether or not a business is being carried on by the executors for their own purposes or not."[8]

Beneficiaries interest—Receipt of shares of a company in exchange—Company doing 'business' and not an executor or trustee—

A company was formed for administering property in which a number of beneficiaries under a will were interested. Each beneficiary assigned his interest in the estate to the company receiving shares in exchange. A good part of the estate was under lease to collieries; and this was the principal income of the company. The company claimed that it was only an executor or trustee for the beneficiaries under the will and was not doing ' business ' but was in effect a landowner. The Special Commissioners and the High Court accepted this claim; but the Court of Appeal unanimously rejected it.

(1) (1919) 2 K. B. 222.
(2) *Ibid.*, 650.
(3) *Ibid.*, 731.
(4) (1920) 1 Ch. 85.
(5) (1920) 2 K. B. 677.
(6) (1921) 2 K. B. 332.
(7) 12 Tax Cases 1006.
(8) *The Executors of E. A. Cohan* v. *Commissioners of Inland Revenue*, 12 Tax Cases 602.

"The company has become the absolute legal and beneficial owner of the estates and no relation of trustee and *cestui que trust* exists between it and the beneficiaries. They are relegated to the ordinary position and rights of shareholders . . . and there is no time-limit whatever to the activities of the company."[1]—*Per Sargant, L. J.*

This decision will evidently apply to India also. A company of this sort would be taxed under section 10 instead of under section 12; and if its income was agricultural, such income would of course be exempt under section 4 (3) (viii).

Mutual Trading Societies—Transaction with members—Surplus from —Whether liable—

A company limited by guarantee carried on insurance business (other than life insurance). The number of members was unlimited. Each insurant became *ipso facto* a member during the period of contract. Each member paid an entrance fee and the Directors set aside and invested reserve funds and could call on the members for the general expenses. The sums in which members were insured could be increased or decreased according to the risk involved by the policy—so as to lead to equitable contributions from each. It was held (with reference to Corporation Profits Tax) by Rowlatt, J., following *New York Life Insurance Company* v. *Styles*[2] & *Commissioners of Inland Revenue* v. *Eccentric Club*,[3] that the company was not carrying on trade or business. But this was upset by the Court of Appeal on the following grounds:—(1) The House of Lords' decision in the *New York Life Insurance Company case* decided only whether such profits are taxable—not whether the company was carrying on a trade. The speeches of Lords Watson and Bramwell in so far as they say that the company did not trade, are only *obiter dicta*; (2) section 53 (2) (*h*) of the Act imposing Corporation Profits Tax explicitly says that profits in the case of mutual trading societies shall include the surplus arising from transactions with members; (3) in the *Arthur Average Association case*[4] and *Padstow Total Loss and Collision Assurance Association*,[5] the Court of Appeal held (though under the Companies Acts) that a mutual association could do 'business'; (4) the *Eccentric Club case* was determined with reference to the peculiar features of a Social Club. On appeal the House of Lords confirmed the decision of the Court of Appeal. *Cornish Mutual Assurance Company* v. *Commissioners of Inland Revenue*.[6]

(1) *Commissioners of Inland Revenue* v. *Westleigh Estates*, 3 A. T. C. 17.
(2) 2 Tax Cases 460.
(3) (1920) 1 K. B. 390.
(4) 10 Chancery Division 542.
(5) 20 Chancery Division 137.
(6) 5 A. T. C. 82.

In the absence of a provision corresponding to section 53 (2) (*h*) of the United Kingdom Act of 1920, this decision cannot apply either to the Indian Super-tax or Income-tax. But the decision is important as giving rise to the possibility of there being a 'trade' or 'business' even though such 'trade' or 'business' may not make taxable profits.

Royalties, annuities or dividends—Receiving and Distributing—

In *Commissioners of Inland Revenue* v. *Marine Steam Turbine Co.*,[1] it was held by the High Court that a company doing nothing else than merely receiving royalties which were in effect payments by instalments of the price of the property sold, and distributing dividends to shareholders out of such royalties, is not doing 'business.' But this decision was overruled in the *Korean Syndicate case*,[2] in which a company, one of whose purposes *inter alia* was to acquire and work concessions, acquired a mining concession and without working the mine itself leased it to another company, receiving in return a percentage of profits as royalty; it was held by the Court of Appeal that the first company carried on 'business.' The House of Lords approved of the principle laid down by the Court of Appeal in the *Korean Syndicate case*[2] in the following case.

A company was formed in 1895 to acquire and carry on a railway under a contract with the Government of India. In 1906 the company sold the whole undertaking to the Government in return for an annual payment of £30,000 or a payment of a certain sum if and when Government determined the arrangement.

Per L. C. Cave:—"It is true....that its pricipal and only function at the present moment is to receive and distribute the fruits of its undertaking; but that is a part, and a material part, of the purpose for which it came into existence."

Per Lord Sumner.—"To ascertain the business of a limited liability company one must look first at its memorandum and see for what business that provides and whether its objects are still being pursued.—*Korean Syndicate Case.*[2] The important thing is that the old business still continues of getting some return for capital embarked in the line. . . . . . Business is not confined to being busy; in many businesses long intervals of inactivity occur."—*South Behar Railway Company* v. *Commissioners of Inland Revenue.*[3]

Investment by a Shipping Company— Business —

A Shipping Company one of whose objects was "to invest and deal with the moneys of the company not immediately re-

(1) (1920) 1 K. B. 193; 12 Tax Cases 174.
(2) (1921) 3 K. B. 258; 12 Tax Cases 181.
(3) (1925) A. C. 476; 12 Tax Cases 657.

quired upon such securities, etc. . . . ." had five ships on the date of outbreak of the War. One of these ships was sold, three sunk and one detained by the enemy. The insurance money and the sale proceeds received on account of the ships were invested. *Held*, that the company was carrying on a ' business.' (*Corporation Profits Tax Case*) *Commissioners of Inland Revenue* v. *Dale Steamship Company.*[1]

Rents received by a company—When treated as income from business—

A company was formed in 1899, its objects being, among other things, to acquire and take over the assets and liabilities of the proprietors of the Theatre Royal, Birmingham. The old proprietors were a joint stock company, who were landowners only and did not work the theatre but had merely received the rents. The new company, on the other hand, acquired the Theatre Royal and other properties subject to an existing lease. Later on, the theatre was rebuilt. During the several years under appeal, the whole of the real estate belonging to the company was let to five tenants under leases, the period of which was in no case less than eighty-nine years. The income of the company consisted of the rents payable under the leases and of interest and dividends on investments. The company contended that it did not carry on a ' trade ' or ' business '. *Held*, that the company was carrying on a trade or business within the principle laid down by the Court of Appeal in *Commissioners of Inland Revenue* v. *Korean Syndicate, Ltd.*

Per Mr. Justice Rowlatt.—Now the question arises whether the company was carrying on business. Undoubtedly it was, it was enjoying the turning to account of the property which it was formed, among other things, to turn to account, but the form in which its revenue came in was the comfortable form of simply receiving rents.

What I should like to have known, of course, was this: If my way of looking at the facts had not been questioned at all would it then have been said that it is quite enough to make a company carry on business if it is simply receiving rents which it had arranged for in the course of turning to account the property it has to turn to account. I very much wish that the Court of Appeal in the *Korean Syndicate Case*[2] could have seen their way to say that if they meant to say it. I do not think Lord Justice Younger meant to say it, nor has anybody said, as far as I can see, that the mere fact that it is a company carrying on something, makes that something a business, when it would not have been a business if a private person had been carrying it on. Nobody has gone the length of saying that, but it is obvious from what the Master of the Rolls said

(1) 12 Tax Cases 712.

(2) (1921) 3 K. B. 258; 12 Tax Cases 181.

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. In the present case I think the inclination of my mind on the whole is in favour of the Crown, because it seems to me that looking at what the company were incorporated to do, they applied themselves to that and they were fairly active in the early years in arranging their property, and during those years they enjoyed it and there is nothing more for them to do; but they have not gone out of their business and been left merely with the rents to collect. One can understand that a company might have had a large factory or something of the kind which ceased to manufacture, but here they had property left in their hands and they continued to draw rents and so on. One might say in that case that they were not carrying on business, but as you are to look at the fact that they are a company, and as you are to look at the objects with which they were incorporated, if you find that the only object was to deal with this property, and they are only to deal with that property, although it happens at the moment that all they have to do is to receive the rents for the next 90 years unless they sell the reversion, then I think it is more within the spirit of the decision of the Court of Appeal to say that they are carrying on business even if I think that they were not. The case is very near the line and of some difficulty, but that is the best conclusion to which I can come, therefore I must give judgment for the Crown here.—*Commissioners of Inland Revenue v. Birmingham Theatre Royal Estate Company, Ltd.*[1]

Company—Business of—

It is more difficult to decide in what circumstances the activities of an individual amount to the carrying on of a trade or business than in what circumstances the activities of a company would similarly amount to the carrying of a trade or business. So far as a company is concerned, an important piece of evidence is its Memorandum and Articles of Association which set out the objects of the company, whereas in the case of an individual a similar piece of evidence is not ordinarily available. A chartered company however (as distinguished from an Incorporated Company) stands on a peculiar footing. A chartered company may do any business that is not specifically prohibited by its charter.

The distinction between a company and an individual in this respect, *viz.*, as to the circumstances in which a particular activity may be a business if conducted by a company whereas if conducted by an individual it would not be a business was set out in *Smith* v. *Anderson*[2] (a case under Company Law). But this distinction was hardly emphasized—in fact it had been lost sight of—in various cases under the Income-tax Acts for quite

(1) 12 Tax Cases 580.
(2) 15 Ch. D. 247.

a long time until it came to prominence comparatively recently in *Commissioners of Inland Revenue* v. *Korean Syndicate, Ltd.*[1] In that case the Court of Appeal reaffirmed the principles set out in *Smith* v. *Anderson*. In the *South Behar Railway case* the House of Lords confirmed the views of the Court of Appeal in the *Korean Syndicate case*. It is probable that if an individual had done what the South Behar Company did, he would not be held to be carrying on a 'trade' or 'business'. In this case as the company's memorandum showed a commercial object the company was held to carry on a trade, because, no matter how passive or quiescent its activities were, it could not be denied that it was functioning with the object set out in its Memorandum in view.

It is arguable whether a company can do more businesses than one, that business being the business set out in the Memorandum and the Articles. That is to say, while a company may have different activities, it could have only one business. But most Revenue decisions (chiefly Excess Profits Duty cases) proceed on the assumption that, at any rate for the purpose of the Taxing Acts, there is nothing to prevent a company's having more than one business.

[2] [(4-A) "The Central Board of Revenue" means the Central Board of Revenue constituted under the Central Board of Revenue Act, 1924 ;]

Its functions under the Act are regulated by section 2 (6) —power to declare a foreign association to be a company; section 2 (11) (*b*)—power to define 'previous year' in certain cases and to delegate such power; section 5 (5)—power to appoint Commissioners, Assistant Commissioners and Income-tax Officers for specified persons, areas or classes of income; section 18 (6)—power to direct to whom tax deducted at source should be paid; section 59—to make rules; and section 64 (3)—to determine the place of assessment when the Commissioners are not in agreement.

(5) "Commissioner" means a person appointed to be a Commissioner of Income-tax under section 5.

See notes under section 5.

(6) "Company" means a company as defined in the Indian Companies Act, 1913, or formed in pursuance of

(1) (1921) 3 K. B. 258; 12 Tax Cases 181.

(2) This clause was inserted by the Central Board of Revenue Act (IV of 1924). Formerly the functions of the Central Board of Revenue under this Act were performed by the Board of Inland Revenue.

an Act of Parliament or of Royal Charter or Letters Patent, or of an Act of the Legislature of a British possession, and includes any foreign association carrying on business in British India whether incorporated or not, and whether its principal place of business is situate in British India or not, which the *Central Board of Revenue*,[1] may, by general or special order, declare to be a company for the purposes of this Act ;

History—

The present definition of company was introduced in the 1918 Act. The definition in the 1886 Act was: " An association carrying on business in British India whose stock or funds is or are divided into shares and transferable whether the company is incorporated or not and whether its principal place of business is situate in India or not."

Companies without shares—

The object of introducing the present definition in 1918 apparently was (1) to confine the definition only to such associations as are incorporated unless they are foreign and (2) to expand the definition so as to include companies other than those doing ' business '; but a probably unintended result is that even companies which have no shares—and are limited by guarantee—are ' companies ' for the purpose of the Income-tax Act. The general framework of the Act (see sections 14 and 48) with its provision for refunds clearly contemplates companies with shares but the explicit definition of ' company ' as ' a company defined in the Indian Companies Act, 1913 . . . .' leaves one no option except to construe ' company ' as including companies without shares.

Company—

The following is the definition given in the Indian Companies Act. " A company formed and registered under this Act or an existing company." It is not intended to summarise here the provisions of the Indian Companies Act but the following important features of the Act may be mentioned.

Any seven or more persons may form themselves into a public company, and any two or more persons may form themselves into a private company (section 5). A ' private company ' is defined as one that by its articles restricts the right to trans-

(1) Amended by the Central Board of Revenue Act, 1924.

for its shares, and limits the number of its shareholders (exclusive of its own employees) to fifty, and prohibits any invitation to the public to subscribe for its shares or debentures (section 2, sub-section 13). Every company, association or partnership formed for the purpose of carrying on business for the acquisition of gain, and consisting of more than twenty persons, must be registered as a company, unless it is formed in pursuance of an Act of Parliament or of the Governor-General in Council, or of a Royal Charter or Letters Patent (section 4, sub-section 2), while if the business to be carried on is banking it must be so registered (subject to the same exceptions) if it consists of more than 10 persons (*ibid.*, sub-section 1).

Either class, public or private, might be limited or unlimited in liability; and various obligations are imposed on companies, *e.g.*, the necessity of filing memoranda and articles of association, the maintenance of proper accounts, the preparation of annual balance-sheets and the audit of the balance-sheet by a duly appointed auditor and the liability to inspection and audit by Government in certain circumstances. Some of these obligations however differ in private and public companies.

The rules about incorporation of companies in other parts of the British Empire differ but if a company has been duly incorporated in accordance with the local laws in those parts, it is a 'company' for the purposes of the Income-tax Act, no matter what the motives of incorporation were.

Foreign buiness associations—

The object of the last part of the section is to include associations, such as the French Societies Anonymes, which, though incorporate bodies, have many characteristics in common with the companies recognised by Indian law. But the Central Board of Revenue can make the declaration only if the association is (1) foreign, *i.e.*, not belonging to the British Empire and (2) it carries on business in British India. Companies of the other classes mentioned in the earlier part of the definition need not necessarily carry on 'business'.

Company—How taxed—

A company is assessed to income-tax on its profits at the maximum rate and the tax is levied even if the profits are less than Rs. 2,000. This is done under the Finance Act. The shareholder, however, is entitled to relief under section 48 in respect of the dividends received by him. The shareholder is not taxed again in respect of the dividends (section 14). The assessment of the company's profits does not depend on the profits distributed. It is based on profits as computed under section 10. The point to be emphasized is that the company is not an agent for the purposes of income-tax acting on behalf of the shareholder. No shareholder has a right to have a dividend declared; and it is only after a dividend has been declared that the dividends become his income.[1] The company is assessable *as a company* on its profits. It is conceivable that the assessable profits may be *nil* while the company may distribute profits from reserves or some other source. Nevertheless the shareholder can get refund of income-tax under section 48.

Company not agent of shareholder—

The position of the company in this respect as already stated is *not* that of principal and agent. By a specific section (section 14) the shareholder is absolved from the liability to pay tax again on the dividends that he has received from the company. In the long run, of course, the dividends distributed must have paid tax if not in the year of distribution, at least in previous years. For a detailed discussion of this question, *see* notes under sections 14 and 48.

Super-tax—

As regards Super-tax, companies pay a flat rate of Super-tax on their profits in excess of Rs. 50,000. This again is regulated by the Finance Act. This tax is in no sense paid on behalf of the shareholder; nor is a refund allowed to the shareholder as in the case of income-tax. As already stated the Income-tax Law does not recognise any agency on the part of the company on behalf of the shareholder, except to the extent that it has indirectly countenanced such agency in sections 14 and 48. See *Maharajadhiraj of Darbhanga* v. *Commissioner of Income-tax, Bihar and Orissa*,[2] cited under section14.

Company Super-tax and Corporation Profits tax—

The super-tax on companies really corresponds to the Corporation Profits Tax in other countries, but with this difference —the Corporation Profits Tax is allowed elsewhere as a deduction from profits for assessment to income-tax whereas the Indian Company super-tax is not. It will be seen that the shareholders in a company are in a worse position than partners in a registered firm. The former have to pay an additional super-tax through the company, though in other respects they are more or less in the same position. Objection has, therefore, been raised to the tax on the ground that it handicaps joint stock concerns; on the other hand the arguments in favour of the tax are that incorpo-

(1) *Commissioners of Inland Revenue* v. *Blott*, 8 Tax Cases 101.
(2) 1 I. T. C. 303; 3 Patna 470.

ration as such confers certain advantages which might be legitimately taxed. These advantages are:—

(1) the possibility of limiting liability,
(2) corporate finance,
(3) freedom of transferring or selling shares,
(4) publicity, audit, etc.
(5) rights of shareholders to enforce liquidation.

It must always be a matter of opinion how far these advantages justify the additional taxation; and sharply opposed views have been held on the subject. In the United Kingdom the Corporation Profits Tax was given up in 1924; but in the United States of America—where the tax was, in fact, anterior to the ordinary personal income-tax—the tax has undergone several transformations and still exists, though partly concealed by certain provisions in the law.

Company and partnership—Difference between—

The principal points of difference between a partnership and a company are the following :—

(*a*) The individual members of a partnership are collectively entitled to the property of the partnership but the property of the company belongs to the company as such and not to the shareholders—*Re George Newman and Co.*[1]

(*b*) The creditors of a firm can proceed against the property of the partners but the creditor of a company can proceed only against the company as such.[2]

(*c*) Unlike a member of a firm a shareholder cannot dispose of the property of the company or incur liabilities on behalf of the company. A shareholder can contract with his company whereas a partner cannot contract with his firm.

All these differences flow out of the fundamental principle that a company is a separate person apart from the shareholders while a firm is not a separate person apart from the partners.

The distinction between a firm or partnership and a company has also been put in another way. A partnership is an arrangement between definite individuals bound together by a contract while a company is so to speak a constantly changing partnership or succession of partnerships.[3] But this cannot be taken to define a 'company' which should fulfil the conditions imposed by the definition in the Income-tax Act before it can be

(1) (1895) 1 Ch. 674.
(2) *Flitcroft's case*, 21 Ch. D. 533.
(3) *Smith* v. *Anderson*, 15 Ch. D. 273.

treated as such for taxing purposes, as there is a clear definition clause in the Act.

Company—Separate entity—

Upon the issue of the certificate of incorporation a company becomes a body corporate—see section 24 of the Indian Companies Act. As already stated it is not like a partnership or family, a mere collection or aggregation of individuals but a separate legal person entirely distinct from the shareholders—a metaphysical entity (as has been described by Palmer), a fiction of law with no physical existence.

'One man'—Companies—Not invalid—

The law does not prescribe any minimum shares to be held by a shareholder nor a maximum. An 'one-man' company therefore is not forbidden by law.

"The statute enacts nothing as to the extent or degree of interest which may be held by each of the seven, or as to the proportion of interest, or influence, possessed by one or the majority of the shareholders over the others."[1] "It was said in the present case that six shareholders other than the appellant were mere dummies, his nominees, and held shares in trust for him. I will assume this was so. In my opinion it makes no difference."[2]

"There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should take a substantial interest in the undertaking or that they should have a mind and will of their own as one of the learned judges seemed to think or that there should be anything like a balance of power in the constitution of a company."[3]

The facts of the above case are as below: Salomon, a leather merchant and the owner of a profitable business, converted his business into a private company. He was perfectly solvent at the time. Of the shares he took 20,000 and his wife and children a share each. Salomon also received debentures to the amount of £10,000 in part payment by the company for the business. Later on, the company went into liquidation and the validity of these debentures was challenged on the ground that the company was a sham. The Court of first instance held that Salomon was bound to pay the unsecured creditors of the company out of his own pocket even though his shares had been fully paid up. This decision was confirmed by the Court of Appeal but on a slightly different ground, *viz.*, the whole scheme

(1) Per L. C. Halsbury in *Salomon* v. *Salomon and Co.*, (1897) A. C. 22.
(2) *Per Lord Herschell, ibid.*
(3) *Per Lord Macnaghten, ibid.*

was a fraud on the law which required substantial shareholders and not mere dummies. This decision was unanimously reversed by the House of Lords who held that there was not a syllable in the law which required the seven shareholders to be beneficially or substantially interested.

The ordinary reason for which a man forms his business into a company is that he may have the advantage of the trading of the company by holding a greater part of the shares and receiving a greater part of the profits in dividends as they are distributed; while at the same time he need not be personally liable on the contracts which are made to earn the profits. That this is a perfectly legitimate object was decided by the House of Lords in the case of *Salomon* v. *Salomon*[1] quoted above.

Incorporation cannot be challenged—

If a certificate of incorporation had been obtained fraudulently that may be a ground for the persons interested to get the certificate cancelled but so long as the certificate is in force it is valid as against the world. The income-tax authorities could not in any case refuse to recognise as a company a 'company' that had actually been registered under the Indian Companies Act; seeing that the definition of 'company' in section 2, sub-section 6 of the Indian Income-tax Act begins 'company means a company as defined in the Indian Companies Act, 1913', *i.e.*, 'a company formed and registered under' the latter Act. (Section 2, sub-section 2, Act VII of 1913.)

Company—Doing business of other persons—

"There may be a position such as that although there is a legal entity within the case of *Salomon* v. *Salomon*[1] that legal entity may be acting as the agent for another person or it is conceivable that although there be a legal entity that legal entity may really be doing the business of somebody else and not its own business at all."[2]

On what profits the company should be taxed is always a question of fact. If a company actually does the business of other persons including companies it is for the Income-tax Department to determine whether and how far in fact the business of the other persons or companies is done by the company. Merely because a company is a properly constituted company under the Indian Companies Act it does not follow that nobody else can be made liable for taxation in respect of the business of that company or *vice versa*. It must all depend on the circumstances of each case. At the same time a company that has

(1) (1897) A. C. 22.

(2) Per M. R. Sterndale in *Commissioners of Inland Revenue* v. *Sansom*, 8 Tax Cases 22.

actually been registered under the Companies Act must be recognised by the Income-tax Officer as a company. He cannot ignore the existence of the company as such. It is, however, quite a different matter whether the company should be taxed in respect of its own profits only or also of the profits of the business of some other company or person which in fact it carries on. In this connection see *Apthorpe* v. *Peter Schoenhofen Brewing Co.*;[1] *St. Louis Breweries* v. *Apthorpe*;[2] *United States Brewing Co.* v. *Apthorpe*;[3] *Gramophone and Typewriter Co., Ltd.* v. *Stanley*;[4] *Commissioners of Inland Revenue* v. *John Sansom*.[5] The Income-tax Officer can examine the genuineness of one-man companies and tax shareholders on the basis of the true nature of transactions, *e.g.*, when dividends are disguised as loans, the Income-tax Officer can tax the shareholder—see *In re Sir D. M. Petit*.[6]

Super-tax—Evasion of—Provisions against—

The absence of liability to super-tax in England on the part of companies has led to the formation of 'one-man' companies merely in order to evade such super-tax. The detailed devices adopted are many. As a check against such evasion provision was made in section 21 of the Finance Act of 1922 enabling the Revenue to tax a reasonable part of the actual income of the company. These powers were found inadequate and considerably widened in 1927. At the present moment there is a Bill before the Legislature in India intended *inter alia* to secure similar checks against evasion by the formation of one-man companies.

(7) "Income-tax Officer" means a person appointed to be an Income-tax Officer under section 5.

See notes under section 5.

(8) "Magistrate" means a Presidency Magistrate or a Magistrate of the first class, or a Magistrate of the second class specially empowered by the Local Government to try offences against this Act.

Magistrate—

The words "specially empowered by the Local Government to try offences against this Act" were introduced in 1918,

(1) 4 Tax Cases 41.
(2) 4 Tax Cases 111.
(3) 4 Tax Cases 17.
(4) 5 Tax Cases 358.
(5) 8 Tax Cases 20.
(6) 2 I. T. C. 255.

in response to non-official opinion. As the Income-tax Act came to be applied with greater strictness it was desired that offences should not be tried by magistrates of insufficient experience or standing.

(9) "Person" includes a Hindu undivided family.

Person—

In the 1886 Act ' person ' was defined as including a firm and a Hindu undivided family. The definition was given up in the 1918 Act as being covered by the definition in the General Clauses Act. Nor did the Bill as introduced in 1922 contain a definition. The Select Committee added the present definition so as to make the position clear though it was not necessary. See also the notes under " Assessee ". As to what is a Hindu undivided family see below. As to whether a person includes an ' infant ' see notes under section 40—*R.* v. *Newmarket Commissioners* (*exp. Huxley*).[1]

Hindu Undivided Family—

For the purposes of the income-tax law it is only necessary to consider what constitutes a Hindu undivided family and what kind of property and income belong to such a family as distinguished from its individual members. No definition of a Hindu undivided family has been attempted in the Act nor is a simple definition possible. The law on the subject is governed by various sacred books of the Hindu, commentaries on and digests of these books, by custom and by rulings of Civil Courts, including the Judicial Committee of the Privy Council. The essential feature about a Hindu undivided family is that it is a coparcenary, or tenancy in common, but such coparcenary or tenancy arises by law among certain relatives of stated degrees including relations by adoption and cannot be created by voluntary contract among strangers or relatives not of the stated degree.

Family—Unit for income-tax—

The important point is that the Hindu undivided family is regarded as a single unit for income-tax purposes, being represented by its manager with whom alone the income-tax authorities are concerned in assessing the income of the family.

Schools of Hindu Law—

Broadly speaking there are two schools of Hindu law : the Dayabhaga and the Mitakshara—the former prevailing in the greater part of Bengal and the latter in the rest of India. Under

(1) 7 Tax Cases 49.

the former system the father of a family is the absolute master of the family property, subject however to the liability of maintaining the sons, etc., and his position is practically that of an individual not belonging to a Hindu undivided family. The younger members of the family have no right either to partition the property or, what follows, to alienate it. All that the sons receive is maintenance. For the purpose of income-tax these younger members who so receive maintenance from the father should be treated as receiving such maintenance *qua* members of a Hindu undivided family. That is, the tax cannot be levied once from the father and again from the sons. The sons have no claim to definite shares or amounts on account of maintenance; and the amounts paid on account of or spent on such maintenance cannot be deducted from the income of the father before he is taxed. It is not the father personally that the law attempts to tax but the family as a whole.

If the father of a Dayabhaga family dies and the sons partition the estate, the position is, of course, clear—each sharer is to be treated as an individual not belonging to the Hindu undivided family. On the other hand the sons or heirs may decide not to partition the estate but to enjoy it in common. In such a case even though the shares of the members under the Dayabhaga law are clearly defined, as the law stands, the different persons should, apparently, be treated as individuals belonging to a Hindu undivided family, *i.e.*, the income received from the joint estate should not be added on to the other income of the individuals for the purpose of income-tax.

It is not, however, in Dayabhaga families that the Hindu undivided family presents so difficult problems for the Income-tax Officer. Under the Mitakshara law which prevails in by far the greater part of India, every male member of the family gets a right in the family property as soon as he is born. The position of the managing member of the family, who is usually the eldest male member, is very much like that of a trustee in relation to his *cestui que trust*. The family which may conceivably include several generations, but in practice seldom exceeds two or three, should be treated as one unit for the purpose of income-tax unless it is partitioned.

As stated by Mayne (Hindu Law, 9th Edition, paragraph 269) a Hindu joint family includes not only those members who form a coparcenary in the sense that they can claim partition of the joint family property but also those members who are merely entitled to maintenance. At one period, a step-mother was entitled, under Hindu Law, to claim a share of the joint family property at partition (Mayne's Hindu Law, paragraphs 477 and 479 (2) and Gour's Hindu Code, page 696, paragraph 1553). In some provinces, a step-mother can still claim such a share.[1] Though this right is not now recognised in all provinces, it has been held even where that right is not recognised that her claim to maintenance is in lieu of her former right to a share.[2]

Whether the actual facts of to-day correspond to the law or not, the law assumes that the normal status of a Hindu undivided family is one of jointness in residence and estate. The presumption in law, therefore, is that a Hindu family is undivided and it is for the person claiming any advantage for the purpose of tax to prove the contrary. The law also presumes that property once joint continues as such until the contrary is proved. Other presumptions are that property acquired by or in possession of a joint member is joint property, and that the property acquired with the nucleus of joint property is joint unless the acquirer has been separated from the family. All these presumptions, however, apply only in the case of male members of the family. If the property belongs to a female member, the position is different as will be seen in what follows about ' stridhanam '.

A partition can be effected in several ways : by decree of a Court, by a Deed of Partition (which under the Registration Act must be registered if it involves immovable property over Rs. 100 in value) by a Deed of Release from a member relinquishing his right to the joint property, by an agreement—oral or written—among the members to remain separate or even a formal declaration by one member that he will remain separate, by actually remaining separate for 12 years and by the conversion of a member to an alien faith.

The family may be partitioned but not the properties, which may be managed and shared in common. The important thing is the status of the family and not whether actually the property has been divided or not. At the same time a family cannot be joint if the property has been divided. Even if the property remains joint, if the family is divided in status the acquisition of the members is individual and not joint property. It is also open to a family to arrange to enjoy a portion of the family property jointly but in specific shares and the arrangement at once becomes a voluntary contract outside Hindu law and is no longer subject to the incidents of Hindu family coparcenership. There is also nothing to prevent a member of a

(1) I. L. R. 38 All. 83.
(2) I. L. R. 38 Mad. 153.

Hindu undivided family from earning on his own account without putting the earnings into the common stock, but once he puts it into the common stock it becomes the family property and not his own.

Partition—Questions of fact and law—

It will be seen from the foregoing that the law merely lays down various presumptions which, of course, can always be rebutted by stronger evidence to the contrary, *e.g.*, the partition might be a mere ruse for hoodwinking creditors and in fact the family might continue to be joint. The essential thing to remember is that it is always primarily a question of *fact* whether a Hindu family is divided or not, and under the Income-tax Act it is entirely for the Income-tax Officer to decide questions of fact and not for the Civil Courts. So long, therefore, as the Income-tax Officer does not misunderstand the law or act without reasonable grounds, the probability is that the High Court will not interfere with the conclusions, that is to say, so long as the Income-tax Officer does not commit an error of law the High Court cannot interfere with the finding.

Stridhanam—

A difficult matter in Hindu undivided families from the point of view of the Income-tax Officer is ' Stridhanam ', *i.e.*, property belonging to a female and subject to special laws. Under the Hindu law a woman, whether married or not, has absolute right over her own property in certain cases. Presents from parents or from the husband, and property, which she has acquired for herself out of the above kinds of property, are all her own absolute property and the family has no claim of any sort upon it. If she gives a portion of her income to others, such payments are gifts pure and simple and should be treated as such by the Income-tax Officer. The right of inheritance of Stridhanam is also peculiar. It is from mother to daughter. Under the Hindu law, a woman may also have a life estate in a property; but it makes no difference for the purpose of income-tax whether a person's interest is only a life interest or not, since what has to be taxed is only the income. A Hindu lady may have to maintain other members, in which case such maintenance cannot be charged again as the income of those maintained.

Benami—

It is not uncommon, for Hindu undivided families —especially trading ones—to transfer *benami*, *i.e.*, fictitiously, the property of the family to one of the female members but actually keeping it as the family property. Cases of this type involve difficult questions of fact, but, all the same, questions of fact which are entirely for the Income-tax Officer to decide. There is no presumption that a property standing in the name of a Hindu female who is a member of a joint family belongs to the family and is not her Stridhanam. The burden of proof lies upon the person who asserts that the apparent is not the real state of things.[1] If all the persons concerned agree that the family is divided, the Income-tax Officer must concede that at that point of time when they so agree the family is divided,[2] unless, of course, the Income-tax Officer has clear evidence to prove that the agreed partition is *benami*.

Maintenance charges—

If the property is impartible and the junior members have a right of maintenance, it is arguable that the proper course is to tax the owner of the property on his net income after deducting the maintenance distributed. On the other hand it can well happen that such maintenance is only a personal obligation of the owner and not a charge on the property. Once, however, it is conceded that it is a charge on the income it would be in accordance with the general spirit of the Act to allow this item to be deducted from that of the owner of the estate. In the hands of the recipient of the maintenance, the amount would of course be taxable. It could not be claimed at the same time that an impartible family is both divided and impartible. Generally speaking, however, except in an impartible family, payments on account of maintenance cannot be deducted from the income of the joint family for the purpose of assessment to income-tax. As regards impartible families for the purpose of super-tax, see *Raja Shiva Prasad Singh* v. *Rex*.[3]

Trading Families—

The most important class of Hindu undivided family from the standpoint of the Income-tax Collector is, undoubtedly, the Hindu undivided family trading firm. Though there is nothing to prevent such a family having income under salaries, interest and securities, property or professional earnings, yet in practice these categories of income are not likely to be as important as income from business, especially if the family is in affluent circumstances. The law regarding these families is slightly different from that regarding non-trading families. If the family carries on an ancestral trade or with the consent of all its members a new trade, it is governed not by the ordinary Hindu law, but by

(1) *Bhuban Mohini Dasi* v. *Kumud Bala Dasi*, 28 C. W. N. 131.
(2) *O.L.K.K.N. Kanappa Chettiar* v. *Commissioner of Income-tax* unreported.
(3) 1 I. T. C. 384, *infra*.

such law as modified by the exigencies and usages of the trade. The partnership is not dissolved by the death of any of the members. No partner can, even when severing his connection with the family, demand accounts of profits and losses. Any member, not necessarily the senior male member, can be the manager of the business and as such can pledge the credit and assets of the family without being accountable for losses or gains. But a partnership based on only some of the members of the family, whether with outsiders or among themselves, is not a business of the family. Even if a business is carried on by all the members of the family, if the profits are divided upon some agreed proportion, the trade is not that of the family but that of an ordinary firm under the ordinary law of partnership.

A Hindu undivided family, originally joint in mess and worship, carried on an ancestral business. There was no capital account in the name of the family as a whole but separate capital accounts as well as personal accounts in the names of the individual members. The profits were not distributed equally between the members but in the ratio of 5 to 3. The profits were enjoyed by each person separately. *Held,* that the persons constituted an unregistered firm and not a Hindu undivided family for the purpose of assessment to income-tax.—*Harisingh Santokchand* v. *Commissioner of Income-tax.*[1]

Basis of Taxation—

So far we have considered what is a Hindu undivided family and what should be reckoned as its joint property. We may now consider how the Indian Income-tax law, *i.e.,* the Income-tax and Finance Acts together, deals with the Hindu undivided family as compared with other assessees. As regards income-tax it is treated just like an individual or an unregistered firm, *i.e.,* it pays a graduated rate of income-tax varying with its total income. As regards super-tax, the first Rs. 75,000 of its income is exempt from taxation as against the first Rs. 50,000 in the case of individuals and unregistered firms. In neither case can a member of the Hindu undivided family in his individual capacity be called upon to pay any tax on his share of the income—section 14—or be made to pay a higher rate by including this share in his total income. Nor can he claim, on the other hand, a refund of tax under section 48 on the ground that his own total income, including his share of the family income, entitles him to a lower rate of taxation than the family. The result, as will be seen, is that the members of a relatively poor or moderately wealthy Hindu

(1) 2 I. T. C. 80.

undivided family have sometimes to face higher taxation than they would if they were separate, while the members of a very wealthy or affluent family may often stand in a better position than if they were separate.

Impartible estate—Whether joint family—

The Finance Act contemplates the larger deduction for purposes of super-tax only if the income is that of a joint family in which all the members are jointly interested and not in the case of an impartible estate in which the income is the property of the holder for the time being. If the estate is impartible, the other members have no rights of coparcenership and all that they have is a right of succession by survivorship. They cannot demand a partition or restrain alienation. The income of the estate is the income of the incumbent for the time being; and the fact that he is bound to maintain the sons does not make the income that of a joint family.[1]

Effect of registration on joint family firm—

The registration of some members of a Hindu undivided family as a firm under section 2 (16) precludes the assessment of the Hindu undivided family as such to super-tax on the income derived from the business of the firm unless the firm so registered has been shown to carry on its business on behalf of and for the benefit of the family. But the mere constitution of a partnership between some members of the family by a formal document does not preclude the assessment of the income of the partnership to super-tax as part of the income of the family if the partnership is conducted on behalf of and for the benefit of the family.[2]

History—

Under the 1886 Act, ' any income which a person enjoys as a member of a Hindu undivided family when the family is liable to tax ' was exempt, *i.e.*, the position was the same as now. The share of the income of the individual member was ignored in assessing him—both as to liability and as to rate. Under the Act of 1918, however, a Hindu undivided family was treated differently. While the family as such was treated as a separate assessee, the amount which an individual member received from the family was taken into account in determining the *rate* at which he should pay income-tax on his other income. This arrangement, however, was abandoned in 1922. Before 1922 no rebate of income-tax was

(1) *Rajah Shiva Prasad Singh* v. *Secretary of State*, 1 I. T. C. 384.

(2) *Chief Commissioner of Income-tax, Madras* v. *Doraiswami Aiyangar and others*, 1 I. T. C. 214: 46 Mad. 673.

allowed to a Hindu undivided family on account of premia of Life Assurance Policies on the life of the members, but under the present Act such rebates are allowed to the extent of $\frac{1}{6}$th of the family income in respect of insurance on the life of any male member of the family or of the wife of any such member.

(10) "prescribed" means prescribed by rules made under this Act.

'*Prescribed*'—See section 59 as to who can make rules and under what conditions. For facility of reference, the rule or rules framed with reference to each section have been given under the section concerned, as well as in one place together—please see pages 111, *et seq.*

(11) "Previous year" means—

(*a*) the twelve months ending on the 31st day of March next preceding the year for which the assessment is to be made, or, if the accounts of the assessee have been made up to a date within the said twelve months in respect of a year ending on any date other than the said 31st day of March, then at the option of the assessee the year ending on the day to which his accounts have so been made up :

Provided that, if this option has once been exercised by the assessee, it shall not again be exercised so as to vary the meaning of the expression "previous year" as then applicable to such assessee except with the consent of the Income-tax Officer and upon such conditions as he may think fit ; or

(*b*) in the case of any person, business or company or class of person, business or company, such period as may be determined by the [Central Board of Revenue][1] or by such authority as the Board may authorise in this behalf.

History—

There was no definition of 'previous year' in the Act of 1886. But section 11 of that Act provided in respect of Joint Stock Companies that the principal officer shall submit accounts

(1) These words were substituted for the words 'Board of Inland Revenue' by Act IV of 1924.

of profits made "during the year ending on the day on which the Company's accounts have been last made up or if the Company's accounts have not been made up within the year ending on the thirty-first day of March immediately preceding that for which the assessment is to be made then of the nett profits so made during the year ending on the said thirty-first day of March." There was a similar provision in respect of "other sources of income" also. The definition in the 1918 Act was the same as clause (*a*) of the present definition. Clause (*b*) was introduced in order to cover exceptional cases in which a commercial community (1) follows a year which is slightly over or under 12 months and (2) follows a year which ends a few days or weeks after the financial year. *See* paragraph 14 of the Report of the All-India Committee of 1921 (Appendix).

Object of proviso—

The proviso in clause (*a*) of the definition is intended to safeguard the interests of revenue. The discretion of the Income-tax Officer is absolute, and it is open to him to impose any conditions that he may think fit. And so long as his action is not *mala fide* or inherently unjust, the intervention of the Civil Courts cannot be invoked. A reasonable Income-tax Officer would of course not impose any conditions beyond seeing that the assessee did not evade any liability to tax. The Income-tax Manual says :—

"The convenience of an assessee in this matter should be studied as far as possible as it is desirable that the accounting period for income-tax purposes should be the same as the accounting period according to which an assessee makes up his accounts for the purpose of his business. but in the actual year of change conditions should be laid down sufficient to secure that the substitution of one year for another shall not result in any profits of an assessee escaping assessment."

Clause (b)—Delegation under—

The Central Board of Revenue has authorised Commissioners of Income-tax to recognise as the 'previous year' any commercial year, in usage, which is not less than 11 calendar months nor more than 13 months and also a year which does not terminate later than 30th April. If these conditions are not satisfied the sanction of the Central Board of Revenue is necessary. The Central Board of Revenue can authorise any period in reason as 'the previous year'[1]; and its consent would of course not be given if there was any danger to revenue.

(1) *Nanakchand Fatehchand* v. *Commissioner of Income-tax*, 2 I. T. C. 167.

Neither the Commissioners nor the Central Board of Revenue can refuse without adequate grounds to exercise this discretion—see *Julius* v *Oxford*,[1] and other cases cited in the introduction.

In the absence of orders by the Commissioner of Income-tax or Central Board of Revenue, the Income-tax Officer is bound by clause (*a*) of the definition, *i.e.*, must adhere to a year of 12 calendar months terminating on some day in the previous financial year.

First occasion of assessment—

It is not necessary that on the first occasion on which a person is taxable the ' previous year ' should consist of at least 12 months, *i.e.*, a firm commencing business on 1st June, 1924, and closing accounts on 31st March can be taxed in 1925-26 on its profits during the 9 months ended 31st March, 1925. There is nothing in the Act requiring the assessee to have been in existence during the 12 months throughout the ' previous year.'[2]

Clause (a)—

The option to adopt a year not ending on 31st March can be exercised only if the accounts have been made up during the course of the previous financial year. Otherwise the ' previous year ' is the year ending on the 31st of March.

Succession—

Where there is a succession under section 26 and the successor is a separate legal entity from the predecessor, the former is entitled to exercise the option allowed by this sub-section once. It is presumably not open to the Crown to contend that the successor takes over all the rights and liabilities of the predecessor. In this connection *see* notes under section 26.

Different businesses—

If an assessee follows different accounting periods for different parts of his business or professions, evidently the income of each part should be made up according to the accounting period actually followed in respect of each part and the incomes added up together. Each of these different periods must satisfy the definition of ' previous year ' with reference to the financial year of assessment. It cannot be said, merely because different accounting periods are adopted in different businesses of the assessee, that no method of accounting has been regularly employed by the assessee within the meaning of section 13. That section can be applied only when the basis of accounting has been irregular.

(1) (1880) 5 App. Cas. 214.
(2) *Nanakchand Fatehchand* v. *Commissioner of Income-tax*, 2 I. T. C. 167.

Temporary change in accounting period—

If an assessee alters his accounting period even temporarily, the consent of the Income-tax Officer is necessary.

Firm—Change in constitution of—

Under section 2 (2) an assessee means a person by whom income-tax is payable, and sections 3 and 55 contemplate firms being assessees. The question therefore arises whether when there is a change in the constitution of a partnership, the partnership as newly constituted is a new assessee. The mere change in the constitution of a partnership will not in itself make the new partnership a separate assessee from the old partnership. It would depend on the terms of each partnership whether a change in constitution involves the dissolution of partnership and the formation of another or not. Under section 253 of the Indian Contract Act, in the absence of any contract to the contrary the relations of partners to each other are determined by the following rules . . . . "(7) if from any cause whatsoever any member of a partnership ceases to be so the partnership is dissolved as between all the other members . . . . (10) Partnerships whether entered into for a fixed time or not are dissolved by the death of any partner." If a partnership is dissolved and a new partnership takes its place, the new partnership is clearly a separate assessee from the old partnership. If, on the other hand, a change in the constitution takes place without necessarily involving a dissolution of the partnership, the partnership as newly constituted is not a separate assessee from the previous partnership.

(12) "principal officer," used with reference to a local authority or a company or any other public body or *any* association, means—

(*a*) the secretary, treasurer, manager or agent of the authority, company, body or association, or

(*b*) any person connected with the authority, company, body or association upon whom the Income-tax Officer has served a notice of his intention of treating him as the principal officer thereof ;

The word 'any' after 'public body or' was inserted by the Income-tax Amendment Act XI of 1924. Otherwise the adjective 'public' would qualify 'association'.

"Income-tax Officers should treat as the principal officer, in the first instance, the officials specified in clause (*a*) ; it is only in cases where the Income-tax Officer has no information regarding the persons who discharge the functions of the officers mentioned in clause (*a*) or where such persons cannot be found that he should use the powers conferred by clause (*b*) of treating as the principal officer any other person connected with the company, etc." (*Income-tax Manual.*)

This definition has been practically the same since 1886.

'Local authority'.—For definition, *see* notes under section 1.

'Connected with' is very vague and might include almost anybody. If the question of imposing any penalty on the person arose, a Court would probably whittle down the meaning of the words "connected with" so as to cover only responsible officers of the company.

No form has been prescribed for this notice, but the service of a notice is obligatory.

Though, there is no express provision, as, for example, in section 43, giving the person served with notice an opportunity of being heard by the Income-tax Officer, it is evidently incumbent on the latter to hear the objections of the person if the latter has any before deciding finally to treat him as 'principal officer'.

(13) "public servant" has the same meaning as in the Indian Penal Code;

Public Servant.—This definition was introduced by the Select Committee in 1922 in order to make it clear that the expression includes all income-tax employees and is not restricted to the particular authorities mentioned in clause 5 (4). The words 'public servant' according to the Indian Penal Code denote a person falling under any of the descriptions hereinafter following, namely :—

"Ninth.—Every officer whose duty it is, as such officer, to take, receive, keep or expend any property on behalf of Government, to make any survey, assessment or contract on behalf of Government, or to execute any revenue-process, or to investigate, or to report on any matter affecting the pecuniary interest of Government, or to make, authenticate or keep any document relating to the pecuniary interests of Government, or to prevent the infraction of any law for the protection of the pecuniary interests of Government, and every officer in the service or pay of Government or remunerated by fees or commission for the performance of any public duty;

Tenth.—Every officer whose duty it is, as such officer, to take, receive, keep or expend any property, to make any survey or assessment, or to levy any rate or tax for any secular common purpose of any village, town or district, or to make, authenticate or keep any document for the ascertaining of the rights of the people of any village, town or district.

Explanation 1.—Persons falling under any of the above descriptions are public servants, whether appointed by the Government or not.

Explanation 2.—Wherever the words 'public servant' occur, they shall be understood of every person who is in actual possession of the situation of a public servant, whatever legal defect there may be in his right to hold that situation."

(14) "registered firm" means a firm constituted under an instrument of partnership specifying the individual shares of the partners of which the prescribed particulars have been registered with the Income-tax Officer in the prescribed manner;

Rule 2.—Any firm constituted under an instrument of partnership specifying the individual shares of the partners may, for the purposes of clause (14) of section 2 of the Indian Income-tax Act, 1922 (hereinafter in these rules referred to as the Act), register with the Income-tax Officer the particulars contained in the said instrument on application in this behalf made by the partners or by any of them.

Such application shall be made—

(*a*) before the income of the firm is assessed for any year under section 23, or

(*b*) if no part of the income of the firm has been assessed for any year under section 23, before the income of the firm is assessed under section 34, or

(*c*) with the permission of the Assistant Commissioner hearing an appeal under section 30, before the assessment is confirmed, reduced, enhanced or annulled, or, if the Assistant Commissioner sets aside the assessment and directs the Income-tax Officer to make a fresh assessment, before such fresh assessment is made.

Rule 3.—The application referred to in rule 2 shall be made in the form annexed to this rule and shall be accompanied by the original instrument of partnership under which the firm is constituted together with a copy thereof : provided that if the Income-tax Officer is satisfied that for some sufficient reason the original instrument cannot conveniently be produced, he may accept a copy of it certified in writing by one of the partners to be a correct copy, and in such a case the application shall be accompanied by a duplicate copy.

FORM I.

Form of application for registration of a firm under section 2 (14) *of the Indian Income-tax Act,* 1922.

To

THE INCOME-TAX OFFICER,

Dated 19 .

$\frac{\text{I}}{\text{We}}$ ——————————beg to apply for the registration of $\frac{\text{my}}{\text{our}}$ firm under section 2 (14) of the Indian Income-tax Act, 1922.

2. $\frac{\text{The original}}{\text{A certified copy}}$ of the instrument of partnership under which the firm is constituted specifying the individual shares of the partners together with $\frac{\text{a copy}}{\text{duplicate copy}}$ is enclosed. The prescribed particulars are given below.

3. $\frac{\text{I}}{\text{We}}$ do hereby certify that the profits for the year ending have been or will be actually divided or credited in accordance with the shares shown in this partnership deed.

Signature——————————

Address——————————

Name and address of the firm.	Names of the partners in the firm with the share of each in the business.	Date on which the instrument of partnership was executed.	Date, if any, on which the instrument of partnership was last registered in the Income-tax Officer's Office.	Remarks

$\frac{\text{I}}{\text{We}}$ ——————————do hereby certify that the information given above is correct.

Signature(s)——————————

Rule 4.—(1) On the production of the original instrument of partnership or on the acceptance by the Income-tax Officer of a certified copy thereof, the Income-tax Officer shall enter in writing at the foot of the instrument or copy, as the case may be, the following certificate, namely :—

" This instrument of partnership (or this certified copy of an instrument of partnership) has this day been registered with me, the Income-tax Officer for in the province of under clause (14) of section 2 of the Indian Income-tax Act, 1922. This certificate of registration has effect from the day of April 19 up to the 31st day of March 19 ."

(2) The certificate shall be signed and dated by the Income-tax Officer who shall thereupon return to the applicant the instrument of partnership or the certified copy thereof, as the case may be, and shall retain the copy or duplicate copy thereof.

Rule 5.—The certificate of registration granted under rule 4 shall have effect from the date of registration.

Rule 6.—A certificate of registration granted under rule 4 shall have effect up to the end of the financial year in which it is granted, but shall be renewed by the Income-tax Officer from year to year on application made to him in that behalf at any time before the assessment of the income of the firm is made, and accompanied by a certificate signed by one of the partners of the firm that the constitution of the firm as specified in the instrument of partnership remains unaltered.

History—

There was no provision in the 1886 Act for registering firms, *i.e.,* no distinction was made between different kinds of firms. There was no definition of the expression in the 1918 Act also as originally passed. Section 14 thereof, however, had a proviso as follows : " Provided that where the assessee is a company or firm constituted under a registered instrument of partnership specifying the individual shares of the partners . . . . . . the income-tax shall be levied at the maximum rate" and section 37 provided for refunds to the partners of such firms if their individual incomes justified such refunds. Later on, however, the Act was amended and a definition introduced on exactly the same terms as at present. It was proposed in 1922 to abandon the distinction between registered and unregistered firms and that all firms should be taxed at the maximum rate, it being left to the Income-tax Officer to determine whether there was in fact a partnership or not. The Select Committee, however, preferred to retain the distinction which still continues. The point of the Select Committee was that the taxation at the maximum rate and subsequent refund would inflict hardship on the smaller assessees. The option to register furnishes an incentive to evade taxation, and checks against such evasion have been proposed in the Amending Bill now before the Legislature.

Application—To be made before assessment—

Till November, 1926, the application for registration had to be made before the date on which the return was due under section 22 (2). If it was made after that date, even if the application was accepted by the Income-tax Officer, it did not affect the assessment on the return and the assessment was made as if the firm was an unregistered firm. In November, 1926, rule 2 was altered so as to permit of applications for registration being made at any time before assessment. The rule was again altered into its present form in 1928 so as to remove certain obscurities and make it clear when registration could be made and when not. It will be noticed that a firm which has concealed a part of its income during its ordinary assessment under section 23 is not eligible for registration in respect of its supplementary assessment under section 34.

In *Hussainbhai Bohari* v. *Commissioner of Income-tax*[1] it was held by the Additional Judicial Commissioner, Central Provinces, that a certificate of registration granted before April in respect of the year commencing on 1st April is not void.

Registration—Application for—Signature of—

The application for registration under rule 2 as well as the application for renewal of the registration under rule 6 need be signed by only one of the partners of the firm. The application should be signed by a partner who is still a partner at the time when the application for registration is made.

Instrument of partnership—Registration of—

The instrument to be produced before the Income-tax Officer to secure the registration of a firm need not be a registered instrument under the Indian Registration Act. The registration by the Income-tax Officer has nothing to do with registration under the Registration Act. The Income-tax Officer as such is not concerned with the fact that the document is insufficiently stamped or requires to be registered under the Indian Registration Act and need not reject such documents as not being legal evidence since they are not adequately stamped nor accept them as being legal evidence merely because they are properly stamped or registered. His duty is to satisfy himself that the transaction evidenced by the instrument is genuine and then act accordingly. He is not bound by the technicalities of the Indian Evidence Act—*see* notes under section 23. As a Public Officer, however, it is incumbent on the Income-tax Officer to impound a document that comes before him if it is insufficiently stamped—*see* section 33 of the Indian Stamp Act.

Registered firm—How taxed—Comparison with unregistered firm—

The position of a registered firm at present is as below: First as regards income-tax. Income-tax is levied on the firm—as

(1) 2 I. T. C. 43.

on a company—at the maximum rate even though the income is less than Rs. 2,000. This is regulated by the Finance Act and not by the Income-tax Act. The partners get refunds, if eligible, under section 48 (2); and their share of the profits is included in their 'total income' [section 16 (1)]. An unregistered firm, on the other hand, is assessed like an individual, *i.e.*, on a graduated scale depending on the income of the firm. This again is regulated by the Finance Act. The partners are *not* entitled to refunds, nor are they taxed on the profits from the firm unless the firm is not taxed; but their shares in the profits of the unregistered firm are taken into account in their 'total income' for fixing the rate at which they should pay tax on their other income [section 16 (1)].—*See* notes thereunder.

If an unregistered firm as such pays no tax on the ground that its income is below Rs. 2,000, the partners are liable to pay tax on their respective shares along with the tax on their other income [section 14 (2) (*b*)].—*See* notes thereunder.

Next as regards super-tax. A registered firm as such is not liable to super-tax. The share of each partner is added on to his other income, and he is then individually assessed to super-tax. An unregistered firm, on the other hand, is taxed just like an individual; and super-tax is not payable on the shares of the profits received by partners, unless the firm was not assessed to super-tax (proviso to section 55).

Set-off—Partners—

As regards the set-off of profits against losses of partners in firms—whether registered or unregistered—*see* section 24 and notes thereunder.

Registered firms—Advantages of—

It will be seen that there are considerable advantages in registering a partnership with the Income-tax Officer unless the firm is petty. The partners are ordinarily not only better off than those in unregistered firms, but also better off than the shareholders in a company. In the latter, while shareholders are entitled to refunds in respect of income-tax paid by the company, it has been held that the super-tax paid by the company at the flat rate of one anna in the rupee is not paid by the company on behalf of the shareholder and that the latter is not therefore entitled to a refund.[1]

Actual division of profits not necessary—

Whether profits are actually divided between the partners or not, the profits are taxable under the law. Each partner will

(1) *Maharajadhiraj of Darbhanga* v. *Commissioner of Income-tax* 1 I. T. C. 303.

be presumed to have received his share of the profits whether he has actually received it or not, and taxed accordingly. That he has actually allowed the profits to remain in the business does not affect his liability nor will his foregoing a refund of income-tax under section 48 affect the liability. The income has accrued or arisen to him and is ready to be received by him and is therefore liable under sections 3 and 4 of the Act. That he prefers not to receive it cannot absolve his liability. Besides, in applying for registration, the partners have to certify under Rule 3 that each partner has received or will receive his share of the profits, and the partners are prevented from claiming any advantage on the ground that they have not actually distributed the profits. The English law is more explicit on this subject (proviso to section 20, Income-tax Act, 1918); *see also* per Horridge, J., in *Gaunt* v. *Inland Revenue*[1] and Rowlatt, J., in *Blott* v. *Inland Revenue.*[2]

Deed of partnership—Which to be produced before Income-tax Officer—

The ruling of the Bombay High Court in *Mellor's case*[3] and the amendment of the Act in 1925 so as to get over that ruling only so far as it related to super-tax, coupled with the non-observance of the ruling in *Mellor's case*[3] even in regard to income-tax outside the Bombay Presidency, had led to considerable confusion in practice. The deed of partnership regulating the distribution of the profits that were being taxed, as well as the deed in force at the time of assessment, had to be produced before the Income-tax Officer when there was any change in the constitution of the firm. All these difficulties have now disappeared, section 26 having been so amended by Act III of 1928 as to cover both super-tax and income-tax. The deed of partnership to be produced now is in all cases the deed in force at the time of assessment.

When Income-tax Officer can refuse to register firm

It is submitted that it is open to the Income-tax Officer to refuse to register a firm if he has reason to think that the instrument of partnership is not genuine. That is to say there should be a firm before the Income-tax Officer can register it; and the mere existence of an instrument of partnership will not in itself bring a partnership into existence if there is really no partnership.[4] On a question of fact the finding could not be questioned by the High Court so long as there is evidence to permit of such

(1) 3 K. B. 395 (1913).
(2) 8 Tax Cases on p. 111.
(3) 1 I. T. C. 320.
(4) *Dickinson* v. *Gross*, 6 A. T. C. 551.

finding. See *Commissioners of Inland Revenue* v. *Sansom* (*C. of A.*)[1]; *Jacobs* v. *Commissioners of Inland Revenue* (*C.S.*)[2]; *Commissioners of Inland Revenue* v. *Whitmore* (*K. B. D.*)[3]; *Sir Dinshaw Petit* v. *Commissioners of Income-tax*[4] in all of which cases of 'one-man' companies it has been held that the Income-tax Officer can go behind the documents and accounts if the facts and circumstances of the case justify his doing so. See also *Hawker* v. *Compton*[5] in which the Commissioners held that no partnership existed and *Morden Rigg & Co., etc.* v. *Monks*[6] in which the Commissioners held that a partnership existed. In all these cases the Courts declined to interfere on the ground that the findings were of fact. It is clear that in the absence of an instrument of partnership the onus falls on the assessee of proving the existence of a partnership. The Amending Bill before the Legislature gives express power to the Income-tax Officer to enquire into the incidents of a partnership.

Registration—Cancellation of—

Except when there is a change in the partnership between the date of registration and the assessment about which see below, it is apparently not open to the Income-tax Officer to cancel the registration even if he finds later on that the partnership is not genuine. This is because the Income-tax Officer cannot revise or review his own orders. But there would be nothing to prevent the Commissioner acting under section 33 in such cases and ordering the registration to be cancelled. The Amending Bill before the Legislature provides for the cancellation of registration of firms that do not produce accounts, etc.

Unregistered firm—Bogus—

In the case of an unregistered firm, which the Income-tax Officer finds to be not genuine, that is, if the Income-tax Officer finds that there is no firm in existence in fact but only in name, it would apparently be open to the Income-tax Officer to ignore the firm and treat the profits of the firm as the profits of the real proprietor of the firm. That is to say, in ascertaining the 'total income' of the partners, the Income-tax Officer will go by the real interests of the partners and not the alleged interests. The Amending Bill now before the Legisla-

(1) 8 Tax Cases 20.
(2) 4 A. T. C. 543; 10 Tax Cases 1.
(3) 5 A. T. C. 1
(4) 2 I. T. C. 255.
(5) 8 Tax Cases 306.
(6) 8 Tax Cases 450.

ture strengthens the powers of the Income-tax Officer in this respect.

Partnership of wife and husband—

In *In re Ambalal Sarabhai*[1] it was held that a partnership between husband and wife in which the husband was almost everything in the concern—having the sole control of the management, the power of determining the partnership and of admitting new partners—was considered to be a valid partnership.

Per Shah, C. J.—" There is nothing in the document to exclude the idea of combining her property, labour or skill in the business of the firm. Indeed the papers sent up with the reference tend to show that she did agree to render herself liable to the Bank as a partner of this firm along with her husband. That involves the idea of contributing property to the business of the firm. . . . . When the parties agree to become partners it is not necessary to state in terms that they agree to combine property, labour or skill. That may be implied and in the present case I see nothing to exclude the idea of combining property, labour or skill when and so far as necessary between the partners. The fact that the control is kept with Mr. Ambalal and that he has certain extra rights as a major partner does not in any sense negative a partnership according to law. It is open to two partners to agree, on the lines on which they have agreed in this case, to allow the business of the partnership to be conducted by one of the partners."

In this judgment there are passages to the effect that if the Income-tax Officer had found the partnership to be bogus in fact, he could have ignored it.

" This reference has been made on the footing that the document evidences a real transaction between the parties. The learned Advocate-General has not suggested, and I do not think that on this reference it could be suggested, that the document does not evidence a real transaction between the parties to the document. But he contends that the question of law that arises is whether on a proper construction of this document the two persons are constituted partners in law."

Partnership—Change in—Between registration and assessment—

If there is a change in the constitution of a partnership between the date of the registration with the Income-tax Officer and the date of assessment, the question arises whether the new firm or rather the firm as newly constituted should be treated as a separate assessee and called upon to make a return of income and register itself if it seeks that privilege. The answer to the question would apparently depend on whether the change in the constitution is such that it automatically dissolves the partnership or not. Under section 253 of the Contract Act a partnership will

(1) 1 I. T. C. 234.

be automatically dissolved in the absence of any contract to the contrary in the following circumstances. . . . .

"(7) If from any cause whatsoever any member of a partnership ceases to be so, a partnership is dissolved as between all the other members. . . . (10) Partnerships whether entered into for a fixed time or not are dissolved by the death of any partner."

It would therefore depend on the terms of each partnership how far a change in the constitution dissolves a partnership. If a partnership is dissolved and a new partnership takes its place, it would seem that the new firm should be treated as a separate assessee and called upon to register itself and also to furnish a return of income. The mere fact that the old firm had already been asked to make a return or had in fact made a return will not attach to it, *i.e.*, to its partners the liability to tax, which liability arises only after assessment. Nor can the return sent in by the old firm which *ex hypothesi* is a different assessee from the new firm bind the new firm. Also the fact that a notice had been served on the old firm will not bind the new firm. The liability of the new partnership in respect of the profits of the old partnership would be governed by section 26.

Obviously all these complications would be avoided if the Income-tax Officer postponed registering the firm till he was ready to make the assessment.

Firm—What is a—

A 'firm' is not defined in the Income-tax Act; nor a 'partner' or 'partnership', though the Act refers to all these expressions. 'There is no such thing as a firm known to the law'[1] though in some countries, *e.g.*, Scotland, a firm is recognised as a separate entity, *i.e.*, a different legal person from the partners. All the same a 'firm' is recognised in commercial practice as a separate entity apart from its partners; and this Act recognises this. See also *ex parte Chippendale*.[2]

"It is argued by the Commissioner that a partnership is for income-tax purposes an entity; but it is not an entity known to the law; it is not a separate entity like a company limited by shares; its name is merely a convenient method of describing its partners each of whom is jointly and severally liable for its debts and for income-tax purposes it is a convenient body to assess, as the partners carry on trade together and keep books in which the partnership transactions are entered and earn together profits or make losses. It is to be observed that, for this purpose no distinction can be made between registered and unregistered

(1) *Ex parte Corbett*, (1880) 14 Ch. 122.
(2) (1853) De G. M. & G.. 10 (36).

firms, for whether a firm is a legal entity or not does not depend on registration."[1]

Presumably the word 'firm' is used in the same sense as defined in section 239 of the Indian Contract Act, but the Bombay High Court threw a doubt on this.[2] This was, however, *obiter*. The second Income-tax Amendment Bill, 1927, now before the Legislature, dealing with bogus firms and companies, lays down that the definitions of 'firm', 'partner' and 'partnership' in the Indian Contract Act shall also apply to the Income-tax Act. Assuming that a 'firm' means a 'partnership' collectively referred to, a partnership is defined in the Indian Contract Act as below:—

"'Partnership' is the relation which subsists between persons who have agreed to combine their property, labour or skill in some business, and to share the profits thereof between them."

But persons who have no mutual rights and obligations do not constitute an association because they happen to have a common interest or several interests in something which is to be divided between them.[3] That is to say, if the shares are distinct and separately transferable, there would only be a co-ownership and not a partnership which can only arise if there is a common business and sharing of profits. Thus the joint proprietorship in defined shares of a house let to tenants would not be a 'partnership' but if the house was used as a hotel under their own management, a partnership would arise in regard to hotel keeping.[4] Part-owners of a ship are not necessarily partners,[5] but if they employ the ship in trade or adventure on joint account they are partners as to that employment and the profit made.[6] Even the joint acquisition of property avowedly for purposes of profit does not make the matter necessarily one of partnership.[7] Sharing *gross* profits will not result in a partnership.[8]

Just as common interest will not in itself create a partnership without a division of profits, so sharing of profits will not unless there is really a common business. Although a right to participate in profits is a strong test of partnership, there may

(1) Per Schwabe, C. J., in *Commissioner of Income-tax* v. *M. Ar. Ar. Arunachalam Chetti*, 1 I. T. C. 278.
(2) *In re Ambalal Sarabhai*, 1 I. T. C. 234.
(3) *Smith* v. *Anderson*, (1880) 15 Ch. D. 247.
(4) *French* v. *Styring*, (1857) 2 C. B. N. S. 357.
(5) *Helme* v. *Smith*, (1837) 7 Bing. 709.
(6) *Green* v. *Briggs*, (1847) 6 Ha. 395.
(7) *London Financial Association* v. *Kelk*, (1884) 26 Ch. D. 107.
(8) *Lyon* v. *Knowles*, (1863) 3 B. & S. 556.

be cases where, upon a simple participation of profits, there is a presumption, not of law, but of fact, that there is a partnership; yet whether the relation of partnership does or does not exist must depend on the whole contract between the parties, and that circumstance is not conclusive.[1]

It is not easy to draw the line between a partnership and a payment of salary by a share of profits.[2] Sharing losses is a strong *prima facie* test of partnership.[3] But it is even possible for a person both to receive a share of the profits in another man's business and share his losses and yet be only a servant of the other person. It would all depend on the terms of the agreement between the two.[4]

A selling association which was formed by an agreement between certain ice manufacturing concerns in order to prevent underselling by constituent firms, and which had the entire control over manufacture, sales, etc., and distributed the profits between constituent members, was held to be a 'firm' within the meaning of the Income-tax Act; and the fact that the constituent firms made heavy losses because of the controlled prices was held to be irrelevant.[5]

Where one man supplied all the capital and bore all the losses, and he and his attorneys had the control of the business including the power to alter the shares of profits of the other persons and even dismiss them, it was held that the relation was one of master and servants, and not a partnership.[6]

The incidents of partnership referred to in Chapter XI of the Indian Contract Act need not subsist in all cases and section 253 of the Indian Contract Act expressly provides for arrangements to the contrary.

Prohibited partnerships—

Both in England and in India the number of persons who may form an ordinary partnership is limited. See section 4 of the Indian Companies Act (VII of 1913). Under section 23 of the Indian Contract Act (IX of 1872) the consideration or object of an agreement is unlawful if it defeats the provisions of any law, and the agreement is void. Therefore a partnership

(1) *Ross v. Parkyns*, (1875) L. R. Eq. 331; *Cox v. Hickman*, (1860) 8 H. L. C. 268 *Mollow March & Co. v. Court of Wards*, (1872) L. R. 4 P. C. 419.

(2) *Steel v. Lester*, (1877) 3 C. P. D. 121.

(3) *Commissioner of Income-tax v. Baboo Sahib & Sons*, unreported.

(4) *Walker v. Hirsch*, (1884) 27 Ch. D. 460.

(5) *Lucknow Ice Association v. Commissioner of Income-tax*, 2 I. T. C. 156.

(6) *Mahomed Kasim Rowther v. Commissioner of Income-tax*, 54 M. L. J. 219 (F. B.)

which is prohibited under the Companies Act will not be recognised as such by the Income-tax Officer. But he can tax profits from illegal transactions. See notes under sec. 4 (3) (vii).

Each partnership to be taxed separately—

Whether a firm is a legal entity or not and whether a 'firm' as contemplated in the Income-tax Act is the same as a partnership under the Contract Act or not, the Income-tax Act requires each firm to be taxed separately from the partners—sections 3 and 55; and the partners are either absolved from liability to tax on their share of profits (section 14) or allowed in the case of a registered firm, a refund of tax (section 48) or to set off losses (section 24). If an individual were a partner in three firms—whether registered or unregistered—there would be four assessments, one on each of the firms and one on the individual, the latter taking into account the shares of his profits in the three firms and the tax paid by the firms on these profits, leaving aside, of course, the assessments on the other partners.

English Law—

In England no distinction is made between registered and unregistered firms. Otherwise the law is, in its essential features, the same, and partnerships are treated very much like registered firms in India; but the details of procedure differ, *e.g.*, as to which partner is liable to make a return, etc. No partnership is liable to super-tax in England, that tax being levied on individuals only. See sections 4, 14 (3) (*c*) and 20 and Rule 10. Cases I and II of Schedule D of the English Income-tax Act of 1918.

Firm—Residence of—

The 'residence' of a firm is determined by the same considerations as the residence of a company, *i.e.*, largely by the seat of the directing power behind the business and not by the physical residence of the individual partners. See notes under section 4 (2); and *T. S. Firm* v. *Commissioner of Income-tax.*[1]

Notices on firms—Service of—

As to the service of notice on a firm *see* section 63 (2).

Returns of firms—

As to returns to be submitted by firms *see* section 22 (2). Unlike a company which has to send in a return without any notice, the firm like an individual need send in a return only after service of notice by the Income-tax Officer.

Discontinuance of business by firms—

See section 25.

(1) 50 Mad. 874; 2 I. T. C. 320.

Firm—Constitution of—Change in—

See section 26.

(15) "total income" means total amount of income, profits and gains from all sources to which this Act applies computed in the manner laid down in section 16 ;

History—

There was no definition of 'total income' in the Act of 1886. In fact the concept itself was hardly relevant to that Act with its four watertight schedules, each charged by itself, and with hardly any graduation in the tax. The definition was first introduced in 1918, but the words "computed in the manner laid down in section 16" were introduced in 1922 in order to remove possible ambiguity.

Total income—Significance of—

The phrase 'total income' occurs in sections 3, 15 (3), 17, 22 (1) and (2), 23 (1) and (3), 48, 55 and 56. The general plan of the law is that except where it is definitely intended otherwise either as a matter of policy, *e.g.*, in the case of the company super-tax or the tax on a Hindu undivided family, or as a matter of administrative convenience, *e.g.*, the taxation of unregistered firms, the tax is a tax on individuals with reference to their total income which determines their ability to pay. But it is administratively convenient to tax as much at source as possible and at the maximum rate, *i.e.*, before the assessee's personal income has been ascertained. This, however, does not dispense with the necessity of determining the individual's liability with reference to his ability to pay, *i.e.*, 'total income'. The only item that does not enter into 'total income' of the individual is his share of income of a Hindu undivided family which has already been taxed. Generally speaking, the 'total income' determines the *rate* of tax as well as the exemptions on account of life insurance, etc. For a more accurate statement of the position *see* section 16.

Special definitions—

Note that 'total income' has been defined differently for the purpose of section 48, and also in the Finance Act—*see* notes thereunder.

(16) "unregistered firm" means a firm which is not a registered firm.

See notes under registered firm—section 2 (14), where the difference between a rgistered and an unregistered firm has been brought out.

CHAPTER I.

CHARGE OF INCOME-TAX.

Charge of income-tax.

3. Where any Act of the Indian Legislature enacts that income-tax shall be charged for any year at any rate or rates applicable to the total income of an assessee, tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions of, this Act in respect of all income, profits and gains of the previous year of every *individual, Hindu undivided family, company, firm and other association of individuals.*

The words "and other association of individuals" were inserted by the Amendment Act XI of 1924.

As to why these words were introduced *see* the notes below.

'Charged'—

This word is not used in the sense of real property law as in section 9 (1) (iv). All that it means is that the tax 'is payable' or that the assessee is commanded to pay the tax—see *Direct Spanish Telegraph Co. v. Shepherd*[1] and *Kensington Income-tax Commissioners* v. *Aramayo.*[2] The United Kingdom law, however, uses, generally speaking, a more unsatisfactory terminology than the Indian law and words like ' assess ', ' charge ' are used in varying senses; and the English decisions are therefore of not much help.

As regards the meaning of the words 'Hindu undivided family', 'Company', 'Firm' *see* section 2 and the notes thereunder. 'Individual' hardly requires any elucidation in the context. In other contexts in other Acts, it may include Corporations, etc., but here it refers only to a single person.

As regards the question whether a foreign State can fall under any of these categories of persons mentioned here *see* pp. 58 *et seq.* (Introduction.)

For the definition of 'total income' *see* sections 2 (15) and 16; for 'previous year' *see* section 2 (11).

'Applicable to the total Income'—

The slight distinction between the wording of section 55 and that of this section is due to the fact that super-tax is levied on the 'slab' system while the rate of income-tax is determined

(1) 13 Q. B. D. 202.
(2) (1916) 1 A. C. 215.

with reference to the 'total income'. Under the 'slab system' there is no single rate or rates "applicable to the total income"; there are different rates applicable to different 'slabs'.

'In respect of' means really 'on'. See per the Master of Rolls in *Kennard Davis* v. *Commissioners of Inland Revenue.*[1]

History—

This section became necessary only in 1922 when it was decided to make the Income-tax Act a mere Act of machinery and procedure, leaving the actual charge of tax to be made by the Annual Finance Acts. In the Bill as originally drafted this was put in as sub-clause (3) of section 16 but the Joint Select Committee transferred it to its present place as being more appropriate.

Computation of income—

As to how income should be computed *see* sections 7 to 13. 'Income' as understood in the popular or business sense has to be subjected to various additions or deductions before it can be taxed.

HOW EACH CLASS OF ASSESSEES IS TAXED.

Hindu undivided family—

As to how a Hindu undivided family is taxed *see* notes under section 2 (9), section 14 and the schedules to the Finance Act.

Company—

As to how a company is taxed *see* notes 2 (6), 14 and the schedules to the Finance Act.

As regards relief to shareholders *see* sections 14 and 48 and notes thereunder.

Firm—

As regards the taxation of firms, *see* sections 2 (14) and (16), 14 and 48 and notes thereunder.

Discontinuance of business, etc.—

See section 25 and notes.

Succession or change in constitution—

See section 26 and notes.

Association of individuals—

Not being a company or firm. Specific reference has been made in the Act—by the Amending Act XI of 1924—to such associations in various sections in the Act, *e.g.*, sections 3, 55, 2 (12),

(1) 8 Tax Cases 341.

63 (2) and 56 so as to place beyond doubt the liability to tax—to the extent that they are taxable at all—of associations like Chambers of Commerce, Clubs, Co-operative Societies, etc. These associations cannot be taxed on profits made from among the members themselves (*see* notes on mutual concerns, *infra*) but they can be taxed in respect of profits made from outsiders, and in certain circumstances, if incorporated, from shareholders also. It is this liability, which has always been enforced but was in doubt, that the amendment makes clear. Presumably a Provident Fund can be considered to be an 'association of individuals' but paragraph 3 of the Income-tax Manual says that they are not to be so assessed except at the source in respect of income from investments [unless of course the Fund is exempt under section 4 (3) (iv)] and that they should not be charged to super-tax at all.

From the grouping of classes of assessees in section 3, it does not seem unreasonable to hold that the expression 'association of individuals' should be construed *ejusdem generis* with the previous words in that section. It is difficult to say what are the common generic qualities contemplated by the framers of section 3 but it might be reasonably argued that (1) there should be joint interests and (2) there should be the right to sue and the liability to be sued as an association.

The members who constitute an 'association of individuals' are not entitled to any relief like members of partnerships in respect of tax paid by them through the association—*see* sections 14 and 48.

The members of a partnership prohibited under the law would apparently not form an 'association of individuals' for this purpose but there is nothing to prevent the individual members of such prohibited partnerships being taxed in respect of income ultimately obtained by each individually. See notes under section 4 (3) (vii). Such members cannot of course claim to be a firm; *see* note under section 2 (14).

Finance Act—Effect of—

The liability to tax under this Act presupposes as an essential preliminary the passing of a separate Act by the Legislature fixing the rates of Income-tax and Super-tax for the year. This is done annually by the Finance Act. The omission to pass such an Act does not, however, keep the entire Income-tax Act in abeyance. Refunds in respect of the previous year, appeals and petitions for revision arising out of the previous year's assessment, additional assessments under section 34 on account of "escaped" income of the previous year, rectification of mistakes under section 35, etc., can be and must be made under the Act. The Income-tax Officer, however, cannot perhaps issue notices under section 22 (2). Nor would there be much point in his doing so, as the only object would be the collection of statistics which is not one of the avowed objects of the Act. The obligation imposed on the principal officer of the company or the prescribed person to furnish a return of salaries paid and tax recovered thereon in the previous year will of course remain, as this is essential to enable the Income-tax Officer to sanction refunds. Similarly the obligation imposed on the principal officer of a company to give certificates under section 20 will remain. All this discussion however is academic as there is not the remotest likelihood of the income-tax being given up temporarily for any year or succession of years.

Provisional Collection of Taxes Act inapplicable—

The Provisional Collection of Taxes Act XVI of 1918 applies only to taxes in the nature of Excise or Customs duties. Income-tax, super-tax and similar taxes can therefore be levied only after the Finance Bill has received the assent of the Governor-General in the usual course, or become law otherwise. This applies as much to taxes collected at source under sections 18 and 57 as to taxes assessed directly on the person liable. In the United Kingdom the Provisional Collection of Taxes Act applies to Income-tax also.

Assessment of Income-tax on married women—

In the absence of a specific provision to the contrary in the Act, a married woman has to be separately assessed in respect of her separate income.

Pensions received from funds such as the Indian Military Service Family Pension Fund by a widow on account of her children and on account of herself are distinct and separate from one another. The pension of a minor orphan paid to his or her mother or a duly appointed or recognised guardian should not be included in the taxable income of the mother or guardian for the purposes of income-tax assessment. (Income-tax Manual, para. 96.)

In the Draft Bill of 1918 an attempt was made to assess married women jointly with their husbands but the Select Committee threw out the clause. A suggestion reviving the idea has been made by the Taxation Enquiry Committee.

Composition not permissible—

The provision in previous Acts that allowed a system of composition of assessment and enabled the Income-tax Officer under specified conditions to enter into compositions with assessees has been omitted from the present Act. No composition of assessment can, therefore, now be made although any composition entered into before the present Act came into force must be given effect to for the period for which the agreement was made.—Income-tax Manual, para. 95.

The existing compositions cannot be renewed when they expire. Such a composition would be null and void, as the Legislature has to determine the rates of tax every year through the Finance Act. In this connection see *Gresham Life Assurance Society v. Attorney-General*[1] in which the Society produced correspondence with the Surveyor of Taxes and asked for a declaration that the correspondence amounted to a valid and binding agreement for the composition of tax for a certain number of years. It was held that the construction put by the Society on the correspondence was not correct and that even if it was, the agreement would be *ultra vires* and invalid.

Composition of taxes was given up in India in 1916.

Source of income—Existence of—In year of assessment—

In the *National Provident Institution* v. *Brown* and the *Provident Mutual Life Assurance Association* v. *Ogston*[2] it was held by the House of Lords, under the United Kingdom Income-tax Acts, that in order to be chargeable to income-tax for a particular year in respect of income from a source, a person must possess that source of income in that year. In *Whelan* v. *Henning*[3] it was held by the House of Lords that not only should the source exist but that income from the source should exist during the year of assessment. In *Grainger* v. *Maxwell's executors*[4] it was held by the Court of Appeal that War Bonds were a different source of income from Exchequer Bills. It has been held, however, that none of these decisions will apply to India.[5] The English decisions were arrived at with reference both to the wording and to the scheme of the United Kingdom Income-tax Acts, which are materially different from the wording and the scheme of the Indian Income-tax Act. Lord Haldane observed in the *National Provident* case that "speaking broadly at all events, the general principle of the Acts is to make the tax apply only to sources of income existing in the year of assessment. Reading the Income-tax Act, as a whole, it appears to me that the tax is one of a single kind based, speaking broadly, on a single principle. . . . It is imposed on existing income; however the amount to be levied is to be computed in particular instances. . . . . There is little room permissible for conjecture based merly on

(1) 7 Tax Cases 36.
(2) 8 Tax Cases 57.
(3) 10 Tax Cases 263.
(4) 10 Tax Cases 139.
(5) *In re Beharilal Mullick*, 54 Cal. 636; 2 I. T. C. 328.

probabilities in a taxing statute but I wish to add that, having regard to the words employed, I have only come to this view after doubt." Lord Atkinson arrived at the same decision but partly from historical considerations.. Lord Cave dissented.

It should be mentioned, however, that the law in the United Kingdom has since been amended so as to get over these decisions of the House of Lords—*see* section 22 of the Finance Act of 1926.

Though the present tense is used in certain sections of the Indian Act, *e.g.*, sections 9 and 10, it is clear, both from the charging sections and the general scheme of the Act, that the tax is levied on the income of the previous year and has to be levied independently of the existence of the source of income or income from that source during the year of assessment. The only anomaly in the scheme is in regard to deductions at source in respect of income from salaries and securities. Though section 18 requires the tax to be deducted in certain cases before it can be known, since the tax can be imposed only by the Finance Act of the next year, it is clear from the general arrangement of the Act that tax is collected in advance in anticipation of its imposition by the next Finance Act.

Therefore in *In re Beharilal Mullick*,[1] Rankin, C. J. observed that, though the intention is clear, the draftsmanship of sections 3 and 18 is defective and that the following words would better express the intention of section 3:—

" Where any Act of the Indian Legislature enacts that income-tax shall be charged for any year at any rate or rates applicable to the total income of an assessee—

(1) tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions of, this Act, in respect of all income, profits and gains of the previous year of every individual, company, firm, etc.;

(2) tax at that rate shall be deducted in accordance with, and subject to the provisions of, this Act from all salaries payable in that year on account of the income-tax, if any, to become chargeable in respect thereof for the following year;

(3) tax at the maximum rate shall be deducted in accordance with, and subject to the provisions of, this Act from all interest on securities payable in that year on account of the income-tax, if any, to become chargeable in respect thereof in the following year."

(1) 54 Cal. 636; 2 I. T. C. 328.

Mutual concerns—Profits from—

'Profits' imply two interests—the trader and some one else with whom he trades. Obviously a person cannot trade with himself. Similarly a body of persons cannot trade with itself, *i.e.*, with its own members. There can therefore be no 'profits' in the case of a club, co-operative society or a similar concern, which sells to or deals with the members only and returns the surplus—which it calls 'profits'—to the members. The position, however, is different if it has any investments or if it has transactions of a 'business' nature with outsiders. The position is also different if the body is incorporated; though in certain circumstances it might make no difference whether the body was incorporated or not.[1] The law in respect of mutual concerns is and has been largely the same both in England and in India. It rests not on express statutory provisions but upon judicial pronouncements. It is possible to attempt a distinction between the English and the Indian law on the ground that in the charging sections the English law refers to 'profits and gains' whereas the Indian law refers to 'income, profits and gains,' and that 'income,' being a wider concept, comprehends other things besides these 'profits and gains.' But even so, income from oneself to oneself would make no sense.

"I do not think that the money received by a club from the members composing it can be regarded as 'income'—a word which itself seems to imply something received from outside."[2]

"No man in my opinion can trade with himself; he cannot in my opinion make what is in its true sense or meaning taxable profit by dealing with himself."[3]

"I do not understand how persons contributing to a common fund in pursuance of a scheme for their mutual benefit, having no dealings or relations with any outside body, can be said to have made a profit when they find that they have overcharged themselves and that some portion of their contributions may be safely refunded. If profit can be made in that way there is a field for profitable enterprise capable, I suppose, of indefinite expansion."[4]

The surplus of receipts over expenditure cannot be profits in the case of a club which does not 'trade' with non-members.[2] On the other hand the Royal Calcutta Turf Club was held to

(1) See *Liverpool Corn Trade Association* v. *Monks* and *Jones* v. *S. W. Lancashire Coal-owners' Association*, 5 A. T. C. (*infra*).

(2) Per Martineau J. in *United Service Club, Simla* v. *R.*, 1 I. T. C. 113; 2 Lah. 109.

(3) Per Palles C. B. in *Dublin Corporation* v. *MacAdam*, 2 Tax Cases 387.

(4) Per Lord Macnaghten in *Styles* v. *New York Life Insurance*, 2 Tax Cases 460.

carry on 'business' and make profits in respect of its receipts from non-members in exchange for advantages provided by the Club. The fees in question were (1) entrance fees to the stand etc., (2) fees paid by owners of horses, (3) license fees of book-makers, (4) share of totalisator receipts.[1]

Even a non-mutual association may sometimes be such as cannot make 'profits' in the strict sense of the term. A society founded for the diffusion of religious literature sold Bibles, etc., at a shop and sent out colporteurs to sell Bibles and act as cottage missionaries. *Held* that this was not 'trade.'

Per the Lord President.—"When we turn to the methods . . they were not commercial methods. . . . The business carried on is not purely that of pushing the sale of their goods but . . . . on the contrary the duty of the salesman is to dwell over the purchase and make it the occasion of administering religious advice and counsel."[2]

On the other hand in *Grove* v. *The Young Men's Christian Association*[3] in which the association ran a restaurant on commercial lines the restaurant was held to constitute a 'trade.'

Under the Indian law, however, the income in the last two cases would be either exempt under section 4 (3) (i) and (ii) or taxable as income from other sources (section 12) or income from business (section 10) according to the facts of each case.

Chit fund—Stake-holder—Not assessable—

The assessee conducted a 'chit' fund as a stake-holder and under the rules of the 'chit' the subscriptions received from the members minus 8 per cent. deducted by the stake-holder for expenses and charges including income-tax were auctioned every month among the subscribers. The lowest bidder at each auction was paid his bid and the difference between this bid and the amount actually put up for auction was distributed as premium among the chit-holders in the shape of reduced subscriptions. The assessee was assessed to income-tax as an agent of the chit fund in respect of the entire premia distributed during the assessment year on the ground that such premia represented the profits of the fund. *Held*, that the sums represented by the premia were not assessable to income-tax as the transactions of the fund could not be said to bring any profit to the subscribers as a whole. Also, even if such premia could be regarded as income,

(1) *Royal Calcutta Turf Club* v. *Secretary of State*, 1 I. T. C. 108; 48 Cal. 844.

(2) *The Religious Tract and Book Society of Scotland* v. *Forbes*, 3 Tax Cases 415.

(3) 4 Tax Cases 613.

the stake-holder could not be taxed on it as he had neither received it nor was entitled to receive it.[1]

Mutual fund—How far taxable—

The Mylapore Hindu Permanent Fund consisted of shareholders who subscribed one rupee per month and the funds were lent out among the shareholders themselves, or occasionally invested in securities or Bank deposits. The profits consisted of (1) the interest paid by borrowers, (2) penalties levied on shareholders, (3) interest on securities and Bank deposits. It was *held* by the Madras High Court following *New York Life Insurance Co.* v. *Styles*[2] and distinguishing *Leeds Permanent, etc., Society* v. *Malladaine*[3] that (3) was taxable but (1) and (2) were not.[4] The *ratio decidendi* is set out in the following part of the judgment :—

"The learned judges (*Wills* and *Grantham*, J.J.) observed:—"The case of *New York Life Assurance Co.* v. *Styles* was not in point, as the society is not a mutual society, whereas that Insurance Company was" (at p. 652). On appeal the whole argument turned on the application of *Clerical, Medical and General Life Assurance Society* v. *Carter*[5] and no reference was made to *Styles'* case either in the judgments of the Court of Appeal or the arguments before it and the decision of the Court of Appeal is no authority on the point now discussed. In that case a benefit building society consisted of two classes of members, (1) Investors each of whom invested one or more sums of £100 and (2) borrowers who do not invest but borrow from the society on shares or fifth parts of shares and pay 2*s*. 6*d*. per share or 6*d*. per fifth part of a share per week to the fund after the borrowing—this sum being intended to be a discharge of (1) the interest on the loan and (2) the principal. The resemblance between that case and the present one is in the fact that both the investors and the borrowers participate in the surplus and that the investors are like the shareholders in the present case but the difference consists in the fact that the borrowers are not like the shareholders and an investor can never be a borrower. It is obvious that the fact, that, while the investors only were the capitalists, the final participators consisted of the investors and borrowers, prevented its being a mutual company. If the real company in that case is regarded as consisting of the investors only, the income was earned from outsiders only and *Styles'* case cannot apply. This must have been the view of the Divisional Court—the borrowers being regarded as outsiders. It is clear that their payments of 2*s*. 6*d*. per share or 6*d*. per fifth part of a share per week can bear no analogy to the sums of £100 contributed by the investors and the final participation of the borrowers in the profits was considered as a bait

(1) *Board of Revenue* v. *North Madras Mutual Fund*, 1 I. T. C. 172.

(2) 2 Tax Cases 460.

(3) 3 Tax Cases 577.

(4) *Secretary, Board of Revenue* v. *Mylapore Hindu Permanent Fund*, 1 I. T. C. 217.

(5) 22 Q. B. D. 444; 2 Tax Cases 437.

to them and as a reduction of the interest they pay and not to alter their position as outsiders.''

With great respect it is submitted that the decision in the *Leeds Society* case depended as much on quite different considerations—for one thing on the ground (arguable no doubt) that ' interest ' was taxable as such if not as ' profits '—the latter alone raising the question of ' mutuality '. This, however, does not affect the correctness of the decision of the Madras High Court which follows *Styles'* case.

A company, partly with permanent capital divided into 'shares' and partly with fluctuating capital called ' subscriptions,' received deposits from its ' shareholders ' and ' subscribers ' as well as from outsiders, and lent moneys to all the three classes, the greater part of the transactions being with outsiders. Held that the society was not ' mutual ' and that its entire profits were taxable.[1]

Golf Club—Fees from non-members—

A golf club, not a ' company ', and admittedly a *bona fide* members' club, was bound under a clause in its lease to admit non-members to play on its course on payment of green fees to be fixed by the lessors but subject to a minimum fixed in the lease. These green fees were paid by the non-members and entered into the general accounts of the Club, which showed an annual excess of receipts over expenditure. *Held,* that the Club, in so far as it admitted non-members, carried on, for income-tax purposes, a concern or business capable of being isolated and defined and in respect of which it received profits that were liable to tax.[2]

Per Kennedy, L. J.—'' . . . . It is not, therefore, the common case of a golf club which admits to the use of its accommodation players who are introduced by a member or are approved by the club committee, and who, upon such introduction or approval, and upon payment according to the rules of the club, are admitted to the privileges of members, according to the rules of the club, for some specified period. It is not necessary to decide the point, but in such a case, I am inclined to think the persons to whom such privileges are accorded might fairly be regarded as becoming, for the time, members of the club, subscribing to its funds. But upon the facts appearing in the case, it appears to me that this club is really carrying on the business of supplying to the public for reward a recreation ground fitted for the enjoyment of the game of golf, and that the receipts derived from this business are in the nature

(1) *Trichinopoly Tennore Permanent Fund, Ltd.* v. *Commissioner of Income-tax*, 53 M. L. J. 881 (F. B.)

(2) *Carlisle and Silloth Golf Club* v. *Smith,* 6 Tax Cases 201.

of profits and gains in respect of which it is liable to assessment for income-tax."[1]

Mutual Insurance Company—

A mutual life insurance company had no members except the holders of participating policies, to whom all the assets of the company belonged. At the close of each year an actuarial valuation was made, and the surplus, if any, was divided between the participating policy-holders, who received their dividends in the shape either of a cash reduction from future premiums, or of a reversionary addition to the amount of their policies. The surplus divided consisted partly of the excess of the premiums paid by the participating policy-holders, over and above the cost of their insurances, and partly of profits arising from non-participating policies, the sale of life annuities, and other business conducted by the Society with non-members. *Held*, by Lords Watson, Bramwell, Herschell and Macnaghten (Lord Halsbury, L. C., and Lord Fitzgerald, dissenting), that so much of the surplus as arose from the excess contributions of the participating policy-holders is not profit assessable to the income-tax.[2]

The principle of this decision is, in the words of Lord Watson, that "when a number of individuals agree to contribute funds for a common purpose, such as the payment of annuities or of capital sums to some or all of them on the occurrence of events, certain or uncertain, and stipulate that their contributions so far as they are not required for the purpose shall be paid back to them, the contributions so returned should not be regarded as profits." In distinguishing the case from the *London Assurance Case*,[3] Lord Watson said :

"In *Styles' Case* there are no shares or shareholders in the ordinary sense of the term, but each and every shareholder of a participating policy becomes *ipso facto* a partner in the company with a voice in the administration entitled to a share in the assets and liable for all losses incurred by it."

The fact that the New York Insurance Company was incorporated did not make any difference. It is seen from Lord Herschell's judgment that the Attorney-General conceded that the incorporation did not affect the issue. Lord Macnaghten pointed out that, so far as participating policy-holders are concerned, the company was not formed for making profits, every member taking a participating policy becoming *ipso facto* a member of the company.

(1) *Carlisle and Silloth Golf Club* v. *Smith*, 6 Tax Cases 201.
(2) *Styles* v. *New York Life Insurance Company*, 2 Tax Cases 460.
(3) 2 Tax Cases 100.

It follows from the principle of the decision in the above case that the business done with the members by such a Society is of a different nature from the business done with non-members. The profits from the latter are taxable. But it should not be inferred from this that in every case the profits resulting from business with members should be separated from the profits from business with outsiders. If this were done it would be necessary, for instance, to exempt from taxation profits made by a Bank in lending to its shareholders or by a Railway in carrying its shareholders. The test is not whether the corporate body deals with its individual members or not but whether the body is in its essence a 'mutual' body. That is, does it so arrange with its members that the surplus is automatically returned to the members ? And does it primarily do business with its own members and only incidentally with outsiders ? In the Mylapore Fund case quoted *supra* if the Fund had freely lent to outsiders the Fund could not have claimed to be a mutual association. The test in such cases is first to find whether an association is ' mutual '; then only can we separate the two parts of its profits.

Proprietary Life Assurance Company—Restricted dividends—Not Mutual—

Under the law of the State of New York a share capital of $100,000 is required to be subscribed by every Life Insurance Society and to be invested in securities. The shareholders of a society established under this law were, by their Charter, entitled to receive a dividend not exceeding seven per cent. per annum. The earnings of the Society over and above the dividends, losses and expenses, were to be accumulated, and every five years after actuarial valuation each participating policy-holder was to be credited with a portion of the available surplus. The Society was managed by Directors appointed by the shareholders. The Charter gave power to the Directors to provide that each policy-holder of $5,000 should be entitled to vote at the annual election of Directors, but this power had not been exercised. The Society granted non-participating policies as well as participating, and did other business, the profits from all sources going to form the surplus. The Society had a branch in London, and it was claimed that the profits of the branch were not assessable to income-tax. *Held,* that the profits were assessable, the case being governed by *Last* v. *London Assurance Corporation*[1] (set out under section 10 *infra*). *Equitable Life Assurance Society of United States* v. *Bishop.*[2]

(1) 2 Tax Cases 100.
(2) 4 Tax Cases 147.

Building Society—

A Building Society, whose members consisted of investors and borrowers, made advances to the latter upon the security of their properties. In all cases the advance was made in respect of one or more shares which the borrower took in the Society, and upon each of which he paid 2*s.* 6*d.* per week in repayment of the advance, together with interest thereon. The Society refused to allow deduction of income-tax by the borrowers in respect of the interest included in the repayments, on the grounds that the interest could not be distinguished, and that it was not 'annual' interest. *Held*, that the Society was liable to assessment on the interest received, whether it be annual or not.[1]

Co-operative Society—

A Co-operative Society which buys milk from its members and sells it to outsiders is making taxable profits.[2]

Per Rowlatt, J.—"It has no profit from buying milk from its own members and if the public to whom they sell do not pay for it they do not get any profit at all. . . . The profits are made by the selling of the article, not by the buying of it at all in the meaning of this sub-section."

The question in the above case arose with reference to the Corporation Profits Tax Act which exempted profits of such societies arising from "trading with its own members"; but the principle enunciated by Rowlatt, J., is capable of extension to income-tax also. It is not clear whether any profits would arise, according to the principle of this decision, if the Society bought from outside and sold to its members. It would seem, not; for that is what every ordinary club does in respect of stores, drinks, etc., consumed by its members. In any case, there is no doubt that if a Society bought only from its members and sold to them only there would be no profits. As regards a 'company' however *see* cases below.

Social Club—

A company was formed to take over a Social Club. There was no share capital and the members of the company were the same as the members of the Club. Th company was of course a separate legal entity apart from the members but in substance the incorporation had not affected the members *inter se* or their relations to the Club. *Held*, that a business or trade or undertaking of similar character was not being carried on by the com-

(1) *Leeds Permanent Benefit Building Society* v. *Mallandaine*, 3 Tax Cases 577 (referred to in the Mylapore Fund Case).

(2) *Commissioners of Inland Revenue* v. *Sparkford Vale Co-operation Society*, 12 Tax Cases 891.

pany.[1] This decision, however, was overruled in the *Cornish Mutual Case* cited *infra*.

Mutual trading—Trading and making profits—Distinction between—

A limited liability company was formed for carrying on insurance other than life insurance. The number of members was unlimited. Every person taking out a contract became a member automatically and remained as such during the currency of the contract. Each new member paid an entrance fee. The directors were empowered to set aside sums for reserve and make calls on shareholders for general expenses. There was no subscribed capital. *Held*, that for the purposes of the Corporation Profits Tax the company was carrying on a 'trade' though it was not liable to income-tax. The House of Lords also doubted the correctness of the decision of the Court of Appeal in the *Eccentric Club Case* and this case must be taken as overruling the *Eccentric Club Case*.[2] See also notes under section 2 (4).

This decision, however, hardly affects the position in India in which there is no provision for taxing the profits of mutual trading concerns as there was in the United Kingdom Corporation Profits Tax Acts. The decision of the House of Lords in the *New York Insurance Case*[3] applies and the profits made by a mutual company cannot be charged either to income-tax or to super-tax. *See* however the cases set out below.

Trade Association—

The Liverpool Corn Trade Association was a company formed to promote the interests of the corn trade by Parliamentary and other action; to adjust disputes between persons engaged in the trade; to provide, regulate and maintain an exchange, market and room for the corn trade in Liverpool; and to establish and maintain a clearing-house for the clearance of contracts. Shares could be held only by persons engaged in the corn trade and no member could hold less than one or more than two shares. The second share could be requisitioned by the company for a new member if no shares were otherwise available. In addition to the members there were also subscribers who were elected from time to time by the directors but had no shares and no right to vote and merely enjoyed the services and facilities provided by the Association. All the fees and subscriptions

(1) *Commissioners of Inland Revenue* v. *Eccentric Club, Ltd.*, 12 Tax Cases 657.

(2) *Cornish Mutual Assurance Co.* v. *Commissioners of Inland Revenue*, 12 Tax Cases 841.

(3) 2 Tax Cases 460.

belonged to the Association absolutely and were disposed of at the discretion of the directors. The directors could set aside sums to the credit of a reserve fund and recommend the payment of dividends which had to be declared by the Association in a general meeting but as a matter of fact no dividends had been declared for nearly 20 years. It was contended by the Association that the transactions with the members were mutual and the resulting profits not liable to tax. The profits made from non-members were admitted to be liable to tax. *Held*, that the profit was assessable to tax even though it resulted from transactions with the members.

Per Rowlatt, J.—" . . . . in the *New York Case* . . . there was no share capital to provide any assets or to form the basis of any dividend . . . . people who came to that corporation and tendered premiums and were accepted for life insurance on a participating basis became what was called members of that corporation—not shareholders but members of that corporation—and . . . . the operation which was carried on and which was said to yield profits in that case was simply the operation of collecting money, to put it quite shortly, from those shareholders—from those members, those policy-holders—and putting them under a proportionate liability to provide further moneys, if necessary, if there were losses, and, on the other hand, affording to those policy-holders the protection of insurance and the possibility of a dividend declared to them, not as shareholders in the ordinary sense, but as policy-holders, which would be made good to them, not by a payment, but by a reversionary addition to the value of their policies . . . . . . where there is not any share capital and no shareholders, but you call the policy-holders members of the company, so that they may go and vote at meetings, and so on, then it does not matter if there is an incorporation, because the corporation is merely an entity which stands at the back, and all it is doing is to collect from a certain body of people certain funds and hand them back to them as far as they are not wanted. . . . . In a case like that it does not matter whether there is an incorporation or not, because there is nothing belonging to the corporation which is severable from what belongs to the aggregation of individuals. . . . . But in a case of this kind, where there is a share capital, with a chance of dividends, a chance to a right to dividends if declared, upon the share capital, and to one side of that a dealing with people who happen to be the owners of the share capital, affording benefits to those people one by one individually, for which they pay money by way of subscriptions and by way of entrance fees as a sort of over-riding subscription, if I may use that word, which opens the door to subscriptions, there is no reason at all for saying that you neglect the incorporation, or that you can regard as otherwise than as profits the difference which is obtained by dealings between that corporation and people who happen to be its members. . . . ."[1]

(1) *Liverpool Corn Trade Association, Ltd.* v. *Monks*, 5 A. T. C. 288.

Mutual insurance—Workmen's compensation—Indemnity against—

The assessees were a company formed to indemnify the members against claims on account of workmen's compensation. The members were colliery owners. Each member had to contribute on the basis of the wages paid by him. The contributions went into a general fund from which sums were from time to time transferred to a reserve fund. The general fund was the primary fund for meeting claims. Part of the risk was reinsured. Members could retire on giving six months' notice and a retiring member was entitled to take with him his proportion of the reserve fund *minus* his proportion of the expenses and liabilities of the association up to the date of his retirement. The Special Commissioners felt some difficulty in reconciling the *New Lork Life Insurance Case*[1] with *Salomon* v. *Salomon & Co., Ltd.*[2] *Held,* that the profits made by the company were not taxable

Per Rowlatt, J.—It is true to say a person cannot make a profit out of himself, if this is what is meant, that a man may provide himself with something at a lesser cost than he could buy it, or do something for himself or provide service for himself—shave himself, if I may take a simple illustration—instead of employing somebody and paying him to do it. He does not make a profit; he saves money, but he does not make a profit, and in that sense it is true to say that a person does not make a profit out of himself. But a company can make a profit, I think, out of its members, quite clearly. That is to say, it may make a profit out of its members as customers. It may do that, although it can only deal with its members; it may make a profit out of its shareholders, to put it quite clearly. An ordinary company may make a profit out of its shareholders as customers, although its range of customers is limited to its shareholders (as Lord Halsbury put it in the *New York Case,* if a betting man is to be taxed on bets, it is none the less betting because he only bets in a certain club), but that is only because the company only deals with the shareholders as customers. and if it makes profits as a railway company by carrying its shareholders, or if a trading company, by trading with its shareholders, even if it is limited to trading with its shareholders, and by buying and selling makes a profit, that profit belongs to the shareholders, in a sense, but it belongs to the shareholder as a shareholder. It does not come back to him as a purchaser or customer. It belongs to him as a shareholder, upon his share. That seems to me quite simple and quite obvious. But now one has got to the case, in the *New York Insurance Company Case*, as I understand it, where all that the company does is to collect money from a certain number of people and apply it for the benefit of those same people, not as shareholders in the company, but as the people who subscribed it, and, as I understand, the *New York Case*, what they said was this, that in that case there is not any profit; it does not matter if you call these people members of the company, or

(1) 4 Tax Cases 460.
(2) (1897) A. C. 22.

call them participating policy-holders, or call them anything you please; all that this company is doing is to collect money from people, for those people, to do things for them, and let them have the balance of their profit in some way or other; that is all it is doing, and there is no profit in that transaction. If the people do it for themselves there is no profit. If they incorporate a legal entity to do it for them, and to provide the machinery for them there is no profit any more; not because you must disregard the entity of the company and say it is only the individuals—which is wrong; that is what seems to puzzle the Commissioners below. It is only because there is not any profit. The money is simply being collected from those people and handed back to those people in their character of the people who have paid it—not handed to them in the character of shareholders or anything else, because that would be introducing different considerations, because there the company would be taking an interest severable from the people who paid the money—but merely receiving the money from one set of people and handing it back to the people who have paid it, and as their right. This is what I understand is the *New York Case*.

Now what have we here? Is there any distinction between this case and the *New York Case?* I do not think there is any. I cannot see any distinction. This money which is subscribed by these members is used for their protection, and the fund belongs to them, and a large amount is kept in hand; and I must say I can see quite well that, inasmuch as the money is not distributed year by year, and the calls are not limited to the actual losses, but a fund is built up, you can say in a certain sense that there this company has got a fund which it holds as a company, and that succeeding people who come in come into a company which has got a fund, and therefore there is something here which the company has which is not divided among the people who pay it, but it is kept in the hands of the company *in medio*, and therefore you have the company here making a fund which does not go back to the people who subscribed it individually. But I think that must have been the case in the *New York Company's Case* too because they had a reserve fund there, and that reserve fund must have meant that, when all is done as regards the particular loss, when a life drops and the assured's executors are paid the amount due upon his policy, with bonus additions, there is still something left in the fund every time, so that the company is always surviving with a fund in its hands beyond what is necessary to pay the claims as they become due. I think that must have been the case in the case of the *New York Life Insurance Co.* v. *Styles*, and yet it made no difference and I think the broad principle laid down was that, if the interest in the money does not go beyond the people who subscribe it, or the class of people who subscribe it, then there is no profit of any sort earned by the people themselves, if the people did it for themselves, and there is none if they get a company to do it for them. That is all there is in the case. . . .[1]

(1) *Jones v. South-West Lancashire Coal-owners' Association*, 6 A. T. C. 641.

Both the House of Lords and the Court of Appeal confirmed Mr. Justice Rowlatt's judgment. The House of Lords considered that *Styles' Case* covered cases of this kind.

Destination of profits—Immaterial—Does not affect liability to tax—

The destination of the income, profits or gains is immaterial, so long as it is income, profits or gains to the assessee who is sought to be taxed. *Paddington Burial Board* v. *Commissioners, Inland Revenue.*[1]

Profits applied in aid of poor rates—held *not* exempt.

Per Day, J.—" Once profits are ascertained to exist . . . . Income-tax attaches."

Mersey Docks v. Lucas,[2] profits applied to creating a sinking fund for extinguishing debts—held *not* exempt.

Per the Lord Chancellor.—" The word ' profits '. . . . . does mean the incomings of the concern after deducting the expenses of earning and obtaining them, before you come to an application of them even to the payment of creditors of the concern. . . . . The gains of a trade are that which is gained by the trading, for whatever purposes it is used, whether it is gained for the benefit of the community, or for the benefit of individuals. . . . ."

Sowrey v. *King's Lynn Harbour Mooring Commissioners*[3] (a similar case).

Per Smith, J.—" If once you get a taxable profit . . . . it is immaterial what the destination of that sum may be."

City of Dublin Steam Packet Company v. *O'Brien*[4] (a similar case).

Blake v. *Imperial Brazilian Ry.*[5]—guaranteed interest received from Government devoted to payment of debenture interest and to payment of sinking fund—*held* that the whole of the guaranteed interest received was taxable. A similar case was *Nizam's Guaranteed Railway* v. *Wyatt.*[6]

See also *Webber* v. *Glasgow Corporation*[7]—application of profits to the common good of the burgh, *Armitage* v. *Moore,*[8] application for the benefit of creditors, and also some of the English cases cited under charitable purposes (the position re-

(1) 2 Tax Cases 46.
(2) 2 Tax Cases 25.
(3) 2 Tax Cases 201.
(4) 6 Tax Cases 101.
(5) 2 Tax Cases 58.
(6) 2 Tax Cases 584.
(7) 3 Tax Cases 202.
(8) 4 Tax Cases 199.

garding charitable purposes is however radically different in the Indian law—*see* notes under section 4 (3) (i) and (ii)).

. . . They are nevertheless for this purpose a trading company and these sums . . . . are not the less profits by reason of their ultimate destination.—Per Baron Pollock—*Dillon* v. *Corporation of Haverfordwest.*[1]

"It does not matter what the income is expended on if the subject-matter is taxable."[2]

"It is idle to argue such a question, *i.e.*, whether the mode of distribution of a person's income cannot affect his liability to taxation, or even to occupy public time in referring to it because the very point was decided by the House of Lords in the case of the *Mersey Docks, etc.* v. *Lucas* and in making that decision Lord Selborne almost apologised for giving his reasons, as in substance the question had been decided twenty years before by the House of Lords. . . . ."[3]

". . . . . . If this is not profit . . . . the amount of profit . . . . must depend on the resolution of the company to pay off or not to pay off debts."[4]—

"Income-tax cannot be due or not due according to the manner in which a person making profit pleases to deal with it."[5]

"If money is otherwise liable to income-tax it cannot escape taxation by reason of its being applied to a capital purpose."[6]

A sum receivable as salary or wages is not the less salary or wages because it has to be applied in a particular manner.[7]

The compulsory application of income to a specific purpose does not prevent it from being income[8] nor does it relieve the income from liability to taxation.[9]

See also *In re Royal Calcutta Turf Club*[10] (an Excess Profits Duty Case).

Income, profits or gains withheld at source—

Difficult problems arise when a portion of the income, profits or gains is withheld at the source before the income reaches the assessee. The test to be applied in such cases is whether the withholding merely represents the payment of a personal

(1) 3 Tax Cases 31.

(2) Per Rowlatt, J.—*Board of Conservators of Severn Fishery District* v. *O'May*, 7 Tax Cases 194.

(3) Per Palles, C.B.—*Dublin Corporation* v. *MacAdam*, 2 Tax Cases 400.

(4) Per Lord McLaren—*Arizona Company* v. *Smiles*, 3 Tax Cases 149.

(5) Per Lord Traynor—*Granite Company* v. *Kitton*, 5 Tax Cases 168.

(6) Per the M. of R. in *Hudsons Bay Co.* v. *Stevents*, 5 Tax Cases 436.

(7) *Smyth* v. *Stretton*, 5 Tax Cases 36.

(8) *Tennant* v. *Smith*, 3 Tax Cases 158, at p. 165; *Harris and Corporation of Irvine*, 4 Tax Cases 221, at p. 232; *Smyth* v. *Stretton*, 5 Tax Cases 36.

(9) *Mersey Docks* v. *Lucas*, 1 Tax Cases 385; *Trustees of Mary Clark Home* v. *Anderson*, 5 Tax Cases 48.

(10) 1 I. T. C. 108.

debt or liability of the assessee or represents a share in the income itself to which the assessee has only a residual claim after the prior claims have been met. In the former case the withheld income clearly belongs to the assessee and is taxable, while in the latter case it is not. In other words, the test is whether there is an effective alienation of the income at the source, *i.e.*, before the assessee can claim it. The test, however, is a difficult one to apply and border-land cases often arise as will be seen from the decisions set out *infra*.

Salary attached—is liable to tax. *See* para. 23,—Income-tax Manual set out under section 7.

Tax withheld at source—Income of assessee—

The income-tax which is withheld at source is clearly part of the assessee's income and of this there can be little doubt. The tax is a personal liability of the assessee and it is only the convenience of the administrative machinery that is responsible for the tax being collected at source. Similarly the portion of a person's income attached in favour of creditors or a compulsory payment by a husband to a wife on account of the latter's maintenance are all personal debts and not shares of income *withheld at source*. A voluntary payment is in no case deductible; and even necessary payments are not always deductible.[1]

Encumbered property—Income from—

Per Lord Davey in *London County Council* v. *Attorney-General*.[2]—" It was no doubt considered that the real income of an owner of incumbered property or of property charged, say with an annuity under a will, is the annual income of the property less the interest on the incumbrance or the annuity."

This was explained by Lord Macnaghten in *Attorney-General* v. *London County Council*[3] to mean that the charge for the interest or the annuity ought to be a *real* burden.

" If the interest or the annuity is discharged by some person other than the incumbered owner or deviser without recourse to such owner or deviser the burden is nominal."

Trust—Liability to tax—

Difficult questions arise in determining who is liable to tax—whether the legal owners or the beneficial owners; and the

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(1) See however *Eadie* v. *Commissioners of Inland Revenue*, *Earl Howe* v. *Commissioners of Inland Revenue*, *Commissioners of Inland Revenue* v. *Paterson*, *Commissioners of Inland Revenue* v. *Wemyss*, *infra*.

(2) 4 Tax Cases 265.

(3) 5 Tax Cases 242.

answers depend, as will be seen from the decisions set out, on the facts of each case and the general law relating to trusts.

See also the decisions set out under section 40, and notes.

Debts—Not charged on income—

"The payment of interest on estate duty was not an outgoing necessary for obtaining the income from investments. The interest on estate duty was not legally charged upon or payable out of the sum received for dividends but was payable out of any moneys in the hands of the appellants as trustees. . . . .

Mr. M. . . . suggested . . . . that when a tax-payer collects an income and is subject to the obligation of diverting it into two streams, one of which streams is to flow into the coffers of a creditor, then he must be considered to have collected that part of his income for and on behalf of the creditor. . . . . . In my view the tax-payer in such a case collects the whole income for himself and then (if he is an honest man) pays his debts to his creditor."[1]

Shares—Beneficially transferred—Dividends on—

With a view to affording certain employees a closer personal interest in the business, the principal controlling shareholder (Sir Charles Parsons) set aside some shares of his to be transferred to each employee when the dividends thereon together with any sums paid by the employee amounted to the par value of the shares. The dividends and any payments by the employees were credited to the shares in a separate account for each employee; and if the employee died before the shares were fully paid for, the full amount credited to his account was to be paid to his estate in cash. But until the actual transfer of the share of employee the shares were in the ownership of Sir Charles Parsons who received the dividends. *Held*, that the dividends were taxable as the income of Sir Charles Parsons.[2]

Profits—Share of—Accumulated—

The assessee made an advance of £7,000 to a company in 1905. In consideration of this he received (i) from the Company, £7,000 5 per cent. Debentures repayable by the Company after December, 1914, by half-yearly instalments of £500, and (ii) from a director of the Company, 5, 600 £1 ordinary shares (being one-fifth of the total share capital of the Company), of which he was to retransfer 400 shares on receiving each payment of £500. Subject to certain adjustments he was also to receive one-fifth of the Company's profits each year up to December, 1914, and thereafter a share of the profits corresponding, in effect, to the proportion of the £7,000 Debentures remaining unrepaid from time

(1) Per Viscount Cave—*Lord Inverclyde's Trustees* v. *Millar*, 9 Tax Cases 14.

(2) *Sir Charles Parsons* v. *Commissioners of Inland Revenue*, 5 A. T. C. 341 (confirmed by the Court of Appeal).

to time. The Company did not pay him in respect of the profits for the years 1915, 1916 and 1917 until January, 1920, when, in accordance with a resolution in general meeting in June, 1919, £6,000 was paid to him in settlement of his dues for those three years. He received nothing further in respect of profits until May, 1921, when, in accordance with resolutions of the directors and the shareholders in general meeting in December, 1920, he was paid £10,000 in full settlement of the liability under the agreement up to the 31st December, 1921, the prospective date of its termination. The sums of £6,000 and £10,000 were assessed to super-tax for the years 1920-21 and 1921-22 respectively as forming part of his total income for the years 1919-20 and 1920-21 respectively and, on appeal, the Special Commissioners confirmed the assessments. *Held* that, under the original agreement, the assessee was entitled to have his share of the profits paid to him each year, and that, for the purpose of computing his income for super-tax purposes, the said sums of £6,000 and £10,000 must be spread over the years in respect of the profits of which they were paid, subject however, to the entire exclusion from liability to super-tax of such part of the sum of £10,000 as represented a composition of his right to receive a share of the profits of the year 1921.[1]

Payments—Accumulated—

On the death of his grandfather on 11th June, 1917, the assessee succeeded to certain estates as heir of entail in possession, his father Lord Binning, the heir apparent, having predeceased on the 12th of January, 1917. By his marriage contract Lord Binning, as heir apparent, had charged the estates with certain payments to his widow and the younger children. On petition by the assessee the Court of Session had restricted the charges on the estate. The assessee contended that the payments to the widow, etc., were not 'payable' till the Court had decided on his petition, *i.e.*, he claimed to deduct from his income the accumulated payments on account of the period from the date of his father's death to the date of the judgment. *Held,* that the charges were payable from his father's death, the Court deciding only the precise amounts payable, *i.e.*, were to be spread over several years and deducted from the assessee's income of each year.[2]

It is doubtful, however, whether this decision and the one in the *Hawley* case will apply to India. Under section 5 of the

(1) *Hawley v. Commissioners of Inland Revenue,* 9 Tax Cases 331.
(2) *Commissioners of Inland Revenue* v. *The Earl of Haddington,* 8 Tax Cases 711.

English Income-tax Act, 1918, in estimating the . . . income of the previous year for the purpose of super-tax,

"any income which is chargeable with income-tax by way of deduction shall be deemed to be income of the year in which it is receivable . . . . notwithstanding that the income . . . . accrued in whole or in part before that year."

In the absence of a similar provision under the Indian Act, there is no authority for spreading income over years other than the year of receipt the latter being determined in accordance with section 13. It is possible, however, that in certain cases of this kind the accumulated income received may be of the nature of capital. Accumulation as the result of the recipient not taking payment regularly would perhaps justify such accumulated income being treated as income and not as capital; but an involuntary accumulation may in certain circumstances stand on a different footing and justify the treatment of the receipt as capital.

Employees—Contingent Interest in business—

The owner of a business, who desired its continuance after his death, provided, *inter alia,* that the net profits should be divided annually among certain selected employees, of whom the appellant was one, in certain shares. Ten per cent. of the profits was to be paid over to the said employees in proportion to their shares, but the remainder was not to be drawn out by them until the whole of the late owner's capital had been paid out. In the meantime their shares were credited to their respective accounts in the books. The employees had no power to sell or dispose of their interests, which did not vest in them till the whole of the capital had been paid out. On a claim by the appellant to abatement—*held,* that the business was the property of the trustees, that the employees were only employees and not partners, and that the appellant was not assessable in respect of his share of the 90 per cent. which was placed to his credit in the books but was not paid over to him, it not being a part of his income.

Per Lord Stormonth Darling.—"Of course the mere fact that under a man's contract of service a portion of his salary is held up or payment of it deferred . . . . does not the less make it a part of his income. The deferred portion of the salary is still salary. . . . . There is all the difference between a case of that kind and one where the fund said to form part of a man's income may, from causes over which he has no control, never be his at all."[1]

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(1) *Walker v. Beith,* (1906) 8 F. 381; 43 Sc. L. R. 245.

House—Life-rent use of—No power to let—Annual value of—Not income—

Under his father's will the assessee was entitled (in the events which happened) during the subsistence of the trust of the residuary estate, to occupy a mansion-house and grounds so long as the trustees should find it expedient to retain it in their hands unlet. The trustees were directed to hold it in trust "for the life-rent use" of the assessee so long as his mother should remain alive, subject to his not contravening a certain condition. The assessee had no power to let the property. The residuary estate was to be held in trust until the mortgages on the testator's estate had been reduced to £100,000, the ultimate remainder being to the assessee absolutely and in fee, if then living, and in default to his issue.

The assessments to income-tax under Schedule A (in respect of the house and grounds) and under Schedule B (in respect of the grounds) were made in the name of the assessee, but the tax was paid by the trustees. *Held* (for the purpose of super-tax) that the annual value of the house and grounds did not form part of the income of the assessee.[1]

Surplus income retained by Trustee—Not income of beneficiary—

Under his ante-nuptial marriage contract the assessee assigned to trustees his interest in certain shares in a company on trust to pay the income to himself for life, but, in the event of the yield from certain of the shares exceeding the rate of 12½ per cent. free of income-tax in any year, the trustees were to retain such excess income and apply it from time to time in reducing the charges on the trust funds created by the assessee.

Subject to a life interest to assessee's wife, if she survived him, the settled funds were to go to the children and, in default of children to attain a vested interest, to revert to the assessee. The assessee also had power to redeem the trust funds for £100,000 to be held on the same trusts.

Held, that the income under the marriage contract from the said shares so far as exceeding 12½ per cent. per annum did not form part of the assessee's income for the purposes of super-tax.[1]

Encumbered property—Income charged in favour of creditors—

"The income there[2] in question was not applicable for payment of a debt of the person to whom it otherwise would have belonged

(1) *Commissioner of Inland Revenue* v. *Wemyss,* 8 Tax Cases 551.

(2) The *Wemyss* case, *supra.*

. . . . the object of the destination of that part of the income was the increase of the settled funds."—*Per Warrington, L. J.*[1]

" The question is whether when a debtor buys a property with borrowed money and charges the proceeds of the property in favour of creditors to repay the debt, these proceeds are income of the debtor . . . . and I may ask if they are not income of the debtor whose income are they? . . . . If it is not the debtor's income it must be the creditor's income and I am not sufficiently topsy turvy to think of a creditor discharging debts due to him out of his own income."—*Per Scrutton, L. J., ibid.*[1]

Alienation of income—Declaration of trust—Whether effective—

In 1916 the assessee decided to make some provision for his wife and daughter. A deed of settlement was drafted in January, 1917. Under this deed he and his wife were appointed trustees. The completion of the deed was, however, delayed till April, 1919. Under that deed trusts relating to property vested in the trustees on or before January, 1917, were to become effective from that date. In respect of other properties specified in the schedule to the deed the trusts were to become effective from the date on which such properties became vested. Along with the items of the schedule were some shares in a company of which the assessee was a director. These shares stood in his name. At a directors' meeting held in February, 1917, sanction was given to these shares being transferred to the joint names of the assessee and his wife, and an account in the joint names of the trustees was opened in the company's books in March, 1917. Thereafter the dividends were paid into the account of the trustees; but until the trust deed had been completed the shares remained in the assessee's name. The assessee had verbally informed his wife that he would eventually transfer the shares to the trustees and that meantime he would hold them upon trust. The question arose whether there had been a valid declaration of trust with effect from January, 1917, and as a consequence the assessee was liable to super-tax in respect of the income after that date. *Held,* by the House of Lords, confirming the decision of the Court of Appeal, that an effective trust had not been created on that date. The verbal declaration made by the assessee to his wife was not an immediate and complete declaration of trust but merely a declaration of his intention to settle his shares. Meanwhile he kept them *in medio* so that they might be ready when the trust was effectually declared.[2]

(1) *Commissioners of Inland Revenue v. Paterson*, 9 Tax Cases 163.
(2) *Allan v. Commissioners of Inland Revenue*, 4 A. T. C. 105.

Trustees—Transfer of shares to— Dividends declared before execution of trust deed—Whose income—

Mr. Stott owned some preference shares in a company which he transferred by a deed dated 29th April, 1919, to the joint names of himself and Mr. B. as trustees for Mr. B.'s minor sons. On 30th April a trust deed was executed which provided *inter alia* that "the trustees will henceforth stand possessed of the said shares, and of the income thereof upon trust" for the benefit of the minors. On the same day, *i.e.*, 30th April, Mr. Stott received from the company a cumulative preference dividend covering the last 7½ years. The cheque for the dividend was dated 29th April. The company registered the transfer of the shares on the 6th of May. On the 9th of May a dividend warrant was endorsed by Mr. Stott and paid into the trustee's joint account. The Commissioners held following the decision in *Duncan* v. *Commissioners of Inland Revenue*[1] that the trust became effective from 30th April and that the dividend was the income of the recipient, *viz.*, Mr. Stott. *Held,* reversing the decision of the Commissioners, that an effective trust had been created by the transfer of the shares. That part of the decision of the Irish Court of Appeal in *Commissioners of Inland Revenue* v. *Allan*[2] which was not appealed against to the House of Lords was followed.[3]

Separated wife—Obligatory payments to—

Under an agreement between the assessee and his wife he had to pay her a weekly sum of £30 for her separate use during their joint lives. *Held,* that the payments could be deducted in computing the assessee's income for super-tax purposes.

Per Rowlatt, J.—"Although he is separated he cannot deduct it if he is separated not on the terms of paying the money, or if he is under no obligation to pay it, but merely sends it because he thinks it is the right thing to do, or, for some other reason, voluntarily sends it week by week. . . . . If he had not paid I do not think he could have defended an action for a moment, if an action had been brought against him. He would have been beaten. . . . . He went on paying the money because he was legally compelled to do so, and was under an obligation to do so. Therefore he is entitled to deduct it."[4]

Partnership—Obligatory Reserve Fund—Not income of partners—

The assessee and his brother were partners in a business of which the property and goodwill had been bequeathed by their

(1) 2 A. T. C. 319.
(2) 3 A. T. C. 497.
(3) *Trustees of Brennan Minors* v. *Scanlan*, 4 A. T. C. 381.
(4) *Kadie* v. *Commissioners of Inland Revenue*, 9 Tax Cases 1.

father's will upon trust for his two sons for life upon condition that they should enter into partnership. In order to preserve the assets of the business the trustees under the will compelled the partners to enter into an agreement under which a certain percentage of the net profit of the business was to be set aside in each half-year to create a reserve fund to meet any losses arising out of the business. Subject to this condition the reserve fund remained the property of the partners. *Held*, that the sum set aside was an annual payment reserved or charged upon the net profits of the partners whereby the income of each of the partners was diminished.[1]

Trustees—Chargeable on full income—No deductions admissible—

Certain trustees who were in Scotland received remittances from trust property abroad and distributed the net income of the trust among the beneficiaries. *Held*, that the full amount received in the United Kingdom is chargeable with income-tax, without any deduction in respect of expenses incurred in the United Kingdom in managing the trust.

Per the Lord President.—It is for them (the trustees) to point to the section of the statutes which entitled them to make such a deduction. I think they have entirely failed.

Per Lord McLaren.—The management of the trustees is really, I venture to think, of the nature of what is described in one of the rules as a private or domestic use . . . . the only kind of deductions allowed is expenditure incurred in earning the profits, and . . . . there is no deduction under any circumstances allowable for expenditure incurred in managing profits which have been already earned and reduced into money—pounds, shillings and pence.[2]

Legacy Duty paid by trustees—included in total income—

The assessee was entitled under a will to a share of the net annual income of the testator's residuary estate. Legacy Duty was chargeable on the sums so payable from year to year, and was duly paid to the Crown by the trustees, who deducted it from their remittances to the assessee.

Held that, although the trustees were primarily accountable for the Legacy Duty, it was, in effect, a personal obligation of the assessee, and that the income receivable under the bequest had been rightly included in the computation of his total income for the purposes of super-tax in the full amount of his share of the net residuary income, *plus* the income-tax applicable thereto, with-

(1) *Stooker v. Commissioners of Inland Revenue*, 7 Tax Cases 304.
(2) *Aikin v. Trustees of C. M. Macdonald*, 3 Tax Cases 306.

out deduction of the Legacy Duty paid by the trustees on his behalf.[1]

Settled estate—Minor — Contingent interest—Accumulated income— Under a will, certain lands of the testator were, subject to certain interests of the widow, to be held in trust for the eldest son living at the time of his death absolutely on his attaining the age of 21 years and the residue of the property both real and personal was to be converted into money and invested. The capital and income of such investment was to be held in trust for all the children in equal shares and were "an interest or interests absolutely vested" upon the testator's death. Discretion was given to the trustees to apply the whole or part of the income to which any child was entitled to his or her maintenance; and the balance was to be accumulated by investment. There was only one son and three daughters. The widow remarried and all that she became entitled to was an annuity from the residuary estate. The son was sought to be assessed to super-tax on the income from real property *plus* the one-fourth share in the income of the residuary estate. The Special Commissioners discharged the assessment on the ground that the income was not 'receivable' by the minor as required by sub-section 2 of section 66 of the Finance Act, 1910. The Crown appealed and the appeal was upheld by Rowlatt, J. :

"Sub-section 2 is not a sub-section which is defining income. It is dealing with the year in which a person's income must be estimated. The word 'receivable' does not come in as defining the income chargeable; it comes in merely to connect 'income' with 'year', any other form of words might have been used just as well."

The more important part of the Crown's case was that the interest of the minor was 'vested' and not 'contingent' and that therefore the Crown was entitled to tax the minor as though he had received the income in question.

The decision on this point was as below :

"The first point which (counsel for the assessee) makes is that it does not matter whether the interest . . . . is vested or contingent, because, even assuming that this specific bequest is vested . . . . still, inasmuch as there is a trust to accumulate a fund during the infancy of the eldest son, subject to a power to the trustees to supply such sum as they think proper for his maintenance, the part of the income which is accumulated is not the income of the minor. It is a very important point, but I have come to the conclusion that he is right. It is perfectly true to say as (counsel for the Crown) did that in a case of that kind the income must come to the infant in the end if

(1) *Colville v. Commissioners of Inland Revenue*, 8 Tax Cases 442.

the interest which he takes is a vested interest; but in my judgment it will not come to him as income; it will come to him in future in the form of capital. . . . It is income which is held in trust for him in the sense that he will ultimately receive it, but it is not in trust for him in the sense that the trustees have to pay the income to him year by year while he is an infant. . . . I think that view of the case is supported by *Inland Revenue Commissioners* v. *Wemyss*[1] . . . . I think this case is quite different from a case where the infant has the right to the money now but where the money remains in the hands of his trustees, not because of any directions in the will which directed it to be accumulated but because he is an infant and cannot receive the money and give a receipt for it, and it therefore remains in the hands of his trustees, being invested but lying ready for him, waiting for the time when the infant can give a good receipt for it. . . . I think the language that was used in the House of Lords in *Drummond* v. *Collins*[2] suggests that view . . . . there are expressions which, in my judgment, point to this conclusion that it is only when the discretion of the trustees is exercised, so as to give the infants a portion of the income which was being accumulated for them, that the liability to income-tax attaches. I find also material support for the view I take, although the point would not come directly under discussion, in *Williams* v. *Singer*[3] . . . ."

Against this the Crown appealed. The Court of Appeal remanded the case for a definite ruling as to whether on the construction of the will the minor's interest was in fact vested or contingent. Tomkin, J., held that it was contingent and this decision was upheld in the Court of Appeal. The question therefore as to what would have been the liability to tax if the interest had been vested was not settled by the Court of Appeal, and Rowlatt J.'s view has neither been affirmed nor overruled.[4]

Payments free of tax—Wills—Marriage settlements—Other contracts—

Under the English law there is an express provision, Rule 23, General Rules (all schedules), declaring that " every agreement for payment of interest, rent, or other annual payment in full without allowing any such deduction shall be void ". This has been construed to mean that the agreement would be void only as regards the particular stipulation for the payment without deduction.[5]

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(1) 8 Tax Cases 551.

(2) 6 Tax Cases 525.

(3) 7 Tax Cases 787.

(4) *Commissioners of Inland Revenue* v. *Blackwell's Trustees*, 10 Tax Cases 235.

(5) See *Gaskell* v. *King*, (1809) 11 East 165; *Wigg* v. *Shuttleworth*, (1810) 13 East 87; *Readshaw* v. *Balders*, (1811) 4 Taunt 57; *Fuller* v. *Abbott*, (1811) 4 Taunt 105; *Tinckler* v. *Prentice*, (1812) 4 Taunt 549.

There is a very large number of English cases regarding the effect of provisions in wills, marriage settlements and other contracts that payments should be made 'free of income-tax'. The decisions are somewhat contradictory but the following general principles can be deduced. Unlike other duties income-tax is a personal tax, not a tax on an estate.[1] Therefore the courts have generally held that all payments under such provisions are taxable in the hands of the recipient (by deduction at source) but if there is clear indication that the object of the testator or other person making the contract was to make the payment free of income-tax the payment should be made free of such tax.[2] A direction in general words such as 'a clear annuity' (*In re Loveless*), or 'free of all duties' (*In re Saillard*), or 'clear of all taxes and deduction '[3] is not enough; there must be either express provision that the income-tax should be borne by the trustees and not by the legatee or provisions which will bear no doubt as to that having been the intention of the testator.

If a will directs the payment of an annuity or other sum free of income-tax the direction must be carried out.[4]

"It is simply a matter of construction . . . . whether the testator has given the annuity together with a sum equal to the income-tax to the annuitant so that the annuitant may receive the annuity free of tax or has simply given an annuity and left the annuitant to bear his own income-tax."[5]

It was also held in *Festing* v. *Taylor*[6] that bequests free of income-tax were not void as wills had not been referred to in section 103 of the 1842 Act (corresponding to Rule 23, General Rules now) and the omission could not be accidental. This is due to the fact that under a will the parties "take their respective rights from the bounty or the forbearance of the testator". Even as regards non-testamentary payments it has sometimes been held that contracts to pay free of tax are not void.

See also the following cases :—*Murdock's Trustees* v. *Murdock and others*[8]; *Smith's Trustees* v. *Gaydon*[9]; *Wilson's Trus-*

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(1) See *Lethbridge* v. *Thurlow*, (1851) 15 *Beav.* 334 and *Sadler* v. *Richards*, (1858) 4 K. and J. 302.

(2) See *Turner* v. *Mullineux*, (1861) 1 John and H. 334; *Festing* v. *Taylor*, (1862) 7 L. T. 429; *Abadam* v. *Abadam*, (1864) 33 Beav. 475.

(3) *Gleadow* v. *Leetham*, (1882) 22 Ch. D. 269.

(4) *Lovat (Lord)* v. *Duchess of Leeds*, (1862) 31 L. J. Ch. 503.

(5) Per Swinfen Eady, L. J., in *In re Sillard Prath* v. *Gamble*, (1917) 2 Ch. 401.

(6) (1862) 3 B. & S. 217; 7 L. T. 429.

(7) See *Brooke* v. *Price*, (1917) A. C. 115 (a settlement on dissolution of marriage); *Beadel* v. *Pitt*, (1865) 11 L. T. 592 (lease).

(8) (1918) 55 Sc. L. R. 664.

(9) (1918) 56 Sc. L. R. 92.

tees v. *Wilson*[1]; *In re Loveless, Farrer* v. *Loveless G. A.*[2]; *In re Bowring, Wimble* v. *Bowring.*[3]

A bequest free of income-tax is not free of super-tax.[4]

The above decisions will not apply to India in so far as the liability of the trustee to deduct tax at source is concerned. Under sections 7 and 18 of the Indian Income-tax Act, it is only annuities that are paid by Government, etc., or a private employer that can be taxed at source. Annuities under wills can be taxed only under section 12, *i.e.*, by the Income-tax Officer making an assessment on the annuitant; and his liability to tax will not be affected even though under the will he may be entitled to be reimbursed this tax from the estate, or if the payment is not under a will, from the person paying him the annuity.

So many complicated cases have arisen in the United Kingdom because under the law there the trustee is taxed on the gross income and is authorised to recoup himself by deducting tax from the annuitant.

Contracts—Free of tax—

Though there is no provision in the Indian Statute corresponding to Rule 23 of the English General Rules, it will apparently make no difference because under section 23 of the Indian Contract Act an agreement not to deduct tax where it has to be deducted is not enforceable. This, however, would not prevent a person so contracting as to pay the other party so much as would after deduction of tax leave him a specified net amount. That is, the consideration for the contract would be the gross amount.[5]

CAPITAL AND INCOME.

The tax is on income, profits and gains and not on capital. Capital receipts would be exempt under 4 (3) (vii) as they would *ex hypothesi* be casual and non-recurring nor could they be "income, profits or gains" even if they arose out of business or the exercise of a profession, vocation or occupation.

In this respect, *viz.*, that of taxing 'income, profits and gains' and not 'capital' there is no difference between the Indian law and the English. "Income-tax is a tax on income."[6]

(1) (1919) 56 Sc. L. R. 256.

(2) (1918) 2 Ch. 1.

(3) (1918) W. N. 265.

(4) See *In re Crawshay, Crawshay* v. *Crashay*, (1915) W. N. 412; also *In re Bates, Selmes* v. *Bates*, 4 A. T. C. 518.

(5) See *North British Railway Co.* v. *Scott*, 8 Tax Cases 332 and *Hartland* v. *Diggines*, 10 Tax Cases 247; *South American Stores* v. *Commissioners of Inland Revenue*, 12 Tax Cases 905.

(6) Per Lord Macnaghten—*London County Council* v. *Attorney-General*, 4 Tax Cases 265.

"I think it cannot be doubted upon the language and the whole purpose and meaning of the Income-tax Acts that it never was intended to tax capital as income at all events."[1]

Similarly the law does not permit losses or expenditure of a capital nature to be deducted from taxable income or profits —*see* sections 9 to 13.

As to what constitutes the distinction between capital and income, it is almost impossible to give a satisfactory definition. As Pollock, M. R., said—

"What is capital and what is attributable to revenue-account I suppose is a puzzling question to many accountants and I do not suppose that it is possible to lay down any satisfactory definition."

Income—

"Income" signifies "what comes in."[2] "It is as large a word as can be used" to denote a person's receipts.[3]

A person's "income"—even "total income from all sources", S. 8, 39 Vd., 16,—means, money, or money's worth, received by him and (in this connection, at least) money's worth must be something that "can be turned into money"[4] the tax, whether under Schedule D or E, is, "not on what saves a person's pocket but, on what goes into his pocket" (*per Lord Macnaghten, Ib*). Therefore, an employee, though of so superior a character as a Bank Manager, who as part of the terms of his employment has to reside on his employer's premises, which residence he gets rent free but cannot sublet or turn to pecuniary account, does not thereby get any addition to his income, any more than does the Master of a Ship who is spared the cost of house-rent while afloat.[5] It may be a gain to him, in the popular sense of the word but it is not "profits or gains," as that phrase is used in Schedule D, nor is it "Salaries, Fees, Wages, Perquisites, or Profits" within Rule 1, Schedule E, nor is it "Profits, Gains, or Emoluments," within Rule 2, Case 3, Schedule D, or "Perquisites . . . . . from Fees or other Emoluments," within Rule 4, Schedule E (*Ib*). V. Income-tax. (Stroud) (But this decision does not apply in its entirety to India—*see* section 7.)

"Profits" and "income" are sometimes used as synonyms; but, strictly speaking, "income" means that which comes in without reference to the outgoings; whilst "profits"

(1) Per the Earl of Halsbury in *Secretary of State for India* v. *Scoble*, 4 Tax Cases 618.

(2) Per Selborne, L. C.—*Jones* v. *Ogle*, 42 L. J. Ch. 336.

(3) Per Jessel, M. R.—*Re Huggins*, 51 L. J. Ch. 938.

(4) Per Halsbury, C.—*Tennant* v. *Smith*, (1892) A. C. 150.

(5) *Tennant* v. *Smith*, (1892) A. C. 150.

generally means the gain which is made when both receipts and payments are taken into account.[1]

Extraordinary profits of a company are "income" or "capital" according to the way in which the Company (acting within its powers) deals with them; if they are distributed as a dividend, they are income."[2] If properly used for creating new shares, they are "Capital".[3] (Stroud.)

These decisions about 'capital' and 'income' however require to be applied with caution. The distinction between the two for the purpose of other Acts, *e.g.*, the Companies Act, is not always—though it is ordinarily—the same as the distinction for purposes of income-tax. Similarly the decision in *Tennant* v. *Smith* referred to above though relating to income-tax will not apply in its entirety under the present Indian law.

Per Fletcher Moulton, L. J.—"The word 'profits' has in my opinion a well-defined legal meaning, and this meaning coincides with the fundamental conception of profits in general parlance, although in mercantile phraseology the word may at times bear meanings indicated by the special context which deviate in some respects from this fundamental signification. 'Profits' implies comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates. For practical purposes these assets in calculating profits must be valued and not merely enumerated. . . . A depreciation in value, whether from physical or commercial causes, which affects their realizable value is in truth a business loss. . . . . But though there is a wide field for variation of practice in these estimations of profits in the domestic documents of a firm or a company, this liberty ceases at once when the rights of third persons intervene. For instance, the revenue has a right to a certain percentage of the profits of a company by way of income-tax. The actual profit and loss accounts of the company do not in any way bind the Crown in arriving at the tax to be paid."[4]

(This however was not an Income-tax Case.)

Gains—

"Although in the Income-tax Act, 1842 (Schedule D and section 100), 'profits' and 'gains' are really equivalent terms, yet the use of the word 'gains' in addition to the word 'profits' furnishes an additional argument for excluding the contention that you are to introduce into the word 'profits' some ideas connected, not with the nature of the thing but, with the manner and rule of its application. What are the 'gains'

(1) *People* v. *Niagara Supervisors*, 4 Hill 23.

(2) *Re Alsbury, Sugden* v. *Alsbury*, 45 Ch. D. 237.

(3) *Bouch* v. *Sproule*, 12 App. Ca. 385; *Svthe, Re Northage*, 63 L. J. Ch. 488; *Vh, Re Paget*, 9 Times Re. 88; *Re Malam*, (1894) 3 Ch. 578; *Re Armitage*, (1893) Ch. 337.

(4) *In re Spanish Prospecting Co., Ltd.*, (1911) 1 Ch. 92.

of a trade? If it could be reasonably contended that the word 'profits' in these (Income-tax) Acts has reference to some advantage which the persons carrying on the concern are to derive from it, it might be said, perhaps, that the same argument might have been raised upon the word 'gains,' but, to my mind, it is reasonably plain that the 'gains' of a trade are that which is gained by the trading, for whatever purpose it is used, whether it is gained for the benefit of a community or for the benefit of individuals.''[1]

Capital—

"I think the word 'capital' itself rather points to something which is to be in its application to a source, I will not say of invested income but a source of income not merely by way of loan, I do not know how to express it better; the construction may be too refined but it seems to me you would not expect such language to be used with reference to a temporary deposit in a bank.''[2]

The emphasis, it will be seen, is on the *temporary* nature of the deposit. The above dictum refers to a case under the English law under which income from land in the shape of fines on renewal of leases is exempt from tax if used as productive capital.

"There is nothing to show that that word should bear a different meaning in the Income-tax Acts (from that in the Companies Acts) when applied to the proceedings of Joint Stock Companies.''[3]

Income—

"Without giving an exhaustive definition it may be described as the annual or periodical yield in money or reducible to money value arising from the use of real or personal property or from labour or services rendered bearing in mind that in some cases, *e.g.*, income derived from house property, the yield must be taken as the *bona fide* annual value and not necessarily as the actual yield.''[4]

Profits—

Should be understood in its natural and proper sense in a sense which no commercial man would misunderstand.[5]

U. S. A.—

The same difficulty has been felt in the U. S. A. As one writer says,

"What is needed is an authoritative definition of 'income.' It cannot be found in the Supreme Court decisions because there are too many differentiations and limitations to make it at all

(1) Per the Lord Chancellor—*Mersey Docks* v. *Lucas*, 2 Tax Cases 29.

(2) Per Wright, J., in *Lord Mostyn* v. *London*, 3 Tax Cases 294.

(3) Per Lord Atkinson in *Scottish North American Trust* v. *Farmer*, 5 Tax Cases 693.

(4) Per Dawson Miller, C. J., in *In re Raja Jyoti Prashad Singh Deo*, 1 I. T. C. 103.

(5) Per Halsbury, L. C., in *Gresham Life Assurance Society* v. *Styles*, 3 Tax Cases 185.

clear what a decision will be in any future case." Another defines 'income' as "the money value of the net accretion to one's economic power between two points of time." This of course will not fit in with the Indian or the English law neither of which taxes the appreciation of capital values—whether realised or not.

"The meaning of that word (income) is not to be found in its bare etymological derivation. Its meaning is rather to be gathered from the implicit assumptions of its use in common speech. The implied distinction, it seems to us, is between permanent sources of wealth and more or less periodic earnings. Of course the term is not limited to earnings from economic capital, *i.e.*, wealth industrially employed in permanent form. It includes the earnings from a calling as well as interest, royalties or dividends . . . . yet the word unquestionably imports, at least so it seems to us, the current distinction between what is commonly treated as the increase or increment from the exercise of some economically productive power of one sort or another and the power itself, and it should not include such wealth as is honestly appropriated to what would customarily be regarded as the capital of the corporation taxed."[1]

The above decision *U. S.* v. *Oregon—Washington* (New York) was given in a case in which it was held that a gift to a corporation was not taxable income.

In *Macomber* v. *Eisner*,[2]

Pitney, C. J., said, "Enrichment through increase in value of capital investment is not income in any proper meaning of the term, that is, if unrealised by the persons who are taxed. Again, after examining dictionaries in common use (Bouve L. D. Standard Dictonary; Webster's International Dictionary, Century Dictionary) we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909.[3] "Income may be defined as the gain derived from capital, from labour or from both combined" provided it be understood to include profit gained through a sale or conversion of capital assets to which it was applied in the Doyle case."

The difference between the U. S. law on the one hand and the English and the Indian on the other in this particular respect is chiefly the taxation of appreciation of capital values in certain circumstances in the U. S. A.

The decisions that have been set out below refer to capital *receipts*. The decisions about capital *expenditure* have been set out under section 10 (2) (ix) which prohibits the deduction of capital expenditure from taxable profits.

(1) *B. & Nev. Co.*, 251 Fed. 211.

(2) 252 U. S. 189.

(3) *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 185.

As regards Capital Receipts, *see* also the decisions that have been set out under ' Business '—section 2 (4) ; and Casual Receipts—section 4 (3) (vii). These subjects overlap.

Bonus Shares—

In *Bouch* v. *Sproule*[1] a testator bequeathed his residuary estate in trust for his wife for life and after her death to some one else absolutely. Part of the residue constituted shares in a company whose directors had power before recommending a dividend to set apart out of the profits such sum as they thought proper as reserve fund for certain purposes. On the recommendation of the directors the company by special resolution passed a new article empowering the directors with the sanction of the company in a general meeting afterwards given to declare a bonus to be paid to the shareholders out of the reserve fund with its profits so enlarged or out of any other accumulated profits in proportion to their shares. The directors allotted to each shareholder new shares in proportion to his existing holdings, crediting the amount taken from the reserve fund as paid upon the new shares. It was held that the allocation by the company was in substance not a distribution of profits but a capitalisation thereof.

Per Lord Justice Fry in the Court of Appeal—

"When a testator or settlor directs or permits the subject of his disposition to remain as shares or stocks in a company which has the power either of distributing its profits as dividend or of converting them into capital, and the company validly exercises this power, such exercise of its power is binding on all persons interested under the testator or settlor in the shares, and consequently what is paid by the company as dividend goes to the tenant for life, and what is paid by the company to the shareholder as capital, or appropriated as an increase of the capital stock of the concern enures to the benefit of all who are interested in the capital."

cited with approval by Lords Herschell and Watson in the House of Lords who confirmed the decision.

Though this decision was not a Revenue decision but merely one relating to the rights of a tenant for life and the remainderman, the general principle underlying it, *viz.*, that if a company validly capitalises its profits, its action is valid as against the outside world was considered in *Commissioners of Inland Revenue* v. *Blott*[2] *infra* to extend to Revenue matters also.

In the *Swan Brewery Company* v. *The King*,[3] however, it was held under an Act of West Australia which specially defined

(1) 12 A. C. 385.
(2) 8 Tax Cases 101.
(3) (1914) A. C. 231.

'dividend' as including "every dividend, profit, advantage or gain intended to be paid or credited to or distributed among any members or directors of any company except the salary or other ordinary remuneration of directors" that bonus shares issued out of undivided profits were taxable as income; that is to say, the company had in effect declared a dividend within the meaning of the Act equal to the nominal amount of the new shares.

But this decision was not followed by the House of Lords in *Commissioners of Inland Revenue* v. *Blott,* though Lord Sumner who delivered the judgment of the Privy Council in the *Swan Brewery case* and also sat in the House of Lords in the *Blott case* considered that the decision of the Privy Council did *not* turn on the special definition of 'dividend' in the taxing statute of West Australia.

Bonus Shares—In same company—Not income—

The assessee was a shareholder in a Limited Company, which, under the authority of its Articles of Association, had declared a bonus out of its undivided profits and, in satisfaction of such bonus, had allotted to its shareholders as fully paid up certain ordinary shares forming part of the company's authorized but unissued capital. The shareholders had no option to receive cash in lieu of shares in satisfaction of the bonus. *Held* (Lords Dunedin and Sumner dissenting), that the shares credited to the respondent in respect of the bonus, being distributed by the company as capital, were not income in the hands of the assessee.

"The money so applied is capital and never becomes profit in the hands of the shareholder at all. What the latter gets is no doubt a valuable thing. But it is a thing in the nature of an extra share certificate in the company. His new shares do not give him an immediate right to a larger amount of the existing assets. These remain where they were. The new shares simply confer a title to a larger proportion of the surplus assets if and when a general distribution takes place, as in the winding up... A shareholder is not entitled to claim that the company should apply its undivided profits in payment to him of dividend. Whether it must do so or not is a matter of internal management to be decided by the majority of the shareholders. He cannot sue for such a dividend until he has been given a special title by its declaration. Until then, no doubt, the profits are profits in the hands of the company until it has properly disposed of them, and it is assessable for income-tax in respect of these profits. But if, acting within its powers, it disposes of these profits by converting them into capital instead of paying them over to the shareholders, that, as I conceive it, is conclusive as against all the outside world, including the Crown, and the form of the benefit which the shareholder receives from the money in the hands of the company is one which is for determination by the company alone."—*Per Lord Haldane.*

". . . . As the capital was increased, it might reasonably be expected that the profits of the company would be increased, and that the shareholders would benefit in this way, but their relative shares in the undertaking remained the same. The use of the sums which had been available for dividend to increase capital would enable the company to carry on a larger and more profitable business, which might be expected to yield larger dividends. These dividends, however, were to be in the future. So far as the present was concerned there was no dividend out of the accumulated profits; these were devoted to increasing the capital of the company. The company had power to do what it pleased with any profits which it might make. It might spend the accumulated profits in the improvement of the company's works and buildings and machinery. These improvements might lead to a great accession of business and increase of profits by which every shareholder would benefit, but of course it could not for a moment be contended that such a benefit would render him liable to super-tax in respect of it. The benefit would not be in the nature of income, and super-tax can be levied only on income. It would be so levied on the dividends afterwards received.

"The benefit, and the sole benefit which the assessee derived, was that the business in which he had a share was a larger one, with more capital embarked in it, precisely as might have been the case if the accumulated profits had been applied in the improvement of the company's works and machinery. . . . . . The preference shares are in themselves valueless."—*Per Lord Finlay.*

"The transaction took nothing out of the company's coffers, and put nothing into the shareholders' pockets; and the only result was that the company, which before the resolution could have distributed the profit by way of dividend, or carried it temporarily to reserve, came thenceforth under an obligation to retain it permanently as capital. It is true that the shareholder could sell his bonus shares, but in that case he would be realising a capital asset producing income, and the proceeds would not be income in his hands. It appears to me that, if the substance and not the form of the transaction is looked to, the declaration of a bonus was, as Mr. Justice Rowlatt said, "bare machinery" for capitalising profits, and there was no distribution of profits to the shareholders."—*Per Lord Cave.*

". . . . It takes two to make a paid-up share. A share issued . . . . is a share to be paid for; paid for by the allottee in meal or in malt; in money, unless by contract between himself and the company he is enabled to satisfy his obligation to pay by some other consideration moving from himself to the company. Under the contract in question, what consideration so moves from the shareholders? None that I can see, except the discharge of the company's debt for a dividend, which has become due to him by being declared. When debt for dividend is set off against debt for calls and the account is squared, the equivalent of payment of a dividend takes place. If the word 'bonus' has some effect to the contrary, then no consideration has moved from the shareholder and his shares are not fully paid. The company can choose whether it will divide its profits in meal or in malt; if it decides to divide otherwise than in cash, a contract to accept something in lieu of cash operates nothing, for no right to cash has accrued. A contract to accept shares in satisfaction instead of cash implies, first a declaration which gives the right that has to be satisfied, and second a satisfaction of that right, which is equivalent to payment. . . . It is just as reasonable to call the shares allotted "mere machinery" for wrapping up a distribution of profits as to call bonus shares " mere machinery " for effecting distribution of capital. . . ."—*Per Lord Sumner* (dissenting).[1]

Bonus Shares—Of Other Company—Income—

The assessee company which was registered and carried on business in England as an Investment Trust Company owned a number of common shares of $100 each in the Union Pacific Railroad Company. It was held by the Supreme Court of the United States that the Union Pacific Railroad Company, an American Company, had so invested its accumulated reserve funds as to contravene the Sherman Anti-Trust Statute. The company was required by the Court to dispose of its entire holding of Common Stock of the Southern Pacific Railway Company in such a manner as to terminate the control of that company by the Union Pacific Railroad Company. An arrangement for this purpose received the approval of the Court, and was carried into effect, under which a portion of the said holding of Southern Pacific Railway Company's Common Stock was transferred to the Pennsylvania Railroad Company in exchange for holdings of Preferred Stock and Common Stock in the Baltimore and Ohio Railroad Company, and the remainder of the holding was sold for cash. The Union Pacific Railroad Company thereupon distributed a substantial portion of its accumulated surplus funds, and declared an Extra Dividend on its Common Stock, to be satisfied by the distribution to the holder of each $100 share of: $12 (par value) Preference Stock and $22.50 (par value) Common Stock in the Baltimore and Ohio Railroad Company and $3.00 in cash. At the same time the Company announced its intention to reduce the regular rate of dividends on its Common Stock from 10 per cent., at which for many years it had stood to 8 per cent., but explained that the annual income derivable from the Stock, etc., comprising the Extra Dividend would compensate approximately for the reduction of 2 per cent. in the rate of dividend.

The assessee company duly received certain Common Stock and Preference Stock in the Baltimore and Ohio Railroad Com-

(1) *Commissioners of Inland Revenue v. Blott*, 8 Tax Cases 101.

pany, together with a payment in cash in respect of the Extra Dividend on its holding of common stock in the Union Pacific Railroad Company, and it sold the stocks included in such Extra Dividend for £1,086-19-6 and credited the proceeds to capital account in its books.

Held, that in the payment of the Extra Dividend there was a distribution not of capital assets but of assets which were profits or gains in respect of which the assessee company was chargeable with income-tax.[1]

Per Sankey, J.—Now there have been many decisions chiefly in connection with the winding up of companies, or the interpretation of wills, where the difference between income, capital and accumulated profits has been discussed and dealt with, and there are undoubtedly some where it has been held that by reason of the facts accumulated profits have been transmuted into capital. For example in *the Bridgwater Navigation Company*[2]; in the *Spanish Prospecting Company, Limited*[3]; *Andrew* v. *Thomas*[4]; it was held that accumulated profits had not been impressed with the character of, or become, capital. In *Bouch* v. *Sproule*[5] it was held they had. . . . . .

As Lord Finlay says in Blott's case[6]—"The case differs *toto caelo* from a case in which a dividend is paid not in money but in money's worth by the delivery, say, of goods or securities." If there has been no release of assets, there has been no distribution and there is nothing to tax; neither is there anything to tax if the release is the distribution of capital. The case of Blott was so decided because the majority of the Members of the House of Lords were of opinion that there had been no release of assets. The company in fact kept the assets in respect of, and distributed, previously unissued capital. Similarly in the case *Bouch* v. *Sproule*[5] the company kept the accumulated profits and allotted new shares (partly paid up) in respect thereof. . . . .

In my view the true test as to whether a distribution of shares falls to be taxed depends upon two questions:—(1) Whether there has been a release of assets, and (2) if so, whether the assets released were capital or income.

As to (1).—In the present case there has been a release of assets within the meaning of the words as used by the majority of the Law Lords in Blott's case. As to (2).—I doubt if it is possible, I am sure it is not desirable, to lay down in answer to the second question any general rule for future guidance. Monsieur Portalis, one of Napoleon's Commissioners, observed, "We have guarded against the dangerous ambition of wishing to regulate and wishing to foresee everything. The wants of

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(1) *Pool* v. *Guardian Investment, etc.,* 8 Tax Cases 167.
(2) (1891) 2 Ch. 317.
(3) (1911) 1 Ch. 92.
(4) (1916) 2 Ch. 331.
(5) (1887) 12 A. C. 385.
(6) 8 Tax Cases 101.

society are so various that it is impossible for the legislature to provide for every case of every emergency." It would be quite easy to put cases decisively on one side of the line or the other, but it is not part of the duty of a Judge, nor indeed is it his right, to decide such cases as against his successors, by anticipation.

The matter appears to be free from authority in England, but it has already been decided in the Supreme Court of the United States where the principles of law to be applied in this respect do not differ, in my view, from our own. In the case of *Peabody* v. *Eisner*[1] it was held that a dividend by a Corporation of shares owned by it in another Corporation is not a stock dividend and is subject to the tax like an equivalent distribution of money. By a stock dividend is meant a dividend paid in the company's own stock which, as the Court pointed out, in fact took nothing from the property of the Corporation and added nothing to the interest of the shareholder, but merely changed the evidence which represented this interest.

Later on the whole matter was discussed and it was decided in *Einser* v. *Macomber*[2] that mere growth or increment of value in a capital investment is not income: income is essentially a gain or profit in itself of exchangeable value, proceeding from capital, severed from it and received by the tax-payer for his separate use, benefit and disposal, and that a stock dividend evidencing merely a transfer of an accumulated surplus to the capital account of the Corporation takes nothing from the property of the Corporation and adds nothing to that of the shareholder and a tax on such dividend is a tax on capital increase.

As Mr. Justice Pitney points out in giving the judgment of the Supreme Court of the United States, at page 206 of the Report, the fundamental relation of capital to income has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop—the former depicted as a reservoir supplied from springs, the latter as the outlet stream to be measured by its flow during a period of time. He cites on the subsequent page various definitions, one of which was that income may be defined as the gain derived from capital, from labour or from both combined, and points out that the essential matter is that income is not a gain accruing to capital but a gain derived from capital.

Applying the metaphor of a reservoir to *Blott's case*[3] the facts found therein may be stated as follows:—From the reservoir of capital certain proceeds were allowed to flow down the outlet stream, but these proceeds were not allowed to reach the shareholder; the company enlarged the area of the reservoir and put back the proceeds into the enlarged reservoir—in other words the proceeds in that case never became the profit or gain or income of the shareholder, but were put back into the capital of the company and the unissued shares issued to the shareholder in respect thereof.

(1) (1917) 247 U. S. Reports 347.
(2) (1919) 252 U. S. Reports, 189.
(3) 8 Tax Cases 101.

Now in the present case just the opposite has happened.

The proceeds have been allowed to flow down the outlet stream, but they have not been put back into capital. They have been allowed to reach the shareholder in the form of a cash payment and a dividend in specie of the shares of another company, or, as Lord Halsbury put it in the case of *Tennant* v. *Smith.*[1] "There has been a distribution of money and of money's worth." I am far from saying that there can never be a distribution of capital to the shareholders of the company. There might certainly be such a distribution in the case of the voluntary winding up of a company and the division of its capital assets among the shareholders, but in the present case, I am entirely unable to say that there was any distribution of capital, as distinguished from profits or gains. I again repeat the words of Lord Finlay in *Blott's case*[2] where he said that that "case differed *toto caelo* from a case in which a dividend is paid not in money, but in money's worth by the delivery, say, of goods or of securities," or as Mr. Justice Pitney in Macomber's case says, at page 215:—"The reliance upon the supposed analogy between a dividend of the Corporation's own shares and one made by the distribution of shares owned by it in the stock of another company calls for no comment beyond the statement that the latter distributes assets of the company among the shareholders while the former does not."

In the present case there has been, as above stated, a distribution of assets and for the reasons that I have endeavoured to give, in my view those assets were not capital assets, but were profits or gains and are taxable under the Income-tax Act.

The so-called dividend was severed from the capital, was not added to it and never became part of it, but was received by the company for its separate use, benefit and disposal.[3]

This decision has been quoted with approval in subsequent cases, *e.g., Commissioners of Inland Revenue* v. *Executors of* Bishop *Fisher.*[4]

For an exposition of the question how far bonus shares or 'stock dividends' as they are called in America can be 'income' *see also* an article by Professor Seligman in the American Economic Review, September 1919, which generally supports the views of the Supreme Court in the case of *Eisner* v. *Macomber* referred to above.

Bonus—Debentures—Same company—Not Income—

A company distributed its undivided profits in the shape of debentures—a portion of which were to be exchanged for fully paid preference shares. *Held* by the House of Lords affirming

(1) 3 Tax Cases 158.

(2) 8 Tax Cases 101.

(3) *A. F. Pool* v. *Guardian Investment Trust Company, Limited,* 8 Tax Cases 167.

(4) 10 Tax Cases 302.

the decision of the Court of Appeal (reversing the decision of Rowlatt, J.) that these debentures were not income in the hands of the shareholders.

The judgment of Lord Sumner (who was in the minority in *Blott's Case*) sets out the *ratio decidendi* very clearly.

My Lords, the authority of *Blott's Case*[1] constrains your Lordships to dismiss this appeal, but, as I regret the necessity for this conclusion, perhaps I may venture to state how it is that, in my view, in spite of considerable differences of fact between the two cases, the result must, nevertheless, be the same.

Shortly stated, I understand that *Blott's Case* was decided on this principle. To attract super-tax to a bonus distributed to him by a company, in which he is a shareholder, what reaches the tax-payer must at that moment bear the character of income, impressed upon it by the Company which distributes it, and by it alone. Provided that the company violates no statute and also keeps within its articles, it can call the subject-matter of the distribution what it likes, and, I think, this involves the corollary, that it can either call it by a new name or simply discard its old one. After all, it is natural for the creature to be named by its creator. Further what the company says it is, that it is as against all the world. What the company says it shall no longer be, that it is no longer for any purpose. How this is effected and by what resolutions, confirmations and instruments does not matter, for such things are "bare machinery." In what the company has said and done is found the answer to the question. What has the subject-matter of the distribution now become or ceased to be, when first it reaches the tax-payer?[2] Transmuted by this alchemy, profits in hard-earned gold became extra share-certificates, and yet the shareholders, who receive them, may be greatly the gainers.

Both cases are alike in the following respects. In both, the company had among its assets considerable amounts of undivided profits and its board proposed to distribute among its shareholders shares of stocks of an aggregate face value corresponding to the amount of the undivided profits, which were to be dealt with. The company passed a resolution to distribute a bonus in the form in the one case of preference shares, part of an authorised but as yet unissued amount, and in the other of debenture stock, newly created for the purpose. In the former case the shares were to be credited as fully paid and, as between the company and the shareholders, the shares distributed carried no liability for calls but enjoyed a full right to participation upon the footing that they were paid up. In truth, however, nothing was paid up on the shares, though alterations in the books and balance-sheet were made as required. In the later case the company executed a trust deed in which a large indebtedness was acknowledged to exist, which in truth was purely voluntary, for the company had borrowed nothing and owed nothing to the trustees, and the deed included a covenant to pay off that indebtedness

(1) (1921) 2 A. C. 171; 8 Tax Cases 101.

(2) See *Viscount Haldane*, pp. 182, 184, 188 and *Viscount Finlay*, pp. 194, 196, 197, of 1921, 2 A. C.

at a future time. To authorise the creation of this stock an amendment had to be made in Articles 42 and 43. Under the heading " borrowing powers," these were originally directed to borrowing money and to securing money borrowed. By this amendment they were extended to securing the payment of sums of money and securing the repayment by an issue of debenture stock. I assume, without deciding, that this amendment authorised what was done, since the Crown has not contested the point, though, even after the amendment, borrowing continues to be the salient and perhaps the pervading feature of the articles. In neither case were any assets "released"[1]; they remained in the business just as before. In each case the advantage, which the company got by what was done, was simply this, that money, which might have been distributed at any time as dividend under ordinary resolutions declaring a dividend and authorising its payment, could no longer be dispersed in this simple way, but, if at all, only by more complicated resolutions duly passed by the shareholders and in *Blott's Case* probably involving liquidation. Were there an antagonism in interest between a company and its shareholders, there might be some intrinsic advantage in such a change, but otherwise the object of it must in *Blott's Case* be sought in some conflict of view between different bodies of shareholders as to the extent of the conservation of assets to be adopted by the company and in the present case also in some private liability affecting some of the shareholders but not the company. As a matter of fact, if the sum, in respect of which the debenture stock was issued in this case, had been distributed as cash dividends, nearly the whole of the ordinary shareholders would have been chargeable with super-tax in the following year, and some of them in large amounts. To the company this mattered nothing, but I cannot think it was lost sight of in the transactions in question.

In both cases the resolution with which the transaction began spoke of " capitalising " the undivided profits and distributing the sum dealt with as a " bonus," and in both cases the use of the word " dividend " was carefully avoided. It was submitted to your Lordships, as the essence of the decision in *Blott's Case*, that assets, consisting of profits earned but not divided, were to be turned into authorised share capital, and that, if so, the decision would not apply in the present case, where no alteration was made in the share capital. I am unable to accept the first reply suggested by the respondents, that the sum actually was turned into capital, namely, loan capital, since it is clear that no such addition to effective capital, as arises when a company borrows a large sum on the security of its assets, was brought into existence at all, and I do not myself think that debts or promises to pay form part of capital, though some debtors do. The second reply was very different, namely, that it was natural to speak of "capitalising" and "converting" into capital in *Blott's Case* for there a purported "capitalisation" took place, but these expressions ought not to be read as limiting the *ratio decidendi* to cases, where new paid-up capital is created in the strict sense of the word. The real application of the principle is to assets, from which any

(1) *Pool's case*, (1922) 1 K. B. 357; 8 Tax Cases 167.

further character of divisible profits has been taken away, whatever may be the substituted character thereafter impressed upon them. If so, that principle applies here. My Lords, for my part I think this argument is right and to hold otherwise would be disloyal to the former decision of your Lordship's House.

There are also expressions in *Bouch* v. *Sproule* and in *Blott's Case* which direct attention to the "substance" of the company's transaction, but I do not think these affect the present appeal either. *Lord Herschell*[1] speaks of looking at "both the substance and the form"; so does Lord Finlay in *Blott's Case*.[2] Lord Cave, on the other hand, uses the expression:[3] "If the substance and not the form of the transaction is looked to." In both cases, however, both the form and substance were fully considered. Not only were the deeds and resolutions construed, but the scheme of the transaction, its financial results, and the supposed desires and intentions of the company were examined. Lord Finlay speaks of the option, which was given to the shareholder in *Bouch* v. *Sproule*, as one which should be ignored because it was merely formal.[2] Lord Cave speaks of that option as at least so substantial that it might make a difference, and as a feature not occurring in *Blott's Case* (p. 202). In spite, however, of these discussions and divergences all the noble and learned Lords, who formed the majority, refused to be influenced by the fact that to call the shares "paid up" was formally untrue, on the ground that the form of transferring the required sum from the category of undivided profits to that of paid-up share capital had been correctly gone through in accordance with the articles.

Accordingly I think the present case cannot be distinguished on this ground. The proposition that the substance of a transaction must be looked to and not merely the form, is generally invoked against those who have carried it out. I think it is unusual, where the form of a transaction is against those whose transaction it is to invoke the substance in their favour, in order to eke out what they have left defective in form. Sometimes, again, it is the "intention" of the company that is said to be dominant;[4] sometimes it is what the company "desired" to do.[5] In any case desires and intentions are things of which a company is incapable. These are the mental operations of its shareholders and officers. The only intention that the company has is such as is expressed in or necessarily follows from its proceedings. It is hardly a paradox to say that the form of a company's resolutions and instruments is their substance. At any rate, in the present case there is no need to distinguish between form and substance in the transaction itself or to refer to desires or intentions, further than to examine what was done, for everything was carried out in plain terms and without concealment.

(1) 12 A. C. 398.
(2) (1921) 2 A. C. 198.
(3) (1921) 2 A. C. 201.
(4) *Burrell's Case*, (1924) 2 K. B. 68.
(5) (1921) 2 A. C. 200.

What the requisite majorities of the shareholders desired and intended is pretty plain, too, but that is another matter.

Equally must the Crown fail in its contention that the shareholder is taxable, because at any rate the company distributed money's worth, namely, debenture stock that could be sold. The point was before the House in *Blott's Case*. Lord Haldane (p. 184) said that the share distributed to the shareholder was " valuable ", and Lord Finlay (p. 196) that it was " valueless ", but this difference of opinion made no difference in their conclusion. Lord Cave (p. 199) expressly deals with it, saying that the shareholder no doubt got something which he could sell, but if he did so he would be selling a capital asset, producing income (p. 200). The fact is that money's worth is not a material circumstance until the bonus distributed has been shown when still in the company's hands and at the time of distribution to be impressed with the character of income of the company. If it is not, the bonus does not attract tax as part of super-tax payer's income, even though he spends it, when he gets it, exactly as he spends his taxable income.

My Lords, the highest authorities have always recognised that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any express terms or of any omissions that he can find in his favour in taxing Acts. In so doing, he neither comes under liability nor incurs blame. It may be a question, however, whether these considerations of justice and public policy apply equally to a limited liability company, a creature of the law strictly controlled by statute, in a case where it has no interest in either payment of or escape from a tax that is not levied upon it. In this case a sum of £64,464-5, part of the profits of the current year 1914, has been dealt with apart from the undivided accumulations, an amount sufficient in itself to have paid a dividend on the issued ordinary shares of 25 per cent. or 5*s.* in the pound for every pound paid up, and by the use of " mere machinery " it has been converted into debenture stock, not redeemable under normal circumstances for six years certain. This is valid as against all the world, because *Bouch* v. *Sproule* now applies to revenue cases and because, under *Blott's Case*, the mere decision of the company, operating through voting majorities, whose private motives and interests may have been no concern of the company at all, has this effect. If any part of the dividends of the year can be so converted, I presume all could be, nor, if a six years' currency of the debenture stock is permissible, do I see why six weeks should be less so. How far this position is tolerable is, however, a matter for the Legislature. It is not material here, but I think it may well be doubted whether, in the long run, it should be permissible for a limited liability company to create obligations, for which no consideration has been given to it, or to increase its paid-up share capital out of its own assets, without imposing on the holders of this additional share capital the usual obligations, which are involved in the subscription of shares.[1]

(1) *Commissioners of Inland Revenue* v. *Execrs of Rt. Rev. Fisher*, 10 Tax Cases 302.

Bonus—Debentures in same company—Not taxable—

Mr. Whitmore owned the whole of the ordinary capital and he and his wife the bulk of the preference capital in Whitmores, Ltd., the rest of the shares being held by their close relatives. The company had a large accumulation of undivided profits which it distributed partly as paid-up shares in the company and partly as debentures. Following *Blott's Case* the shares were not taxed but the debentures were taxed by the Revenue. *Held*, following *Fisher's Case*, that the value of the debentures was not taxable.[1]

Per Rowlatt, J.—He has not received a payment of the debt but he has become an acknowledged creditor, a secured creditor, instead of having an interest in the profits . . . . the Court of Appeal have held that for the purposes of a payment of this kind capital is to include loan capital in the application in *Blott's Case*[2] . . . . It is said (by the Crown) that *Fisher's Case*[3] is distinguishable . . . . because there, as in *Blott's Case*, the indications were that the company wanted to keep the money. Here . . . . the company . . . . . merely wanted to turn it into debenture capital for a span and then pay off the debenture capital soon. Now having regard to the two limbs in the decision in *Fisher's Case* so clearly stressed by Lord Justice Scrutton I do not think it is possible to find any distinction on a consideration of the kind.

The following dictum of Rowlatt, J. is of importance.

"It has not been argued before me that it was a finding (of the Commissioners) that these debentures were fictitious, were mere pieces of paper shown to the Inland Revenue and that the real transaction was that the profits were to be distributed in cash at any early date. . . . If what is meant is that the company adopted this transaction, being a real transaction, and one which does not make the shareholder liable to super-tax in lieu of another transaction, which would have made him liable that circumstance has no materiality as many cases show, in a contest of this kind."

Bonus shares—Option to receive cash—

In *Wright* v. *Inland Revenue Commissioners*[4] bonus shares were issued and the shareholders given the option of receiving either cash or shares. The assessee exercised the option in part and received a certain number of shares and certain amount of cash. *Held* (by the Court of Appeal reversing the decision of Rowlatt, J.) that the existence of the option did not affect the nature of the bonus which had been capitalised by the company. In *Bouch* v. *Sproule*[5] also there was an option though it was not exercised.

(1) *Whitmore* v. *Commissioners, Inland Revenue*, 5 A. T. C. 1.
(2) 8 Tax Cases 101.
(3) 10 Tax Cases 302.
(4) 5 A. T. C. 525.
(5) (1887) 12 A. C. 385.

That decision having been followed in *Blott's* and *Fisher's* cases, the existence of the option could not in *Wright's Case* make the bonus "income". The Master of the Rolls said : "We have to treat the company as dominant for all purposes."

Bonus shares—Employees—Issue of to—

Though the company may be dominant for all purposes and capitalise its profits as against the rest of the world even without giving any option to the shareholders, as in *Blott's Case,* it cannot capitalise its debts. What happens in such so-called capitalisations is that the creditor receives the debt and pays for the shares with it. It was held therefore, when a manager of a company was paid his remuneration in the shape of additional shares, that the value of the shares was taxable.[1]

Bonus shares—Same Company—

A company distributed its dividends in the shape of fully paid-up shares in the concern, the shareholders having no option to take the profits in any other form. *Held,* following *Commissioner of Inland Revenue* v. *Blott*[2] and distinguishing *Swan Brewery* v. *The King,*[3] that there was no ' income, profits or gains ' to the shareholders which was taxable to super-tax. The Court emphasised the word ' advantage ' which occurred in the Colonial Act in the *Swan Brewery Case. Steel Bros. & Coy.* v. *Secretary of State.*[4] The Crown appealed to the Privy Council for leave under the prerogative powers but the Privy Council refused to give leave.

A similar decision was given by the Madras High Court in *Commissioner of Income-tax* v. *Binny & Coy.*[5] in which Binny & Company as shareholders in the Deccan Sugar and Abkari Company received a share of the accumulated undistributed profits of the latter concern in the shape of bonus shares.

In all these cases about bonus shares and debentures, an important point to emphasise is that the recipients of the bonus shares or debentures did not *trade* in them. If they did—if for instance John Blott had been a stockjobber or Binny & Company or Steel Brothers investment or trust companies, it might have been held that the bonus shares or debentures were part of their stock-in-trade and therefore taxable indirectly as swelling

(1) *Parker* v. *Chapman,* 6 A. T. C. 1000. (Confirmed by the Court of Appeal.).
(2) 8 Tax Cases 101.
(3) (1914) A. C. 231.
(4) 1 I. T. C. 326.
(5) 1 I. T. C. 358; 47 Mad. 837.

their profits from trade even though the bonus shares had been 'capitalised' by the issuing company.

Investments—Appreciation of—Capital or Profits—

"It is quite a well-settled principle in dealing with questions of assessment of income-tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income-tax Act of 1842 assessable to income-tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realisation, the gain they make is liable to be assessed for income-tax.

What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?"[1]

Investments—Appreciation of—

An Investment Trust Company had powers in its Memorandum of Association to vary its investments and generally to sell or exchange any of its assets; *held*, (1) that the net gain by realising investments at larger prices than were paid for them constitutes profits chargeable with income-tax; and (2) that the liability of such profit to assessment is not affected by a depreciation in the book value of other investments which the company continues to hold.[2]

Per the Lord President.—"The varying the investments and turning them to account are not contemplated merely as proceedings incidentally necessary for they take their place among what are the essential features of the business. . . . . My view of this company is therefore that its position in the present question is entirely distinguished from that of a private individual or an ordinary trader. Accordingly I think that it is wrong in its contention that increases on realisation of stocks of the company are capital sums."

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(1) Per the Master of Rolls in the *National Provincial Bank of England*, 5 Tax Cases 11.

(2) *Scottish Investment Trust Company* v. *Forbes*, 3 Tax Cases 231.

Investments—Appreciation of—Treasury Bill—Sale of—Taxable—

The National Provident Institution bought certain Treasury Bills, of which some were held by it until maturity, others were sold in open market during their currency and the remainder were converted into War Loan. *Held,* that the whole difference between the price paid for a Treasury Bill and the sum realised by the purchaser whether by holding the Bill until maturity or by selling it or converting it before maturity, represents a profit chargeable to income-tax and that no part of that profit is an accretion of capital; (2) that profit so made constitutes income of the year in which it is received.

Per Viscount Haldane.—" By a majority, Lord Justice Warrington dissenting, the Court of Appeal held that the whole of the difference between the amount contracted for and the amount received for a bill which was sold or converted into War Loan during its currency was not necessarily taxable as a profit on a discount. The difference did not necessarily represent only a profit by way of income but might in part represent an accretion to capital. Such an accretion might be due to the state of the money market and the rise or fall in the value of money and the rates of interest thereon by which the price of the Treasury Bill might have been caused to rise or fall without strict correspondence with its progress towards maturity. The only amount to be taxed as profit or discount in such a case was therefore the amount by which its value had increased merely by reason of its advance towards maturity. The assessment was therefore ordered to be remitted . . . for adjustment by elimination of the element of profits due to accretion of capital on this principle.

My Lords, on this . . . . question I am unable to agree with the view of the Court of Appeal. I see no answer to the argument as stated by Lord Justice Warrington. It is concise and I will adopt his words. " When a holder, whether the original purchaser or not, realises during currency, he really receives a proportion of the total profits resulting from the fact that the bill was bought at a discount. It is true that the proportion may not bear an exact relation to the period of currency, but may be determined by variations in the value of money, in the public credit and so forth but it seems to me that the total of the profits received by the various sellers after deducting losses, if any, cannot exceed the difference between the price originally paid and the sum receivable at maturity and that the considerations I have referred to merely affect the distribution of that difference between the various holders. Profits made by discounting bills seem to me to rest on the same footing and conversion into War Loan also. This last is simply a sale on certain terms fixed by the Government and investment of the proceeds." My Lords, I do not think this reasoning is really answerable.

Per Lord Sumner.—" It is to be remembered that this is a case of a company which carries on a business and employs its funds for and in that business. The case stated finds no fact to distinguish these transactions from any other business use of money. It is not the case. as to which I say nothing, of a private person who, not in the course of any business at all, realises an investment and comes well out of it. Similarly, I see no warrant for trying to discriminate between the capital used in the transaction and the income obtained from its use. The Statute says nothing about it. To discount a Bill, even a Treasury Bill, you must have money or money's worth but whether an accountant would say that it came out of or should be debited to capital or income makes no difference to the fact of discounting. The excess of what is got back to-morrow over what is put in to-day is profit and it is but rarely that even an economist can tell us what is appreciation of capital and what is not."[1]

Realising assets—Capital or Income—

The assessee company, which was formed of solvent contributories of a Bank, acquired from the liquidators the outstanding assets of the Bank, including sums expected to be recovered from estates of contributories, paying therefor a sum sufficient to enable the liquidators to discharge the liabilities of the Bank. From time to time the company sold portions of these assets at prices exceeding the values at which they were estimated in the books of the liquidators. *Held*, that the case, as stated, did not contain materials for a decision whether profits liable to assessment to income-tax had been made. But the judgment set out general principles.

Per Lord Young—" . . . . Now, what about recoveries from debtors? The company took them over. I should say that I have really no doubt that any person, or any company, making a trade of purchasing and selling investments, will be liable to income-tax upon any profit which is made by that trade. It is quite an intelligible business. . . . . . . But it is another proposition altogether that, where there is not a trade, a gain or loss upon the purchase and resale of property comes within the meaning of the Income-tax Acts. Take even proper traders: if proper traders sell their old premises and buy new ones, and sell the old premises at a higher price than they paid for them. . . . . I should say it was a totally untenable proposition that anything in excess of what they had paid for the old premises . . . . is income within the meaning of the Act. I do not think it is at all. It is no more so in the case of a trader's income than in the case of a private individual selling his house at more than he had paid for it. . . . . They were not making a trade of buying and selling debts. . . . . The proposition that where anybody purchases a doubtful debt, and makes more than he paid for it—one purchase, he not being a trader in that kind of thing—that that is income is, I think, a proposition which cannot be sustained. . . . ."[2]

(1) *The National Provident Institution* v. *Brown and Ogston* v. *The Provident Mutual Life Assurance Association*, 8 Tax Cases 57.

(2) *Assets Co.* v. *Forbes*, 3 Tax Cases 542.

Property—Sale of—Receipts from—Capital or Income—

A company formed for the purpose, *inter alia*, of acquiring and reselling mining property, first acquired and worked various properties. After sometime it resold the whole to a second company receiving payment in fully paid shares of the latter company. *Held*, that the difference between the purchase price and the value of the shares for which the property was exchanged was a profit assessable to income-tax.

The company's contention was that the case was one of substitution of one kind of capital for another and that in any case no tax should be levied until the value of the shares had been realised in money. The Court held that the company was formed with the object of making profit from the sale of its property and that therefore the profits in question were liable. Lord Justice Clerk stated that it was a well-settled principle that where the owner of an ordinary investment realised it at an enhanced price the difference was not assessable unless the transaction amounted to carrying on a business (as in the case of a person or group of persons buying or selling lands, etc., speculatively).[1]

Estates—Sale of—Receipts from—Capital or Income—

A company was formed with the object of acquiring estates in the Malay Peninsula and developing them by planting and cultivating rubber trees. Power was taken in the Memorandum of Association to sell the property and such a sale was contemplated in the prospectus issued at the inception of the company. Two estates were purchased, but the original capital being insufficient to develop them the whole of the undertaking was sold to a second company for a consideration (mainly in shares of the second company) in excess of the capital expended. At the date of the sale a considerable acreage had been planted, but no rubber had yet been produced or sold. *Held*, that the profit on the sale was not a profit assessable to income-tax, but was an appreciation of capital.

Per Lord Salvesen.—The only difficulty arises from the decision in the *Californian Copper Syndicate*.[1] That facts in that case were not unlike those which occur here; but the grounds of the decision appear to me not to be applicable. Lord Trayner said (in that case).—" I am satisfied the appellant company was formed in order to acquire certain mineral fields or workings—not to work the same themselves for the benefit of the company but solely with the view and purpose of reselling the same at a profit."[2]

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(1) *Californian Copper Syndicate* v. *Haris*, 5 Tax Cases 159. This case was cited with approval in *Commissioners of Taxes* v. *Melbourne Trust*, (1914) A. C. 1001.

(2) *Tebrau (Johore) Rubber Syndicate, Limited (in Liquidation)* v. *Farmer*, 5 Tax Cases 658.

Estates—Sale of—Receipts from—

The Hudson Bay Company were established by Charter. Prior to 1869, they were the owners of large territories in Rupert's Land, North America. In 1869 they surrendered to the Crown their territory and rights of government in exchange, *inter alia,* for a money payment and for a right to claim, within fifty years, a twentieth share in certain lands in the territory as from time to time the lands were settled. The lands granted to the company in pursuance of this agreement were sold by the company from time to time, and the proceeds applied partly in payment of dividends and partly in reduction of capital. *Held,* that the proceeds of the sales of the lands so granted were not profits or gains derived by the company from carrying on a trade of dealing in land, and were not assessable to income-tax.

Per the Master of Rolls.—"The real question is whether this money can be regarded as profits or gains derived by the company from carrying on a trade or business. In my opinion it cannot. The company are doing no more than an ordinary landowner does who is minded to sell from time to time, as purchasers offer, portions suitable for building of an estate which has devolved upon him from his ancestors. I am unable to attach any weight to the circumstance that large sales are made every year. This is not a case where land is from time to time purchased with a view to resale; the company are only getting rid by sale, as fast as they reasonably can, of land which they acquired as part of a consideration for the surrender of their Charter."

Per Farwell, L. J.—"It is clear that a man who sells his land, or pictures, or jewels, is not chargeable with income-tax on the purchase-money or on the difference between the amount that he gave and the amount that he received for them. But if instead of dealing with his property as owner he embarks on a trade in which he uses that property for the purposes of his trade, then he becomes liable to pay, not on the excess of sale prices over purchase prices, but on the annual profits or gains arising from such trade, in ascertaining which those prices will no doubt come into consideration. . . . A landowner in England may establish a game farm on part of his estate, and make profits thereby which would be liable to income-tax, and he may also sell parts of his estate for building purposes, but his trade as a game farmer does not bring his sales as a landowner within the Income-tax Acts; and I see no difference in this respect between his position and that of the company. Again, a landowner may lay out part of his estate with roads and sewers, and sell it in lots for building, but he does this as owner, not as a land speculator. . . . . Land-owning is not a trade. . . . . The actual claim by the Crown is extravagant. . . . . If the company were to be treated as trading they must at least be allowed the price paid for the land."[1]

(1) *Stevens v. Hudson Bay Coy., Ltd.*, 5 Tax Cases 424.

Estates—Sale of—Receipts from—

The assessee company was incorporated in 1904 with the primary object of acquiring, managing and developing with a view to ultimate sale, certain lands in British Columbia which were held in trust for various persons who were interested therein either as owners, joint owners or as trustees. Subject to an extraordinary resolution, the company had power to deal in other lands, but it had not at any time exercised that power. The share capital of the company was fixed at a nominal amount, solely to facilitate division among the beneficiaries, and was not determined by reference to the value of the lands acquired. All the ordinary shares had been allotted in consideration of the conveyance of the lands to the company, and these shares had been continuously held by the original allottees, or their representatives. Working capital had been provided by the issue to ordinary shareholders of preference shares for cash. In 1908 the company created and allotted to persons other than the ordinary shareholders deferred shares in return for services which enhanced the value of the lands. *Held,* that the surplus arising from the sale by the company of portions of the lands was not the profits of a trade or business, and, that the function of the company was merely to realise the capital value of the respective interests in the land under the trust.

Per Rowlatt, J.—" In this case the question is whether the company which was formed for what I may call family reasons is liable for income-tax on what it makes by selling the lands. Now the question is whether the company has really only realised some property held as capital by those who became its shareholders, namely, the people entitled under the trust or who started or founded the trust or whether it has got to the point of embarking in a trade or business of which these receipts are the resulting profits. . . . . . Now the company proceeded in a very enterprising way undoubtedly. It cleaned the land and formed roads. It sold parts of it and kept some of the money and put it back into the land and so on, and it gave a share in its capital to certain people who were instrumental in bringing a railway there. Undoubtedly it has done very well. Under these circumstances the Attorney-General and the Revenue contend that it has gone beyond the stage of merely realising the property and has embarked upon a business in land which it has not in the real sense bought but in land which came to it. The Commissioners have held that it is not so and I am not prepared to differ from the Commissioners. I very much doubt . . . whether it is not a question of fact and only appealable in the sense of the question whether there is any evidence of it or not. It is a case which is not very far from the line but I think it is on the right side of the line. If this had been an individual, he need not have had a company. He might have done all these things and if he had been a prudent or a public-spirited man, he would have done all these things. If a landowner finding his property appreciating in value sells part of it and uses part of his money still further to develop the remaining parts, and so on he is not carrying on trade or business, he is only properly developing and realising his land.[1]

Estates—Sale of—Receipts from—

The assessee company was incorporated with the primary object of acquiring, developing and turning to account certain concessions in German South-West Africa which included, (i) mineral rights, (ii) railway rights, and (iii) the right to the freehold of some 3,000,000 acres of land to be selected by the company. The company had power under the concession to transfer any or all of its rights to other persons or companies, and in particular had the right to turn the land granted to it to any account it might think most beneficial for its interests, though it was understood between the company and the German Government that the colonisation of the country should be encouraged by the sale of land to settlers. From time to time throughout the life of the company sales of land were made to settlers and considerable tracts were also sold to other companies. The proceeds of the land sales were always carried to capital account, but the profits made on the sale of shares received from one of the companies in consideration of land transferred to it was distributed by way of dividend. Apart from the acquisition of the original concession, the company never purchased for itself any land or land rights. *Held,* that the profits derived by the company from sales of land were not of a capital nature and should be taken into account in computing for income-tax purposes the profits arising from the trade, adventure, or concern in the nature of trade exercised by the company.

"The question that we have to determine is whether the moneys derived from these sales of land fall into income or are to be treated as capital of the company. . . . . The conclusion that I come to on reading the documents presented to us is this—that there is no definite segregation of the moneys received from the sales of land for the purpose of capital. . . . . In the *Hudson's Bay Coy.* v. *Stevens* what. . . . . is decided by the Court is this, that inasmuch as the Commissioners found the facts and had drawn the inference negativing the fact that the company were carrying on a trade in buying and selling land, therefore they were not liable to income-tax for such profits or gains by the sale of land; they are not derived by trading or carrying on business but by the sale of an old possession."[2]

(1) *C. H. Rand* v. *The Alberni Land Coy., Ltd.*, 7 Tax Cases 629-30.

(2) Per Pollock M. R.—*Thew* v. *South-West Africa Company, Ltd.*, 9 Tax Cases 141.

In 1870 the State of Alabama raised a loan for the purpose of constructing a railway. In 1876 the State defaulted and transferred to certain trustees for the benefit of bondholders certain lands. The trustees were to sell the property, pay 10 per cent. of the proceeds to the State till the State had received all interests paid by it on the bonds before the default, and to distribute the balance amongst the bondholders.

At the end of 10 years all bonds not presented or surrendered were to be barred from the benefits of the trust and to carry no claims against the State. A Company was formed with the object of putting into a marketable form the interests of the bondholders who had surrendered the bonds. The capital of the Company was 10,000 Preferred A Shares of £10 each. to be subscribed at par, and 26,000 Deferred B Shares of £1 each to be issued fully paid, 2-B Shares being given as bonus on each A share subscribed for. The bondholders were given the first option of subscribing for the Preferred Shares and they were also given the choice of surrendering to the Company their interest in exchange for non-interest-bearing Instalment Certificates equal to the amount of the bond plus accrued interest thereon plus 3-B Shares for each bond.

Of the original issued capital 56 per cent. belonged to bondholders and 44 per cent. to others. After paying off the State, 70 per cent. of the net proceeds from the sale of lands was applied in paying off the Instalment Certificates and 30 per cent. in paying dividends on A Shares and redeeming them at par. By 1886 the State had been fully paid off. The interests of all bondholders except those who had not surrendered the bonds within the 10 years' limit had also been acquired by the Company. Also an American Company had been formed to hold the trust lands in place of the trustees whose term had expired and the whole of the shares in this American Company had been allotted to the assessee Company. The assessee Company purchased certain other lands to develop the trust property. In 1904 all the Preferred Shares had been paid off and by 1912 two-thirds of all the Instalment Certificates had been repaid. In that year, however, further Deferred Shares were issued and the capital thus raised was used in paying off the bulk of the remaining Instalment Certificates.

Held, that the Company was carrying on a trade.

The Hudson Bay Co., Ltd. v. *Stevens,*[1] *and Rand* v. *The Alberni Land Company, Ltd.,*[2] distinguished.

Per Rowlatt, J.—"There were these lands in the hands of the bondholders, it is not as if a band of speculators outside the bondholders had come and bought these lands. . . . . . the bondholders themselves as individuals said: '. . . . . let us take these lands from the body which we are, and we can get some other people to come in with us . . . . we ourselves can put up some more money, and we will take these lands, and give for them certain preferential rights, ... We will not launch out widely . . . . . . but we will launch out. We will embed the realization of these lands in an undertaking, which must be wider than the bare realization, with

(1) 5 Tax Cases 424.
(2) 7 Tax Cases 629.

the minimum of nursing and the minimum of necessary expenditure which a landowner himself might be inclined to indulge in.' "[1]

Securities—Sale of—Surplus—When taxable—

Per Lord Dunedin in *Commissioner of Taxes* v. *Melbourne Trust.*[2] . . . . . "In the present case the whole object of the company was to hold and nurse the securities it held, and to sell them at a profit when convenient occasion presented itself.

"Their Lordships therefore come to the conclusion that there is ample evidence here that the company is a trading company and that the surplus realized by it by selling the assets at enhanced prices is a surplus which is taxable as profit. . . . ."

Coal bings—Sale of—Receipts from—Not Income—

Certain bings of colliery dross which had been lying on an estate for many years were disposed of by the land owner to various parties who contracted to remove the whole of the dross within a limited period (3½ months).

Held, that the payments were capital receipts and not profits.

Per Lord Cullen.—"It is not suggested that Lord Belhaven traded in bings; . . . . the transaction was a contract of sale of the contents of a capital asset consisting of the bing and the price received . . . . represented merely a change in the form of. . . . capital."[3]

Land—Sale of—Unpaid purchase-money—Interest on—Income—

The Hudson Bay Company owned large tracts of land in Canada and from time to time sold plots or blocks of land to purchasers desiring to take up and occupy land for settlement in that country. The company entered into agreements with purchasers unable to provide the whole purchase-money in one sum, under which the purchaser paid a certain sum down when the contract was signed and the balance by equal annual instalments, each with interest calculated on the balance of the purchase-money remaining unpaid. The company agreed on completion of payment of the purchase-money and interest to convey the land to the purchaser, and meanwhile permitted the purchaser to occupy the land until default be made in payment of the sums of money agreed upon, in which case it reserved the right to cancel and determine the agreement and to re-enter upon or to resell the lands, all payments theretofore made on account being forfeited to the company. *Held*, that the interest on unpaid purchase-money was income and not capital.[4]

(1) *The Alabama Coal, Iron, Land and Colonization Co., Ltd.*, v. *Mylam*, 11 Tax Cases 232.

(2) (1914) A. C. 1001.

(3) *Roberts* v. *Lord Belhaven's Executors*, 9 Tax Cases 501.

(4) *Hudson Bay Co.* v. *Thew*, 7 Tax Case 206.

Premium—Mining Lease—Rent—Royalty

'Salami' or premium paid at the beginning of a mining lease for a long period represents the purchase price of an out-and-out sale of the property and the sum received is 'capital' and not 'income'. But 'rent' or 'royalty' paid periodically is income.[1]

Business closing down—Sale of stock—Capital or income—

Whether the realisation of the value of stock of a business which is closed down is a capital receipt or a profit is a difficult question. It really depends on the question—when does a business which is being closed down cease to be a business which is being carried on? The answer clearly is that the whole thing depends on the circumstances of each case. That is to say, it is largely a matter of *fact* to be determined by the income-tax authorities.

Per Lord Atkinson.—"A trader who wishes to retire from business may wind up his business in several ways; he may sell his concern as a going concern, or he may auction off his stock. But there is another way quite as effectual, and that is by continuing to carry on his business in the ordinary way, but not replenishing his stock which he has accumulated as it is sold. Then he will leave himself with no stock, and, therefore, he can retire from business. But the fact that he realises stock in the process of carrying on the trade as he has hitherto done will effectuate both purposes."[2]

See also per *Lord Phillimore* in *Doughty* v. *Commissioners of Taxes* (a Privy Council case) :[3]

"Income-tax being a tax upon income, it is well established that the sale of a whole concern which can be shown to be a sale at a profit as compared with the price given for the business, or at which it stands on the books, does not give rise to a profit taxable to income-tax. . . It is easy enough to follow out this doctrine, where the business is one wholly or largely of production. . . Where however a business consists. . . entirely in buying and selling, it is more difficult to distinguish between an ordinary and a realisation sale, the object of either case being to dispose of goods at a higher price than given for them. . . The fact that large blocks of stock are sold does not render the profit obtained anything different in kind from the profit obtained by a series of gradual and smaller sales. This might even be the case if the whole stock was sold out in one sale. Even in the case of a realisation sale, if there were an item which could be traced as representing the stock sold, the profit obtained by that sale, though made in conjunction with a sale of the whole concern, might conceivably be treated as taxable income."

See also *Martin* v. *Lowry* set out under sections 2 (4) and 4 (3) (vii).

(1) *Raja Shiva Prasad Singh* v. *Rev.* 1 I. T. C. 384.

(2) *See J. and R. O'Kane and Company* v. *Commissioners, Inland Revenue*, 12 Tax Cases 303.

(3) (1927) A. C. 327; 43 T.L.R. 207.

Mineral lease —Foreclosure of —Compensation paid

The compensation paid to a lessee of mineral rights for compelling him to foreclose his lease is a capital receipt. The fact that compensation is based on the value of the minerals left unworked does not make the payment one of an accumulated loss of profits.

Per Lord Buckmaster.—"There is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the application of that test. I am unable to regard this sum of money as anything but capital."

Per Lord Wrenbury.—"Is a sum profit which is paid to an owner of property on the terms that he shall not use his property so as to make a profit? The answer must be in the negative. The whole point is that he is not to make a profit and is paid for abstaining from seeking to make a profit. . . . . The matter may be regarded from another point of view—the right to work the area in which the working was to be abandoned was part of the capital asset consisting of the right to the whole area demised. Had the abandonment extended to the whole area, it would be impossible to contend that the compensation would be other than capital. It was the price paid for sterilising the assets from which otherwise profit might have been obtained. What is true of the whole must be equally true of part."[1]

This principle was also followed in *Guinness Son & Coy.* v. *Commissioner of Inland Revenue*[2] . . . . in which the firm who were brewers and whose stock of barley was commandeered by the Crown during the War claimed that the profits made on the compulsory sale to Government were not assessable to tax on the ground that they were not 'income' but 'capital' receipts. The Irish Court of Appeal upheld the contention (Pim, J. dissenting). Pim, J.'s point was that the barley was part of the circulating capital of the company not its fixed capital and that, therefore, the case was more like that of *Beynon* v. *Ogg*[3] than like the *Glenboig* case.

In *Commissioners of Inland Revenue* v. *Newcastle Breweries*[4] however, in which the greater part of the rum imported by the firm for blending purposes had been similarly commandeered by the Admiralty it was held by Rowlatt, J. that the compensation paid was a profit arising from the firm's trade. The decision of the Irish Court in the *Guinness* case was deliberately departed from. The reasoning of Rowlatt, J. was that in a case like

(1) *Glenboig Union Fireclay Company* v. *Commissioners of Inland Revenue*, 12 Tax Cases 427.

(2) 3 A. T. C. 686.

(3) 7 Tax Cases 125.

(4) 12 Tax Cases 127.

the *Glenboig* case what was done was to stop the trade and pay compensation whereas in the *Sutherland*[1] case and the present one all that happened was a compulsory sale of a portion of the goods and that the fact that the sale was compulsory could not make any difference. The Court of Appeal confirmed Rowlatt, J.'s judgment. The House of Lords confirmed the judgment of the Court of Appeal but considered the *Guinness* case distinguishable.

Annuities—Repayment of debt—Not taxable—

The Secretary of State for India exercised the option of purchasing the undertaking of a Railway Company by payment of an annuity for a term of years instead of a lump sum. *Held*, by the House of Lords, that income-tax could not be charged on the annuity.

Per Vaughan Williams, L. J.—I assent to a great deal that the Attorney-General has said about annuities; but it seemed to me that the outcome of this argument left him in this position:—He could not say that every annual sum which was payable under a contract was necessarily an annuity within the Income-tax Acts. It had really to be admitted that in any case in which it appeared upon the face of the contract that there was a debt existing independently of the contract which gave rise to the annual payment, if the annuity or annual payment was, on the face of the contract, of such a nature that you could say on reading the contract, 'This is not a contract for the purchase of an annuity, it is a contract under which a debt is made payable by instalments' that the income-tax would not apply in such a case to the whole sum payable by such annual instalments. It is not denied, but that the Income-tax Acts would apply and income-tax be payable in respect of so much of the annual payment as was not a repayment of an instalment of the antecedent debt, it was not denied—and is not denied in the present case—that income-tax is payable upon so much of this annual sum, the annual instalment of purchase-money payable by the Indian Government, as consists of interest. The whole question in this case is: Is income-tax payable upon that portion of the annual payment which you can discover from the very terms of the contract is a mere payment of an instalment necessary to complete the payment of an existing debt? In my judgment no income-tax is payable in such a case.

Per Stirling, L. J.—We have express authority in the case of the *Nizam's Guaranteed State Railway Company* v. *Wyatt*[2] of the Divisional Court for saying that the mere fact that a sum is designated as an annuity is not conclusive but that the real nature of the transaction must be looked at. Now if we look at the real nature of the transaction here, these so-called annuities are simply annual payments of equal amount,

(1) 12 Tax Cases 63.
(2) 4 Tax Cases 621.

being instalments of a debt, and are made up partly of principal, partly of interest, calculated at a particular rate. On the face of the contract, therefore, it appears that each annual instalment contains principal money and a portion of interest which can be readily ascertained by a competent actuary. It seems to me, therefore, that in that state of things we are right in following the principle which I take to be laid down in *Foley* v. *Fletcher*[1] that the word "annuity", under those circumstances, is not to be read in such a way as to make capital taxable. . . . . Now the difficulty which I certainly felt in the case arises from this: that it is said (and forcibly said) by the Attorney-General: "If that be so, then in the case of every terminable annuity which has been purchased for value the same thing occurs, and you ought, if you logically follow out the principle, to say that each annual payment of that annuity ought to be split up between capital and interest and the only portion which represents interest ought to be taxed." I feel the full force of that remark; but it seems to me that the cases are not the same. Those are cases of purchase of annuities, where investment has been made in that form of property, and the legislature in so many words has said that that is to be taxed; and it is recognised in this very case throughout that an annuity of that kind is taxable. And I in no way depart from that. The case to which I have referred seems to me to show that it is a different matter where it appears, on the face of the transaction, that the so-called annuity is not a thing of that kind, but simply represents instalments of an existing debt.

Per Mathew, L. J.—"Annuity", in the ordinary sense of the expression, means the purchase of an income. It generally involves the conversion of capital into income, and, reasonably enough, where the buyer places himself in that position, the Act of Parliament taxes him; he is taken at his word, he has got an income secured in the way I have mentioned. Now, has such a case any analogy whatever to the present? It appears to me, none. Here was a sum of money, a lump sum, stipulated for in the first instance, which was to represent the capital outlay. If that money had been handed over to those who were entitled to it, it might have been invested, ought to have been invested, and probably would have been invested, and, if invested, the income of it would be taxable and not the principal sum. Now that sum representing the capital outlay is by the terms of the contract a sum that may be paid off by what is called (unfortunately) in the contract an annuity. It really meant "by annual instalments."

Per the Lord Chancellor.—I do not at all say that the question is not surrounded by some difficulties. I think it is. The loose use of the word "annuity" undoubtedly renders a great many of the observations that have been made by the Attorney-General and Solicitor-General very relevant to the question under debate. Still, looking at the whole nature and substance of the transaction (and it is agreed on all sides that we must look at the nature of the transaction and not be bound by the mere use of the words) I cannot doubt that in this contract (it cannot be denied

(1) 3 H. & N. 769.

that what was done and agreed to was in that sense under a contract: but, undoubtedly, this is not the case of a purchase of an annuity, it is a case in which under powers reserved by a contract one of the parties agrees to buy from the other party what is their property) I cannot doubt, I say, that what is called an "annuity" in the contract between the parties and in the Statute was a mode of making the payment for that which, by the hypothesis on which I am speaking, had become a debt to be paid by the Government. If it was to be a debt paid by the Government, it introduces this consideration: was it the intention of the Income-tax Act ever to tax capital as if it was income? I think it cannot be doubted, both upon the language of the Act itself and the whole purport and meaning of the Income-tax Acts, that it never was intended to tax capital, as income at all events.

Under the circumstances, I think I am at liberty so far to analyse the nature of the transaction as to see whether this annual sum which is being paid is partly capital, or is to be treated simply as income, and I cannot disagree with what all the three learned Judges of the Court of Appeal pointed out, that you start upon the inquiry into this matter with the fact of an antecedent debt which has got to be paid; and if these sums, which it cannot be denied are partly in liquidation of that debt which is due are to be taxed as if it was income in each year in which it is being exacted, the result is that you are taxing part of the capital. As I have said, I do not think it was the intention of the Legislature to tax capital and, therefore, the claim as against those sums fails.

My lords, as I have already said, I do not think it is a matter on which one can dogmatize very clearly. There is no doubt that what has been pointed out is true, that in one sense the Legislature has, in the sense in which I have used the words myself, taxed capital. Where you are dealing with income-tax upon a rent derived from coal, you are in truth taxing that which is capital in this sense, that it is a purchase of the coal and not a mere rent. All I have to say upon that and other illustrations of the same character is this, that the income-tax is not and cannot be, I suppose from the nature of things, cast upon absolutely logical lines, and that which justifies the exaction of the tax under these circumstances is that the things taxed have either been or have been by construction by Courts held to be what has been specifically made the subject of taxation; and my answer to an argument derived from those circumstances here is, that looking at the words here used and the word "annuity" used in the Act, I do not think that this comes within the meaning which (using the Income-tax Acts themselves as the expositors of the meaning of the word) is intended to hit at by the word "annuity" which is the only word that can be relied upon here as justifying what would otherwise be to my mind a taxation of capital.[1]

Royalty—coal—Capital or income—

Per Mukerjee, J.—The case of *Foley* v. *Fletcher*[2] is an authority for the proposition that where a principal debt is made repayable by

(1) *Secretary of State for India* v. *Scoble and others*, 4 Tax Cases 618.
(2) (1858) 3 H. & N. 769.

periodical instalments, none of the instalments is chargeable with income-tax; where, therefore, the purchase-money of an estate is made payable by periodical instalments, although each instalment may, in substance, partially consist of interest, the periodical instalments are not liable to be assessed with income-tax. This principle was adopted by the House of Lords in the case of *Secretary of State for India* v. *Scoble.*[1] There the Secretary of State had power by contract to purchase a Railway, paying for the purchase the full value of all the shares of the company with the option of paying instead of a gross sum an annuity for a term of years, each instalment of the annuity representing in substance an instalment of the purchase-money and interest on the amount of the purchase-money unpaid. The House of Lords affirmed the decision of the Court of Appeal, *Scoble* v. *Secretary of State for India,*[2] that, as capital could not be taxed as income, income-tax was not payable upon that part of the annuity which essentially represented capital. In this very case Lord Halsbury L.C. pointed out that where we are dealing with income-tax upon a rent derived from coal, we are in truth taxing that which is capital in this sense, that it is a purchase of the coal and not a mere rent. The Lord Chancellor further observed that the income-tax is not and cannot be, from the nature of things, cast upon absolutely logical lines, and to justify the exaction of the tax, the things taxed must have been specifically made the subject of taxation. We are, therefore, brought back to the question whether 'royalty' is income within the meaning of the Income-tax Act. The term "income" is not defined in the Act, and the explanation given in section 3, clause (5) that it means income and profits accruing and arising or received in British India, does not throw much light upon the question. The word "income" however is, to use the language of Sir George Jessel in *In re Huggins,*[3] as large a word as can be used to denote a person's receipts, and it seems to me that it is wide enough to include a royalty received from a mine. The nature of a royalty was examined at some length by Lord Denman, C. J. in *Reg* v. *Westbrook* and *Reg* v. *Everist*[4]; it appears to have been contended in that case that it is altogether wrong in principle to consider the royalty as rent, because it is a sum paid not for the renewing produce of the land, but for severed portions of the land itself. The learned Chief Justice answered this argument by observing that the occupation of a mine is only valuable by removal of portions of the soil, and whether the occupation is paid for in money or in kind, is fixed beforehand by contract or measured afterwards by the actual produce, it is equally in substance a rent, inasmuch as it is the compensation, which the occupier pays the landlord for that species of occupation; which the contract between them allows. As pointed out by Lord Denman, this would not admit of an argument in an agricultural lease, where a tenant was to pay a certain portion of the produce, which would be admitted to be in all respects a rent service with every incident to such a rent. The same view was adopted in substance by Sir Charles

(1) (1903) A. C. 209; 4 Tax Cases 618.
(2) (1903) 1 K. B. 494.
(3) (1882) 51 L. J. 935, 938.
(4) (1847) 10 Q. B. 178; 74 R. R. 248.

Abbott, C. J. in *King* v. *Attwood*[1] and by Lord Blackburn in *Coltness Iron Company* v. *Black*.[2] Lord Blackburn referred to the observations of Lord Cairns in *Gowan* v. *Christie*[3] that a mineral lease, when properly considered, is in reality a sale out-and-out of a portion of the land, but remarked that this did not justify the inference, that no income-tax should be imposed on the rent reserved on a mineral lease. The distinction between a price paid down in one sum for the out-and-out purchase of the minerals forming part of the land, and the rent and royalty which constitute, in reality, a payment by instalments of the price of those minerals, is intelligible, though it may not be quite logical, thus affording an illustration of Lord Halsbury's observation in *Quinn* v. *Leathem*[4] that law is not necessarily a logical Code and is not always logical at all. The view I take receives some support from the definition of the word "income" as given in the Oxford Dictionary, Vol. V, page 162. Income is defined to be "that which comes in as the periodical produce of one's work, business, lands, or investments considered in reference to its amount and commonly expressed in terms of money, annual or periodical receipts accruing to a person or corporation." The same view of the matter appears to have been adopted in the American Courts, in which it has been held that the term 'income' includes a sum accruing as royalty under an oil lease of land granted in consideration of a royalty of part of the oil : see *In re Woodburn's Estate*.[5] In the case of a mine, the rent may be (*a*) a fixed sum; (*b*) a certain annual sum; (*c*) a royalty on the amount of minerals extracted payable at fixed intervals or times; (*d*) such a royalty, but not less in the aggregate than a fixed amount each year (as in the lease produced in the present case); and (*e*) such royalty and a covenant to mine a certain minimum amount or pay royalty thereon. But whatever form the consideration for the lease may assume, the money or thing which is paid for the occupation of the mine, though it is in one sense a preferred debt, is in its essence rent and has all the qualities thereof : see *Raynolds* v. *Hanna*,[6] where it was held that money received as royalty from a mine was "income" and distributable as such and not as a part of the corpus of the estate, because royalty is the most appropriate word to apply to rental based on the quantity of coal or other mineral that is or may be taken from a mine (see also a number of similar cases collected in Barringer and Adams on Mines, pp. 9-15). I must hold consequently that the royalty received by the plaintiff is 'income' within the meaning of Act II of 1886.[7]

Annuity—Patent—Sale of— Receipt from—

A, a non-resident alien, gave to B, an English Company, the right to sell and manufacture certain articles by a secret pro-

(1) (1827) 6 B. & C. 277.
(2) (1881) 6 App. Cas. 315, 335.
(3) (1873) L. R. 2 H. L. (Sc.) 273.
(4) (1901) A. C. 495, 506.
(5) (1891) 21 Am. St. Rep. 932.
(6) (1893) 55 Fed. Rep. 783, 800.
(7) *Manindra Chandra Nandi* v. *Secretary of State*, (1907) 34 C. 257.

cess in return for a payment of a percentage on the gross receipts from sales. Before paying the amount to A, B deducted the income-tax due thereon. *Held* that B was entitled to do so.

Per Phillimore, J.—This case is not like *Scoble's case*[1] or the case *of Foley* v. *Fletcher*,[2] because there is no first ascertaining of a lump sum and it is an arrangement under which no lump sum is apportioned to the annual payment, and I cannot help noticing—whether the argument carries force with me or not, it certainly did seem to carry force with the House of Lords—that the process by which the annuity was ascertained in that case was a process which involved in the first instance the finding of a lump sum. To my mind it can make no difference but it obviously made a difference with the House of Lords in the case of *Scoble* v. *Secretary of State for India* and if it does make a difference in the opinion of the highest tribunal I must pay attention to it. I find here there is no such fact. Therefore upon the whole I think this is an annuity.[3]

In India B could not deduct the tax; but the income in question would be taxable.

Patents—Sale of—Consideration for—Payments in instalments—

The British Dye Stuffs Corporation gave an American Company the right to exploit its patents and secret processes in certain territories. In return the Corporation received £25,000 a year for 10 years. *Held,* that the annual payments were income and not the repayment in instalments of the purchase price of a capital asset.

Per Rowlatt, J.—"It is one of those cases that just depends really on how you look at it. . . . . It is really using this property if you like and taking an annual return, for it roughly corresponds probably to its average life, and not a sale once and for all of a capital asset."

Per Bankes, L. J.—In the Court of Appeal: "I do not myself think that the method of payment adopted in carrying through a transaction. . . . . is very much a guide of the true nature of the transaction. I read this agreement taking it as a whole as a trading convention. . . . . The amount which is payable by the one company to the other is not in truth and in fact the purchase price of part of the property of the English Company, but it is only a method of arriving at the value of the processes and patents. . . . . ."[4]

Patents—Sale of—Consideration for—Shares in another company—Lump sum paid—

A company sold the patent rights it had to two Companies in Japan and America respectively in consideration of a lump

(1) (1903) 1 K. B. 494; 4 Tax Cases 618.

(2) (1858) 28 L. J. Ex. 100; 3 H & N 769.

(3) *Delage* v. *Nugget Polish Co.,* (1905) 92 L. T. 682.

(4) *British Dye Stuffs Corporation* v. *Commissioners of Inland Revenue*, 3 A.T.C, 532.

sum payable by 10 equal instalments plus a royalty in the former case and in consideration of a certain share in the American Company in the latter case. *Held* by the Court of Appeal (reversing the decision of Rowlatt, J.)—

(1) That it was a question of fact—to be decided by the Commissioners—whether the company was trading in patents or merely realised their capital rights in their patents.

(2) That the Commissioners had ample evidence before them to arrive at a finding.

(3) That the High Court could not interfere with the decision.

(4) And that even on merits the findings of the Commissioners were right, *viz.*, that the money apart from the royalty was 'capital'.[1]

Patents—Sale of—Royalty—Dependent on profits—Income—

The assessee was joint inventor and jointly entitled to letters patent in respect of certain appliances which were manufactured and sold, under a license from the assessee and his co-inventor, by a company of which they were the sole directors and shareholders. In conjunction with the company they agreed to sell to another company, *inter alia,* (*a*) the said inventions, letters patent and all rights appertaining thereto, and (*b*) the goodwill of the company, in consideration of a sum of £750 payable as to £300 by three instalments of £100 each and as to the balance of £450 by a "royalty". There was no liability to super-tax in respect of this payment of £750, which was a capital receipt. The purchasers also agreed to pay by way of additional consideration a "further royalty" of 10 per cent. upon the invoice price of all machines constructed under the said inventions and sold during a period of ten years. *Held,* that the "further royalty" did not constitute part of a capital sum but represented a share of the profits of the purchasing company and formed part of the income of the assessee and that, as such, it had been correctly included in the assessment to super-tax made upon him.

Per Rowlatt, J.—I do not think there is any law of nature, or any invariable principle, that because you can say a certain payment is considered for the transfer of property, therefore it must be looked upon as the price in the character of principal. It seems to me that you must look at every case, and see what the sum is. A man may sell his property for a sum which is to be paid in instalments, and when you see that that is the case, that is not income or any part of it—that was the case of *Foley v. Fletcher.*[2] A man may sell his property for what is an annuity, that

(1) *Firth Brearley Stainless Syndicate v. Collins,* 9 Tax Cases 520.
(2) 7 W. R. 141; 3 H & N 769.

is to say he causes the principal to disappear and an annuity to take its place. If you can see that that is what it is, then the Income-tax Act taxes it. Or a man may sell his property for what looks like an annuity, but you can see quite well from the transaction that it is not really a transmutation of a principal sum into an annuity, but that it is really a principal sum the payment of which is being spread over a time, and is being paid with interest, and it is all being calculated in a way familiar to accountants and actuaries, although taking the form only of an annuity. That was *Scoble's Case*[1] when you break up the sum and decide what it really was. On the other hand a man may sell his property nakedly for a share of the profits of a business, and if he does that, I think the share of the profits of the business would be undoubtedly the price paid for his property, but still that would be the share of the profits of the business and would bear the character of income in his hands, because that is the nature of it. It was a case like that which came before Mr. Justice Walton in *Chadwick* v. *Pearl Life Insurance Company.*[2] It was not the profits of a business, but a man was clearly bargaining to have an income secured to him, and not a capital sum at all, namely, the income which corresponded with the rent which he had before.

I therefore think that what one has to do is to look and see what the sum payable really is. I think that (assessee) is right in this sense, that the ascertaining of an antecedent debt is not the only thing that governs it. It does not govern it by magic, but it is a very valuable guide in a great many cases, undoubtedly. Here, when we look at it, I do not think there is any difficulty in seeing what was intended. The property was sold for a certain sum, and in addition the vendor took an annual sum which was dependent, in effect, on the volume of business done; that is to say, he took something which rose or fell with the chances of the business. I think, when a man does that, he does take an income—that is what it is. It is in the nature of income, and on that ground I decide this case.[3]

Patents—Guaranteed Royalty—Not Capital receipts—

By an agreement between an inventor and a company formed to develop his patents the inventor was guaranteed a minimum royalty for a specified period.

Held, that the guaranteed payments were not capital receipts but income to the inventor.

Per Rowlatt, J.—"It is not the case of paying a purchase price by instalments."[4]

Patent—Consideration for—

The assessee and another were joint inventors of synchronising gears which were patented both in the United Kingdom

(1) 4 Tax Cases 618.
(2) (1905) 2 K. B. 507.
(3) *William John Jones* v. *Commissioners of Inland Revenue*, 7 Tax Cases 310.
(4) *Wild* v. *Ionides*, 9 Tax Cases 392.

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and in the U.S.A. The inventions were used by the Governments of both countries during the war; and ultimately the inventors were given £70,000 by the British Government and £15,000 by the United States Government for the use of the patent. The assessee claimed that the payments were capital and not liable to tax. *Held,* by the House of Lords that, in view of the fact that the corpus of the patent had not been given up by the inventor and that the Royal Commission for Awards had fixed the compensation at the probable reasonable royalty for four years, the payments represented royalties for four years and were therefore taxable as income.[1]

Leasehold—Sale of—Receipt from—

A owned the leasehold of a property subject to a ground-rent of £300. The property was sublet to B for a gross rent of £1,625. A contracted to sell his interest to B by two deeds. The first deed assigned to B the property for the remainder of the lease subject to the payment of the ground-rent to the landlord, the consideration being the payment of £1,000 by B to A. Under the second deed B agreed to pay to A £1,625 per annum by quarterly payments for the remainder of the term of lease. No sum was settled in lump as the price of the property. *Held,* that the quarterly payments were income and not capital.

Per Walton, J.—It is obvious that there will be cases in which it will be very difficult to distinguish between an agreement to pay debt by instalments and an agreement for good consideration to make certain annual payments for a fixed number of years.

In the one case there is an agreement for good consideration to pay a fixed gross amount and to pay it by instalments; in the other there is an agreement for good consideration not to pay any fixed gross amount but to make a certain or it may be an uncertain number of annual payments. The distinction is a fine one and seems to depend on whether the agreement between the parties involves an obligation to pay a fixed gross sum.[2]

Land—Price of—Received by local authority from Company—

Under an agreement between a local authority and a company the authority purchased the site and erected the buildings required for generating electricity and the company fitted up the plant for the undertaking. The company received the profits but paid the authority every half-year the amount paid in the previous half-year by the authority in repayment of the debt incurred by the authority in acquiring the land and erecting the

(1) *Constantinicsco v. The King*; 11 Tax Cases 730.
(2) *Chadwick v. Pearl Life Assurance Co.*, (1905) 2 K. B. 507.

buildings. *Held,* that the half-yearly payments made by the company were not capital.[1]

Liquidation—Assets distributed—Capital—

A firm held shares in a number of single ship companies. On the sale or loss of its ship each company went into voluntary liquidation and its surplus assets, including reserves set aside out of profits, and other undivided profits, both accumulated and current, were distributed. *Held,* that on the liquidation of a company undistributed profits can no longer be distinguished from capital and that the portion of the distributed assets, representing undivided profits, was not liable to tax.[2]

Per Pollock, M. R.—"These sums have not been distributed to the shareholders as dividends. The voluntary liquidation has deprived the directors of the power of declaring a dividend. The rights of the Crown and the subject must be governed by what is and not what might have been. Further it is a misapprehension, after the liquidator has assumed his duties to continue the distinction between surplus profits and capital."

Per Atkin, L. J.—" But (the liquidator) has no power to capitalise or decapitalise, to distinguish in his distribution between capital and income. His duty is simply to distribute assets. . . . . In fact (the shareholder) receives his share of the joint stock, as L. J. Scrutton said in the *Blott Case*[3] not income of the property but the property itself."

There are suggestions by the Court of Appeal in the course of argument in *Commissioners of Inland Revenue* v. *Wright*[4] that the decision in the *Burrell Case* might not apply to the payment of arrears of dividends by liquidators. The decision in the *Burrell Case* has been got over in the United Kingdom by amendment of the law—*see* Finance Act of 1927.

Advances—'One-man' companies—Whether capital or income—

The assessee was the sole director and was in complete control of a limited company, of which the whole of the share capital, consisting of 2,500 £10 shares had been allotted to him in 1911 as part of the consideration for the sale to the company of his business. Of these shares, 2,499 had been continuously held by him until September, 1917, when the company was voluntarily wound up. The one remaining share had been given to a former employee, from whom it was purchased in May, 1917, by the assessee's daughter. The company had made considerable profits during the years 1911 to 1917 but had declared no divi-

(1) *Surbiton Urban District Council* v. *Callender Cable Construction Co.*, (1910) 74 J. P. 88.

(2) *Commissioners of Inland Revenue* v. *Burrell*, 9 Tax Cases 27.

(3) 8 Tax Cases 101.

(4) 11 Tax Cases 181.

dends, the profits made up to 1916 having been accumulated and used for the purposes of the business. In the year 1916-17 the company, under the authority of its Memorandum of Association, had advanced to the assessee without interest and without security various sums, amounting in the aggregate to £6,531, which in the company's balance-sheets were described as "Loans or Advances", and these moneys were utilised by him to purchase War Stock in his own name. In winding up the company's affairs in 1917 the Liquidator had not required the assessee to repay to the company the sums in question, but had taken them into account in determining the share of the assets to which the assessee was entitled. An assessment had been made upon the assessee upon the basis that the payments, amounting to £6,531, made to him by the company in the year 1916-17 were in fact not "Loans or Advances" but constituted income received by him. Upon appeal the Special Commissioners had found as facts (*inter alia*)—

(i) that the company was a properly constituted legal entity;

(ii) that it had power to make, and did make, loans to the assessee;

(iii) that such loans did not form part of the assessee's income; and they accordingly discharged the assessment.

On appeal to the High Court Mr. Justice Rowlatt ordered the case to be remitted to the Special Commissioners on the ground that they had not found as a fact whether the business had been carried on by the company or whether it had really been carried on by the assessee to the exclusion of the company. . . . . . The assessee appealed against Mr. Justice Rowlatt's order remitting the case to the Special Commissioners. Judgment was delivered by the Court of Appeal against the Crown, with costs, their Lordships holding that by their findings of fact in the case stated the Special Commissioners had by implication found as a fact that the business was carried on by the company and not by the assessee.[1]

The importance of this decision lies in its emphasis on such questions being questions of fact, *i.e.*, whether a company is really doing the business of an individual, the company being a mere cloak, whether the loans are genuine loans or merely devices to distribute profits and evade income-tax.

'One-man' Company—Loans—

The assessee was the controlling shareholder of five private limited companies. From time to time he withdrew sums of

(1) *Commissioners of Inland Revenue v. Sansom*, 8 Tax Cases 20.

money from each company, which were shown as 'loans' in the accounts of the companies. The loans were not secured by any document, there was no provision for the repayment of interest and the companies did not pay any dividends. One of the companies was liquidated voluntarily through the assessee as liquidator who did not settle the accounts with the shareholders but simply took over the business in the style of a firm and did not repay the loans taken by him. The Special Commissioners held that the loans in question were not genuine loans and should be assessed as income of the assessee. *Held,* that there was evidence before the Commissioners to support their finding of fact.[1]

Private Company—Loans written off—Whether income of shareholder— In a private company the assessee and his brother held all the ordinary shares and by virtue of the articles the company was entirely under their control. For some years the company had paid no dividend on the ordinary shares though it had made large profits. On the other hand it had made large loans to the two brothers. Under the articles the company could lend money; and it was conceded by the Crown that the loans were *bona fide* loans. On 31st December, 1919, the brothers owed the company about £283,000; and the company had large accumulated profits. The brothers wanted to write off the loans but were advised by Counsel that a reconstruction was necessary for the purpose. Nevertheless on the advice of their auditor the company wrote up the values of their assets by £226,000 and transfered this amount to a newly opened General Reserve to which they also transferred £57,000 from the undivided profits. To the other side of this reserve they transferred the loans so that the reserve automatically vanished. The Special Commissioner held that in effect the profits had been distributed as far as they could go (*i.e.*, £117,000) to meet the sum of £283,000. *Held* reversing the decision of the Special Commissioners that the write off of the loans did not effect a distribution of the profits.

Per Rowlatt, J.—Of course if a General Reserve Fund had been created in effect, and allowed to live beyond its birth, it would have appeared in the next balance-sheet simply as a liability against the whole body of assets and if that had been divided, say as a bonus dividend, and if a bonus dividend had been divided to that amount, that bonus dividend undoubtedly would have been good so far as the undivided profits existed to satisfy it. It would not have gone against the general reserve in particular; it would merely have been taken out of the assets of the company and it would have been good so far as there were profits to meet it. But it seems to me perfectly clear that these people had no intention what-

(1) *Jacobs v. Commissioners of Inland Revenue,* 10 Tax Cases 1.

ever of dividing their undivided profits up to the hilt. . . . What they purported to do, in perfectly clear terms, was this : "We are going to create a fund to give to these people, to treat as belonging to these people, in order to cancel their loans against us. We are going to create a particular fund. We are going to do it by writing up the assets to the tune of £226,000. We are going to put into it profits to the tune of £57,000." I cannot conceive how it can be said that the action of dividing whatever profits there might be beyond the £57,000 can be attributed to them. . . . . . Now supposing that the loan had been exactly of the same amount as the amount that was obtained by the inflation in the valuing up of the assets, and they had said, "We will carry to General Reserve Account the amount by which we inflated the assets. We will leave the exact amounts of the loans and we will carry to the Reserve Account the amounts of the loans too and so cancel them." Could it then have been said, "Well, although they have said nothing whatever about profits, and are simply seeking to cancel the loan against the inflation of their fixed assets, they are to be taken *nolentes volentes* as having distributed the undivided profits, though they never hinted that they wanted to disturb the profits of the company in the smallest degree? I do not think it would have been said. On the other hand . . . . supposing that the loans had amounted to just the same amount as the amount which they were taking from the profits, and they had not inflated the assets at all . . . . that would have been the strongest possible case for the Crown. They have mixed the two together. . . . Now am I to hold that the Commissioners were entitled to dissect this combined fund, so to speak, and attribute £57,000—because I do not see that they could do more—to the cancellation of the loan?"

There is another fact which in my judgment just turns the scale. They sought to cancel these loans altogether. I am conceiving the possibility that they cancelled them to the tune of £57,000 by the division of profits. But the loans were not owing by the two brothers equally. The £57,000 has got to be apportioned between them somehow; either it has got to be said that the loans were written off equally in point of amount, but not equally in proportion, or I have got to say that there has got to be a distribution of profits, not on the footing of equality between the shares, because the brothers had the same shares, but giving a greater dividend to one brother in order that he might have a proper proportion of his loan written off. Whichever you do, you have to mould the transaction into a shape that the people never intended it should bear. *Non constat* that they would have written off any of the loan if they could not write it all off; *non constat* that they would have written it off unequally as regards proportion; *non constat* that they would have written off equally as regards proportions and therefore unequally as regards amount. It seems to me that in the result I cannot hold that it is open to the Commissioners to say that they can treat this transaction as necessarily having the effect of a distribution of profits. I can quite understand that when a series of acts are done and are called by a wrong name, you can apply the right name to them and the Court is not to be constrained by language; but it does seem to me here that what is sought to be done and has been done has gone beyond that and the Commissioners have taken it upon themselves to say that one set of facts shall be another set of facts.[1]

The Court of Appeal, following *Miles* v. *New Zealand Alford Estate Co.*[2] affirmed Rowlatt J.'s judgment. The point stressed by that Court was that the debts due by the shareholders had not been validly cancelled, *i.e.*, the Directors still owed the loans to the company since there was no consideration in return for which the loans could have been cancelled.

Sir D. M. Petit formed four private limited companies, each with a capital of between 30 to 40 lakhs, and owned all the shares excepting 3 preference shares (of Rs. 10 each) in each company, these three shares being held by his subordinate employees. Sir D. M. Petit paid for the shares allotted to him by agreeing to make over to each company a block of shares and securities of other concerns which he held, but as a matter of fact he did not so make over the shares, each company, at the time of its formation, appointing him or his nominee as trustee for itself to hold the shares on its behalf and allowing him to keep the shares without formal transfer to the company until the company should call upon him to do so. The shares were in Sir D. M. Petit's name. When he received dividends and interest, book entries were made in each company crediting them with dividends and interest on securities, giving Sir D. M. Petit loan at 6% without security or voucher. Neither capital nor loan nor interest was ever repaid. The memorandum of each company contained 38 objects but the companies did nothing beyond receiving dividends and giving loans to the assessee. This continued for six years, during which period no dividend was declared by these four companies.

Held, that the Income-tax Officer could enquire into the genuineness of one-man companies, though he should not start with the presumption that they are simulacra or shams, and that in this case there was evidence to justify the finding that the loans were not genuine. *Held also*, that a formal transfer of shares is not in itself conclusive proof of the ownership of shares.[3]

Guaranteed profits—

Profits received by a company from an independent guarantor guaranteeing to the shareholder a certain dividend are not the profits of the company, the latter being merely the vehicle for handing over the guaranteed money to the shareholders.[4] But

(1) *Hall* v. *Commissioners of Inland Revenue*, 11 Tax Cases.
(2) 32 Ch. D. 283.
(3) *Sir D. M. Petit* v. *Commissioner of Income-tax*, 2 I. T. C. 255.
(4) *In re south Llanharran Colliery Co.*, 12 Ch. D. 503.

where there is no such outside guarantee profits received by a company in the course of its business even though held in trust for debenture-holders, etc., are profits of the company.[1]

Annuity—Guaranteed—Ear marked for sinking fund—Income and not capital receipt—

The Nizam's Government guaranteed a company which constructed a railway in Hyderabad an annuity for 20 years of 5 per cent. on the issued share and debenture capital, to be applied in paying interest on such capital and in forming a sinking fund for the redemption of the debentures, subject to provisions for repayment of the sums paid, with interest, out of profits earned. *Held,* that the whole annuity, including the sums applied to sinking fund, was chargeable with duty.[2]

Foreign remittances— Capital or income— Question of fact—

An insurance society invested sums in Australia; interest accruing was retained abroad and invested; principal moneys periodically repaid to the Society's agent in Australia were mixed with other moneys in his bank account, and after varying intervals of time corresponding amounts were remitted to Scotland. *Held,* that such remittances are not to be treated as remittances of capital but of interest. It is a question of fact whether it is capital or interest.

Per the Lord President.—" When however the question is whether particular remittances, the real origin and character of which as capital or interest are not definitely established should be regarded as consisting of capital or of interest the fact that the amounts were entered in the accounts . . . . and treated as income in this country may be admissible evidence upon that question. It further appears to me that under the circumstances indefinite remittances to this country must be presumed to consist of interest, not of capital so long as the amount of capital remitted to Australia for investment still remains invested there."

Per Lord McLaren.—But where a capitalist company as in the present case has invested large sums for a period of 15 years in a colony and has an agent employed not only to receive interest but also to receive the capital of the investment when paid up and to reinvest it, even if unappropriated remittances are made to this country, I think every one would agree that they must be dealt with according to the ordinary course of business and these remittances must be presumed to be paid in the first place out of interest so far as they are income and in the second place out of principal or capital. I think that rule results from the fact that

(1) *Commissioners of Inland Revenue* v. *City of Buenos Ayres Tramways,* 6 A. T. C. 195.

(2) *Blake v. Imperial Brazilian Railway,* 2 Tax Cases 58, followed: *Nizam's Guaranteed State Railway Co.* v. *Wyatt,* 2 Tax Cases 584.

no prudent man of business will encroch upon his capital for investment when he has income uninvested lying at his disposal.

Per Lord Chancellor.—The mere nicknaming the sum received and ascribing to it, because it is so named, the character of capital and not of income cannot defeat the right of the Crown to have the tax levied upon that which in substance and truth is profit earned abroad but brought to this country.

Per Lord Shand.—The question is . . . . one of fact. The amount of money which was sent out by the company as capital remains in Australia. It has been gradually increased and not diminished. The moneys that have come home were therefore in the nature of interest.[1]

In *Murugappa Chettiar* v. *Commissioner of Income-tax*[2] the Madras High Court held on the authority of the case of *Scottish Provident Institution* v. *Allan* that money remitted to the headquarters of a firm in British India from its foreign branch must *prima facie* be presumed as having come out of profits rather than as a remittance of capital and that the burden of proof was cast upon the assessee to show the contrary.

Dividend Equalisation Fund—Receipts from—Income—

Several directors of a limited company of whom the assessee was one held between them all the ordinary shares therein. Each year for 5 years in succession, the company set aside out of profits certain sums as a reserve fund to be at the complete disposal of the directors for the time being, and in particular as a provision for equalising dividends. On the retirement or death of any director a proportionate share of this " Dividend Equalisation Fund " was payable to him or his legal representatives. Some years later, the company authorised the directors to distribute the Fund among the ordinary shareholders " as a funded debt payable at the option of the directors in cash or in fully paid preference shares at par ", and four days later the directors resolved to pay the Fund in cash and to credit the amount to which each shareholder (director) was entitled to his loan account with the company, but no special arrangement was made as to interest on the amounts so credited or for their redemption by the company. The directors' loan accounts were used for crediting their fees, dividends and interest, and they were in the habit of withdrawing varying amounts therefrom from time to time. Interest was allowed on these accounts at 5 per cent. for two years, and thereafter at 6 per cent.

Held, that the Dividend Equalisation Fund was receivable by the directors as income on the passing of the resolution authoris-

(1) *Scottish Provident Institution* v. *Allan,* 4 Tax Cases 591.
(2) 2 I. T. C. 139.

ing the distribution of the Fund and that the assessee's share of the Fund was therefore properly included in computing his total income for super-tax purposes.[1]

Special dividends—Obligation to purchase shares with them—Income, not Capital—

To enable a particular director to withdraw from the management of a company it was arranged that the remaining shareholders, of whom the assessee was one, should be placed in a position to buy the greater part of his shareholding. In order to provide the remaining shareholders with funds for this purpose the directors recommended that £45,000 should be distributed out of the profits of the company by way of special dividend, and the retiring director further agreed to apply the special dividend on his own shares and the cash received for their sale in taking up £45,000 debentures in the company. A few days later the company declared, out of accumulated profits, special dividends on ordinary and preference shares amounting to £60,000 in all, or £45,000 after deduction of income-tax. Prior to the passing of the resolution the assessee signed a letter authorising the directors to use his portion of the special dividend in payment of the consideration money for such of the retiring director's shares as were purchased by him, and similar letters were signed by the other shareholders. With three exceptions the existing shareholders, including the assessee, duly applied their portion of the dividend to the purchase of shares from the retiring director, who in turn duly took up and paid for £45,000 debentures in the company.

Held, that the transaction was in no sense a capitalisation of profits, that the special dividend was receivable by the shareholders as income, and that the arrangement, whether binding or not, to apply it in the purchase of other shares in the company, could not affect the liability to tax.[2]

Profits—Share of—Accumulated—

See *Hawley* v. *Commissioner of Inland Revenue*[3] set out on page 236. .

Interest on securities—Sales 'cum' interest—Whether income of vendor or purchaser—

Under a contract of sale dated 29th November certain securities of a company were sold together with accrued interest.

(1) *Commissioners of Inland Revenue* v. *Blott*, 8 Tax Cases 101, distinguished; *Commissioners of Inland Revenue* v. *Doncaster*, 8 Tax Cases 623.

(2) *Roe* v. *Commissioners of Inland Revenue*, 8 Tax Cases 613.

(3) 9 Tax Cases 331.

The actual transfer was made on 14th December. The books of the company were closed from 16th to 30th November; and the interest was paid by the company to the vendor, who made it over to the purchaser under the Rules of the Stock Exchange.

Held, that the interest was the income of the purchaser and not of the vendor.[1] In the hands of the latter it would have been a capital receipt. This point arose in the following case in which stock was sold *cum* interest and it was held that the interest was included in the price.

Per Rowlatt, J.—"The truth of the matter is that the seller does not receive 'interest' and 'interest' is the subject-matter of taxation. He receives the price of the expectancy of interest and that is not the subject of taxation. You cannot put the case without relying on the theory that the interest accrues *de die in diem.* If that could be said, it would be at any rate correct in point of figures and economics but that cannot be said. . . . . The point of course is that there is no guarantee that when the due time comes the purchaser will get the interest. So many contingencies might intervene. It follows from this that what the vendor gets is part of 'capital' unless his circumstances are such that he is held to trade in such securities or shares."[2]

Sales 'cum' dividend—

On the 25th November, 1919, the assessee purchased certain shares in a company for a sum exceeding their par value by £50, the excess being expressed in the contract to be paid "to cover the portion of the dividend accrued to date." On the 13th May, 1920, a dividend of 10 per cent. free of income-tax was declared and paid by the company for the year ending the 28th February, 1920. . . . . The assessee contended that, of the dividend so receivable on his shares, £50 plus income-tax (*i.e.*, £71 in all) should be treated as capital in view of the terms of the contract of purchase.

Held, that the transaction was in substance an ordinary one of purchase of shares, and that the sum of £71 in question could not be excluded from the assessee's taxable income.[3]

Sales 'cum' dividend—Sale after declaration of dividend—

The assessee arranged with a financial corporation for the sale at a price of £3 per share of the whole of his shareholding, comprising 79,920 out of the total issued ordinary share capital of 80,552 £1 shares, in a company of which he was the Managing Director. One of the conditions of the proposed purchase was

(1) *Commissioners of Inland Revenue* v. *Sir John Oakley*, 9 Tax Cases 582.
(2) *Wigmore* v. *Thomas Summerson & Sons*, 9 Tax Cases 577.
(3) *Commissioners of Inland Revenue* v. *Forrest*, 8 Tax Cases 704.

that, prior to the transfer of the shares, the assessee, through his controlling interest in the company, should make the company declare out of the balance of its undivided profits a bonus or special dividend of 10*s*. per share on its ordinary shares, the proceeds of which should be held by the assessee as part of the agreed purchase price. The company duly declared such bonus or special dividend free of income-tax, and free also of super-tax up to a sum not exceeding £6,000 should a claim upon any shareholder for the latter tax arise by reason of the receipt of the bonus. The assessee received from the company two months later, a payment of £39,960 in respect of the bonus or special dividend on his shares. The terms of the agreement for sale were first included in a written document a month after he received the special dividend. In that document the purchase price was stated to be £2.10 per share, but it was also stated that the assessee was entitled to, and had previously received, the bonus or special dividend of 10*s*. per share, which had already been declared.

Upon an appeal by the assessee the Special Commissioners held that the sum of £39,960 and the income-tax applicable thereto constituted part of the purchase price of the shares and did not form part of the assessee's total income upon which he was liable to super-tax.

Held, that the evidence before the Special Commissioners did not justify the conclusion of fact that an enforceable agreement for sale had existed between the parties prior to the written agreement and that the bonus or special dividend therefore formed part of the assessee's income and had not been received by him on behalf of the purchaser.[1]

Special provisions have been made in the United Kingdom in the Finance Act of 1927 in order to check the avoidance of super-tax by sales *cum* dividend.

Accumulated dividends—

Mr. Bason was a substantial shareholder in a group of 3 private companies, which pooled their profits. A resolution was passed by the Directors of one of the companies that, after a dividend of 10 per cent. had been paid, 1|3rd of the balance of profits should be given as a bonus to the working Directors. Mr. Bason objected to the resolution and brought a suit. The money intended to be paid to the Directors was kept in suspense; and finally as a compromise the company, with the consent of the Directors, paid

(1) *Commissioners of Inland Revenue v. Frank Bernard Sanderson*, 8 Tax Cases 38.

Mr. Bason one lakh of rupees as his share of bonus. It was held that this was merely an accumulated dividend paid out of accumulated profits.[1]

Super-tax—Free of—Income or capital—

In the above case of Sanderson £6,000 was paid by the company on account of the super-tax payable by Sir F. B. Sanderson and the question was raised whether the amount was his 'income'. *Held*, that it was part of the purchase price of the shares sold by him and not received by him in his capacity as shareholder and therefore not chargeable to any tax.

Per Rowlatt, J.—" One cannot look at it as a dividend; it is not one. It is not a percentage on the shares . . . . it is with reference to an unascertained sum. (As to 'unascertained'—'you cannot declare a thing free of super-tax which would only come on next year, if it will please Parliament and to an amount in the pound which will please Parliament.'). . . . . He was not entitled as against the company at any time to have his £6,000. . . . . It simply was a statement that the company would do what was anticipated. . . . . This money came to him under and because of the execution of and not *before* the agreement. . . . ."[2]

Isolated transaction—Profit from—Capital or Income—

A company carried on business as Coal Merchants, Ship and Insurance Brokers, and as sole selling agent for various Colliery Companies. In the latter capacity it was part of the company's duty to purchase waggons on behalf of its clients. The company made a purchase of waggons on its own account as a speculation and subsequently disposed of them at a profit. It was contended that, this transaction being an isolated one, the profit was in the nature of a capital profit on the sale of an investment. *Held*, that the profit realised on this transaction was made in the operation of the company's business and was properly included in the computation of the company's profits.

Per Sankey, J.—"To begin with, the waggons were not bought as plant and machinery for the purpose of the appellant company's trade. . . . . They were—I do not like to use for a moment in this connection the word 'capital'—no part of the capital bought for the purpose of the appellant company's trade and I do not think that the purchase price of the waggons when sold ever formed part of the capital of the business. It is expressly found that they had nothing to do with the purchase and sale of the waggons. Then it is admitted that these waggons were purchased for the purpose of resale. . . . . I do not think

(1) *Bason* v. *Commissioner of Income-tax*, (Cal.) unreported.
(2) *Commissioner of Inland Revenue* v. *Sanderson*, 9 Tax Cases 80.

that it is possible to say that the mere fact that it was an isolated transaction at once takes it out of the category of chargeable property. I think in most cases an isolated transaction does not fall to be chargeable but I think you have to consider the transaction and you cannot bring it down as a matter of law without regard to the circumstances that in this case the £2,500 (the profits on the resale of waggons) is not chargeable. . . . . Although it is perfectly true that the transaction began with one purchase and ended with one sale, that I think is only a coincidence."[1]

Hired out goods—Sale of—Surplus from—Whether profits or capital—

A company manufacturing waggons used to hire out some of the waggons. Later on it sold the waggons and the question arose whether the profits from the sale of waggons were 'profits' or 'capital'. The company claimed that hiring waggons was a separate business from selling waggons and that profits from selling outright the former class of waggons were an accretion of capital. *Held* by the House of Lords that the surplus was trading profits, as there was only one business.[2]

Interest—Dividends wrongly paid—Not taxable—

In *in re National Bank of Wales*[3] it was held that when a former director repaid the liquidator with interest the amount of dividends wrongly paid out of capital, the interest was not taxable as it was of the nature of damages.

Interest—Included in damages—Part of damages—Capital receipt—

Interest which is taken into account in settling the amount of damages is not 'interest' but part of damages, *i.e.*, it is a capital receipt and therefore not chargeable to tax.[4]

Compensation—Cancelled contracts—

To decide whether compensation for cancelled contracts is capital or revenue, one must look at the intrinsic nature of the business. In the course of business one enters into a great number of contracts, some of which are fulfilled, some broken and others terminated. So long as the assessee has no less power than other persons to terminate his contracts upon terms mutually acceptable, *e.g.*, if he does not enter into a restrictive covenant preventing him from undertaking other contracts, the compensation for closing a contract is merely the price paid for immediate freedom in the course of business from the responsibility for executing the particular contracts, and not the price received as compensation for a burden thrown on the assessee not to

(1) *T. Beynon & Co., Ltd.* v. *Ogg*, 7 Tax Cases 125.

(2) *Gloucester Railway Carriage Coy.* v. *Commissioners of Inland Revenue*, 12 Tax Cases 720

(3) (1899) 2 Ch. 629.

(4) *Commissioners of Inland Revenue* v. *Ballantine*, 3 A. T. C. 716.

carry on the trade. It was held accordingly that the compensation received by a ship-builder for the cancellation of contracts to build certain ships was not a capital receipt.[1]

See also *John Smith & Sons* v. *Moore*,[2] set out under section 10 (2) (ix).

Following *Hall* v. *Commissioners of Inland Revenue*,[3] Sargant L. J. said in *Short Bros. Case*.[1] "You cannot stop at one definite period and say : 'Here was a contract; the contract must be looked upon as an equivalent to the sale or purchase of an annuity, payable at fixed dates, of a definite amount, and therefore any sum received in lieu of the contract being carried out must be looked at as a capital sum received for the surrender of the annuity'".

A company running steamships had a running contract for the supply of coal. Owing to the reduction in the number of ships it found itself with too much coal and transferred the benefit of the coal contracts to another company in return for a premium. It was contended that this premium was a capital receipt arising out of the sale of a contract and that it was a casual transaction. *Held*, that the receipts were trading receipts.[4]

Per Rowlatt, J.—" On the facts I think this is simply a case of a person who is bound to buy a certain amount of consumable stores, who over-buys it, and is lucky enough to dispose of these consumable stores which he has got in the way of his business in relief of his business at a profit."

The assessees who were chalk merchants and owned quarries entered into a contract to supply chalk to a person for ten years and had under the contract to have a wharf for the loading of chalk. The contract was subsequently cancelled and the assessees received compensation which they used for writing down the value of the wharf on their books. The wharf was not required for their other business. *Held*, following the case of *Short Bros.* v. *Commissioners of Inland Revenue*, that the compensation was really a new form of profit in lieu of that under the contract and therefore a trading receipt and not a capital receipt.[5]

Stock—Purchase of—Undervaluation—

A company acquired for £25,000 the assets of another company in liquidation. The assets stood in the books of the latter

(1) *Short Bros.* v. *Commissioners of Inland Revenue*, 12 Tax Cases 955.

(2) 12 Tax Cases 266.

(3) (1921) 3 K. B. 152; 12 Tax Cases 382.

(4) *George Thompson & Co.* v. *Commissioners of Inland Revenue*, 6 A. T. C. 972.

(5) *Commissioners of Inland Revenue* v. *Northfleet Coal and Ballast Co.*, 6 A. T. C. 1030.

at £75,000. The £25,000 was apportioned between various items, £5,625 being taken against stock. Stock was taken and the actual value was found to be £12,798. The question was whether this difference between £12,798 and £5,625 was taxable as profit.

Held, by the Scottish Court of Session that the difference was not taxable, as no one could tell what was the exact price paid for each asset and there was only one alternative so far as stock was concerned *viz.*, its real value.[1]

Rent dependent on capital and interest—Deduction of income-tax from—

A local authority raised a loan and purchased a tramway. The loan was repayable in half-yearly instalments with interest spread over thirty years. The tramway was leased to another local authority for such a rent as should enable the lessors to repay the principal and interest of the loan in thirty years. The lessees claimed that they could deduct income-tax from the payments made by them whereas the lessors claimed that the net payment due to them after deduction of tax if any was such a sum as would repay the loan in thirty years. *Held*, that the contention of the lessees was correct.[2] That is to say the payments were income and not repayments of capital in instanlments.

Debenture—Trust deed—Payment of interest—Whether capital or income—

Under a debenture trust deed arrears of interest had to be paid before the principal. A debenture-holder having commenced an action, the Court directed that the trusts should be given effect to. The rates of interest on the debentures varied. The Court distributed the funds from time to time to the debenture-holders in proportion to the amounts due to them for interest. These funds consisted of rent and royalties from which income-tax had been already deducted. Afterwards the assets were sold and the Court was asked to make a final distribution. It was contended that the payments already made to the debenture-holders were payments of capital.

Held by Farwell, J., that as the debenture-holders did not possess the same interests and the deeds provided for payment of interest before principal, the debenture-holders could not waive their rights under that provision in the absence of agreement of all the debenture-holders, although the provision was inserted in the deed for the benefit of the debenture-holders, and that the payments made must be in accordance

(1) *Craig (Kilmarnock), Ltd. v. Cowperthwait,* (1914) 51 Sc. L. R. 321.
(2) *Poole Corporation v. Bournemouth Corporation,* (1910) 103 L. T. 828.

with the terms of the deed and that income-tax must be deducted from such payments as had not already borne the tax.[1]

In another case of a similar debenture trust deed in which there had been similar default and the Court had ordered the carrying into execution of the trusts it was held on the facts of the case and on the construction of the orders directing payment that, as it was clearly to the benefit of the debenture-holders that the payments should be appropriated to principal, they ought to be so appropriated without putting the payees to their election and that no income-tax should be deducted.[2]

Application of Act.

4. (1) Save as hereinafter provided, this Act shall apply to all income, profits or gains, as described or comprised in section 6, from whatever source derived, accruing or arising, or received in British India, or deemed under the provisions of this Act to accrue, or arise, or to be received in British India.

The Act applies to all income from whatever source it is derived if it accrues or arises or is received in British India, or is, under the provisions of the Act, deemed to accrue or arise or to be received in British India. The tax is, therefore, payable on all income arising or accruing in British India whether the recipient resides in British India or not. The tax is also payable in respect of income received by a resident in British India irrespective of whether it accrued or arose within or without British India. Tax is also payable in respect of income which is "deemed under the provisions of this Act to accrue or arise or to be received in British India." The particular cases where income is "deemed under the Act to accrue or arise or to be received in British India" are specified in section 4 (2), section 7 (2), section 11 (3), and section 42. (Income-tax Manual, para. 14.)

Scope of this section—

The marginal note against section 3 is 'charge of income-tax' and that against section 4 is 'application of Act'. Section 3 defines who has to pay, *i.e.*, every individual, company, etc., on what he has to pay, *viz.*, the income, profits and gains of the previous year; and at what rates, *viz.*, the rates imposed by the Finance Act every year. Section 4 circumscribes the scope of sec-

(1) *Ex Queensland Land and Coal Co., Davis v. Martin*, (1903) unreported.
(2) *Smith v. Law Guarantee and Trust Society C. A.*, (1904) 2 Ch. 569.

tion 3 by defining and limiting the nature of the income that may be taxed. It is not all income, profits and gains of the previous year, but only certain kinds of income that may be taxed.

History—

In the Act of 1886 ' income ' was defined as

" Means income and profits accruing and arising or received in British India and includes in the case of a British subject within the dominions of a Prince or State in India in alliance with Her Majesty any salary, annuity, pension or gratuity payable to that subject by the Government or by a local authority established in the exercise of the powers of the Governor-General in Council in that behalf."

that is, it corresponded partly to section 4 (1) and section 7 (2) of the present Act; and the charging section ran as below :

" Subject to the exceptions mentioned in the next following section there shall be paid in the year beginning with 1st April, 1886, and in each subsequent year, to the credit of the Government of India or as the Governor-General in Council directs in respect of the sources of income specified in the first column of the second schedule of this Act a tax at the rate specified in that behalf in the second column of that schedule."

In the Act of 1918 a separate definition of ' income ' was dropped and the necessary changes were made in the charging sections. The words ' accrue and arise ' were altered to ' accrue *or* arise ', an important change which has avoided the necessity for discussion as to the difference between the concepts ' accrue ' and ' arise '. The new charging sections ran as below :

Section 3 (1). Save as hereinafter provided, this Act shall apply to all income from whatever source it is derived if it accrues, or arises or is received in British India or is under the provisions of this Act deemed to accrue or arise or to be received in British India.

* * * * * * *

Section 14 (1). The aggregate amount of an assessee's income chargeable under each of the heads mentioned in sections 6 to 11 shall be the taxable income of the assessee.

(2) Subject to the conditions hereinbefore set out there shall be levied in respect of the year beginning with the first day of April 1918 and in respect of each subsequent year, by collection in that year and subsequent adjustment as hereinafter provided, upon every assessee in respect of his taxable income at the rate specified in Schedule I, etc., etc. . . . .

These sections have been replaced by sections 3 and 4 (1) of the present Act and the Finance Act of each year.

As regards the effect of the changes in 1922, *see* notes under section 14.

'*Save as hereinafter provided*'.—This clearly refers to the exemptions under section 4 (3), the exemptions granted by section 60, and to special provisions like those which take into account the income outside British India of non-residents in order to determine their title to refunds under section 48.

'*Apply.*'—The word '*apply*' is a word of somewhat indefinite connotation. It obviously means that income to which the Act does not apply shall not be taken into account for any purpose under the Act.[1] On the other hand, the income to which the Act applies can be taken into account for some purpose or other defined in the Act. Thus it is not necessary that income to which the Act applies should be taxed. It may be taken into account merely in fixing the rate of tax—*see* section 16.

Income, profits and gains—

See notes under section 3. Capital receipts are excluded.

As described or comprised in section 6—

There is no special point in the two words 'described' or 'comprised'. Both amount to much the same thing so far as the object here is concerned.

From whatever source derived—

The meaning of this is not clear. A similar phrase is used in the law in the U.S.A. and there it has been used in order to catch realised appreciation in capital values which is taxed neither in India nor in England. The object of the framers of the Indian Act is merely to refer to the sources in section 6; and in this view the words "from whatever source derived" are mere surplusage. (*See also* notes below.)

Accrue or arise—Meaning of—

There are at least four different elements in the concept 'accrue'—(1) that of *time*; (2) that of *place*; (3) that of *source*; and (4) that of the *person* to whom the income accrues.

The element of time arises principally in deciding *when* income should be taxed. This question is dealt with in the notes under section 13. Once income has accrued, that is, assuming that the 'time' factor has been solved, the liability to tax is determined by the other three factors only. In practice, however, it is more usual to settle the liability to tax with reference to the other three factors and then consider the 'time' element when computing the income liable.

(1) See per Krishnan, J., in *Commissioner of Income-tax* v. *Arunachalam Chetty*, 1 I. T. C. 89.

There is also another aspect of the time element. Section 3 merely says that a person is to be taxed in respect of his income of the previous year, and section 4, that income accruing, etc., in British India is to be taxed; it does not necessarily follow from these sections together that the income to be taxed should have accrued to the person in the previous year in British India.

If ' accrue ' *in* a place means to be derived from a source in or earned in that place, there is no separate element of source to be considered. The two elements merge into one. But if it means something like a right to receive and nothing else, and has no reference to the origin or the source of the income, the place of accrual may not be the place where the income originates or is earned.

In all cases, wherever and whenever income may accrue, it must accrue to some person who is the person sought to be taxed.

As section 4 (1) is worded it takes no account of the person to whom the income accrues. All that it requires is that the income should accrue or arise or be received in British India before it can be taxed. It is the same thing whether the person to whom the income accrues is a resident or not. In this respect it differs radically from the English law. The only question with which we are therefore left is what is meant by accrual *in* a place. Does accrual merely mean receivability in that place or does it involve the concept of the income either being earned in that place or being derived from a source of income situated in that place ?

The arguments in support of the former construction are the following :—(1) The words ' from whatever source derived ' become surplusage if they merely refer to the sources described in section 6. The only meaning to be given to these words, if we are not to treat them as surplusage, is to construe them as referring to sources both within and outside British India. That is to say, all income which accrues, etc., in British India is taxable irrespective of the location of the origin or source of the income. In that case obviously the word ' accrue ' cannot mean earned or derived from a source in British India; and the only meaning to be given is that of receivability. (2) Section 42 contemplates the ' accrual,' outside British India (unless the income accrued outside, there would be no object in ' deeming ' it to accrue inside), of income to a non-resident, from ' business connection ' or ' property ' in British India. Even ' business connection '—whatever it may mean—clearly connotes that the source of income if not actually or wholly in British India has either some connection with British India or lies partly in British India. The idea of earning—apart from receiving—something outside India from a source which is at least partly in British India is somewhat difficult to explain. Doubts have been felt whether 'property' in section 42 (1) means the same as 'property' in section 9; if it does, as the Bombay High Court have said *obiter* in the *Hongkong Trust Corporation Case*,[1] the word 'accrue' in that section cannot mean 'earned' or 'derived'. Even if 'property' were construed in a wider sense, it would still be the case that the source of income, or at least some part of it whether corporeal or not, was still in British India whereas the income 'accrued' outside. (3) Sec. 4 (2) also suggests that "accruing" refers to receivability rather than to the place of origin. In the circumstances we are led to construe 'accrue' as meaning something else than earned or derived.

On the other hand, (1) sub-section (2*a*) of section 18 clearly assumes that salaries payable to a Government servant out of India by or on behalf of Government are taxable, *i.e.*, they 'accrue' or 'arise' in British India within the meaning of section 4 (1). This is possible only if 'accrue' means earned. (2) The fact that pay, leave salaries and pensions paid out of India by the Government of India have been exempted under sction 60 shows by implication that they are taxable. This is possible only if 'accrue' or 'arise' is equivalent to 'earned.' It must be admitted, however, that this is not altogether in consonance with section 7 (2) which assumes that salary paid to a Government servant in India but outside British India does not 'accrue' in British India. This might be reconciled on the footing that section 7 (2) applies only to salaries which are neither earned nor received in British India, *e.g.*, the case of Political Officers accredited to Indian States. But in that case the difficulty still remains —why should it be necessary to exempt the salary of officers on *duty* outside India? It may be possible to argue that leave salaries and pensions are in the nature of deferred pay, and that even though the officer is neither resident in British India nor receiving leave salary or pension in British India the leave salary and pension are 'earned' in British India. But the case of an officer on duty, say, in England is no different from that of a Government servant on duty in an Indian State, inasmuch as in either case the income is neither earned (accrues) nor received in British India, and it follows that either section 7 (2) or the exemption about pay of officers on deputation in the United Kingdom or a Colony is superfluous. It is submitted that the latter is superfluous, and also possibly the exemption about leave salary and

(1) Unreported.

pension paid out of India to an officer not residing in India. The taxation of overseas pay, however, rests on a different footing, and there can be no doubt that it is earned in British India. In no case however can it be argued that merely because something is paid out of funds ultimately met by the Government of India the income accrues in British India. The position regarding salaries, leave allowances and pensions paid out of British India is in a welter of confusion as will be seen above. (3) The more natural meaning of ' accrue ' or ' arise,' and more particularly the latter, when used only with reference to a place and without reference to a person or source, is to connote something springing up from the place, *i.e.*, from a source in it—*see* the authorities cited in the Judgment of Oldfield, J. in *Board of Revenue* v. *Ramanathan Chetti.*[1] The idea of 'receivability' is less natural and is usually imposed only by the necessity of the context in construing a particular Act or Acts, as in the United Kingdom. See *Colquhoun* v. *Brooks.*[2]

The expressions 'accrue' and 'arise' have been construed in other countries but these constructions cannot be followed in India on account of the difference in the wording of the Acts. In *Commissioners of Taxation* v. *Kirk* (cited *infra*), a case from New South Wales, it was held by the Privy Council that 'accrue' or 'arise' meant the same as 'derived', but the case was distinguished from English decisions on the ground that the language and aim of the United Kingdom statutes were different. In two New Zealand cases also—*Commissioners of Taxes* v. *Lovell and Christmas* and *Commissioners of Taxes* v. *Eastern Extension, etc., Telegraph Co.* (*infra*), 'accrue' was held to mean the same as 'derived'. On the other hand, in the United Kingdom it was held in *Colquhoun* v. *Brooks*[2]—that 'accrue' meant only a 'right to receive' (per Fry, L. J., in the Court of Appeal—the judgment was reversed by the House of Lords on different grounds altogether).

None of these decisions, as already stated, can be applied to India. In the Colonial cases the statutes used the word 'derived' more or less as a variant to 'accrue' or 'arise'; while in the English law the idea of accruing *to a person* resident in the United Kingdom is prominent.

In India the meaning of the words has been considered in the following cases:—*Commissioner of Income-tax* v. *Ramanathan Chetti* (*infra*)—the point in issue being whether income from business abroad not remitted to British India 'accrued' or

(1) 1 I. T. C. 37.
(2) 2 Tax Cases 490.

'arose' in British India because the business was subject to general supervision by the owner from British India; *Commissioner of Income-tax* v. *Arunachallam Chetti*[1] (see section 13), in which the point was *when* income 'accrued'; and *Rogers Pyatt Shellac Co.* v. *Secretary of State*[2] (cited under section 42) relating to profits accruing to a non-resident from business connection in British India, in which M. N. Mookerjee J. quoted with approval the meaning given in *Colquhoun* v. *Brooks*, but there are passages in his judgment which show that he inclined to the other view also. In *Commissioner of Income-tax* v. *North Anantapur Gold Mines*,[3] however, in which the company contended that no profits arose or accrued in India because the sales were made in England and the money received there, the Madras High Court, while refusing a mandamus to ask the Commissioner to state a case on the ground that the High Court had no jurisdiction to do so, incidentally expressed the opinion that the profits had 'arisen' or 'accrued' in India, having regard to the difference in the wording of the Indian and the English Acts. See also *In re the Aurangabad Mills*[4] and *Board of Revenue* v. *Ripon Press and Sugar Mills*,[5] in both of which, notwithstanding the location of the head office and the control in British India, it was held that the income accrued or arose outside British India. These decisions, however, do not decide as between the 'earned' (or 'derived') theory and the 'receivability' theory. On the other hand, in the *Rogers Pyatt Case* Chatterjee J. thought it.

> "possible to conceive of cases where a property may be situate in British India and the profits thereof may accrue or arise out of British India."

On the whole, having regard to the wording of the Indian Act, it is submitted that the construction, least open to objection, of 'accrue' or 'arise' in section 4 (1) appears to be to make them equivalent to 'earned' or 'derived'. In that case the words "derived from whatever source" in section 4 (1) become surplusage and are to be taken merely as reinforcing the meaning of 'accrue' or 'arise' as referring to sources in British India. (This phrase as already observed has been used in American law but with quite a different object, *viz.*, in order to catch the appreciation of capital values—which neither under the English nor under Indian law is taxable.) In sections 4 (2) and 42, however, 'accrue' must be construed as suggesting a 'right to receive', inasmuch as those

(1) 1 I. T. C. 75.
(2) 1 I. T. C. 363.
(3) 1 I. T. C. 133.
(4) 1 I. T. C. 119.
(5) 1 I. T. C. 202.

sections stress the idea of the *person* to whom income 'accrues'; and there would be no inconsistency between this construction and that of interpreting ' accrue ' as being earned or derived when the word appears only with reference to the place of accrual and without reference to the person to whom the income accrues. Section 42 is an exceedingly difficult section to interpret as will be seen from the notes and decisions under that section.

But even if ' accrue or ' arise ' in British India be construed to mean to be earned or derived from sources in British India, the problem is one of difficulty when the profits arise from activities partly in and partly outside British India. In this connection see the case of *Ramanathan Chetti* cited below.

A somewhat difficult case is that of debts raised by residents in British India on which the interest is payable outside British India to non-residents. In such cases it is difficult to say where the interest is 'earned'; more appropriately it is where the debtor could be sued for the debt or the interest, and the place of 'earning' becomes also the place of the 'right to receive'.

It is also a question whether, when the contract is governed by foreign law and no suit in respect of it can lie in British-Indian courts, and the non-resident is not one of those in respect of whom the Indian Legislature has jurisdiction under section 65 of the Government of India Act, income resulting from such contracts and payable only abroad can be taxed at all, even though such income may be said to result ultimately from sources in British India or activities there.

Is interest on the sterling securities of Government of India or on the sterling securities issued by English companies carrying on business in British India income-tax?—

Where such interest is received by the debenture or security holder in British India, it is clearly liable to Indian income-tax under section 4 (1): where, however, it is not received in British India, the tax will only be payable under the terms of the same section if the interest can be held to accrue or arise there. "Accrue or arise" as used in this connection are general words descriptive of a right to receive, and in this view the relevant portion of section 4 (1) of the Act may be paraphrased by stating that the income to which the Act applies is income received in British India or income which there is a right to receive in British India. If this test is applied, interest on the sterling securities of the Government of India, if not received in British India, will not be chargeable with Indian income-tax; and similarly the interest on sterling debentures issued by companies will not be chargeable if, as is usually the case, there is a right to receive it in England. For the purpose of the test it is immaterial in what currency the security or loan and its interest is expressed, and consequently the same principle is also applicable in determining the liability to Indian income-tax of the interest on foreign (other than sterling) debentures. On the other hand, interest on promissory notes of the Government of India enfaced for payment in England is liable to Indian income-tax, since here the right to receive payment of interest is a right to receive it in India, and the concession by which Government paper can be enfaced for payment of interest in London does not constitute any part of the actual contract entered into by Government. (Income-tax Manual, para. 15.)

Accrue—Arise—Difference between—

Under the Indian law as it stands since 1918 it is immaterial whether or not there is any difference between the meaning of the words 'accrue' and 'arise' but attempts have been made to distinguish between the two.

"The word 'accrues' seems to be the more appropriate word to be used in connection with a periodically recurring right to receive an income which is usually defined in amount while 'arises' seems to be used more appropriately and frequently in connection with a business in which rights arise to receive income of a more fluctuating kind and at more uncertain intervals."[1] "Strictly speaking 'accrues' should not be taken as synonymous with 'arise' but in the distinct sense of growing up by way of addition or increase or as an accession or advantage; while the word 'arises' means comes into existence or notice, or presents itself. The former connotes the idea of a growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable. It is difficult to say that this distinction has been throughout maintained in the Act and perhaps the two words seem to denote the same idea or ideas very similar, and the difference only lies in this that one is more appropriate than the other when applied to particular cases."[2]

'Deemed'—

When a thing is to be 'deemed' something else it is to be treated as that something else with the attendant consequences, but it is not that something else.[3] When a statute enacts that something should be 'deemed' to have been done which in fact and truth was not done, the Court is entitled and bound to ascertain for what purposes and between what persons the statutory fiction is to be resorted to.[4]

(1) Per Sadasiva Iyer, J., in *Board of Revenue* v. *Arunachallam*, 44 Mad. 65; 1 I. T. C. 75.

(2) Per M. N. Mukerjee, J., in *Rogers Pyatt Shellac Co.* v. *Secretary of State*, 1 I. T. C. 363.

(3) Per Cave, J.—*R.* v. *Norfolk Coy.*, 60 L. J. Q. B. 380.

(4) Per Jones, L. J.—*Ex parte Walton*, 17 Ch. D. 756. (Stroud).

United Kingdom Law—

The relevant parts of Schedule D are as below. The other Schedules (for which *see* notes under section 6) excepting, to some extent, Schedule E (which relates to public offices, and annuities, etc., payable by the Crown or out of the public revenues), refer to sources of income in the United Kingdom.

1. Tax . . . . shall be charged in respect of—

(*a*) The annual profits or gains arising or accruing,

(i) to any person residing in the United Kingdom from any kind of property whatever, whether situate in the United Kingdom or elsewhere; and

(ii) to any person residing in the United Kingdom from any trade, profession, employment, or vocation, whether the same be respectively carried on in the United Kingdom or elsewhere; and

(iii) to any person, whether a British subject or not, although not resident in the United Kingdom....from any property whatever in the United Kingdom or from any trade, profession, employment, or vocation exercised within the United Kingdom; and

(*b*) * * * *

2. Tax under this schedule shall be charged under the following cases respectively; that is to say—

Case I.—Tax in respect of any trade not contained in any other schedule;

Case II.—Tax in respect of any profession, employment, or vocation not contained in any other schedule;

* * * *

Case IV.—Tax in respect of income arising from securities out of the United Kingdom except such income as is charged under Schedule C;

Case V.—Tax in respect of income arising from possessions out of the United Kingdom. . . .

RULES.

Case I.—The tax shall extend to every trade carried on in the United Kingdom or elsewhere. . . . .

Case II.—The tax shall extend to every employment by retainer in any character whatever . . . . and to all profits and earnings of whatever value arising from employments. . . . .

Case IV.—1. The tax . . . . shall be computed on the full amount . . . arising in the year of assessment, whether the income has been or will be received in the United Kingdom or not. . . . .

2. The foregoing rule shall not apply—

(*a*) to any person who satisfies the Commissioners of Inland Revenue that he is not domiciled in the United Kingdom, or that, being a British subject, he is not ordinarily resident in the United Kingdom. . . . .

Case V.—1. The tax in respect of income from stocks, shares or rents, whether the income has been or will be received in the United Kingdom or not. . . . .

2. The tax in respect of income from possessions other than stocks, shares or rents shall be computed on the full amount of the actual sums annually received in the United Kingdom from remittances payable in the United Kingdom, or from property imported, or from money or value so received on credit or on account in respect of such remittances, property, money or value brought or to be brought into the United Kingdom, etc. . . . . .''

The English law, as will be seen, gives rise to various important problems. First of all, is a person, whether an individual or a corporate body, a *resident?* This is the primary question to be settled. If so, a minor question is, is he *ordinarily* resident? Next, how are we to distinguish between the following classes of trade: trade wholly carried on in the United Kingdom, trade carried on partly in the United Kingdom and partly outside, and trade carried on wholly outside? This is also important because, unless the trade is wholly carried on outside, a resident is liable to tax on the whole profits, wherever arising, irrespective of its being remitted to the United Kingdom. Then, in what circumstances can 'trade' be said to be 'carried on' or 'exercised' in the United Kingdom? Is a trade wholly carried on outside, a foreign 'possession'? What are 'securities' as distinguished from shares, etc? and so forth.

As regards 'residence' the difficulty has generally been in respect of incorporated persons, that is, companies; and the Courts have held that a company resides where its head and seat and directing power reside and that it can so reside in more places than one. *See* the cases set out under section 4 (2), (the *De Beers* group). In the Indian law 'residence' is not of much importance as will be seen from the notes under that sub-section.

As regards trade carried on partly in and partly out of the United Kingdom, it is a matter of much importance whether the business can be separated into two, so that the income from the trade outside can be taxed only on the part brought into the United Kingdom. There is a large group of cases dealing with this problem—*The London Bank of Mexico group, infra.*

As to when a trade is exercised in the United Kingdom, the question has been of importance in catching foreigners trading in the United Kingdom. This is a vexed question with a large number of rulings dealing with it—*The Sulley* v. *Attorney-General group, infra.*

Except the decisions about 'residence' which are not of much importance considering the Indian law, the other groups of decisions are not directly applicable to India where the provisions of the law are radically different. At best they can be applied only inferentially, due allowance being made for the different scheme and wording of the Indian Act.

COLONIAL CASES.

Mines in New Zealand—Sales in London—Taxable in New Zealand—

Under the New South Wales Income-tax Act, 1895, under which income "(1) arising or accruing to any person wheresoever residing, from any profession, trade, etc., carried on in New South Wales" or . . . "(3) derived from lands of the Crown held under lease" or "(4) arising or accruing to any person wherever residing, from any kind of property. . . . or from any other source whatever in New South Wales", was taxable, it was held in the case of a mining company that won and refined the ore in New South Wales but sold the product in England, that the profits accrued from business in the New South Wales.

"The real question, therefore, seems to be whether any part of these profits were earned or (to use another word, also used in the Act) produced in the Colony. This is a question of fact.

"At first sight, it seems startling that the ultimate result, in the form of profit, of a business carried on (as found by the special case) in the colony, is not to some extent taxable income there, but if it cannot be brought within the language of the Act that must of course be the result. Their Lordships turn to the construction of the Act. The word 'trade' no doubt primarily means traffic by way of sale or exchange or commercial dealing, but may have a larger meaning so as to include manufactures. But if you confine 'trade' to its literal meaning, one may ask why is not this income derived ('mediately or immediately') from lands of the Crown held on lease under section 15, sub-section (3) or from some other source in New South Wales under sub-section (4). Their Lordships attach no special meaning to the word 'derived', which they treat as synonymous with arising or accruing. It appears to their Lordships that there are four processes in the earning or production of this income—(1) the extraction of the ore from the soil; (2) the conversion of the crude ore into a merchantable product, which is a manufacturing process; (3) the sale of the merchantable product; (4) the receipt of the moneys arising from the sale. All these processes are necessary stages which terminate in money, and the income is the money resulting less the expenses attendant on all the stages. The first process seems to their Lordships clearly within sub-section (3), and the second or manufacturing process, if not within the meaning of 'trade' in sub-section (1), is certainly included in the words 'any other source whatever' in sub-section (4).

"So far as it relates to these two processes, therefore, their Lordships think that the income was earned and arising and accruing in New South Wales. . . . .

"The fallacy of the judgment of the Supreme Court in this and in *Tindal's Case*[1] is in leaving out of sight the initial stages, and fastening their attention exclusively on the final stage in the production of the income. The learned judges refer to some English decisions on the income-tax Acts of this country (United Kingdom), which in language, and to some extent in aim, differ from the Acts now before their Lordships. The language used in the English judgments must of course be understood with reference to the cases then under consideration."[2]

Company in London working as Commission Agents to Dairies in New Zealand—

A company carried on business in London as commission agents for provisions. It had a salaried employee in New Zealand who had no other business. Every year another servant of the company also went to New Zealand to arrange for the business. The business was as below. The produce was consigned to the London company directly by the consignors, who were local dairies. Against these consignments, the dairies were granted advances through credits in New Zealand banks, opened by the London company. The London company, however, acted only as commission agents, the unsold surplus being returned to the dairies in New Zealand and the sale proceeds less commission and expenses being made over to them. *Held,* that the profits of the company were actually made in London and that the earlier transactions in New Zealand were insufficient to make the profits taxable as profits derived from business carried on in New Zealand. The relevant expression in the New Zealand Act was 'derived from business carried on in New Zealand'.

"One rule is easily deducible from the decided cases. The trade or business in question in such cases ordinarily consists in making certain classes of contracts and in carrying those contracts into operation with a view to profit; and the rule seems to be that where such contracts, forming as they do the essence of the business or trade, are habitually made, there a trade or business is carried on within the meaning of the Income-tax Acts, so as to render the profits liable to income-tax. . . . . But the decisions do not seem to furnish authority for going further back, for the purpose of taxation, than the business from which profits are directly derived, and the contracts which form the essence of that business."[3]

(1) 18 N. S. W. L. R. 378.

(2) Per Lord Davey in *Commissioners of Taxation* v. *Kirk*, (1900) A. C. 588.

(3) *Sulley* v. *Attorney General*, (1865) 2 Tax Cases 149: *Grainger* v. *Gough*, 3 Tax Cases 462, followed; and *Erichsen* v. *Last*, 4 Tax Cases 422, distinguished; *Lovell and Christmas* v. *Commissioners of Taxes*, (1908) A. C. 47.

International Telegraph Company—Profits from Telegrams from Port Darwin to Madras received through New Zealand—Not taxable in New Zealand—

A company with its head office in London owned submarine cables and did business—international telegraphy—in New Zealand, Australia and elsewhere. In New Zealand the telegraph lines belong to the Government who alone can use the lines. The Government received messages from the public together with the entire charge (5*s.* 2*d.* a word) and sent the message on to the nearest station of the company, after deducting a penny a word, being that Government's share of the message fee. It was claimed by the New Zealand Government that the profits in respect of the telegrams were taxable even though the profits did not relate to the company's cables in New Zealand (the profits in question related to the lines from Port Darwin in Australia to Madras) nor were received by the company in New Zealand. *Held*, that the profits from the telegrams from Port Darwin to Madras were not taxable as there was no contractual obligation on the part of the New Zealand Government to receive messages on behalf of the company and send them to their ultimate destination. The profits therefore were not received by the company in New Zealand, either by themselves or by agents, nor were the cables from which the profits in question were derived within New Zealand. There was no dispute as to the liability of the profits from the company's lines between New Zealand and the adjacent colonies.[1]

CASES IN THE UNITED KINGDOM.

Exercise of trade by foreigner—

A firm of New York where it had its principal business had a branch in England where one of the partners purchased finished goods for exportation to America where the goods were sold. *Held*, that the firm did *not* exercise a trade in the United Kingdom.

"Wherever a merchant is established, in the course of his operations his dealings must extend over various places; he buys in one place and sells in another. But he has one principal place in which he may be said to trade, *viz.*, where his profits come home to him. That is where he exercises his trade. It would be very inconvenient if this were otherwise. If a man were liable to income-tax in every country in which his agents are established, it would lead to great injustice."[2]

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(1) *Commissioners of Taxes* v. *Eastern Extension, etc., Telegraph Company*, (1906) A. C. 526.

(2) Per Cockburn, C. J.—*Sulley* v. *Attorney-General*, 2 Tax Cases 149.

Danish Marine Cable Company—Telegraph messages abroad—Exercises trade in the United Kingdom—

A Danish Company had marine cables communicating with the Government telegraph lines in the United Kingdom. The company had work-rooms in the United Kingdom. Telegraph messages from the United Kingdom were sent over the Government lines and thence through the company's cables to other countries. The United Kingdom Post Office under an agreement collected the message fees and paid the company the fees after retaining what was due to the Post Office. The company made no profits from the land lines in the United Kingdom. *Held*, that the company exercised a trade in the United Kingdom.

"Whatever the word 'exercised' may mean, it certainly includes carrying on . . . . and therefore carrying on trade is within that word. . . . I think a carrier who simply regularly undertakes the carriage of goods abroad for money paid in this country as part of his ordinary business, would be carrying on trade in this country although the whole of the carriage was done abroad."—*Per Jessel, M. R.*

"I think it would in the first place be nearly impossible, and in the second place wholly unwise, to attempt to give an exhaustive definition of what is a trade exercised in this country. The only thing that we have to decide is whether, upon the facts of this case, this company carry on a profit-earning trade in this country. I should say that whenever profitable contracts are habitually made in England, by or for foreigners, with persons in England, because they are in England to do something for or supply something to those persons, such persons are exercising a profitable trade in England even though everything to be done by them in order to fulfil the contracts is done abroad."—*Per Brett, L. J.* (quoted with approval by Lord Herchell in *Grainger* v. *Gough*).[1]

". . . . Whenever a foreigner, either by himself or through a representative in this country, habitually does and contracts to do a thing capable of producing profit and for the purpose of producing profit he carries on a trade or business."—*Per Cotton, L. J.* (quoted with approval by Lord Watson in *Grainger* v. *Gough*[1]).[2]

French wine firm—Selling in England through a London firm—Trading in the United Kingdom—

A firm of wine merchants resided and carried on business in France. The senior partner visited England every year for about 4 months, when he saw customers and took orders from English merchants. A London firm acted as agents for the French firm. A room was provided in the office of the London firm for the use of the French firm's senior partner, for which the latter paid rent. The French firm's name was painted on the pre-

(1) 3 Tax Cases 462.
(2) *Erichsen* v. *Last*, 4 Tax Cases 422.

mises and the firm had its own clerk. The wine ordered and sold was shipped from France, and the bills of lading and invoices were sent therefrom sometimes to the English agents and sometimes direct to the purchasers. The English agents collected the monies and did such business as was not done by the senior partner during his annual visit. The English firm received a commission and not salary. The commission not only covered the expenses of the agents but a guarantee for debts. *Held*, that the French firm exercised a trade in the United Kingdom.[1]

Norwegian Ship Company—Chartering arranged by Glasgow firm—Trading in United Kingdom—

A company incorporated in Norway had its registered office there, in which the share list and books were kept and the shareholders' meetings held. There were two Managers, both in Norway. The company owned a ship, the chartering of which was arranged by a Glasgow firm, who received the freight and spent it, retaining the balance till required for payment of dividends. *Held*, that the foreign company exercised a trade in the United Kingdom.[2]

French wine firm—Selling through an Agent in United Kingdom—Trading in United Kingdom—

A French wine firm had a sole agent in the United Kingdom, who received all out-of-pocket expenses plus a commission on sales. The agent had no other business and his business premises were in his own name. He employed travellers as well as sub-agents for canvassing orders. The orders when obtained were collected by the agent and sent to the French firm, the latter complying with the orders either direct to the purchaser if the quantity was large or through the agent who had a small stock in England belonging to the firm. The wines were invoiced in the French firm's name as vendors. The goods were supplied from France at the purchaser's risk. The French firm had a banking account in London. All gains and losses went to the firm and did not affect the agent who simply canvassed orders and collected the money. Bills and drafts were payable to the order of the French firm; and the agent always sent the bills to them for endorsement. *Held*, that a trade was exercised in the United Kingdom.

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(1) *Tischler* v. *Apthorpe*, 2 Tax Cases 89.
(2) *Wingate* v. *Webber*, 3 Tax Cases 569.
(3) *Pommery and Greno* v. *Apthorpe*, 2 Tax Cases 182.

French wine firm—Selling through London firm—Trade exercised where contracts made—

A London firm were sole agents to a French wine firm. The prices were settled by the latter. The London firm received an inclusive commission on *all* sales in England (whether through the agents or not) out of which they met their out-of-pocket expenses. The English premises were in the London firm's name. The French firm's name was published in the London Directory with the English agent's address. No wine was stocked in England. The wine was advertised by the agents, price-lists and circulars being issued by them under the authority of the principals. The orders were collected and sent to France whence the wine was consigned direct to the purchasers in the French firm's name as vendors. Payments were made either in France or through the agents in London. The French firm had no banking account in England. Formal receipts were sent by the French firm to all purchasers. It was conceded by the assessee that the contracts were made in the United Kingdom. *Held*, that the foreign firm exercised a trade in the United Kingdom.

"Getting the order is the foundation of the trade. . . . . The making of the contract is the foundation, substance and essence of trading. . . . . To constitute trading in this country by a foreign firm it is not necessary that the payment for goods sold should be made here." —*Per Brett, M. R.*

"Trade may be carried on in England without an establishment at all."—*Per Lopes, L. J.*

"In the present case the appellants have an agent or agents residing within the United Kingdom, who, according to my conclusion from the facts, had the receipt of profits and gains, not, it is true, after they have been ascertained as such by the deduction from the gross income of the expenses and outgoings, but as a part of the gross sum which is paid to them. It is obvious that whatever profits and gains there may be from the business exercised within this country, they must be part of the sums which are received by the agents, and I think they are not the less in receipt of profits and gains because they are in receipt of something else as well."—*Per Fry, L. J.*[1]

French wine Merchant—Advertised by an English firm—Supply from France—Not trading in United Kingdom—

An English firm acted as agents for a French wine merchant. The English firm canvassed for orders and sent them when obtained to the French merchant who used his discretion in executing them. The wine was sold "delivery ex-warehouse" in France, the purchaser taking all the risk and cost of freight,

(1) *Werle & Coy.* v. *Colquhoun*, 2 Tax Cases 402.

etc. Payments were made sometimes direct to the French merchant and sometimes through the English firm. The principal's name appeared in the London Directory. *Held*, that the French merchant did not exercise a trade in the United Kingdom.

Per Lord Herschell.—" . . . . In all previous cases, contracts have been habitually made in this country. Indeed, this seems to have been regarded as the principal test whether trade was being carried on in this country. Thus, in *Erichsen* v. Last,[1] the present Master of the Rolls said: 'The only thing which we have to decide is, whether, upon the facts of this case, this company carried on a profit-earning trade in this country. I should say that, whenever profitable contracts are habitually made in England, by or for foreigners, with persons in England, because they are in England, to do something for or supply something to those persons, such foreigners are exercising a profitable trade in England, even though everything to be done by them, in order to fulfil the contracts, is done abroad.' . . . . In the case of a trade exercised in this country, I think any agent who received, for the foreigner exercising such trade, moneys which included trade profit, would be within the provisions of section 41. . . . . In the first place, I think, there is a broad distinction between trading *with* a country and carrying on a trade *within* a country. Many merchants and manufacturers export their goods to all parts of the world, yet I do not suppose any one would dream of saying that they exercise or carry on their trade in every country in which their goods find customers. . . . ."

Per Lord Watson.—"I agree with the opinion expressed in that case (*Erichsen* v. *Last*) by Cotton, L. J., that whenever a foreigner, either by himself, or through a representative in this country, 'habitually does, and contracts to do, a thing capable of producing profit, and for the purpose of producing profit, he carried on a trade or business', and that the profits or gains arising from these transactions in the United Kingdom are liable to income-tax. . . . . There is no substantial difference between obtaining orders for wines, according to the method pursued by Louis Roederer, and attracting customers to Rheims by advertising and sending circulars to the trade in England. . . . . I do not think that the employment of an English agent to collect and remit the debts due by the purchasers can be regarded as an exercise of trade in this country by the foreign merchant . . . . there may be transactions, in my opinion, by or on behalf of a foreign merchant in this country so intimately connected with his business abroad that without them it could not be successfully carried on, which are nevertheless insufficient to constitute an exercise of his trade within the meaning of Schedule D."

Per Lord Davey.—"Canvassing for custom is no doubt ancillary to the exercise of trade, and it may be assumed that Mr. Roederer's trade with this country is increased by the employment of agents for the purpose, as it might be by systematic advertisement. But Mr. Roederer's trade is selling his champagne, and he exercises that trade where he makes his sales and the profits come to him. Nor do I think that it makes any

(1) 4 Tax Cases 422.

difference that it is within the scope of Messrs. Grainger's authority to collect moneys for Mr. Roederer. . . . . It is, in my opinion, no more than if Mr. Roederer were, for the convenience of his customers, to open a banking account in London to which they might pay what they owe him.''[1]

Foreign firm selling goods in England through an English firm on Commission—Exercise trade in United Kingdom—

A foreign firm used to consign goods to an English firm for sale on commission. The latter sold the goods in their own name, collected the monies and assumed all the responsibility for the payments. Full accounts were rendered to the foreign firm both gross receipts and expenses being shown and the commission deducted. *Held*, that the foreign firm exercised a trade in the United Kingdom.[2]

New York Company selling through an English firm as agents Trading and carrying on a business in United Kingdom—

An English firm acted as agents to a New York company. The agents submitted all orders to the principals who rejected orders as they liked, and the agents accepted the orders only after obtaining the principal's authority. Goods were shipped *f.o.b.* Boston and consigned to the agents at Liverpool who distributed the goods to the customers. Most of the sale proceeds was collected by the agents and subsequently remitted to Boston by drafts. In some cases, customers forwarded their acceptances direct to the principals. *Held*, that the contracts for, as well as the delivery of, the goods were made in the United Kingdom.

Per Wills, J.—''Even if the contract had been made in New York, an executory contract for sale, a man cannot get his money and can make nothing out of it unless he delivers the goods in this country; when he does deliver the goods in this country, he exercises a trade and carries on a business.''[3]

French Company—Glasgow firm sole agents—Contracts made in England—Supply of goods outside United Kingdom—Trading in United Kingdom—

A Glasgow firm were sole agents in the United Kingdom for a French company with phosphate mines in Algeria. Contracts were entered into by the agents on their own authority subject to minimum prices fixed by the principals. There was no stock in the United Kingdom. The agents appointed sub-agents all over the United Kingdom but subject to the company's ap-

(1) *Grainger & Son v. Gough*, 3 Tax Cases 462.
(2) *Watson v. Sandie and Hull*, 3 Tax Cases 611.
(3) *Thomas Turner v. Rickman*, 4 Tax Cases 25.

proval. Delivery of goods was outside the United Kingdom. The contract required price to be paid 'by cash in London' but in practice crossed cheques were received, sometimes in favour of the agents and sometimes in that of the company. No cheques were cashed by the agents, and all were sent to France. The company had no banking account in the United Kingdom. The agents were remunerated by a commission. *Held,* (1) (Lord Dundas dissenting) that the company did not exercise a trade in the United Kingdom and (2) that the agents were not in "receipt of any profits" of the principal.[1]

But this decision has been overruled.

" . . . . The decision in *Crookston* v. *Inland Revenue* may probably be supported for the second reason given by the Court, *viz.,* that the profits there in question had not been received by the agents; but on the question first discussed, namely, as to the place where the trade was carried on, I think that the reasoning of Lord Dundas is to be preferred to that of the other members of the Court."—Per Lord Chancellor Cave in *Maclaine & Co.* v. *Eccott.*[2]

"It humbly appears to me that the judgment of the majority of the learned Lords of the second division (in Crookston's case) was erroneous. I think that the weight of authority upon the subject in England was much too lightly treated."*Per Lord Shaw, ibid.*

Belgian yarn firm—Sale in United Kingdom through Agents—Trading in United Kingdom—

A Belgian firm had agents in the United Kingdom for the sale of their yarn. After obtaining the approval of the principals in each case, the agents entered into contracts in the United Kingdom on behalf of the firm. The goods were sent to the agents who distributed them to the purchasers and received payment and gave final receipts. Monthly account sales were sent to Belgium and also quarterly accounts for expenses and commission. The agents received commission on business done but were liable for half the bad debts. *Held,* that the Belgian firm exercised a trade in the United Kingdom.[3]

Industrial Bank of Japan—Loans floated in United Kingdom—Collections through Banks in England on commission—Carrying on business in United Kingdom—

The Industrial Bank of Japan which had no office in the United Kingdom floated loans in the United Kingdom, subscrip-

(1) *Crookston Bros.* v. *Furtado.* 5 Tax Cases 602.
(2) 10 Tax Cases 481.
(3) *Macpherson & Co.* v. *Moore,* 6 Tax Cases 107.

tions to which were received by three Banks in England. The Yokohama Specie Bank collected these amounts (*less* commission, etc.) and remitted them to Japan or made them over to the Japanese Government's account in London. The loans were floated with the consent of the Japanese Government whose consent was necessary to the Industrial Bank undertaking business outside Japan. The Yokohama Bank from time to time acted as agents in the United Kingdom for the Industrial Bank but had no general agency power. It was held that the Industrial Bank did not carry on a business in the United Kingdom.[1]

Per Rowlatt, J.—"A man does not carry on business here because he employs a solicitor to act for him as his agent here."

But the judgment was overruled by the Court of Appeal in *Maclaine & Co.* v. *Eccott*, on the ground that the Tokio Bank exercised, through an agent, the trade of floating loans in the United Kingdom.

Dutch Incandescent Mantle Company— Selling through agents in United Kingdom—

The sole selling agents in the United Kingdom of a Dutch Company making incandescent mantles, were to sell the mantles at the best possible prices but to keep a day-book of sales open to the inspection of the company at all times. The company sold the goods to the agents at cost price *plus* 10 per cent. The agents were to get 5 per cent. commission for expenses and the *del credere,* and the profits were to be divided. Neither party bore the loss of the other. The name of the company was not shown on the invoices but appeared on the brassplates of the agents' premises though there was no clear authority for it. *Held,* (1) that there was evidence on which the Commissioners could find that the Dutch company carried on a trade in the United Kingdom; (2) that the English firm were agents in receipt of profits of the Dutch company.[2]

The *ratio decidendi* in this case was that though the absence of privity of contract between the foreign principal and the local purchaser, and the property in the goods having passed to the local agent were important features, yet it did not prevent the foreign principal being considered to 'exercise a trade' through the agent. A man may act through an agent even though the acts of the agent do not bind the principal; and it is not unusual for agents to obtain special property in goods secured by advances made to principals.

(1) *Yokohama Specie Bank, Ltd.* v. *Williams*, 6 Tax Cases 634.
(2) *Weiss Biheller & Brooks, Ltd.* v. *Farmer*, 8 Tax Cases 381 (C. of A.).

Danish Machinery Manufacturers—London office for inspection of installation of machinery sold in England—Not trading in United Kingdom—

A Danish firm carried on business at Copenhagen as manufacturers of machinery. There were two partners both of Danish nationality and both resident in Denmark. The firm had an office in London in charge of an employee who ascertained the requirements of the customers, inspected the sites of the proposed installations and generally superintended the installation of the machinery when sold. Contracts were arranged for and made directly from Denmark whence the goods were consigned *f.o.b.* During the war the firm purchased parts of machinery in England and used them for repairs or for new installations; and it was conceded by them that the profit from the resale of the goods purchased in England was liable to tax. *Held,* that (except as regards the goods bought and sold in the United Kingdom) the evidence before the Commissioners did not justify the conclusion that the firm exercised a trade in the United Kingdom.

Per M. R. Sterndale.—"I doubt if it is possible, and in any case I do not think that it is necessary, to lay down an exact definition of what constitutes such an exercise of trade."

Per Atkin, L. J.—"There are indications in the case cited (*Grainger* v. *Gough*[1]) and other cases that it is sufficient to consider only where it is that the sale contracts are made which result in a profit. It is obviously a very important element in the enquiry. . . . . But I am not prepared to hold that this test is decisive. I can imagine cases where the contract of re-sale is made abroad, and yet the manufacture of the goods, some negotiation of the terms, and complete execution of the contract take place here under such circumstances that the trade was in truth exercised here. I think that the question is, where do the operations take place from which the profits in substance arise? . . . ." (approved by the H. of L.) *Smidth & Company* v. *Greenwood.*[2]

Foreign firm—Working through commission agent—Agent concluding contract—

A firm of cotton merchants in Egypt appointed an agent in Manchester for the sale of their cotton. He was not described as their sole agent. As a matter of fact the agent carried on no other business but he was at liberty to do so. From time to time he received from the principal firm authority to sell specified quantities of cotton on terms fixed by the principals on each occasion. He also obtained offers locally which he referred to the principals for acceptance or rejection. In either event the contract was concluded by the agent in England. No stocks were kept by the agent, and the goods were shipped directly by the

(1) (1896) A. C. 325; 3 Tax Cases 462.
(2) 8 Tax Cases 193.

principals *c.i.f.* in Alexandria, and the invoices sent by them direct to the purchasers. The bills of lading were sent to the purchasers through the ordinary commercial and banking channels, *i.e.*, in exchange for acceptances of bills drawn by the principals and discounted in Alexandria. The agent at Manchester was in no way concerned with the payment for the goods, nor responsible for bad debts. His remuneration consisted of a commission on sales out of which he met his own expenses. *Held,* that the Egyptian firm were exercising a trade within the United Kingdom and were properly assessed in respect of the profits of that trade in the name of their Manchester agent who was an authorised person carrying on their regular agency.[1]

Contracts between non-residents—

Per the Master of Rolls : ". . . . profits on contracts made here (in the United Kingdom) for the shipment of goods from this country, whether the vendor has sold *f. o.b.* or *c.i.f.*, by residents here, or by non-residents—if the proceeds are received here by the agents—are taxable. Profits on contracts made here for the shipment of goods from Rotterdam to residents in the United Kingdom are liable. Profits on contracts for shipment of goods from Rotterdam to this country made between non-residents are not within the charge unless the profits thereof are received in this country."[2]

See notes under section 42 as to the difference between the Indian and the United Kingdom law in this respect.

Danish Company—Trading through Agents—

Assessees were agents in England acting for Danish steamers. Goods for shipment were brought in by consignors direct to the quay, and the agents put them on board. The agents arranged for the berthing of the steamers, loading and unloading them, clearing through Customs, bunkering coal, and collecting freights. The agents were responsible to the Danish shipowners for freight. The agents' clerk signed bills of lading 'for the Master'. The agents were remunerated by commission. *Held,* that the Danish owners exercised a trade in the United Kingdom through the agents.[3]

'Exercise a trade' and 'carry on business'—Difference between—

"The words 'exercise a trade within the United Kingdom' have no technical meaning and have been said by more than one learned judge to be synonymous with 'carry on business,'"—Per Lord Salvesen in *Crookston Bros.* v. *Furtado.*[4]

But recently a distinction has been attempted.

" The question is whether the profits brought into charge are ' profits arising or accruing ' to the respondents ' from any trade . . . .

(1) *Wilcock* v. *Pinto & Company*, 9 Tax Cases 111.
(2) *Muller, Ltd.* v. *Lethem*, 5 A. T. C. 597.
(3) *Neilson, Anderson & Co.* v. *Collins* and *Turn* v. *Scanlan*, 5 A. T. C. 580.
(4) 5 Tax Cases 619.

exercised within the United Kingdom ' within the meaning of Schedule D of the Income-tax Act, 1853. The question is not whether the respondents carry on business in this country. It is whether they exercise a trade in this country so that profits accrue to them from the trade so exercised."—Per Atkin L. J. in *Smidth and Company* v. *Greenwood.*[1]

The point of this distinction is not clear. Either it is that without actually carrying on business in the country it is possible for the non-resident to exercise a trade in the country so that profits accrue to him from the trade so exercised, in which case it would somewhat correspond to the difference between 'business' used in section 10 of the Indian Act and 'business connection' in section 42 of the same Act; or it is that, even though a person may carry on business (which is a wider term than 'trade') in the country, it might be that he is not exercising a trade from which profits accrue to him. If what is meant is the latter, section 42 of the Indian Act which refers to 'business connection' brings within the ambit of taxation a wider area of income than the United Kingdom Acts.

Business abroad—Whether separable from business within the country—

As already pointed out—*see* page 307, it is a matter of much importance under the English law whether the business of a resident, which is carried on outside is separable from that carried on in England. In the case of a bank which had its headquarters in London and branches in Mexico and Lima, and the London office did not receive current banking accounts but merely did the London business of the branches, it was held that 'the bank does not carry on two businesses. . . . . They have only one business, which they carry on in England. It is true that part of the profits of that business carried on in England, is earned by means of transactions abroad, but that is not carrying on the business abroad; it is carrying on the business in England by means of some transactions of it which are carried on abroad '.[2] In *De Beers* v. *Howe*[3] it was held that the business of the company was one business, 'namely, first to dig for diamonds in Africa, and then to secure the sale of them on the London market'.—*Per Mathew, L. J.* (affirmed by the House of Lords). In *Colquhoun* v. *Brooks*[4] it was held that the residence in England of a sleeping partner of a firm whose activities were wholly in Australia did not result in the firm carrying on a part of the trade in the United Kingdom merely because

(1) 8 Tax Cases 193.
(2) Per M. R. Esher—*London Bank of Mexico* v. *Apthorpe*, 3 Tax Cases 143.
(3) 5 Tax Cases 198.
(4) 2 Tax Cases 490.

the sleeping partner resided in England. In *Denver Hotel* v. *Andrews*[1] it was held that an English company which owned a hotel in the United States and had it run by a manager under the orders of the directors in England, carried on a single business the entire profits of which were taxable in England irrespective of their not having been remitted to England. Somewhat similar cases are *Grove* v. *Elliot and Parkinson*[2]; *Frank Jones Brewing Company* v. *Apthorpe*[3]; *United States Brewing Company* v. *Apthorpe*[4]; *St. Louis Breweries* v. *Apthorpe*[5]; *Apthorpe* v. *Peter Schoenhofen Brewing Company*[6]; and in all these cases the tendency was to emphasize the principle that it was wholly a question of fact where a trade was carried on.

On the other hand, in *Kodak* v. *Clark*,[7] an English company carrying on business in the United Kingdom acquired 98% of the shares in an American company and thus obtained a predominant position in controlling the American company. The remaining two per cent. of the shares were held by independent persons. The English company had no power—nor had it attempted—to exercise any control except as a dominating shareholder. *Held*, that the foreign company was not carried on by, nor was it the agent of, the English company. The profits of the American company were therefore not taxable except when brought to the United Kingdom. Again, in *Gramophone and Typewriter* v. *Stanley*[8] in which all the shares of a German company were held by an English company, and the Commissioners found that the English company controlled the German company, it was held that the possession of all the shares, in itself, was not enough for the purpose of holding that the business of the German company was the business of the English company.

The pendulum however swung the other way again in *Ogilvie* v. *Kitton*[9] in which the sole owner of a business in Canada resided in Aberdeen, and the business was carried on by paid managers in Canada who sent weekly reports, and the owner alone was entitled to the profits and liable for losses. It was held in this case that the business was carried on in the United Kingdom.

Per Lord Stormonth Darling.—" It is a matter of power and right, and not of actual exercise of a right or power. Not a single instance

(1) 3 Tax Cases 356.
(2) 3 Tax Cases 481.
(3) 4 Tax Cases 6.
(4) 4 Tax Cases 17.
(5) 4 Tax Cases 111.
(6) 4 Tax Cases 41.
(7) 4 Tax Cases 549.
(8) 5 Tax Cases 358.
(9) 5 Tax Cases 338.

has occurred in which he has as a matter of fact attempted to exercise this control or to give directions even about the smallest detail. Yet the right of control is there all the time and it might be exercised any moment. It is a matter, it seems to me, of power and right and not of the actual exercise of the right or power."

This dictum, however, was qualified in *Egyptian Hotels* v. *Mitchell.*[1] In that case the Egyptian business of a company which owned hotels in Egypt, was carried on by a local board which met in Egypt. The local board had all the powers necessary for carrying on the Egyptian business. Only general meetings of the company held in Egypt could bind the local board or affect the Egyptian business. The local board retained the profits in Egypt and remitted such sums to England as were necessary to pay dividends and expenses in the United Kingdom. The London board kept the accounts and recommended dividends, which were declared by general meetings of shareholders in England. The directors met only in the United Kingdom and looked after the general control of the company including its general financial affairs. The Commissioners found that the real control of the business was in England, and Horridge J. took the same view. But the Court of Appeal held the contrary; and opinion being equally divided in the House of Lords, the decision of the Court of Appeal was confirmed. Extracts are given below from the judgments of Lord Parker and Lord Sumner who agreed with the Court of Appeal :—

Per Lord Parker.—". . . . . The important point, therefore, was not whether he had power to interfere with the trade or business, but whether he had so, in fact, interfered during the period for which the Crown alleged that he was assessable under Case I. . . . . The trade or business we have to consider is a trade or business from which profits or gains can arise, and not the trade or business of disposing of and dividing such profits and gains when they have arisen, and I can see no reason why a corporation, any less than an individual, should not be engaged in more than one trade or business at the same time. . . . . . . It may well be possible that the board of directors of the company still retain powers by virtue of which they could, if occasion arises, so interfere with the company's business in Egypt that such business would cease to be carried on wholly outside this country, but, as I have already pointed out, it is not what they have power to do, but what they have actually done, which is of importance for determining the question which now arises for decision."

Per Lord Sumner.—". . . . . The question is whether the profits are wholly or partly earned from a business wholly or partly carried on in the United Kingdom. If he takes a part at home in earning the profits, its importance relatively to that taken by his agents abroad

(1) 6 Tax Cases 542.

does not matter, nor does the liability to be charged under Case I depend on active interference. Control exercised here over business operations abroad, though they are far greater in volume or magnitude, will suffice for Case I.[1] So, too, will mere oversight regularly exercised, even though actual intervention never becomes necessary, everything abroad going smoothly without it.[2] Some actual anticipation in carrying on the trade is necessary, though it may not go beyond passive oversight and tacit control. It is not enough that the proprietor merely has the legal right to intervene; otherwise *Colquhoun* v. *Brooks*[3] would have been otherwise decided, for there the respondent was entitled to intervene at any time, though in fact he never did so, but took his share of the profits just as they happened to be earned by those in control abroad. . . . . . . I am of opinion that what the board of directors actually did, fell short of taking any part in or exercising any control over the carrying on of the business in Egypt, and that where the directors forbore to exercise their powers, the bare possession of those powers was not equivalent to taking part in or controlling the trading. . . . . To say that part of a company's business is to pay dividends, if it has earned them, seems to me to be a play upon words."

English Company—Mines in Bolivia—Management delegated to Local Board—

An English company owned certain mines in Bolivia. The management was delegated to a Local Board in Bolivia, the object being to get the advantage of the decision of the House of Lords in the *Egyptian Hotels' Case*. An assessment was made on the Local Board in the name of a firm who were the agents in London of the company. Later on, another assessment was made under Case I upon the company itself. *Held*, by the House of Lords, that (1) the assessment upon the firm was bad; and (2) the assessment on the company was good. It was admitted that the company was resident in England, and it was found as a fact by the Commissioners that the trade was at all events partly carried on in England during the period of assessment. The assessment on the company was therefore good. The assessment on the firm was, however, bad because, in the first place, the Local Board in Bolivia had no separate corporate existence and were merely the agents in Bolivia of the English company; also the agents in England were agents not of the Local Board but of the principal of the Local Board, *viz.*, the appellant company itself. Besides, when the company itself had a residence in

(1) *San Paulo (Brazilian) Railway Co.* v. *Carter*, (1896) A. C. 31; 5 Tax Cases 407.

(2) *Ogilvie* v. *Kitton*, (1908) S. C. 1003; 5 Tax Cases 338.

(3) 2 Tax Cases 490.

England, the Commissioners had no right to tax either the Bolivian Board or the agents of the company.[1]

Applicability of United Kingdom rulings—

As already observed these English cases cannot be applied in India without qualifications. But they can be followed to some extent in determining what constitutes the exercise of trade or carrying on business in British India. If trade or business is carried on in British India there is little doubt that the profits from the trade accrue in British India itself, if the words 'accrue in British India' mean to be earned or derived from sources in British India. Thus the principle of *Ogilvie* v. *Kitton*[2] as modified by Lord Sumner in *Egyptian Hotels* v. *Mitchell*[3] could be applied in cases of the type of *Ramanathan Chetty's*,[4] having due regard to the circumstances of each case. Similarly, there can be little doubt that the circumstances which would justify a foreigner being declared to 'carry on' or 'exercise' a trade in the country, will *a fortiori* justify his being declared to have a 'business connection' with the country (though the words 'business connection' are vague and would justify almost any one being declared as having a business connection. These words 'business connection' really sweep aside to some extent Lord Herschell's distinction between trading with a country and trading in a country. Even trading *with* a country involves a business *connection*.)

'Accrue'—When a question of law

" . . . . The question whether income can be said to accrue or arise in British India would ordinarily be a question of fact, but whether income accruing outside British India can be taxed as accruing in British India because the company is registered in British India is a question of law. . . . "[5]

Money lender—Business abroad—Whether profit accrues in British India—

The assessee was the proprietor of a money-lending business carried on on his behalf in various places in Indo-China. The business was carried on by agents appointed for fixed periods, who used their own discretion in lending money to customers. The only part taken by the proprietor was to acquaint himself with the general state of the business and occasionally to issue general instructions. The profits were not brought into India.

(1) *Aramayo Francke Mines, Ltd.* v. *Eccott*, 4 A. T. C. 261; 9 Tax Cases 445.
(2) 5 Tax Cases 338.
(3) 6 Tax Cases 542.
(4) 1 I. T. C. 87.
(5) Per Macleod, C. J., in *In re Aurangabad Mills*, 1 I. T. C. 119.

Held, that the profits were not liable as they did not accrue or arise in India.

Per A. Rahim, Offg. C. J.—" The tax is leviable with reference to the place where the income accrues or arises or is received, and not with reference to the residence of the person who is entitled to the income. This seems to be the entire scheme of the Act, and sections 31 and 33 would appear to be illustrations of that principle. Whatever meaning be attached to the words 'accrue' or 'arise', or such as, 'grows' or 'becomes due or payable', it is impossible to hold that the income in this case could be said to have accrued or arisen in British India. If loans are made and the borrowers reside outside British India and if accounts are adjusted, the moneys lent are realised with profit or are capable of being realised and the profits are periodically ascertained and dealt with outside British India, it is impossible to hold that the income of such business accrued or arose in British India. . . . . A number of English decisions were discussed before us, but it is unnecessary to deal with them in any detail, because the English Statute under consideration in those cases differs in many material respects from the Indian Act. In the English Statute the place of residence of a person is a basis of assessment but is not so as pointed out above in Act VII of 1918."

Per Oldfield, J.—"The primary meaning given for the word in the Oxford Dictionary is ' to arise or spring as a natural growth or result '; in Webster's Dictionary, ' to come by way of increase '; and in Wharton's Law Lexicon 'to grow to or arise.' These, the only authorities referred to, show that the origin of the thing, which accrues, in the exertions of some person or otherwise, is not an essential element in the definition of the word ' accrue ' and cannot affect its application. This is fatal to the attempt made in the first form of the argument to identify the place of accrual referred to in section 3 (1) with the place in which such exertions, in the present case by carrying on business, have taken place. I, however, refer at once to sections 10 (3), 31 and 33 of the Act, in the light of which it is contended that section 3 (1) should be construed. It might be sufficient to say that the first in which a very definite exception is specified, and the others occurring in a chapter headed ' Liability in special cases,' cannot be invoked as exemplifying any general principle or controlling a general definition. But, in fact, the sole similarity between the cases dealt with in these provisions and the case before us is that all relate to profits earned where they are not enjoyed. The special provision in section 10 (3) for liability to assessment in British India of professional fees, which a resident there has received elsewhere, can be referred to no general foundation, and is merely the recognition of a presumption of law that the earnings of a resident in British India will be brought there for enjoyment, whilst sections 31 and 33 (of which the former statedly deals only with income chargeable under the Act) are easily intelligible provisions for the liability to the tax of the person, through whose hands, in one capacity or another, the profits in question will pass in British India, and whom therefore the Crown can reach in order to collect it. It may on the other hand be observed that the existence of special and explicit provision in section 10 (3) for the taxation of the one kind of income not received in British India is strong reason for refusing to hold others liable by implication. The argument of the learned Advocate-General in the first form is accordingly unsustainable with reference either to the significance of the word 'accrue', or to any construction of section 3 (1) with reference to other parts of the Act: and it must be rejected.

"His argument in its second form derives at first sight some support from the secondary meanings of 'accrue' given in the Century Dictionary as used in law for 'to become a present and enforceable right' and in Bouvier's Law Lexicon as 'to become a present right of demand,' the suggestion being that respondent's profits in Saigon accrued to him in British India, when, being in the latter place, he had a right to demand them of his agent in the former; and to show that income is regarded in the Act as accruing, before it is received and when there is only a right to receive it, reference has been made to the use of the word 'receivable' in section 7. There is, however, a short answer to this. Firstly, this meaning of 'accrue' is excluded by the context in section 3 (1). For it is not the right to demand the profits, which it is proposed to tax, but the profits themselves. And, secondly, if the word 'receivable' in section 7 is interpreted in the light of the provision in section 15 (3) for the method of payment of the tax on interest on securities the description of income with which section 7 deals, its use will be seen to involve recognition, not of any kind of income as existing independently of and before its receipt, but of income, to which liability for the tax attaches at the moment of its receipt, when the tax is to be deducted by the person responsible for its disbursement."[1]

"Some attempt has been made to support this argument by reference to English decisions. But it is useless to deal with them at length in view of the material differences between the wording of the Act before us and that of the English statute in question."

If the degree of control from headquarters had been greater, perhaps the Court would have been prepared to hold that the profits accrued or arose in British India. See *Ogilvie* v. *Kitton*[2] and *Egyptian Hotels* v. *Mitchell*.[3]

The following extract from paragraph 14 of the Income-tax Manual should also be noted :—

"A money-lender resident in an Indian State who advances loans in an Indian State to persons residing in British India and who receives his interest in the State is not liable to pay income-tax on the interest which he receives."

That is, it is neither earned nor received in British India, even though the interest may be met out of income arising from the exertions of the resident in British India.

(1) *Board of Revenue* v. *Ramanathan Chetty*, 1 I. T. C. 37.
(2) 5 Tax Cases 338.
(3) 6 Tax Cases 542.

Company—Manufacture abroad—Whether profits accrue in British India—

A company with head office and control in British India had a press in an Indian State. The press levied a charge on persons bringing material to be pressed, and this was received wholly at the factory. The only receipt of money in British India was the remittance to the head office for expenditure. The dividends of the company were payable only at the factory. *Held*, that the income of the company did not arise, accrue nor was received in British India, nor could be deemed to accrue, arise or be received in British India within the meaning of section 3 (1) of the Income-tax Act, 1918 (corresponding to section 4 (2) of the present Act).

Per C. J. Obiter—"Even the small amounts received at the head office are not taxable."

Per Coutts Trotter, J.—"The same sum of money cannot be received *qua* income twice over, once outside British India and once inside it."[1]

Accrue—Profits from manufacture outside British India—Control from British India—Not relevant—

The profits of a company which are derived from manufacture carried on beyond British India cannot be said to 'accrue' or 'arise' in British India on account of the head office being in British India.[2] The doctrine of 'control' enunciated in various English decisions does not apply.

(2) Profits and gains of a business accruing or arising without British India to a person resident in British India [3] [*shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be profits and gains of the year in which they are so received or brought*], notwithstanding the fact that they did not so accrue or arise in that year, provided that they are so received or brought in within three years of the end of the year in which they accrued or arose.

Explanation.—Profits or gains accruing or arising without British India shall not be deemed to be received

(1) *Board of Revenue* v. *Ripon Press and Sugar Mills*, 1 I. T. C. 202.

(2) In re *the Aurangabad Mills*, 1 I.T.C. 119.

(3) These words were substituted for the words "shall be deemed to the profits and gains of the year in which they are received or brought into British India" by section 2 of Act XXVII of 1923, Gen. Acts, Vol. IX.

or brought into British India within the meaning of this sub-section by reason only of the fact that they are taken into account in the balance-sheet prepared in British India.

Resident—

The idea of 'residence' does not enter into the Indian Income-tax law except in the following connections: (1) in regard to profits from business accrued or arisen without British India to a resident in British India and subsequently received in British India (in this sub-section); (2) in regard to profits arising or accruing to a non-resident through or from any business connection or property in British India [section 42 (1)]; (3) the deduction of super-tax at source in certain cases (section 57); (4) professional fees earned in India by a person ordinarily resident in British India [section 11 (3)]; and (5) refunds on account of 'small incomes relief' (section 48).

There is no definition of 'residence' in the Act or in the General Clauses Act. In the circumstances, presumably the general principles underlying the English decisions, of which there are many, will apply to India also. In England the question is one of considerable importance because the taxation of residents rests on an altogether different basis from that of non-residents.

United Kingdom Law—

In England a 'resident' is taxed in respect of profits from trade carried on partly inside and partly outside the country, on the whole of the profits irrespective of where such profits accrue or arise, and in determining what constitutes the 'residence' of corporate bodies, the Courts brought in the question of control. In India a resident can be taxed only in respect of income accruing, or arising or received in British India, or what is deemed to so accrue or arise or be received. He cannot be taxed in respect of his whole profits wherever arising as in the United Kingdom. But the English decisions as to what constitutes 'residence' are, it is submitted, not inapplicable to the extent that 'residence' enters into the Indian Act, *e.g.*, section 4 (2) profits remitted to British India or section 42—profits of non-residents as explained above.

Remittance from abroad by non-resident

While a resident is liable to be taxed on foreign profits brought into British India, to the extent specified in section 4 (2), a non-resident is not liable to be taxed on foreign profits remitted to this country. The idea apparently is that such remittances are capital which the non-resident sends to this country. If a resident changed his residence temporarily out of British India he cannot evidently claim to be a non-resident for the purpose of this section. The assessee need be a resident only when the profits are brought into British India; the fact that he was not so resident when the profits originally accrued or arose abroad would not give a title to exemption.

Residence—What is—

'Residence' signifies a man's abode or continuance in a place.

"When there is nothing to show that it is used in a more extensive sense (it) denotes the place where an individual eats, drinks and sleeps or where his family and servants eat, drink and sleep."[1]

'But it is an ambiguous word.'[2] But *qua* assessed taxes, a person resides not only where he sleeps but at his place of business.

Per Pollock, C. B.—"The word 'reside' does not necessarily mean 'dwell'.

Per Martin, B.—"Strong ground for contending that one who spends the day at his shop attending to his business, and may there be seen and conversed with on matters of business, and does not choose to be communicated with elsewhere, is 'residing' there."[3]

The words 'residence' and 'place of abode' are flexible and must be construed according to the object and intent of the particular legislation where they may be found.[4]

Domicile has nothing to do with residence.[5] A man can have two or more residences in two or more different countries but can have only one domicile.[6] See also *Walcot* v. *Botfields*[7] (a case of construction of a will). The domicile of an infant may be in a country to which he has never been physically. 'Residence' connotes the idea of the person's bodily presence at some time or other. In *In re Young*[8] a master mariner who was abroad for the greater part of the year was considered to be

(1) Per Bayley J. in *R.* v. *North Curry*, 4 B. & C. 959.
(2) Per Cotton L. J.—*In re Bowie Exp. Breull*, 16 Ch. D. 484.
(3) *A. G.* v. *McLean*, 1 H. & C. 750.
(4) *R.* v. *Fermanagh Justices*, (1897) 2 I. R. 563; *R.* v. *Tyrone Justices*, (1901) 2 I. R. 510 (from Stroud).
(5) *Attorney-General* v. *Coote*, (1817) 4 Price 183.
(6) *Lloyd* v. *Sulley*, 2 Tax Cases 37.
(7) (1854) Kay 534.
(8) 1 Tax Cases 57.

'resident' because his wife and family resided in the United Kingdom in a house of which he was the tenant. A similar decision was given in *Rogers* v. *Inland Revenue*[1] and *Lloyd* v. *Sulley*[2] (in the latter case the assessee resided mostly at Leghorn where he carried on business). In *Turnbull* v. *Foster*[3] it was laid down that

"The test of liability is not having a residence in the United Kingdom, it is residing in the United Kingdom."—*Per Lord Trayner.*

If the person does not reside even for a day in the United Kingdom during the year of assessment, he is not a 'resident' for this purpose. In *Inland Revenue* v. *Cadwalader*[4] a foreigner who had a shooting in Scotland for a term of years and spent two months there every year was held to 'reside' in the United Kingdom.

Per the Lord President.—"A person may have more than one residence if he maintains an establishment at each of them."

An establishment is not necessary in order to have a residence in a country. Even a tramp must be resident in a country. If a man chooses to live in hotels or even to stay with friends or relations it makes no difference.[5]

In *Brown* v. *Burt*[6] the assessee—an alien, who had lived for 20 years on board a yacht anchored near the shore in an English port—was held to 'reside' in the United Kingdom. In *Thomson* v. *Inland Revenue*[7] it was held that a person employed by an English company in Nigeria, who was the rated owner of a residence in England where his wife and family resided and who spent four months a year there 'resided' in the United Kingdom.

Per L. J. Clark.—"I think, in the sense of the Income-tax Acts, a man may reside in more than one place at the same time."

"When you are considering a question like residence, you are considering just a bundle of facts."—Per Rowlatt J. in *Loewenstein* v *De Salis*.[8]

". . . must be a question of degree and of fact. . . I suggest as a characteristic factor for consideration, even if it does not fulfil the nature of a test, to ascertain if the suggested alternative place of residence is one which the subject seeks willingly and repeatedly in order to obtain rest or refreshment or recreation suitable to his choice; when

(1) 1 Tax Cases 225.
(2) 2 Tax Cases 37.
(3) 6 Tax Cases 206.
(4) 5 Tax Cases 101.
(5) *Lysaght* v. *Commissioners of Inland Revenue*, 6 A. T. C. 64.
(6) 5 Tax Cases 667.
(7) 7 Tax Cases 137.
(8) 10 Tax Cases 424.

for a time he is embedded in the enjoyment of what he desired to attain, and found in the abode of his own option. Another factor may be found and an important one—if he returns to and seeks his own fatherland in order to enjoy a sojourn in proximity to his relatives and friends."—Per M. R. Hanworth in *Levene* v. *Commissioners of Inland Revenue.*[1]

Decisions under the English Acts, *e.g.*, Military Service Acts, would probably not be applicable to income-tax.

Residence of companies—

Per Lord Loreburn in *De Beers* v. *Howe.*[2]

"A company cannot eat or sleep but it can keep house and do business. We ought therefore to see where it really keeps house and does business. The decisions of Chief Baron Kelly and Baron Huddleston in the *Calcutta Jute Mills* v. *Nicholson* and the *Cesena Sulphur Company* v. *Nicholson,*[3] now 30 years ago, involved the principle that a company resides for purposes of income-tax where its real business is carried on. These decisions have been acted on ever since. I regard that as the true rule, and the real business is carried on where the central management of control actually abides."

A company, registered both in the United States of America and Ireland, purchased raw linen goods in Scotland and Ireland, arranged for manufacture by other firms and folded the finished goods themselves and sold them chiefly in the United States of America. The registered office of the company was in Belfast where general meetings were held, the minute book was kept, the accounts were audited and dividends were declared. But the sole director who had exclusive control resided in the U.S.A. *Held,* that the company was resident in Ireland.[4]

In *New Zealand Shipping Company* v. *Thew*[5] the company was incorporated in New Zealand with registered office there; with two boards of directors, one in London and the other in New Zealand. The London board had exclusive control over finance and administration and bigger questions of policy. The other board conducted the business in Australasia and negotiated independently of the London Board most of the freight contracts. General meetings were held and the share registers kept in both countries but the accounts were kept and the dividends declared in London. *Held,* that the Commissioners had sufficient evidence before them to arrive at the finding that the company was resident in London, and that where a company or a person resides is a question of fact.

(1) 6 A. T. C. 323.
(2) (1906) A. C. 455; 5 Tax Cases 198.
(3) (1876) L. R. 1 Ex. D. 428; 1 Tax Cases 83 and 88.
(4) *John Hood and Company* v. *Magee*, 7 Tax Cases 327.
(5) 8 Tax Cases 208.

An English company which was registered in the United Kingdom and carried on business there, promoted a company to own certain cotton mills in the U.S.A., the latter company being incorporated and registered in the U.S.A. No part of the output of the mills was sold in the United Kingdom. The entire stock of the American company was owned by the English company either directly or through trustees. Under the bye-laws of the American company, there had to be seven directors of whom three had to reside in America. The current business of the company was to be directed by an executive committee of three directors resident in America and the regular meetings of the board were to be held in America, extraordinary meetings being held in the company's office in England. The more important powers could be exercised only by the extraordinary meetings of directors in England: for example, the appointment of higher officials, the filling of casual vacancies among directors, entering into contracts for over one year, the appointment of directors, the borrowing of money, etc. In practice, dividends also were declared in the extraordinary meetings in the United Kingdom. *Held*, that there was sufficient evidence before the Commissioners to justify their finding that the American company was resident in the United Kingdom. This decision reiterates the principle that residence is essentially a question of fact.[1]

See also incidentally *San Paulo Railway* v. *Carter*[2]; *Apthorpe* v. *Peter Schoenhofen, etc.*[3]; *Grove* v. *Elliots and Parkinson*[4]; and *St. Louis Breweries* v. *Apthorpe.*[5]

Company can have more than one residence—

The question whether a company could have more than one residence was decided only recently. There had, however, been *obiter dicta* to the effect that it can have two residences—see per Channel J. in *Georz* v. *Bell*[6]; *per* Phillimore J. in *De Beers* v. *Howe*[7] (the House of Lords did not disapprove of this *obiter dictum*); per Buckley, L. J., in *American Thread Company* v. *Joyce.*[8] The decision in *Mitchell* v. *Egyptian Hotels, Limited,*[9] though it did not expressly decide this point, is, as pointed out by *Lord Cave in Swedish Railway Co.* v. *Thompson* (*infra*), inconsistent with the view that a company cannot have more than one

(1) *American Thread Company* v. *Joyce*, 6 Tax Cases 1 and 163.
(2) 3 Tax Cases 407.
(3) 4 Tax Cases 41.
(4) 3 Tax Cases 481.
(5) 4 Tax Cases 111.
(6) (1904) 2 K. B. 136.
(7) (1906) A. C. 455.
(8) 6 Tax Cases 1.
(9) (1915) A. C. 1022; 6 Tax Cases 542.

residence. A definite pronouncement was made on this question only recently in England in *Swedish Central Railway Company* v. *Thompson*,[1] *infra*; and this decision was followed by the Madras High Court in *T. S. Firm* v. *Commissioner of Income-tax*[2] in which they held that the residence of a firm does not depend on the physical residence of the partners but on the place of control, and that a firm can have more than one residence simultanoously. It is submitted that the principle of these decisions will apply also to associations of individuals and Hindu undivided families.

A company owned a railway in Sweden, which was let to a company in Sweden. The income of the former company whose registered offices were in London consisted only of the rent received for the railway. The Secretary resided in London but the direction resided in Sweden. The control was exercised in Sweden and only the formal administrative business was conducted in London by a Committee residing there. *Held* (Lord Atkinson dissenting) by the House of Lords that a company which is controlled from abroad but which is registered in the United Kingdom can for the purpose of income-tax reside both in the United Kingdom and abroad.[1]

Per Lord Chancellor Cave.—An individual may clearly have more than one residence[3]; and on principle there appears to be no reason why a company should not be in the same position. The central management and control of a company may be divided and it may keep house and do business in more than one place, and if so, it may have more than one residence. . . . . (But) I am not prepared to say that registration in the United Kingdom would itself be sufficient proof of residence here : that point does not arise in this case and I express no opinion on it. But however that may be, I am satisfied that the fact of registration together with the other circumstances which were found by the Commissioners to exist were sufficient to enable them to arrive at a finding.

Per Lord Buckmaster.—The reference to the registered office is important; it is to my mind one of the critical facts in determination of residence in this country, but not necessarily the sole and exclusive fact. It varies in consequence in every instance. Nor, even if it were the sole fact, would it follow that a company incorporated and with a registered office elsewhere could not also be resident here for purposes of income-tax.

In a later case it was decided that a registered office in itself involved " residence ".

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(1) 9 Tax Cases 342.
(2) 50 Mad. 847; 2 I. T. C. 320.
(3) *Cooper* v. *Cadwalader*, (1904) 5 Tax Cases 101.

"The question . . . . . is whether an English company having . . the establishment which the law requires in this country, does not necessarily reside there, although its whole control and management may be abroad . . . the Companies' Act puts upon a company which is incorporated in England the obligation to have a residence here. It is not only that a company is compelled to perform certain duties here, and make certain returns, and so on; that it might possibly do from abroad; but the Act requires that it shall have a place here from which it does it. It seems to me, applying the analogy from a natural person to a company upon the question of residence, that that is saying that a company shall always be at home in England at a particular place.

Sir John Simon in his argument treated the obligations of the company as being practically to have an address at which it could be served with process . . . . . . but it is all the other obligations which are laid upon a company which must be borne in mind, the keeping of the register, the right of the public to inspect the register, and so on . . . It seems to me that that fulfils the idea of residence. Lord Parker has observed that a company can change its residence. Of course that is perfectly true of its voluntary residence which it obtains by having its control in a particular place; but I do not think what he said touches the question I have now to decide, as to whether an English company does not necessarily reside in this country if it performs, as it must perform, the duties laid upon it by Parliament . . . a company cannot be incorporated under the Companies' Act as an ambulatory being that can have no residence anywhere, or at any rate not a residence where it has its registered office . . . . I do not think that what he (Warrington, L. J.) said (in the *Swedish Central Railway's Case*[1]) was really *obiter*. . . . (but) was a reason for his decision, although he also could have, and I . . think did decide it upon a wider ground."—Per Rowlatt J. in *Egyptian Delta, etc., Co.* v. *Todd*,[2] approved by the Court of Appeal.[3]

Scope of sub-section—

This sub-section does not apply to any income other than profits and gains of a 'business.' The sub-section is necessary because in its absence such profits would not be taxable. Income cannot be received twice over by the same person as income once outside British India and again in British India. The receipt on the second occasion must be presumed to be of capital and not of income. See *Sundar Das' Case*[4] and *Sir Ali Imam's Case*[5] cited *infra*.

As regards this point as well as the fixing of the three years' limit, *see* the following extract from the Income-tax Manual :

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(1) 9 Tax Cases 342.
(2) 6 A. T. C. 42.
(3) 6 A. T. C. 357.
(4) 1 I. T. C. 189.
(5) 1 I. T. C. 402.

Section 4 (2) was inserted in the present Act owing to the tax having previously been evaded in the case of income accruing or arising out of British India and received in British India by bringing in the said income at intervals and claiming that as such income was not received in British India in the year in which it arose or accrued out of British India, it was, when brought into British India, not income but accumulated profits or savings or capital. The sub-section is restricted in its application to the case of *business profits or gains* and provides with respect to such profits or gains that they shall be deemed to be profits and gains of the year in which they are received or brought into British India notwithstanding that they did not accrue or arise in that year, provided that they are so received or brought in within three years of the end of the year in which they accrued or arose. The provision relates, of course, merely to income, profits or gains, and not to the importation of capital; it provides for the inclusion in the assessable income, profits or gains of the year in which it was received or brought into British India, of business profits or gains accruing or arising within the previous three years which would, apart from the provisions of this sub-section, have been taxable had they been brought into British India in the year in which they arose or accrued.

A person resident in British India carrying on and controlling a business abroad is not, therefore, liable to tax on the profits of the business abroad unless and until such profits are received or brought by him into British India, and when so brought or received he is only liable to tax on the profits of the last three years, but the profits of those three years are included in his taxable income of the year of receipt. (Income-tax Manual, para. 14.)

There was no corresponding provision in the earlier Acts, but in *Narasammal* v. *Secretary of State*[1] the Madras High Court held that annuities received through an agent in Mysore and then remitted to the assessee in British India were taxable under the Act of 1886. The *ratio decidendi* was that 'income' means 'what comes in'—a definition which will clearly embrace sums derived from a source like this and it is incontestable that in this case these sums were 'received in British India.' This view, however, was abandoned in later cases: *Board of Revenue* v. *Ripon Mills*[2] *Sundar Das' Case*[3], and *Sir Ali Imam's*

(1) 1 I. T. C. 10.
(2) 46 M. 700; 1 I. T. C. 202.
(3) 1 I. T. C. 189.

Case[1]; on the ground that money could not be *received* twice over by or on behalf of the same person as income and that the remittance or the second receipt should be considered to be receipt of capital. In fact it was for this very reason that section 4 (2) of the present Act was introduced. It may be possible, however, to distinguish *Narasammal's Case* from the subsequent cases on the ground that in the former an agent received the money outside British India whereas in the latter the assessee himself received it. But no such distinction is possible with *Sir Ali Imam's Case* as in that case the money was received by the assessee's Bank—as agent—in Hyderabad. At the same time it is doubtful whether the suggested distinction is valid. The agent's receipt outside British India constitutes a final discharge for the person paying the money, the act of receipt by the agent being considered in law to be a receipt by the principal, and what comes into British India is in performance of the duty of the agent to account to the principal. Such a remittance is not 'income'. Nor does the receipt accrue or arise in British India. It is submitted therefore that the judgment in *Narasammal's Case*, which is not fully reasoned out, is not correct.

Profits—Cannot be received twice over—

The assessee, a contractor during the war, received large sums of money from Government, but all the payments were made to him at Quetta in British Baluchistan which was then excepted from the operation of the Income-tax Act except that part of the Act which imposed the tax upon salaries. The assessee invested about 23 lakhs of rupees in the Punjab, mainly in buying immovable property. The question was whether the sum so invested in the Punjab came within the purview of section 3, sub-section (1) of the Income-tax Act (VII of 1918) and was consequently liable to income-tax. *Held,* that it did not so come and was therefore not taxable. [Section 3 (1) of the Act of 1918 corresponds to present section 4 (1).][2]

Per Shadilal, C. J. (Full Bench, other Judges concurring) :—" It is not contended that the latter portion of this sub-section has any application to the case before us, and it is also admitted that the income in question accrued or arose not in the Punjab, but in British Baluchistan, which, as already stated, is exempted from the operation of the Act. The matter then is reduced to this. Was the income 'received' in the Punjab? Now the statement of the case makes it absolutely clear that a very large sum of money was received by the assessee at Quetta and that a portion of it was afterwards invested in the Punjab. Upon the material

(1) 1 I.T.C. 402.
(2) *Sundardas v. Collector of Gujrat,* 1 I. T. C. 189.

supplied to us we are not in a position to say whether the sum invested in the Punjab was actually brought into, or transmitted to, the Punjab, whether it was paid to the vendors of the immovable property by cheques drawn upon a bank in Baluchistan.

"Assuming, however, that the assessee after receiving the money in Baluchistan brought it into, or transmitted it to, the Punjab, I do not think that the money thus brought or transmitted can be held to be income received in the Punjab. The assessee undoubtedly received it in Baluchistan where he was not chargeable with the tax, and I fail to understand how he can receive the same thing again when he has not parted with it in the interval. Whether he brought the money with himself or transmitted it by a cheque or by any other method, it remained all the time under his control, and the process cannot be described as a second receipt of the money.

"The Act contains no definition of the word 'receive' or 'received,' but in Murray's Oxford Dictionary the expression 'receive' is defined as 'to take in one's hand or into one's possession (something held out or offered by another) to take delivery of (a thing) from another, either for oneself or for a third party.' In the Imperial Dictionary the same expression is defined as 'to get or obtain; to take, as a thing offered, given, sent, committed, paid, communicated or the like; to accept.' It seems to me that the word 'receive' implies two persons, namely, the person who receives and the person from whom he receives. A person cannot receive a thing from himself.

"It is a sound principle that the subject is not to be taxed without clear words to that effect; and that, *in dubis* you are always to lean against the construction which imposes a burden on the subject.

"Bearing these principles in mind and taking the expression 'received' in its ordinary dictionary meanings, I am of opinion that the assessee, who had already received the money in Baluchistan, did not receive it again when he brought it into, or forwarded it to, the Punjab."

The same principle, *viz.*, that money once received outside British India cannot be again received in British India by the same person unless such remittance can be deemed to accrue or arise in British India under sub-section 4 (2) was followed in *Sir Ali Imam* v. *Commissioner of Income-tax, Bihar and Orissa.*[1] In this case Sir Ali Imam received a gratuity on the termination of his services in the Hyderabad State. The gratuity was paid to him voluntarily by the State and he was not entitled to it. The gratuity was paid into his account at the Imperial Bank of India at Hyderabad and afterwards remitted to him at Patna. The Court had doubts as to whether the gratuity in question was a gratuity, fee, perquisite, etc., within the meaning of section 7 (1) rather than a casual non-recurring receipt not arising from

(1) 1 I. T. C. 402

a vocation, etc. [section 4 (3) (vii)], but they decided the case on the other ground that assuming that it was a gratuity within the meaning of section 7 (1), it could not be deemed to have been received a second time in British India as sub-section (2) of section 4 provides only for the *profits and gains of a business* and not for "salaries, etc. . . . . " being deemed to arise or accrue in British India when brought into it.

Remittance from abroad—Onus of proof, etc.—

In respect of a remittance from abroad, it is for the assessee to prove that the remittance was capital and not income, and in the event of his failure to discharge this onus the presumption would apparently be that so long as the capital in the foreign branch is not depleted, all remittances are of profits. See *Schulze* v. *Bensted*[1]; *Scottish Provident Institution* v. *Allan.*[2] See the case of *Murugappa Chetty* v. *Commissioner of Income-tax*[3] as to onus of proof in respect of remittance to headquarters from a foreign branch. It would largely be a question of fact in each case how the remittances should be apportioned as between Capital and Income. Relevant evidence would be the accounts of the foreign branches or offices as well as the assessee's British Indian accounts, the flow of remittance transactions in either direction, the state of the capital accounts in the head office and the foreign branches, etc. The much-discussed doctrine of ' constructive receipt ' would have to be applied in many such cases, *e.g.*, where the profits of the branch are appropriated to meet a debt due from the head office. But the theory of ' constructive receipt ' cannot solve the problem of what is ' capital ' and what is ' profits.' All that it does, if the case admits of that doctrine being applied, is to enable ' profits '—which would otherwise escape—to be taxed. It cannot enable the Income-tax Officer to tax the remittance of what is clearly capital. Thus if the foreign branch remitted, say, a large sum, for the cost of goods and the Indian office sent back the equivalent worth of goods, or, say, if the foreign branch borrowed money and remitted it to British India the remittance would in either case be one of capital and not of profits. Similarly the doctrine of ' constructive receipt ' cannot ordinarily enable an assessee to set off the profits of one foreign branch against the loss of another foreign branch. That is to say, there can be no ' constructive receipt ' of a loss, at least in ordinary circumstances.

(1) 8 Tax Cases 259.
(2) 4 Tax Cases 591.
(3) 2 I. T. C. 139.

In assessing a person to tax, each year's transactions would have to be taken into account as a whole. If the accounting year of the foreign branch does not coincide with that of the head office, the Income-tax Officer can, if necessary, use his powers under section 13 and make the best that he can out of the accounts.

If a person has at his credit abroad profits which accrued within the last three years as well as profits which accrued before that period, and if he brings the profits into British India, it will be a question of fact in each case whether a particular remittance came from the profits of the last three years or the profits of the previous period. In the absence of any evidence the presumption would probably be that the profits anterior to the three years had been capitalized and that what is being brought is income unless the assessee can prove that it is capital. The assessee cannot claim that in the absence of evidence to the contrary it should be assumed that the remittances were brought into British India in the order in which the profits were made outside British India—that is to say, each particular remittance would represent the oldest part of the unremitted profits at that particular moment. *Clayton's Case*[1] which is usually quoted in support of this view is not a Revenue decision; and whatever may be the position as between a creditor and debtor or between a banker and customer, an assessee cannot claim an advantage merely by refusing to give information on a matter on which he alone can give the information. In such a case the presumption is against the assessee and not in his favour. The law casts upon him the burden of proving that the profits accrued or arose more than three years before, a matter, after all, peculiarly within his knowledge and not within that of the taxing authorities.[2]

As already stated, it is a question of fact in each case whether a particular remittance relates to capital or relates to profits more than three years old. It follows, therefore, that an assessee cannot escape taxation merely by debiting the remittance to capital when in fact the remittance does not relate to capital. The method of accounting cannot be used in order to defeat the revenue—see notes under section 13.

It is the actual amount brought into British India that is liable to tax. No set-off can be claimed on account of losses incurred more than three years before. Even if there has been a loss in the last three years, no set-off can be claimed unless the assessee can show that he has withdrawn his capital from abroad.

(1) 35 Ch. 781.
(2) *S. K. R. S. L.* v. *Commissioner of Income-tax*, 50 Mad. 853.

If a resident in British India is a partner in a firm outside British India and makes advances of money to the firm, being genuine loans bearing interest, and takes periodical credit for the interest through his account in the firm as a partner, there can be no doubt that there is a constructive remittance of the interest from outside British India into British India, and the interest therefore would be taxable in the hands of the resident in the year in which he takes credit for the interest.

The presumption ordinarily is that a branch office does not make a 'loan' to its head office or *vice versa*. The relation of creditor and debtor cannot exist between a head office and a branch. It follows therefore that the remittance of so-called interest on such loans would be treated as remittance of profits.

It is similarly a reasonable presumption that a man's private expenditure is in the absence of evidence to the contrary met out of income and not out of capital. Where, therefore, the accounts do not show clearly that a remittance is capital but the assessee uses such remittance for his private expenses, the assessee can be put to proving that the remittance is not income but capital.

In a case in which there was a continuous running account between the Madras branch of the business and that in Malaya, and there was an entry in the Madras books which had the effect of cancelling the indebtedness of the resident partner to the Madras branch on account of his personal drawings, the Commissioner assumed that there was an appropriation of profits remitted from abroad, and the assessee did not disprove this assumption. The High Court held that the Commissioner had legal evidence to support his finding.[1]

The three years' limit is of course to be strictly applied. The fact that meantime the profits have been 'capitalised' in the accounts of the assessee does not affect his liability to tax. Nor, on the other hand, will his liability continue beyond 3 years even if his profits have *not* been 'capitalised' by him.

Explanation.—This explanation was introduced at the instance of the Legislative Assembly in 1922. It is really more or less otiose and does not enact anything new. It represents a well-known doctrine embodied in several decisions of which the most important is *Gresham Life Assurance Society* v. *Bishop*,[2] decided by the House of Lords—cited *infra*. The decision in India to enunciate the doctrine was *In re Aurangabad Mills*.[3]

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(1) *K. V. A. L. Ramanatha Chetti* v. *Commissioner of Income-tax*, unreported.
(2) 4 Tax Cases 464.
(3) 1 I. T. C. 119.

Remittance—Question of fact—

Whether profits earned abroad have been brought into the country or not is a question of fact. All that the explanation to this section does is to prevent foreign profits being taxed merely on the strength of the foreign profits being incorporated in the accounts kept in British India. In the *Nedungadi Bank* v. *Commissioner of Income-tax, Madras*.[1] in which there was no separate account to show the profit or loss in the foreign branches and all the profits and expenses were transferred from the foreign branches to the British Indian Head Office by regular entries in the books and the remittances from the foreign branches exceeded the remittances to the foreign branches, it was held by the Madras High Court that the amounts earned as profits in the foreign branches were transmitted to British India. The question was one of fact and the facts having been found by the Commissioner, the High Court could not interfere unless it was shown that there was no evidence to support the finding of the Commissioner.

Though Chetti firms usually make paper adjustments of interest as between branches with the sole object of adjusting the commission payable to local agents, and not of reflecting actual loans made or interest received, it was held in *Somasundaram Chetti* v. *Commissioner of Income-tax*[2] that, if on evidence the Commissioner found that interest was actually paid by one branch to another, the finding was one of fact in which the High Court could not interfere.

Income from abroad—Foreign taxes paid thereon—

If the income in question is received in British India after it has paid a foreign income-tax it is not clear whether the income for the purpose of Indian income-tax should be the gross income including the foreign tax or the nett income after deducting it. In those cases in which the income is entitled to Double Income-tax Relief under section 49, the income is computed exactly as it would be for the purpose of Indian income-tax if there were no question of Double Income-tax Relief; and where a share of the income is assessed under Rule 33, the share taken is of the 'gross' income of the assessee including foreign taxes.[3] But the case of income received from outside British India which has already paid income-tax to some other Government is somewhat different. Presumably only the nett income brought in should be taxed, the foreign tax being treated as a business expense. This

(1) 49 Madras 910.

(2) 2 I. T. C. 61.

(3) See *Chief Revenue Authority* v. *Eastern Australasian Telegraph Co.*, 1 I. T. C. 120.

is the practice in the United Kingdom in respect of income not receiving Double Income-tax Relief.

Place of receipt—

The place where income is received is a question of fact and not a matter to be determined with reference to intention. In *Sir Syed Ali Imam* v. *The Crown*[1] the Finance Member of the Nizam's Government asked the Agent of the Hyderabad Branch of the Imperial Bank of India to arrange to pay a sum of money to Sir Ali Imam through the Patna Branch of the Bank and take a formal receipt from him. The Hyderabad Agent wrote to the Patna Agent, enclosing duplicate receipts to be signed by Sir Ali Imam and asking him to pay the amount to Sir Ali Imam and return the receipts signed in duplicate. Sir Ali Imam returned the receipts duly signed but asked the Patna Agent to instruct the Hyderabad Branch to place the money to Sir Ali Imam's credit at the Hyderabad Branch until further instructions. There was no book-entry in the Patna Branch crediting Sir Ali Imam and debiting the Hyderabad Branch. About a fortnight later Sir Ali Imam asked the Hyderabad Branch to transfer the balance at his credit to the Patna Branch. It was argued by the Commissioner that (1) the instructions of the Finance Member of the Hyderabad State to arrange for payment through the Patna Branch showed the intention of the employer; (2) the assessee's acknowledgment being signed at Patna constituted a receipt in British India; and (3) the instructions given by Sir Ali Imam to the Patna Branch were really to transfer the amount back to Hyderabad. None of these contentions was upheld by the High Court. The intention of the employer is irrelevant and it must be a question of fact where and when a sum of money is received. Though the written acknowledgment of receipt is undoubtedly evidence of the fact that the money has been received it is not always conclusive. Such receipts are frequently demanded before actual payment of the money; and in the present case nothing had been credited to Sir Ali Imam in the books of the Patna Branch until, in accordance with Sir Ali Imam's subsequent instructions a fortnight later, the balance at Hyderabad had been transferred to Patna. The third contention also was wrong inasmuch as there was nothing at Patna to be transferred to Hyderabad, the Patna Branch not having credited Sir Ali Imam with anything in the first instance.

The Amir of Bokhara entrusted the assessee, a trader of that place, and two servants of his own, with valuable furs, for

(1) 1 I. T. C. 402.

sale in Europe. After selling these for 16 lakhs of rupees and depositing the money in a Bank in England, the assessee returned to India, and found that Bokhara was under the Bolsheviks and the Amir a refugee in Kabul. The assessee settled down in Peshawar permanently. The Amir sued the assessee and the two servants in the Peshawar Civil Court for the sale proceeds of the furs, and by a compromise decree the assessee was given two lakhs of rupees as commission. The assessee claimed that the money had already been received in England and deposited in the Bank there, and that the receipt of two lakhs as commission was a second receipt of the same sum and therefore not taxable. *Held*, that in the absence of any authority given to him to appropriate a part of the sale proceeds towards his commission he was not the owner but the trustee of the money until the compromise decree, and that the two lakhs was therefore received by him for the first time after the decree and therefore taxable under section 4 (2).[1]

Remittance—From abroad—Constructive—

" The money received by the agents in America remains in their hands and it remains in their hands for investment there. But then an equivalent for the amount of that interest is retained by the managers in this country out of money borrowed by them on debenture for the purpose of being sent out to America and invested upon foreign securities there so that the one sum is just set against the other in the books of the company; and it is for the Court to determine whether that *species facti* . . . . does not sufficiently satisfy the words of the rule . . . . that the interest upon the foreign securities has been received in this country. . . . According to the way in which this company keeps its books, it has really converted a sum which was received in this country as capital into an equivalent for the interest upon the foreign securities. . . . They have received it (the interest) in the most proper sense of the term that it enters their books in this country as such interest and is paid away as such."[2]

A Scottish Life Assurance Society lent out sums of money in Australia on interest. The interest accruing was not remitted to the United Kingdom *in forma specifica,* but retained abroad and invested, or used to cover the expenses of the Australian branch office. It was, however, entered in the revenue account of the Society as received. *Held,* that interest not received in the United Kingdom was not assessable to income-tax, and that

(1) *Board of Revenue* v. *Ripon Mills,* 1 I. T. C. 202, *Sundardas* v. *Collector of Gujrat,* 1 I. T. C. 189, and *Sir Ali Imam* v. *Commissioner of Income-tax,* 1 I. T. C. 402, distinguished; *Tora Gul Boi* v. *Commissioner of Income-tax,* 8 Lah. 335.

(2) Per the Lord President in *Scottish Mortgage Company* v. *McKelvie,* 2 Tax Cases 165.

the facts in these cases did not amount to 'constructive remittance."[1]

An English Fire Insurance Company doing business in America received there as part of its profits interest on American securities. The interest was brought to account in the books of the company in England as profit, but it was not remitted to England, being invested in America in American securities in order to build up a reserve as required by the laws of the United States. *Held*, that the interest formed part of the profit of the company assessable under Case I of Schedule D; and also that the interest was in effect received in England.

Per Wright, J.—" If there is a trade which cannot be carried on without making investments abroad, the interest arising on the investments necessarily made for the purpose of the trade is, it seems to me, part of the gains of the trade. . . . . (Also) in effect it seems to me that the £5,000 is received in this country because . . . . . this money would have to be sent out from here if it were not otherwise provided."[2]

(The second part of the decision must be taken as overruled by the *Gresham Society Case, infra.*)

An English Assurance Society with branches in India received there certain interest from securities in India and the colonies. This interest was applied in India towards the payment of the various obligations of the Society arising for settlement in India, *inter alia*, its obligations under policies, and it was not remitted to England *in forma specifica*. It was, however, treated in the Society's accounts as if it had been remitted to England. *Held*, that the interest was constructively remitted to England.

Per Kennedy, J.—" I think that the facts stated. . . . show that this Indian interest . . . . was not merely entered in the accounts of the Society, which by itself would be a matter of little consequence, but was retained in India merely as a matter of commercial convenience and that but for such retention an equal sum must have been remitted to India to discharge the Society's liabilities there and that in reality the amount of this Indian interest was treated by the Society as part of the divisible property upon which . . . . dividends had been declared and paid in the United Kingdom. . . . . In these circumstances it appears to me that there is a 'constructive remittance' according to the law as applied in *Scottish Mortgage Company* v. *McKelvie*[3] . . . . . . and in . . . . . . the *Norwich Union Fire Insurance Company* v. *Magee*[2] . . . . *Forbes* v. *Scottish Widow's Fund, etc.*, and

(1) *Scottish Mortgage Company* v. *McKelvie*, 2 Tax Cases 165, distinguished; *Forbes* v. *Scottish Widow's Fund and Life Assurance Society*, 3 Tax Cases 443.

(2) *Norwich Union Fire Insurance Company* v. *Magee*, 3 Tax Cases 457.

(3) 2 Tax Cases 165.

Forbes v. *The Scottish Provident Institution*[1] appear to me to be distinguishable. In neither case . . . . . was the interest received abroad treated . . . . as forming part of the divisible profits. It was simply retained and used abroad for purposes of loan and investment.[2]

This case was overruled by the House of Lords in *Gresham Life Insurance Society* v. *Bishop—post.*[3]

A Life Insurance Company established in the United Kingdom carried on business outside. The business was managed by directors abroad who had power of accepting risks, but all investments abroad had to be sanctioned at the head office. Remittances *in forma specifica* of interest received abroad were not made, and remittances out of the receipts abroad of interest and premiums were made only as required by the general policy of the company. At a quinquennial valuation, and in the yearly statement of accounts, the whole of the receipts abroad, including the interest on investments abroad were brought into account in the division of the profits of the company. *Held,* that the interest received abroad and invested or applied abroad was not 'received' in the United Kingdom within the meaning of Case IV of Schedule D.[4]

A Life Insurance Company established in England carried on business abroad, and re-invested abroad moneys, including interest, received abroad. The interest received abroad was not remitted to England, but included in the company's yearly statement of accounts and in the triennial valuation, on which the profits of the company were estimated. *Held,* that interest so received abroad and applied or re-invested abroad was not "received" in the United Kingdom within the meaning of Case IV of Schedule D.

This is the leading case on the point which overrules some of the previous decisions, and the following extracts from the speeches in the House of Lords will show that while the House was unanimous as to the particular case they were not altogether agreed as to the circumstances in which a 'constructive' remittance might be presumed. That the actual passage of money from hand to hand is not a necessary condition of payment or receipt is not only in accordance with commercial practice but

(1) 3 Tax Cases 443.

(2) *Universal Life Assurance Society* v. *Bishop*, 68 L. J. Q. B. 962; 4 Tax Cases 139.

(3) 4 Tax Cases 464.

(4) *Scottish Mortgage Company of New Mexico* v. *McKelvie*, 2 Tax Cases 165, distinguished (Lord Young dissenting); *Standard Life Assurance Company* v. *Allan*, 4 Tax Cases 446.

has received recognition in two Privy Council decisions.[1] Neither case however was under income-tax law.

Per Lord Chancellor Halsbury.—". . . . Now, here the money has not actually been received in this country. It is to be observed that the Legislature has assumed by the distinction which it has made between the mode of ascertaining the amount payable generally upon the balance of gains and profits and the amount taxable in respect of the interest payable upon foreign investments, that it had earmarked that sum and made it subject to distinct and peculiar incidents. The difficulty of identifying the actual sum is no limit on the enactment. The Legislature must be supposed to have contemplated the possibility of drawing a distinction between money received in this country and money accounted for or credited in account. If it were not for the difficulty of ear-marking money I should think no one would have any doubt that the money must be received in this country to bring it within the words of the statute. If it were not money but some commodity, say tobacco, which a trader carrying on business in London and Paris was accounting for to his London house, no one would say that though the Paris tobacco was credited in account as a set-off against some expense or something that the supposed London firm had to set off against the same claim, and that as the London firm was paid by the Paris tobacco, therefore, the tobacco was liable to the import duty on tobacco because it was taken into account in the books of the London firm.

In no way that I can give any reasonable interpretation to, has the money reached this country or been received in this country. It, like the tobacco in the case suggested, has not been imported, and if the Legislature had intended that bringing it into account was to be equivalent to its being received, it would have been easy to say so. It cannot be said that the use of artificial meaning to be attached to ordinary language is either unknown or unusual in legislation; and if it was intended to make this a special subject of taxation, to be taxed whenever and wherever an equivalent amount was credited or booked or in any other way recognised as having come under the dominion of the owner in this country, nothing could have been easier than to enact it in plain terms.

I decline to go beyond the words used, and I do not think this money was received in this country.

I do not think any amount of book-keeping or treatment of these assets, wherever they may be, will be equivalent to or the same thing as receiving the amount in this country. . . .

Per Lord Macnaghten.— . . . I do not understand what is meant by constructive receipt in such a case as this, or how any sums can be said to have been received in the United Kingdom unless they have been brought to the United Kingdom, or unless there has been a remittance "payable in the United Kingdom", to borrow the language of the rule applicable to the fifth case. The circumstances that the business of the

(1) *North Sydney Investment and Tramway Company* v. *Higgins*, (1899) A. C. 263; *Larocque* v. *Beauchmein*, (1897) A. C. 358 (a case from Quebec).

Society is "one indivisible business", and that the Society in the statement of its affairs and in its dealing with its shareholders and customers takes into consideration its foreign assets and liabilities, seems to me to be immaterial to the present question. As my noble and learned friend Lord Robertson, when Lord President, observed in the case of the *Provident Scottish Institution*,[1] "Every man and every company having foreign or colonial investments of course knows of the interest arising from them, takes note of it, and enters it in any statement of affairs which may require to be made up." But that, as I think, and as the Lord President thought, is a very different thing from bringing the interest home, a very different thing from the receipt of the money here, either in specie or as represented by a remittance payable in this country.

The difficulty seems to have arisen from a misunderstanding or a misapplication of the judgment in the *New Mexican* case. That was a very special case. Whether the decision was right or wrong it can have no bearing upon the question now before your Lordships. Speaking for myself, I think the decision was right. In that case, as it seems to me, in the transmission to this country of money which the company was free to distribute and the transmission to America by way of exchange of an equivalent amount which the company was bound to re-invest, the company acted as their own bankers, and did for themselves, by an entry in their books, what might have been done less conveniently and less economically by an ordinary bank or financial agent on their behalf. . . . .

Per Lord Shand.—. . . . As they left that interest where it was gained, it was never received in this country. When it was entered in the company's balance-sheet in order to enable the ascertainment of the profits of the year, it was so entered as estate which had not been received in England, but as property belonging to the company which they acquired abroad, which had not been brought home or received here, but which was part of their foreign assets. Money or securities in that position was properly taken into account in the ascertainment of the year's profits, not because it had been received in England, but because although not so received, it was part of assets of value which the company had acquired and held abroad. In the Scottish case of the *Investment Company of New Mexico*,[2] the *species facti* was different, for there the company treated the money as received in this country and merely saved themselves the expense of cross remittances. . . . .

Per Lord Brampton.—. . . . . But it was argued that if not actually it was "constructively" so received in the accounts of the Society. I confess I do not like that expression, nor do I quite understand what it means. If a "constructive" receipt is the same thing as an actual receipt, I see no reason for the use of the word "constructive" at all. If it means something differing from or short of an actual receipt, then it seems to me that a constructive receipt is not recognised by the Statute, which, in using the word "received" alone, must be taken to have used it having regard to its ordinary acceptation.

(1) 3 Tax Cases 443.
(2) 2 Tax Cases 165.

The Master of the Rolls (Sir A. L. Smith) in his judgment in the Court of Appeal, while stating that there must be "an actual receipt of the amount," added "but that receipt need not be in specie, it may be in account," and he then proceeded to deal with the accounts of the appellants set forth in the Appendix and to draw from them the inference that the appellants had actually received and dealt with these foreign dividends in the United Kingdom and had distributed them as having been so received. Now, I am not prepared to deny that accounts may be so worded as to contain admissions justifying such an inference, but I differ with the view he took that such admissions, or anything approaching them, are to be found in the accounts before your Lordships. . . .

For the Crown, the case of the *Scottish Mortgage Company of New Mexico* v. *Commissioners of Inland Revenue*[1] was much relied upon. I am not satisfied with the correctness of the judgment in that case, but, assuming it to be sound, it is distinguishable from the present case. . . .

Per Lord Lindley.—. . . . I agree with the Court of Appeal that a sum of money may be received in more ways than one, *e.g.*, by the transfer of a coin or a negotiable instrument or other document which represents and produces coin, and is treated as such by businessmen. Even a settlement in account may be equivalent to a receipt of a sum of money, although no money may pass; and I am not myself prepared to say that what amongst businessmen is equivalent to a receipt of a sum of money is not a receipt within the meaning of the Statute which your Lordships have to interpret. But to constitute a receipt of anything there must be a person to receive and a person from whom he receives and something received by the former from the latter, and in this case that something must be a sum of money. A mere entry in an account which does not represent such a transaction does not prove any receipt, whatever else it may be worth. . . . . Has that sum been received in this country by the Gresham Company? The special case clearly shows that it has not in fact been remitted to this country in any way whatever. Applying the test already suggested, no one here has received that sum; the agents who received it abroad still have it abroad, or have dealt with it otherwise than by sending it to the company here. No account even is forthcoming to show that the sum has ever been treated as remitted here so as to justify the inference that in any commercial sense the sum has been received in the United Kingdom as distinguished from other countries.

What has been done and all that has been done is that the Gresham Company, in making up its accounts with a view to ascertain what profits it could divide in a particular year, entered on its asset side the sum of £143,483 as money received during the year. . . . But when required to pay duty on the item of £143,483 on the ground that this sum is made up of interest or dividend received in the United Kingdom the company objects on the ground that it represents nothing of the sort. Nor does it, in truth.

(1) 2 Tax Cases 165.

The fact that the profits shown by the account have been divided amongst the shareholders of the company does not carry the case any further. No part of the £143,483 has come over here or been in any sense received here, and then applied in payment of dividend . . . thinking as I do, that *McKelvie's case* may be properly upheld, I am not prepared to adopt it as a new starting point for further inferences. The language of the Statute is the true starting point on each case. *Forbes'* case and the *Standard Life Assurance Company's* case were both based on this sound principle, and were, in my opinion, both clearly rightly decided. The Court of Appeal, in my opinion, considered this case undistinguishable from *McKelvie's* but I am unable so to regard it. Assuming them to be undistinguishable, it would, in my opinion, be more correct to overrule *McKelvie's case* than to decide the present appeal in favour of the Crown.[1] . . . . .

Remittance—Capital or income—Question of fact—Onus of proof—

A Life Insurance Society invested funds in Australia. The interest realised was retained and reinvested. In the accounts of the Australian branch capital and interest accounts were mixed together and occasional remittances were made to the head office. *Held* by the House of Lords that the remittances were of interest and not of capital and that it was a question of fact whether the remittances were the one or the other.

Per Lord Shand.—"The question is as your Lordship has put it entirely one of fact. The amount of money which was sent out by the company as capital remains in Australia. It has been gradually increased and not diminished and that amount of money still remains there. . . . . The moneys that have come home were therefore in the nature of interest and I do not think that the mere circumstance of there being such letters as are here founded upon, as making them out to be capital though they are really interest, can have that effect."

Per Lord Halsbury.—"It is for the company to show, if the fact be so, that the remittance ought to be subject to a certain amount of deduction, because a good deal of it . . . . was repayment . . . . of capital."[2]

Foreign securities—Income from—Reinvested abroad—

A part of the Revenue of a Life Assurance Society, which carried on business in the United Kingdom only, consisted of interest on foreign Bearer Bonds and other foreign Securities. The Securities were kept at the Head Office and the interest included in its revenue account. As the interest fell due, the coupons, etc., were sent from the Head Office to the Society's agents abroad, who received the interest and invested it abroad, as directed by the Head Office, in foreign Bearer Bonds and other foreign

(1) *Gresham Life Society* v. *Bishop*, 4 Tax Cases 464.

(2) *Scottish Provident Institution* v. *Allan*, 4 Tax Cases 591.

Securities, and these in their turn were sent to the United Kingdom. *Held,* that the interest was not "received" in the United Kingdom within the meaning of the 4th Case of Schedule D, and was therefore not liable to assessment to income-tax.

Per the Lord President.—Now, actual receipt of money, it seems to me, can only be effected in one of two ways. Either the money itself must be brought over in specie or the money must be sent in the form which, according to the ordinary usages of commerce, is one of the known forms of remittance. . . . . .

As far as the bond itself is concerned, it is, of course, a piece of paper, but it represents a debt. . . . .

. . . . According to the argument of the Crown the money was received in this country the moment the bond came into the company's safe in London or in Edinburgh. Equally it was in America, because the day of payment had not yet come, and therefore it was, so to speak, in the pocket of the debtor. How it can be at one time both in America and in this country is, I think, a difficulty which surpasses even the powers of legal fiction.[1]

Foreign Securities—Income from—Reinvested abroad and sent home and sold—

A company possessed securities in America. The interest received on them was reinvested in bearer bonds and these bonds were sent to the company's head office in Scotland. Soon after their receipt at the head office the bonds were sold. *Held,* that the proceeds of the sale of the bonds were taxable.

Per the Lord President.—Now the argument for the Crown is that this has been received in Great Britain in the year of assessment and therefore must be charged. The argument for the institution is that inasmuch as it was not earned in the year it does not fall within the Income-tax Act at all.

* * * * * *

When a profit or an interest is earned in this country, the question really cannot arise because the profit which is earned in this country is necessarily received in this country. I use the word "received" because you may quite well have a profit which has not been paid to you in hard cash. In many and many a partnership it does not pay its profits in hard cash, or a partner does not take his profits in cash, but nevertheless it is earned, and being earned it is necessarily received by the partner at the time it is earned. But when the profit is earned abroad it is not necessarily received at the same time in this country. It is of course received in the sense of your having a right to it there, but it is not received in this country, and accordingly this fourth Case has said that the duty was only to be computed on sums which have been or will be received in

(1) *The Scottish Widows' Fund Life Assurance Society* v. *Farmer*, 5 Tax Cases 508.

the current year. As soon as they are received I think they become chargeable.[1]

Remittance from abroad—Capital or income—Onus of proof—

The appellant had received certain income from Trieste which was assessed to tax. He did not furnish the information required by the Commissioners but contended (1) that under the banking system in Trieste all sums deposited bore interest from the date of lodgment and therefore the remittance was of capital and not of income; (2) that the remittance was a loan to him from a trust of which he was trustee. The Commissioners found as facts that the account in the Trieste Bank was an omnibus account that stood in the assessee's name as an individual and that as he had not attempted to discharge the onus that lay on him of distinguishing which part of the income was capital, the remittances must be presumed to be his income. *Held*, that as the appellant had not disclosed the necessary information, the evidence before the Commissioners was sufficient to support the conclusions of fact at which they had arrived.[2]

See also the case of *A. V. P. M. R. M. Murugappa Chettiar*,[3] in which it was held, following *Scottish Provident Institution* v. *Allan*,[4] that the presumption was that remittances were of profits and that it was for the assessee to rebut the presumption.

(3) This Act shall not apply to the following classes of income :—

General—

The exemptions in this sub-section remove liability for both super-tax and income-tax. The income under these heads cannot be taken into account under 'total income' under section 16. In other words the income has to be completely ignored for *all* purposes under this Act. Even if the income should fall under one of the heads described in section 6, it would nevertheless be exempt if it is covered by one of the sub-clauses of section 4 (3). *See* notes on income from usufructuary mortgages of land under section 2 (1).

The fact, however, that income is exempt under section 4 (3) does not remove the liability to tax of employees of charities or other recipients of income from these exempted sources,

(1) *The Scottish Provident Institution* v. *Farmer*, 6 Tax Cases 38-39.
(2) *Schultze* v. *Bensted*, 8 Tax Cases 259.
(3) 49 Mad. 465; 2 I. T. C. 139.
(4) 4 Tax Cases 591.

if the employees or recipients are themselves taxable under the Act. In fact in the 1886 Act there was an explicit provision to the effect that "An officer or servant is not exempt from taxation by reason only of the income of his employer being exempt therefrom."

Exemptions granted under section 60, on the other hand, stand on a different footing. Those exemptions may be partial; and even if the incomes are wholly exempted they may be included in the 'total income' of the person under section 16, *i.e.*, in order to fix the rate at which he is taxable, if the exemption is granted on that condition.

(*i*) Any income derived from property held under trust or other legal obligation wholly for religious or charitable purposes, and in the case of property so held in part only for such purposes, the income applied, or finally set apart for application, thereto.

(*ii*) Any income of a religious or charitable institution derived from voluntary contributions and applicable solely to religious or charitable purposes.

* * * * * *

In this sub-section "charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility.

CHARITIES

History—

In the 1886 Act "any income derived from property solely employed for religious or public charitable purposes" was exempt; and there was no definition anywhere in the Act of what was 'property.' In the 1918 Bill as introduced the provision ran as below:—

"Any income derived from property held under trust or other legal obligation for religious or public charitable purposes in so far as that income is applied to those purposes. In this clause 'charitable purpose' includes relief of the poor, education, medical relief and the advancement of any other object of public utility."

The Select Committee, however, considered that income derived from property which is held on a purely religious or charitable trust should be entirely exempted and that the Collector in such a case should not be bound to satisfy himself that the income is so applied. In the case of mixed trusts, however, the Committee thought that the Collector might be properly required to enquire as to the application of the income. The Committee also considered it necessary to add a provision exempting voluntary contributions received by religious or charitable institutions for religious or charitable purposes. Since 1918 no change has been made in these two clauses of sub-section (3) of section 4. The definition of 'charitable relief' was relegated to the end of the sub-section, because in the Act of 1918 as passed there were two clauses dealing with charities as against the single clause in the Bill.

'Property'—

There was no definition of 'property' in the 1918 Act; and the expression used in section 5 of that Act corresponding to section 6 of the present Act was *house* property. Sections 3 and 4 were recast in 1922. In the 1918 Act the sub-section of exemption (corresponding to section 4 (3) of the present Act) formed part of a section which merely dealt with the liability to tax of income *generally,* which arose, accrued or was received in India or was so deemed. In the 1922 Act, on the other hand, the main sub-section of the section fixed the liability of "all income, profits or gains as described or comprised in section 6. . . . ." The insertion of these words alters (though unexpectedly) the interpretation to be placed on the sub-sections relating to charities. Sub-section (3) of section 4 is only an exception to sub-section (1) of that section; and the same word cannot be used in two different senses in the same section, the more especially when the one part is only an exception to the other. It would seem, therefore, that the definition of 'property' as given in section 9 "Buildings or lands appurtenant thereto" restricts the meaning of the word as used in 4 (3) (i). This result, however, was clearly unintended by the framers, and is confirmed by the use of the word 'property' in section 4 (3) (iv) where securities are referred to as 'property', in which context the definition in section 9 would make no sense. The word therefore should evidently be construed in its wider sense.

In *In re Lachhman Das Narain Das*[1] a firm was registered under section 2 (14) and the shares of the respective partners were divided in the following way:—Madan Gopal, the head of the firm, had seven annas in the rupee, Benarsi Das had three

(1) 1 I. T. C. 378.

annas, Kunji Lal had three annas, and a charitable or religious object under the name of Radha Ballabh—a temple in Muttra—had three annas. The question was whether the class of income, of which 3|16ths in this case was undoubtedly devoted to charity, was within the exemption contained in section 4 (3) or could be brought within the exemption at all. *Held*, that the answer was in the negative.

Per Walsh and Ryves, JJ.—"In our view income derived from profits made by a trading concern in business, is not income derived from property held under trust. The provision in the deed in question is merely an allocation of the proportionate part of the profits to religious purposes. The exemption deals with a totally different subject-matter. In most countries in a manner with which we in India are familiar, Government has, within certain limits, exempted from the ordinary liabilities to contribute to public revenue, endowed property set apart by pious people, or held under pious trusts for purposes which are wholly religious or charitable, or in the case of properties which are only partly so held, that part alone which is applied by the trust, or the instrument creating it, to religious or charitable purposes, is granted an exemption, and the language used in section 4 (3) (i) is in our opinion appropriate to an exemption of that kind and to no other. It is impossible to hold, having regard to the terminology used in this Act, that the profits of a trading concern are in any sense derived from property held under a trust or a legal obligation for religious purposes. That view is strengthened by a perusal of sections 9 and 10 in which the Legislature has demarcated the boundary line between property strictly so-called, and a business, and has laid down the circumstances under which income-tax is payable upon property, and payable upon profits derived from a business. . . . ."

The reasoning in the above decision is not clear. All that their Lordships decided seems to be that the trading profits in question were taxable and the decision evidently was based on the facts of the case, having regard to the second sentence in the extract given above. The question whether securities or other endowments held wholly in trust would be 'property' within the meaning of this sub-section is still open. If 'property' is construed as defined in section 9, income from such securities should be taxed. If a different view were taken, as apparently it must be, 'property' must be construed in its ordinary meaning which is quite comprehensive, and it cannot be limited to Real Property only.

" 'Property' is the generic term for all that a person has dominion over." "Property is the most comprehensive of all terms which can be used inasmuch as it is indicative and descriptive of every possible interest which the party can have."[1]

(1) *Jones v. Skinner*, S. L. J. Ch. 90 (Stroud).

"It seems to me therefore that the word 'property' in the exemption in question cannot import legal ownership. It imports the right of possession and exclusive enjoyment. Moreover that is the ordinary meaning of the term. The word 'property' is not a technical expression. No one in ordinary language would speak of land or buildings vested in a trustee and in which the trustee has no beneficial interest as his 'property'. . . . I may observe that if your Lordships will turn to the Act of 1854 . . . . you will find the very expression 'property of the institution' used in more than one place to denote real and personal property held on trust for the purposes of the institution, though not legally vested in the institution itself."[1]

The General Clauses Act (X of 1897) while not defining 'property' defines 'moveable property' as all property that is not immoveable. 'Property' has been held to apply to debts, in certain circumstances, to choses-in-action of all kinds, to copyrights, to patents, to debentures and even to Government annuities; but even this wide interpretation cannot include the right to a future salary.[2]

A possible distinction between income from business and that from property is that in the latter case the person to whom income accrues takes no active part in the operations producing profits; but this line of reasoning is ruled out by the decisions in Excess Profits Duty cases, of which the leading one is *Commissioners of Inland Revenue* v. *South Behar Railway*,[3] holding that it is possible to have a business without being busy!

In the Allahabad case cited above, their Lordships held that in substance the partners devoted a part of the profits for charity. It is true that the purpose to which a man's personal income is used is ignored in Income-tax Law, and the profits in question would be taxable if the deduction was a voluntary charity on the part of the proprietors, which they could revoke or withdraw at their will. If, on the other hand, the deity—Radha Ballabh—could *sue* the partners for its share, the income from trade would evidently satisfy the conditions of the sub-section,—if the widest possible meaning was given to 'property', as it ought to be, unless the word is construed as in section 9. There is really no half-way house between the two positions. The Income-tax Manual, however, contemplates the exemption of income from securities, etc., belonging to a charitable or religious institution (see paragraph 58, Income-tax Manual), but says nothing about profits from business, etc.

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(1) Per Lord Macnaghten in *Mayor of Manchester* v. *McAdam*, 3 Tax Cases 491.
(2) *Eggar* v. *Commissioner of Income-tax*, 2 I. T. C. 286.
(3) 12 Tax Cases 657.

'Held under trust'—

These words refer to cases in which there is a regular trust.

'Other legal obligation'—

This has not been defined, but the framers must clearly have had in mind obligations in the nature of trusts contemplated in sections 80 to 95 of the Indian Trusts Act. That is to say, a formal trust is not necessary to secure the exemption.[1] All that is required is a legal obligation to apply the income to charitable or religious purposes. But mere entries in the assessee's books will not in themselves constitute a trust or other legal obligation.[2]

Trust—existence of—question of fact—

Though it is not necessary in order to create a trust that the person in whose favour the trust is created should know about it, the absence of such knowledge is a circumstance to be taken into consideration by the Commissioner in coming to a conclusion as to whether or not there had been a real dedication to a charity and as to whether or not the fund so created or the trust so said to be created can be revoked. This is purely a question of fact.[2]

Wholly—

This word means 'solely' and not mainly. See *Commissioner of Income-tax* v. *Maulana Malak*.[3]

Property held in part for such purposes—

In such cases the Income-tax Officer has to satisfy himself as to the actual application of the income. It is not necessary that the income should have been so applied before the assessment or in the year of receipt. It will be sufficient if it is "finally set apart for application" to charitable or religious purposes. The Income-tax Officer cannot insist on the income having been applied as a condition precedent to the grant of exemption, and refuse to be satisfied with its having been merely set apart for the purpose.

'Finally' evidently means irrevocably—

Where the property is under trust or other legal obligation *wholly* for religious or charitable purposes, the Income-tax Officer cannot enquire into the actual application of the income. The trustee will take the consequences under the law for any breach of trust, but the Income-tax Officer cannot refuse exemption on

(1) *Eggar* v. *Commissioner of Income-tax*, 2 I.T.C. 286.
(2) *Rm. Ar. Ar. Rm. Ar. Arunachalam Chettiar* v. *Commissioner of Income-tax.*
(3) 105 I. C. 155.

the ground that the income is not in fact being applied to the purposes of the trust. Examples of partial trusts are where property is bequeathed subject to the maintenance of certain charities or when a manager of a charity gets a share of the trust income as his remuneration.

Expenses of Management—

Where property is held in part only for religious or charitable purposes, a proportionate share of any expenses incurred on management should be considered as applied to these purposes (paragraph 17, Income-tax Manual).

Religious—

The word has not been defined, nor is a simple definition possible. The English law forbids bequests for 'superstitious purposes' but there is no such prohibition in India. Whether a particular purpose is 'religious' or not would depend on the circumstances of each case, on the personal law of the person concerned, and on custom. Temples, mosques, mutts, schools for teaching theologies, recital of prayers, performance of sacrifices, etc., are all clearly 'religious'. It is not clear, however, whether what is 'religious' according to the Christian religion would not be construed in India with reference to English practice. And in any case, in borderland cases—whatever the religion under consideration—the Courts would presumably give the benefit of the doubt to the trust, having regard to the general principle of construing fiscal legislation.

Charitable purpose—

The Act defines 'charitable purpose' as *including* 'relief of the poor, education, medical relief, and the advancement of any other object of general public utility.' Analogous definitions in other Acts are of interest. Section 3 of the Charitable Endowments Act (VI of 1890) defines 'charitable purpose' as including relief of the poor, education, medical relief, and the advancement of any other object of general public utility, but not a purpose which relates exclusively to religious teaching or worship. The latter part of this definition is omitted from the definition in the Income-tax Act, but 'religious' purposes also get the exemption under the Indian Income-tax Act. Section 17 of the Transfer of Property Act refers to 'rligious and charitable' endowments as being 'for the benefit of the public in the advancement of religion, knowledge, commerce, health or any other object beneficial to mankind'.

As the word used is 'includes', the definition is not exhaustive. But charitable endowments which are neither religious nor meant for the advancement of some general public utility, are difficult to conceive of. If the endowment is religious, the question of public utility does not arise. If it is not religious, and at the same time it is meant to benefit a few persons, it can hardly be considered 'charitable'. The words 'general public utility' however, should be construed, in a negative sense as not confined to the advantage of a few specified persons, and not as meaning to the benefit of the community generally irrespective of class or creed. It would be quite sufficient if the benefit went to a section of the community. See *Re Mellody,*[1] a case of a bequest providing for an annual treat to some school children. The point in all such cases is that the donor does not intend the benefit to go to particular individuals nor to let them *claim* the benefit. A trust or gift is not charitable merely because it is beneficial to the public,—see *In re Headmasters' Conference.*[2] A benevolent purpose or a liberal purpose is not necessarily a charitable purpose.[3] The guiding principle is given in *Re Nottage*[4] in which a testator endowed a cup for yacht-racing, and the endowment was not considered charitable.

Per Kekewich, J. (whose judgment was affirmed by the Court of Appeal).—"In order to uphold this gift as charitable, I think I ought to see that it is by itself directly, and *as its necessary and intended result,* beneficial to the community. Almost any gift may in some sense be said to be beneficial to the community."

The point is that the avowed object must be the benefit of the community; that is, there can be no charity, without there being a charitable *intention.*

Nor is it necessary that a 'charity' should benefit only the poor to the exclusion of the rich.

"I am quite aware that a trust may be charitable though not confined to the poor, but I doubt very much that a trust would be declared to be charitable which excluded the poor."[5]

"To ascertain whether a gift constitutes a valid charitable trust . . . . a first enquiry must be held whether it is public,—whether it is for the benefit of the community or an appreciably important part of the community. The inhabitants of a Parish or town or any particular class of such inhabitants may for instance be the objects of such a gift, but private individuals, or a fluctuating body of private individuals cannot. If this test is satisfied, is it necessary to find further that the

(1) (1918) 1 Ch. 228.

(2) 10 Tax Cases 73.

(3) Per Lawrence L. J. in *Trustees of Robert Marine Mansions* v. *Commissioners of Inland Revenue,* 11 Tax Cases 425.

(4) (1895) 2 Ch. 649.

(5) Per Lindley, L. J. in *In re Macduff,* (1896) 2 Ch. 451.

class is confined to poor persons to the exclusion of persons not poor? Is poverty a necessary element?''

Per Lord Wrenbury in *Verge* v. *Somerville*[1] in which he cited with approval the dictum of Lindley, L. J. quoted above and the Privy Council held that a valid charitable trust may exist although its benefit is not confined to the poor to the exclusion of the rich.

The following are some of the Indian decisions as to what constitutes 'charities'. A University which conferred degrees only and did not teach[2]; a professorship[3]; the construction or maintenance of a well or cistern for drinking water for men and animals[4]; the construction or maintenance of a choultry, dharamsala or poor-feeding house (Authorities hardly necessary, as such charities are so common in the country); a School[5]; the giving of alms including food to the poor, fakirs, ascetics, travellers, etc.[6] a dispensary or hospital.[5]

On the other hand, while a University is undoubtedly a charitable institution, it is doubtful whether the income of a University not derived from its endowed funds but from its fees, etc., is exempt under this section. To avoid doubt, however, the Government of India have exempted such fees, etc., by Notification under section 60.

A Hospital or School could well be not 'charitable'. Proprietary schools are not unknown in this country. Before an institution can claim to be charitable, it must possess some eleemosynary feature. A hospital conducted on business lines, which took only paying patients is not a 'charitable' institution even though the profits might be applied *inter alia* to the improvement of the premises.[7] Nor, on the other hand, will the fact that some people pay for the benefits make an institution other than charitable, if on the whole it is really 'charitable', nor the fact that the charity does not go far enough.[8]

Institution—

It is a word employed to express several different ideas. It is sometimes used in a sense in which the 'institution' cannot be said to consist of any person or body of persons who could, strictly speaking,

(1) (1924) A. C. 596.

(2) *University of Bombay* v. *Bombay City Commissioners*. 16 Bom. 217.

(3) *Manorama* v. *Kalicharan*, 31 Cal. 166.

(4) *Karuppa* v. *Arumuga*, 5 Mad. 383; *Tricumdas* v. *Khinji*, 16 Bom. 626.

(5) *Hardasi* v. *Secretary of State*, 5 Cal. 528; *Mazhar Hussain* v. *Abdul Hadi*, 33 All. 400.

(6) *Ganapati* v. *Savitri*, 21 Mad. 10; *Rajendralal* v. *Raj Kumari*, 34 Cal. 5.

(7) *St. Andrews Hospital* v. *Shearsmith*, (1887) 19 Q.B.D. 624, 2 Tax Cases 219; *Blake* v. *Mayor of London*, (1887) 18 Q. B. D. 437, 2 Tax Cases 209.

(8) *Trustees of Mary Clark Home* v. *Anderson*, (1908) 2 K. B. 645, 5 Tax Cases 48.

own property. The essential idea conveyed by it, in connexion with such adjectives as 'Scientific or literary', is often no more than a system, scheme or arrangement by which literature or science is promoted, without reference to the persons with whom the management may rest, or in whom the property appropriated for these purposes may be vested save in so far as these may be regarded as a part of such system, scheme or arrangement. That is certainly a well-recognised meaning of the word. One of the definitions contained in the Imperial Dictionary is as follows: "A system, plan or society, established by law or by the authority of individuals for promoting any object public or social."[1]

"It is a little difficult to define the meaning of the term 'institution' in the modern acceptation of the word. It means, I suppose, an undertaking formed to promote some defined purpose having in view generally the instruction or education of the public. It is the body (so to speak) called into existence to translate the purpose as conceived in the mind of the founders into a living and active principle."—*Per Lord Macnaghten.* (*Ibid*).

There can really be no precise definition of an 'institution', but the word implies (1) a certain degree of permanency and (2) a certain public nature. (2) is already conditioned by the adjective 'religious or charitable' both of which imply a public or semi-public nature. As regards (1), an individual collecting contributions for a casual charity could not claim exemption under this clause of the sub-section. Such income would be exempt but as casual receipts, etc., under clause (vii). The contributions should be *voluntary* and made without consideration. The price paid for admission into the institution, for instance, would not be voluntary. See, however, notes below.

Applicable solely to religious, etc., purposes—

The income of the institution should be applicable solely to religious or charitable purposes before it can be exempted. It is not ordinarily the function of the Income-tax Officer to enquire whether in fact it is so applied. All that he has to see is whether under the rules and constitution of the institution the income is *applicable*. Where there is no clear condition in the rules of the institution, the fact that the income is not actually applied to the purpose may be evidence that it is not so applicable, and to that extent the Income-tax Officer may, in fact must, enquire into the application of the income. The word 'applicable' in clause (ii) is not even so strict as the words "finally set apart for application" in clause (i).

'Voluntary'—

What exactly the Select Committee had in mind in inserting 4 (3) (ii) is not clear; and in particular, what they meant by

(1) *Per* Lord Herschell in *Mayor of Manchester* v. *MacAdam*, 3 Tax Cases 491.

"voluntary contributions". It is also not clear whether the draftsman was influenced by the wording of similar provisions in the United Kingdom. However that may be, if 'property' in clause (i) is construed in a comprehensive sense, it does not really matter what "voluntary contributions" mean. If, on the other hand, it is read in a restricted sense, it is a matter of some importance what "voluntary contributions" connote. In the United Kingdom where charities as such are not exempt but only in respect of specified sources of income, the meaning of the expression has been the subject of discussion.[1]—*Per Smith, J.* :—

"It was said that the word 'payment' was synonymous with 'contribution', and that the word 'voluntary' did not mean gratuitous but meant given without compulsion. . . . . In my judgment, what is or is not a voluntary contribution must in each case depend on the object for which, and the object to which the contribution is made. In each case, it seems to me, it must be a question of fact. . . . . To pay £1 to a benefit match of a professional cricketer for his own pocket would, I should say, be a voluntary contribution. To pay £1 to get access and right to a special seat upon the ground for the match, I should myself not call a voluntary contribution at all. . . . . I decline altogether to attempt to give an exhaustive definition of what are or are not funds voluntarily contributed, for if I did, I should, as it appears to me, land myself in the same difficulties in which the learned judges who decided the cases in question, as it appears to me, got themselves into. . . . ."

Law in the United Kingdom—

Under Schedule A (property Tax) exemption is given to (1) public buildings and offices belonging to any college or hall in any University (not occupied by any member or by any person paying rent); (2) public buildings, offices and premises belonging to any hospital, public school or alms-house (not occupied by any officer whose income amounts to £150 a year or by any person paying rent); (3) any building being the property of any literary or scientific institution which is used solely for the purpose of such institution and in which no payment is demanded or made for any instruction given there by lectures or otherwise (if the building is not occupied by any officer or by a person paying rent); (4) rents and profits of lands, tenements, hereditaments, etc., belonging to a hospital, public school or almshouse, or vested in trustees for charitable purposes in so far as the income is applied to charitable purposes (till 1921 this did not extend to the premises owned and occupied by the charity); (5) under Schedule C—Government and other securities—

(1) *Commissioners of Inland Revenue* v. *New University Club*, 2 Tax Cases 270.

on stock belonging to charities. In 1921 exemptions were given (1) in respect of Schedule B—occupancy tax—in respect of lands occupied by a charity provided that the work in connection with the 'husbandry' is mainly carried on by the beneficiaries of the charity and the profits applied solely to the charity; (2) in respect of Schedule D—trading—if the work is mainly carried on by the beneficiaries of the charity and the profits solely applied to the charity. The changes in 1921 were made at the instance of the Royal Commission on Income-tax, which commented on the anomalous state of the law as it stood before. Section 24 of the Finance Act of 1927 extended the exemption in respect of Schedule D profits to cases in which the trade is exercised in the course of the carrying out of the primary object of the charity, even if the trade is not carried on by the beneficiaries. As a result of these changes, some of the decisions in England have become obsolete.

It will be seen from the general outline of the exemptions to charities, etc., in the English law that the details of the English system are inapplicable to India. As Pollock M. R. put it in a recent case.[1]

"There is under the (United Kingdom) Income-tax Acts no general exemption for charities as such from income-tax. . . . . . Unless the charity can justify a claim to the particular exemption allowed in respect of tax collected under the several Schedules it remains liable to the tax."

On the other hand in India there is a general exemption in favour of charities. The only English decisions therefore that can be of help, are those as to what is or is not charitable, etc., but even these have to be applied with caution.

Under the English law all religious purposes are also charitable,[2] but certain purposes which would be religious according to non-Christian or rather non-Anglican standards would be 'superstitious' and not 'religious'. A technical meaning has been assigned to the words 'charitable purposes' by the Court of Chancery in England. Certain charitable objects were enumerated in the preamble to Statute 43 Elizabeth c. 4, but the Courts have given a very wide interpretation to the words. The subjects are enumerated in the Mortmain and Charitable Uses Act, 1888, as below:

"Relief of aged, impotent and poor people, maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in Universities, repair of bridges, ports, havens, causeways, churches, sea-banks and highways, education and preferment of orphans, relief,

(1) *Brighton College* v. *Marriott*, 10 Tax Cases, 235.

(2) *In re White—White* v. *White*, (1893) 2 Ch. 41, 52; *Commissioners of Income-tax* v. *Pemsel*, 3 Tax Cases 53.

stock or maintenance for houses of correction, marriages of poor maids, supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, relief or redemption of prisoners or captives, aid in case of any poor inhabitants concerning payment of fifteenths, setting out of soldiers, and other taxes.''

The meaning of the words 'charitable purposes' in the income-tax laws was threshed out in *Commissioners of Income-tax* v. *Pemsel.*[1]

Per Lord Macnaghten.—'' In all English Statutes when there is no controlling context a technical meaning is attached to the word 'charity', and synonymous therewith is the word 'charitable' as used in such expressions as charitable trust, etc. . . . . . Charity in its legal sense comprises four principal divisions—trusts for the relief of poverty, trusts for the advancement of education, trusts for the advancement of religion, and trusts for other purposes beneficial to the community not falling under any of the preceding heads. The trusts last referred to are not any the less charitable in the eye of the law, because they incidentally benefit the rich as well as the poor, as indeed every charity must do either directly or indirectly. The (Income-tax) Act has nothing to do with casual alms-giving or charity of that sort nor indeed has it anything to do with charity which is not protected by a trust of a permanent character. The provisions of the Act are concerned with the revenue of established institutions—the income of charitable endowments. . . . .''

Note that as regards the fourth head, the benefit of the community, there is no mention of poverty.

'' The words in the preamble of 43 Elizabeth, c. 4, are not a definition of charitable cases but are a detailed statement of certain cases which are to be charitable and in dealing with the matter the course which the Court of Chancery has pursued has been to look at the enumeration of the charities in the statute and to include under the word 'charitable' any gift of funds for a public purpose which is analogous to those mentioned in the statute.''—Per Lord Wrenbury in *Verge* v. *Somerville.*[2]

In a United States Sunday Act, charity has been held to include '' everything which proceeds from a sense of moral duty or kindness or humanity for the relief or comfort of another and without any regard to one's own benefit or pleasure ''.[3]

Many of the leading cases in the United Kingdom do not apply to India because of the difference in the exempting provisions of the law already pointed out. The most important group of cases culminating in *Coman* v. *Rotunda Hospital*[4] decide that it is not the motives of a concern but whether it is run on 'business' lines and adopts 'business' methods that decides the liability

(1) 3 Tax Cases 53.
(2) (1924) A. C. 596.
(3) *Doyle* v. *L. & B. R. R.*, 118 Mass. 197.
(4) (1921) 1 A.C. 1; 7 Tax Cases 517.

to tax. And it is for the charity seeking exemption to justify the particular exemption with reference to the different schedules under the Income-tax Act. In India, on the other hand, even a 'business' will be exempted if it is held under trust or legal obligation for charitable or religious purposes, assuming of course that "property" as used in section 4 (3) (1) includes a business; and the English cases are not therefore of much assistance. But see the decision of the Madras High Court in *Commissioner of Income-tax* v. *Thevara Patasala*.[1] It is only if there is no trust or other obligation for charitable or religious purposes that we can seek any useful guidance from the English cases; and even then only as to whether the profits arise from a 'business' or not. But the point is not of much importance because whether the income should be considered to arise from 'business' or some other source it is taxable all the same so long as it is not exempt on account of the existence of a trust or other obligation or because the contributions are voluntary. The source would only affect the computation of the income and not its taxability.

Exemption of charities—Procedure in the United Kingdom—

Till 1925 the procedure for referring to the High Court questions relating to the exemption of charities was by a mandamus obtained from the High Court—see notes under section 66.

Hospital—Paying patients—

In *St. Andrews Hospital, Northampton* v. *Shearsmith*[2] a hospital received paying patients at remunerative prices and applied its surplus income to the extension and improvement of the hospital buildings. *Held*, that the surplus was profit assessable to the income-tax as the institution was not 'charitable'. In *Needham* v. *Bowers*[3] an institution for the insane in which some patients paid sufficiently well for all the inmates to be supported without payment and which was therefore self-supporting was held to be not 'charitable' although it was founded by charitable donations and made no profit. In *Cawse* v. *Lunatic Hospital, Nottingham*,[4] however, an asylum with substantial charitable endowments which took in patients at remunerative prices was considered to be 'charitable'. The difference between these decisions was founded on the fact that in the one case the institution was chiefly dependent on the fees while in the other it was so dependent on the endowments.

(1) 2 I. T. C. 171.
(2) 2 Tax Cases 219.
(3) 2 Tax Cases 360.
(4) 3 Tax Cases 39.

College—Endowed—Receiving fees—

A college was built and endowed to enable young women to carry on their studies after leaving school. Each student paid in fees £90 a year or upwards, the receipts from the endowment being as to fees in the proportion of about two to one. *Held*, that the college was not exempt as a "charity school".[1]

See per Phillimore, J., in *Governors of Bradford Grammer School*[2] following the tests laid down in *Charterhouse* School v. *Lamarque*[3] and *Southwell* v. *Holloway College*.[1]

"Now a school which is nearly self-supporting but has some assistance from endowments is not a charity school. A school which is almost entirely supported by endowments but gets some little assistance from fees paid by scholars is a charity school and in the same way a hospital which is almost entirely charitable is exempt as a hospital although it has a few paying patients. *Per contra* if the hospital is almost entirely self-supporting it is not exempt because it has some residual endowment. The whole matter therefore is a question of degree."

Charities—Contingent and not exclusive—

Mr. Joseph Rank by an indenture made in March, 1917, settled upon trustees certain funds, to be held, together with the income thereof, upon trust "for the benefit of such persons, institutions or purposes as the said Joseph Rank shall by any writing under his hand or by will appoint". In default of any such appointment the trust funds and income were to be held by the trustees upon trust for the benefit of the Wesleyan Methodist Church. The whole of the income of the trust for the three years ended 5th April, 1918, 1919 and 1920 was applied by the trustees to certain charitable institutions in accordance with written directions given at various dates by Mr. Joseph Rank. The trustees applied to the Special Commissioners for repayment of the income-tax which had been deducted at the source from the trust income during the three years ended 5th April, 1918, 1919 and 1920, on the ground that under the deed of trust the income in question was applicable to charitable purposes only and had been so applied. The application was unsuccessful and the trustees applied for and obtained a rule *nisi* calling upon the Special Commissioners to show cause why a writ of mandamus should not issue commanding them to allow exemption from income-tax on the income in question and to repay the tax which had been deducted therefrom. *Held*, discharging the rule *nisi* that inasmuch as the settlor possessed under the deed of settlement power to execute

(1) *Southwell* v. *The Governors of Holloway College*, 3 Tax Cases 386.
(2) 6 Tax Cases 136.
(3) 2 Tax Cases 611.

an appointment in favour of purposes that were not charitable, the deed did not create a trust for charitable purposes only, although ultimately powers were exercised by the settlor in favour of charity.[1]

Mutual Benefit Association—

The objects of an institution were to afford relief to decayed members in distress, sickness and old age, and to aid widows and protect children. Subscription was an essential condition of membership, but relief was claimable only where the circumstances were necessitous, and no members were entitled as of right to such relief, an absolute discretion in the matter vesting in the directorate. *Held,* that the institution was not a charitable institution, but substantially one for the mutual benefit of the subscribing members, who in the event of the directors misapplying the rules or declining to act upon them according to their proper construction, would have a right to redress in a Court of Equity.

Trade Societies—Benefit restricted to members—

Exemption claimed on behalf of a Scotch Incorporated Trade Society on the ground that its income was legally appropriated and applied to a " charitable purpose ". *Held,* (1) that the meaning of the words " legally appropriated " is that the appropriation must be of such a kind as to create a legal obligation upon the part of the administrators of the property, to apply it in a particular manner; (2) that funds belonging to an incorporated body which are derived from entry moneys of members, and are solely applicable as pensions to decayed members, or widows of members, at the absolute discretion of a governing body, are not to be regarded as funds " legally appropriated and applied for any charitable purposes " within the meaning of the statute.[3]

Masonic Lodge—

A Grand Lodge of Masons claimed exemption in respect of the income of certain funds devoted to the relief of necessitous Masons, or their dependents, at the discretion of the administering bodies. Every Mason by whom, or by whose dependents, benefit was received from the funds, had to some degree contributed thereto through his Lodge, but the funds were largely derived from other sources than such contributions and the greater

(1) *Rex* v. *The Special Commissioners of Income-tax (Ex parte Rank's Trustees)*, 8 Tax Cases 286.

(2) *The Linen and Woollen Drapers, etc., Institution* v. *Commissioners of Inland Revenue*, 2 Tax Cases 651.

(3) *The Incorporation of Tailors in Glasgow* v. *Commissioners of Inland Revenue*, 2 Tax Cases 297.

proportion of each individual Mason's contributions to his Lodge did not go to these funds. *Held,* that the exemption applied.

Per the Lord President.—I think it is clear, and indeed no argument is addressed against this view, that the meaning of "legally appropriated and applied" does not necessarily mean that there never can be any change—as if a thing is fixed back but it means that the practical condition of the Fund is that it is so applied and that it is in terms of either the direction of the trust or the constitution of the body which owns it. Therefore the first thing to be got at is whether any particular portion of corporate property is really what may be called (to use more general words) dedicated to charity. Now when we take these funds, the particulars of which are set forth in the case before us, there is no doubt whatsoever that they are dedicated to charity. They are entirely used for the relief of distress in some form or other, and accordingly *prima facie* I think there would be no question but that they fall within the exemption. But then it is said that they do not really do so, because when you look into the source from which these funds come you will find that the participants in these funds have themselves been at some period or other compulsory contributors to these funds—I mean compulsory in this sense that they could not have been in the body in which they are unless they had conformed themselves to the Rules of that body, and that the Rules of that body enjoin a certain contribution to those funds. Therefore, the Crown argued, this is nothing more nor less than really a Benefit Society, and if it is a Benefit Society you are really purchasing what you get, and then it is not charity in the proper sense of the word. And in illustration of that position they particularly relied upon the case of the *Incorporation of Tailors in Glasgow* v. *The Inland Revenue*[1] in 14 Rettie, which was decided in this Court, and the case of the *Linen and Woollen Drapers*[2] which was decided in England. . . . In the Incorporation of Tailors in Glasgow the whole contributions were for the purpose of swelling those funds and swelling those funds alone which afterwards were doled out in a charitable way, and no doubt the case, so far, was a strong one in so far that it settled that it was none the less a Benefit Society, even although the person who contributed did not necessarily get anything back, because the particular recipient of the bounty always had to trust to his particular case recommending itself to the distributors of the charitable fund.

* * * * * * *

But when you come to these funds, you find that to a certain extent these funds are swelled by the contributions of those who will eventually participate, that is to say, there is nobody who takes a benefit from these funds but is in the position that he, in the past, through the medium of the payment which his Lodge has made in respect of him, will have contributed some minute portion of the funds from which he is taking benefit; but none the less the great proportion of his contributions do not go to that at all. He does not join the Masons as a Benefit Society, but in

(1) 2 Tax Cases 297.
(2) 2 Tax Cases 651.

order to participate in the other benefits of Freemasonry, and the actual contributions which go to the making of each particular fund are not at all limited to those funds, but some of them come from purely charitable sources and some from other funds which are voted by the Grand Lodge. I think, therefore, it comes to be a question of degree. If you take, for instance, an extreme case at the other end, nobody could suppose, if, say an hospital (or in this part of the world we should call it an Infirmary) was endowed certainly for a charitable purpose, it would not exempt the Corporation, from the fact, which undoubtedly would be a fact, that some patient might in past years have given a subscription to the hospital. I think that is an extreme case at the other end. I think this case is nearer that than a complete Benefit Society, which you had in the Incorporation of Tailors. . . . . .

Per Lord Mackenzie.—It appears to me that the question whether a particular fund falls within the exemption of the statute or not is largely a question of degree. If the objects of the Corporation are purely mutual benefit, if the individual corporators make their contributions as an investment, the case would be governed by the principles laid down in the *Incorporation of Tailors in Glasgow*.[1] From the bye-laws which govern the Tailors' Incorporation it appears that all that was left was for the mutual benefit of the individual members. So, too, in the English case *Re The Linen and Woollen Drapers, etc., Institution*,[2] which was founded upon by the Crown, it appears from the opinion of Pollock, B., that the institution was a Mutual Benefit Society. As the rules are not printed in the Report it does not appear upon what grounds this opinion was reached, but the opinion of the Lord President in the Incorporation of Tailors in Glasgow is referred to and adopted by Hawkins, J., in his judgment.

In the present case it does not appear to me that the contributions by individual Freemasons are of such a character or amount as to necessitate the Court arriving at the conclusion that the funds in question are not legally appropriated and applied for a charitable purpose. The individual pays not to any of these funds but to a daughter lodge and makes these payments in order to become a Freemason. From the rules, the consequence results that a small proportion of his contributions goes to these funds. That, however, is not the main object he has in view when he makes his contribution. He makes his contribution in order to share in the benefits of Freemasonry, and this is not confined to making payments from these funds.[3]

Temperance Council—Not charitable

The Temperance Council of the Christian Churches of England and Wales, the principal object of which was united action to secure legislative and other temperance reform, was considered

(1) 2 Tax Cases 297.
(2) 2 Tax Cases 651.
(3) *Grand Lodge, etc., of Masons, etc.* v. *Commissioners of Inland Revenue*, 6 Tax Cases 116.

not to be a 'charitable' institution, but an institution established for political purposes as its object was to secure legislative reform.[1]

Widows and orphans of medical men—Society for the relief of—

This Society was formed in 1788 and later on incorporated by a Royal Charter in 1864. According to the Charter the object of the Society was to relieve the widows and orphans of the deceased members who might need assistance; and according to the same Charter the Society claimed to unite the advantages of a provident with those of a benevolent society, inasmuch as by a small yearly subscription the members were enabled to protect their widows and orphans from destitution should they need relief, and it was benevolent inasmuch as its benefits were conferred only in straitened circumstances. The funds of the Society were raised by interest of moneys, legacies and donations, and subscriptions of members. As a matter of fact by far the greater portion of the members were in such circumstances that the dependents would not in the ordinary course require relief. *Held*, that the funds of the Society were solely devoted to the relief of individuals and that this was a 'charitable' purpose on the authority of the decisions given in the Court of Chancery.[2]

Medical Charitable Society—

This Society was established to help (1) members disabled by illness or accident and in needy circumstances; (2) the dependents of deceased members in necessitous circumstances; and (3) in the education of the children or disabled members. The members of the Society were also themselves eligible for relief and subscriptions and donations were received also from persons unconnected with the medical profession. This case was decided along with the case of the Society for the Relief of Widows and Orphans, etc., and it was held in the same judgment that this Society also was 'charitable.'[3]

Per Rowlatt, J.—"A purely mutual society among very poor people whose dependents would be quite clearly always poor would not, I think, be a charity; it would be a business arrangement. . . . That would not be a charity . . . (the beneficiaries in the case) have not the

(1) *Commissioners of Inland Revenue* v. *The Temperance Council, etc.*, unreported.

(2) *Spiller* v. *Maude*, 32 Ch. D. 158, followed; *Cunnack* v. *Edwards*, 12 T. L. R. 614; *Re Clarke*, 1 Ch. D. 497, distinguished; *Commissioners of Inland Revenue* v. *Society for the Relief of Widows and Orphans of Medical Men*, 11 Tax Cases.

(3) *Commissioners of Inland Revenue* v. *Medical Charitable Society for the West Riding of Yorkshire*, 11 Tax Cases.

right to anything; the funds are vested in trustees who have to do their duty, of course faithfully, but they have to select the objects with a view to making as far as their resources go, a due and fair relief of indigence. . . . Is that really a bargain mutually between the members for mutual relief limited to the contingency of indigence, or is it really only a means of qualifying for the receipt of what is in itself a charity? . . . . The immateriality of the element of private subscriptions seems to be emphasised in the case of *Spiller* v. *Maude*.

Nursing facilities—Society giving—

An association whose object was the provision of nursing facilities to poor people had three classes of members paying subscriptions at different rates, the bulk of the members being in the lowest class. Facilities were given only to members, in most cases at less than cost, the deficit being met out of donations or income from investments of donations, etc., from the public. *Held*, that the association was charitable.[1]

Library—Corporate body, of—

A Corporate body possessed buildings which were occupied as a library, and owned also mortgages, railway shares, and bank deposits. It claimed total exemption. *Held*, (1) that the Society's library was not property "legally appropriated and applied for the promotion of education, literature, science, or the fine arts" (note the difference in the wording of the English and the Indian law); (2) that the income of the Society was exempt only to the limited extent that it was legally appropriated by contract to the perpetual endowment of a chair of conveyancing in the University of Edinburgh . . . . . ; (3) that the words "legally appropriated" did not mean "lawfully" appropriated, but that the appropriation was to be of such a kind as to be legally binding upon the parties.[2]

Library—Free—Partly used for Subscription Library—

A building belonging to the Magistrates and Town Council of Dundee was used mainly as a Free Library, but in one of the rooms accommodation was afforded by special arrangement for the books belonging to a Subscription Library. These books were under the control of the Librarian of the Free Library, and after being a year in circulation among the subscribers were handed over to, and became the absolute property of, the Free Library. *Held*, that the building was not within the exemption in favour of

(1) *Commissioners of Inland Revenue* v. *Peebleshire Nursing Association*, 11 Tax Cases 325.

(2) *Society of Writers to the Signet* v. *Commissioners of Inland Revenue*, 2 Cases 257.

buildings used solely for the purposes of a literary or scientific institution.[1] (In India a literary or scientific institution would, unless a proprietary institution, be charitable if it was an educational institution, as it would in most cases be, or an institution of public utility.)

Library—Free—

A building was owned by a Municipal Corporation, and was maintained for the purposes of a Free Library under the provisions of the Public Libraries Act, 1892. *Held*, (by Lords Herschell, Macnaghten and Morris, Halsbury, L. C., dissenting) that the building was within the exemption from income-tax granted to Literary or Scientific Institutions.[2]

University College—

The University College of North Wales was founded to provide instruction in all the branches of a liberal education except theology. It derived income from investments of which a part was appropriated specifically to various educational purposes, and part applied to the general purposes of the College. *Held*, that the College was a Corporation established for " charitable purposes" only within the meaning of the Income-tax Acts, that the revenues applied to the general purposes of the College were applied to "charitable purposes " only, and that the College was entitled to exemption.[3]

Institution of Civil Engineers—Main object—Promotion of Science—Exempt—

Exemption claimed on the ground that the property and income of the Institution of Civil Engineers were legally appropriated and applied for the promotion of science. *Held*, by Lords Watson and Macnagthten (Lord Halsbury, L. C., dissenting), that the primary object of the Institution was the promotion of science in the abstract, and that the property and income were legally appropriated by Charter, and applied in fact to that object; that, if the further object of the advancement of the professional interest of members was to be also inferred, it was at least secondary to the main and chief object.[4]

Royal College of Surgeons—Library, Museum Buildings—Not exempt—

The Royal College of Surgeons was incorporated " for the advancement of the science of surgery within Her Majesty's

(1) *Musgrave* v. *Magistrates and Town Council of Dundee*, 3 Tax Cases 552.

(2) *Mayor, etc., of Manchester* v. *McAdam*, 3 Tax Cases 491.

(3) *The King* v. *The Commissioners for Special Purposes of the Income-tax* (*ex parte University College of North Wales*), 5 Tax Cases 408.

(4) *Commissioners of Inland Revenue* v. *Forrest*, 3 Tax Cases 117.

Dominion." It granted various surgical qualifications, and was both an examining and teaching body in surgical subjects. *Held*, that the objects of the College were mainly professional; that it was not a 'scientific institution' and was therefore not entitled to exemption for buildings belonging to it, used as a library, museum, etc., for the purposes of the College. The question being a mixed one of fact and law, this judgment did not follow that of the House of Lords in *Commissioners of Inland Revenue* v. *Forrest*.[1]

Per Lord Adam.—". . . . If, in the sense of the Act, the main and leading purpose of the institution is the advancement of science, it will not be the less entitled to the exemption claimed because it aids incidentally, consequentially, the promotion of professional purposes, and that appears to be the case, or very much so, of the Institution of Civil Engineers in London. On the other hand, if the main and leading object be that of advancing a profession, then that it may also incidentally and as a consequence of that, promote science, will not (the less) make it other than a professional institution."[2]

(The Indian law does not give any exemption to a scientific institution unless it is 'charitable'; and such an institution is not 'charitable' as its object is 'professional', and not educational or of 'general public utility').

Common pastures—Grazing charges used for the benefit of—

The freemen of Bootham Ward had possessed certain rights of common pasture over certain lands. By a certain statute some of these lands were vested in the Mayor of the place, for the benefit of the freemen. Grazing charges were made upon 'non-freemen', and these sums were used for the benefit of some of the widows of the freemen. Claim was made that the property was legally appropriated and applied in a manner expressly prescribed by Act of Parliament, and also that the property was legally appropriated and applied for a charitable purpose. *Held*, (1) that the manner of the enjoyment of the property, or the income of it, was immaterial, and that the words of the sub-section were satisfied if the property was appropriated, in express terms, to a prescribed object; (2) that although an interpretation short of, and different from, the technical meaning assigned to the term "charitable purposes", by the Courts and adopted by the House of Lords in the Income-tax case of *Pemsel*,[3] should be given to the same term in the Corporation Duty Act, yet that interpretation should be a sufficiently wide and liberal one. . . . . It would

(1) 3 Tax Cases 117.
(2) *Sulley* v. *Royal College of Surgeons, Edinburgh*, 3 Tax Cases 173.
(3) 3 Tax Cases 53.

not, however, include a case in which the beneficiaries of the charity had no right to the benefits and received them only through the consent of the real owners, *viz., the freemen.*[1]

It will be observed that "legally appropriated, etc.," occurring in all these English cases corresponds to 'trust or other legal obligation' in the Indian law.

Lands vested in trust—Rents and profits for religious purposes—

Lands were vested in trustees in trust to apply the rents and profits in maintaining (1) the missionary establishments among heathen nations of the Moravian Church, (2) a school for the children of ministers and missionaries; and (3) certain religious establishments denominated choir houses. *Held,* by Lords Watson, Herschell, Macnaghten, and Morris (Halsbury, L. C., and Lord Bramwell dissenting), that the trust was one for "charitable purposes" within the meaning of the Income-tax Acts. In those Acts the words charitable purposes are to be interpreted, not according to their popular meaning, but according to their technical legal meaning.[2] This is one of the leading cases on the subject. Extracts from Lord Macnaghten's judgment have been given on p. 363.

Charity—Scottish Law—

In *Wilson and others* v. *The Crown*[3] the Scottish Court of Session held that in Scotland a charity should be construed according to Scottish and not the English law.

Property of the Royal College of Surgeons Income not legally appropriated for promotion of science of surgery—

By the Customs and Inland Revenue Act, 1885, a duty was imposed by way of compensation to the Revenue for Death Duties that obviously cannot be levied on Bodies Corporate and Unincorporate, the rate of Duty being five per cent. per annum on the net annual value, income and profits of real and personal property belonging to such bodies. "Property which, or the income or profits whereof shall be legally appropriated and applied for any charitable purpose or for the promotion of education, literature, science, or the fine arts" [48 and 49 Vict., c. 51, section 11, sections (2) and (3)] (Customs and Inland Revenue Act, 1885) was exempt; and the Royal College of Surgeons claimed exemption from this duty. *Held,* that the College had two main objects neither of which was subsidiary to the other: (1) The promotion of the science of surgery: (2) The promotion of the practice and

(1) *In re Bootham Strays, York Commissioners of Inland Revenue* v. *Scott and others,* 3 Tax Cases 134.

(2) *Special Commissioners of Income-tax* v. *Pemsel,* 3 Tax Cases 53.

(3) 5 A. T. C. 378.

encouragement of surgery including the interests of those practising surgery as a profession, and including also the examination of students and others to qualify for practice or honours in surgery. There was no legal obligation either to apply the property or the income to the first main object, or not to apply them to the second main object, and as there was no appropriation by the college by conveyance, declaration of trust or otherwise, there was no "legal appropriation" for a purpose exempting from duty. Neither was the property and income brought into charge "applied" so as to exempt it from duty.[1]

Wills—Surplus after satisfaction of specific trusts—

Construction of will of Sir Thomas Gresham—whether the surplus, if any, after satisfaction of specific trusts belonged to the Corporation of the City of London absolutely, or was to be held by them for the purpose of a general trust over the whole property. *Held,* that the property other than the Royal Exchange itself was not legally appropriated and applied to the benefit of the public at large, etc., nor did it fall within the words "or in any manner expressly prescribed by Act of Parliament"; and that the limited trusts referred to in the will had been properly excluded from the assessment. The Corporation were beneficial owners of the surplus, and were not bound by any trust or new trust in respect of it, and as equitable owners subject to specified charges, obtained no charge on the property for expenditure in re-building and improvements. Further, they were not entitled to claim as a set-off against an account of annual income, sums paid away in respect of past capital expenditure.[2] (The facts relating to the will are rather obscure.)

Technical education—

A college imparting technical education in all branches of the woollen industry and maintained mostly out of subscriptions from woollen manufacturers was held to be an educational institution.[3]

Agricultural Society—

A society, numbering about 3,000 members, unincorporated and without any deed of trust, held annual shows and interested itself generally in the improvement of agriculture, including *inter alia* the improvement of agricultural lands. The income

(1) *The Royal College of Surgeons of England* v. *Commissioners of Inland Revenue,* 4 Tax Cases 344.

(2) *Gresham Trustees (City's Moiety)* v. *Commissioners of Inland Revenue,* 4 Tax Cases 304.

(3) *Scottish Woollen Technical College* v. *Commissioners of Inland Revenue (C. of S.),* 11 Tax Cases 139.

comprised gate money, subscriptions, etc., and the excess of income over expenditure was invested. *Held* by the Court of Appeal that there was a charitable purpose.[1]

Convalescent House—

A home established for the benefit of members of the drapery and allied trades obtained its income from the original endowment and other investments, from donations and subscriptions from concerns in the trades and from payments by visitors. The persons using the home were convalescents from illness, persons requiring rest and change of air and persons taking a holiday; and the last class had to pay higher rates than the others. The visitors were admitted either on the recommendation of the donor and subscriber firms or on special letters of introduction.

Held, by the Court of Appeal, following *Re Estlin*,[2] and *Re Gardom*,[3] that there was a charity.[4]

Temperance refreshment rooms—

The object of a trust was "to assist the inhabitants of Falkirk by providing them with comfortable rooms where wholesome refreshments may be obtained, where they are free from the temptation of intoxicating liquors." The trustees maintained two cafes, in one of which prices were charged as in ordinary restaurants and in the other at lower rates in order to benefit the working classes. There were free reading and recreation rooms. The trustees avoided making profits as far as possible.

Held, that the promotion of temperance was a charitable object, and that as the only way in which the trust could be given effect to was by the adoption of commercial methods, that feature should be ignored and that the trust should be exempt. Lord Sands however thought that if the Crown had shown that there was a separable branch working at a profit, it might have been different.[5]

School in receipt of full fees—Not a charitable institution—

A school in which full fees are paid by the students, and the surplus is devoted to the improvement of the College, is not

(1) *Commissioners of Inland Revenue* v. *Yorkshire Agricultural Society*, 6 A. T. C. 862.

(2) 72 L. J. 687.

(3) (1914) 1 Ch. 662.

(4) *Commissioners of Inland Revenue* v. *Trustees of Roberts Marine Mansions*, 11 Tax Cases 425.

(5) *Commissioners of Inland Revenue* v. *Falkirk Temperance Cafe Trust*, 11 Tax Cases 353.

a 'charitable institution' but conducts a 'trade'—decided by the Court of Appeal in *Marriot* v. *Brighton College*, reversing the decision of Rowlatt, J.

Per Scrutton, L. J.—". . . . When any person habitually and as a matter of contract, suppies money's worth for full money payment, he trades within the meaning of Schedule D. . . . . This is not a case where persons subscribe to enable transactions to be carried on which could not be carried on by the commercial returns alone. . . . ."

This decision was upheld by the House of Lords.[1]

Associations for promoting the interests of the teaching profession and the cause of education—Not charitable—

An Association formed for the promotion of the interests of the teaching profession in Preparatory Schools, though it also furthered the advancement of education was considered to be not 'charitable'.[2]

The Headmasters' Conference — an Association for the protection of the interests of the teaching profession, the settlement of the disputes affecting members of the profession, etc., though the association was interested in the cause of secondary education generally, was similarly treated to be not 'charitable'.[3]

Per Lord Eldon in *Morice* v. *The Bishop of Durham*[4]—quoted in *R.* v. *Special Commissioners* (*ex parte Rank's Trustees*)[5] and again in the Headmasters' Conference case above. "The question is whether, if upon the one hand he might have devoted the whole to purposes in this sense charitable, he might not equally according to the intention, have devoted the whole to purposes benevolent and liberal and yet not within the meaning of charitable purposes as this Court construes these words."

Benevolent Society—Commercial methods—

In *Trustees of Psalms and Hymns* v. *Whitwell*[6] it was held that the business of selling a hymn book was a trade, even though the resulting profits were distributed among widows and orphans of ministers and missionaries. In *Religious Tract and Book Society* v. *Forbes*[7] in which the society, whose primary object was the diffusion of religious literature, incidentally carried on a bookselling shop it was considered to that extent to be engaged in a trade. At the same time it was held that a colportage agency

(1) 10 Tax Cases 235.

(2) *R.* v. *Special Commissioners* (*ex parte the Incorporated Association of Preparatory Schools*), 10 Tax Cases 73.

(3) *R.* v. *Special Commissioners* (*ex parte* the Headmasters' Conference), 10 Tax Cases 73.

(4) 10 Vesey 532.

(5) 8 Tax Cases 286.

(6) 3 Tax Cases 7.

(7) 3 Tax Cases 415.

carried on by the same society in which the chief business was not so much that of pushing the sale of the goods as that of administering religious advice was not a trade.—*Per Lord President Robertson*:

"While . . . . the establishment and conduct of the colportage all rest upon the same ultimate motive, yet at the same time the two operations seem to be essentially distinguished. The shops are simply bookseller's shops—the other is a combination of the sale of books with a missionary enterprise."

A Society formed for the improvement, spiritual, mental, social and physical, of young men, carried on a Restaurant, as well as Educational Classes, Gymnasium and Publication Department; the restaurant was carried on on the usual commercial principles, and was open to the public. *Held,* that the Association was liable to income-tax on the profit made by the Restaurant.

Per Ridley, J.—" I cannot escape from the conclusion that the object is to carry on the Restaurant as a trade consistently with the other objects of the Association. The Association would indeed carry it on even without a profit, with a view no doubt of benefiting the other objects of the Association; yet I think it is carried on as a ' trade '. It is conducted on the usual commercial principles . . . . "[1]

These three decisions were cited with approval in *Coman* v. *Rotunda Hospital*[2] in which it was held that a hospital which let its rooms for entertainments and meetings was carrying on a trade. See also *Brighton College* v. *Marriott*.[3] These decisions, however, are partly obsolete even in the United Kingdom, in view of the amendments in the law there in 1921 and 1927. So far as India is concerned these decisions are inapplicable if the profits are, under trust or legal obligation, to be used for charitable or religious purposes within the meaning of the Indian Act. *See* notes on page 364.

It was held, however, in *Commissioner of Income-tax* v. *Thevara Pathasala*[4] by the Madras High Court, following the above decisions in the United Kingdom and the decision of the Allahabad High Court in *In re Lachmandas Naraindas*[5] (the latter, however, was not based on the United Kingdom rulings), that a business conducted by a charity which competed with other businesses that paid income-tax should be held liable to income-tax. At the

(1) *Grove* v. *Young Men's Christian Association*, 4 Tax Cases 613.
(2) 7 Tax Cases 517.
(3) 10 Tax Cases 235.
(4) 2 I. T. C. 171.
(5) 1 I. T. C. 378.

same time the decision was not based on the interpretation of 'property' in the restricted sense in which that word is used in section 9. It is respectfully submitted that there is nothing either in the wording or in the scheme of the Act to suggest that a business which competes with other businesses paying income-tax, must be held liable to income-tax merely because it so competes. Whether such exemption is equitable or not is, it is submitted, a matter not of construction of the statute but of policy for the Legislature to decide.

Property vested in charity—Not exempt before it is settled—

The exemption can be claimed only after the property vests in the charity. On the 10th of November, 1921, the assessee executed a Trust Deed whereby she conveyed a part of her property to the R. N. Wadia Charitable Trust Settlement. The income of the property so settled, which was earned up to the date of the deed of settlement was assessed under section 3. *Held,* that for the financial year 1922-23, the assessee is to be assessed on the income, profits and gains of the previous year, and it is only when the income, profits and gains of the previous year include income derived from property held under trust for religious or charitable purposes that such income is free from assessment. The fact that certain income received during the current financial year is derived from property held upon trust for charitable purposes, does not prevent the liability of the assessee to be taxed on such income received during the previous year before the property was settled.[1]

The following English case may also be noted. Mr. Denzil Thomson died on the 15th November, 1914, leaving the residue of his estate to Dr. Barnardo's Homes National Incorporated Association. The testator's next-of-kin contested the will, and the proceedings were compromised by the Association making over to the next-of-kin one-third of the residuary estate. The proceedings delayed the division of the residuary estate, and the investments constituting and representing the same, remained under the control of the Executors until May, 1916, between which date and December, 1916, two-thirds of the investments were transferred to the Association and one-third to the testator's next-of-kin. The income arising from the investments received under deduction from such income during the period between the date of the testator's death and the dates of transfer by the Executor amounted to £498-0-11.

(1) *Commissioner of Income-tax* v. *Bai Jerbai Nowrosji Wadia,* 1 I. T. C. 255.

The Association applied, to the Special Commissioners of Income-tax for repayment of two-thirds of that sum, *viz.*, £332-0-7, as being the income-tax on income payable to the Association, and applicable, and in fact applied, by it solely for charitable purposes. The application being unsuccessful, the Association applied for and obtained a rule *nisi* calling upon the Special Commissioners of Income-tax to show cause why a writ of mandamus should not issue to them commanding them to allow exemption from income-tax on the income in question.

Held, discharging the rule *nisi,*—

(i) that the assent of the Executors to the bequest to the Association of the residue of the estate did not relate back to the date of the testator's death;

(ii) following the decision in *Lord Sudeley* v. *Attorney-General*[1] that, prior to the ascertainment of the residue, the Association, as residuary legatee, had no interest in the testator's property, that the taxed income of the estate prior to such ascertainment was income of the Executors, and that it was not received by them as trustees on behalf of the Association; and

(iii) that the Association was, therefore, not entitled to claim repayment of the income-tax deducted from the income.[2]

The law in the United Kingdom was however altered as a consequence of this decision by section 30 of the Finance Act of 1922; and a part of the income accruing in the interval will be now treated as income of the charity.

(*iii*) The income of local authorities.

Local authorities—

The income of local authorities has always been exempt in India. In the United Kingdom, on the other hand, they have been exempt only in respect of such profits as result from public services within the area of the local authority, the argument being that such profits are not profits at all and merely represent the surplus paid by the persons constituting the local body, *i.e.*, the local citizens.[3] Local authorities have to pay income-tax on 'property', on investments and on profits made by selling gas, water, etc., to areas outside the jurisdiction of the authorities. The essential thing to bear in mind in grasping this distinction between the United Kingdom and India is the difference

(1) (1897) A. C. 11.

(2) *The King* v. *Commissioners for the Special Purposes of the Income-tax Acts* (*Ex-parte Dr. Barnardo's Homes National Incorporated Association*), (1921) 2 A. C. 1; 7 Tax Cases 646.

(3) See *Dublin Corporation* v. *MacAdam,* 2 Tax Cases 387.

in the historical setting of the two countries. Local authorities in India to-day are almost all of them creations of Government, whereas most local authorities in the United Kingdom are of long standing and have submitted only in recent years to control by Government and only because they depend on Government for subsidies.

(*iv*) Interest on securities which are held by, or are the property of, any Provident Fund to which the Provident Funds Act, 1897,[1] applies, * * *[2]

Exemption of Provident Funds—

Under section 4 (3) (*iv*) the interest on securities held by certain provident funds, under section 4 (3) (*v*) capital sums paid as accumulated balances at the credit of subscribers to such funds, and under section 15 (1) contributions paid by subscribers to such funds up to a certain limit are exempt from the tax. The words "accumulated balance" are intended to include not only contributions and subscriptions but also interest thereon. These provident funds are only those to which the Provident Funds Act of 1897 applies, that is, the provident funds of public servants or *quasi*-public servants, the constitution and control of which are regulated by the Provident Funds Act and the rules made thereunder. The exemption granted to Provident Funds which comply with the provisions of the Provident Insurance Societies Act, 1912, or which have been exempted from the provisions of that Act has been withdrawn by the Income-tax (Amendment) Act, 1924 (XI of 1924). Provident Insurance Societies to which the Provident Insurance Societies Act applies, or which have been exempted from its provisions and which were in existence before the 1st April, 1924, will continue to enjoy the exemptions under section 4 (3) (*iv*) and (*v*) and section 15 (1), to which they were entitled under Act XI of 1922, before it was amended by the Act XI of 1924. These concessions cannot be claimed by any other Provident Insurance Societies. Nor can they be claimed by any private provident funds whatever, irrespective of whether they had previously been exempted by Local Governments, by a general or special order, from the provisions of the Provident Insurance Societies Act, 1912.

These remarks refer to the money in the funds and to the payment by subscribers and contributions made by employees to

(1) *See* now Act XIX of 1925.

(2) The words "or any Provident Insurance Society to which the Provident Insurance Societies Act, 1912, is, or, but for an exemption under that Act, would be, applicable" were omitted by section 4 of Act XI of 1924.

these funds. The contributions by *employers to Provident Funds* stand on a totally different footing, and are dealt with in paragraph 45, but the special privileges conferred by these particular sections do not apply to any funds which have not a recognised legal footing.

A special exemption has been granted (see exemptions under section 60) in the case of Railway Provident Funds, but this applies only to the gratuities paid out of these funds in the event of the retirement or death of the subscribers. (Income-tax Manual, para. 18.)

Meaning of the word "securities" as used in section 4 (3) (iv)—

The definition of the phrase "interest on securities" in section 8 of the Act, should not be applied to determine the interpretation to be given to these words in section 4 (3) (*iv*), since the words as used in section 8, are in a specially restricted sense, and do not cover, for example, interest on so typical a form of security as a mortgage. Nor should the meaning of the word "securities" in section 4 (3) (*iv*) be restricted to the ordinary limited legal sense, in which it must always have reference to a loan. Provident Funds are entitled to invest in any trustee security, and it has not been the intention of Government to discriminate between the various classes of investments which are thus legally authorised. The word "securities" in section 4 (3) (*iv*) should therefore be interpreted as covering all securities mentioned in section 20 of the Indian Trusts Act. (Income-tax Manual, para. 19.)

The Provident Funds Act of 1897 has been repealed by the Provident Funds Act, 1925 (XIX of 1925), which is now in force. The Act applies to all Government and Railway Provident Funds and to such provident funds as may have been established for the benefit of its employees by any local authority as defined in the Local Authorities Loans Act, 1914, to which the Local Government may by notification extend the Provident Funds Act.

The exemption in this sub-section was formerly given by Notification. In 1918, the exemption was incorporated in the Act.

Also see notes under section 8.

(*v*) Any capital sum received in commutation of the whole or a portion of a pension, or in the nature of consolidated compensation for death or injuries, or in payment of any insurance policy, or as the accumulated balance at the credit of a subscriber to any such Provident Fund.

Capital sums—Insurance policies, etc.—

The exemption was formerly given by Notification under the Act of 1886.

The insurance policy need not necessarily be a life insurance policy, but as regards insurance against loss of profits, or loss of circulating capital, *e.g.*, trading stock,—see notes under section 10 (2) (iv).

While commuted values of pensions are exempt, lump sum gratuities in lieu of pension are taxable under section 7, except gratuities received by Railway servants, which have been specially exempted under section 60. The position is anomalous and presumably due to the fact that the framers of section 7 had in mind recurring gratuities, *i.e.*, voluntary payments forming perquisites of office and not the lump sum gratuities that are often paid in lieu of pensions, *e.g.*, to Government servants who have not rendered sufficient service to entitle them to a pension.

The word ' insurance ' has not been defined in the Act.

" There is no magic in the words insurance or guarantee; whether the transaction is the one or the other, depends on the character of the contract itself."[1]

From the use of the word ' such,' it will be seen that the provident funds contemplated by this clause are the same provident funds as those contemplated in the previous clause, namely, those to which the Provident Funds Act applies. It follows therefore that the concession given in this clause, does not apply to private provident funds in commercial houses, etc. In these provident funds it has been arranged by executive orders that if the provident funds are constituted under an irrevocable trust over which the employers have no control, the contributions made by the employers may be treated as admissible deductions from business profits, under section 10 (2). So far as the employees' contributions are concerned, they are not entitled to any exemption from income-tax under section 7, when they are deducted every month from the pay. The capital sum accumulated from such contributions paid by the employee will be automatically exempt when the money is withdrawn on the ground that the accumulation is capital and not income. But the portion which represents the employer's contribution, will be taxed when the accumulation is withdrawn from the provident fund. Such accumulation forms part of the income of the employee in the year in which the money is withdrawn. A more appropriate and equitable arrangement would, no doubt, be to tax the employer's con-

(1) *Per* Romer, J. in *Seaton* v. *Heath*, (1899) 1 Q. B. 782 (Stroud).

tributions for each year, assuming that the fund has been constituted under an irrevocable trust, as part of the income of the employee for that year, but the present law does not provide for it. As the law stands, they can not be treated as part of the employee's income in the year in which the employer makes the contribution because the contributions do not reach the employee at once and may not, in some cases, reach him at all. See however *Smyth* v. *Stretton*[1] cited under Sec. 4 (3) (*vi*) *infra.*

(*vi*) Any special allowance, benefit or perquisite specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit.

In the 1886 Act, the corresponding provision was partly contained in the definition of 'salary' which ran as below :—

> " Includes allowances, fees, commissions, perquisites or profits received in lieu of or in addition to a fixed salary in respect of an office or employment of profit, but subject to any rules which may be prescribed in this behalf, it does not include travelling, tentage, horse or sumptuary allowances, or any other allowance granted to meet specific expenditure."

Perquisites or benefits not capable of conversion into money—

The provision in section (3) (2) (*ix*) of the Act of 1918 that "any perquisite or benefit which is neither money nor reasonably capable of being converted into money" was not liable to tax, has been omitted in the Act, as the existence of that provision made it impossible to assess to income-tax, for example, rent-free residences, in cases where the assessee had not the power to sub-let, while rent-free residences were liable to the tax, where the assessee had the power to sub-let. An explanation has been added to section 7 (1) of the Act specifically providing for the taxation of perquisites in the form of rent-free residences.

Under section 7 (1) of the Act, all perquisites received by an employee in lieu of or in addition to salary or wages, are liable to the tax. House-rent allowances and the value of rent-free quarters, form additions to the remuneration of an employee; and even where residence in a particular town or building is necessary for the proper performance of the employee's duties, such allowances or perquisites cover expenses of a personal character which the employee would otherwise have to incur. They do not therefore "meet expenses wholly and necessarily incurred in the per-

(1) 5 Tax Cases 36.

formance of the duties of an office or employment of profit," and are therefore not covered by the exemption in section 4 (3) (*vi*) of the Act, and are taxable under section 7 or section 12.

Two conditions have to be fulfilled before the exemption specified in section 4 (3) (*vi*) can apply. The expenses incurred by the employee must be wholly and necessarily incurred in the performance of his duties as an employee, and the allowances or perquisites must have been granted by the employer with the said purpose of meeting the extra expense thus caused to the employee, and *that* extra expense only. It is thus a question of fact in each case whether a house-rent allowance or the value of rent-free quarters, is exempt from the tax, but the following examples will serve to indicate the lines on which the decision should be made :—

(*a*) A currency officer is granted rent-free quarters in his currency office. Even though his residence in that office is necessary for the proper performance of his duties, he will be liable to the tax on the value of his rent-free quarters, since he would in any case have had to provide himself with a residence, and the perquisite does not therefore meet expenses wholly incurred in the performance of the duties of an office or employment of profit.

(*b*) A firm in Calcutta makes a practice of providing its employees with rent-free quarters, and houses some of its employees in its business premises as resident clerks. The employees of the firm, including the resident clerks, will, as in the previous case, be liable to income-tax on the value of their rent-free quarters.

(*c*) A Government office has its headquarters in Bombay, but proceeds for some months in the year elsewhere, and grants its ministerial establishment house-rent allowances or rent-free quarters in the place to which it proceeds, with the specific object of providing for the maintenance of a second and, from the point of view of the grantees, unnecessary residence in order that they may perform their duties there. The allowance or the value of rent-free quarters will be exempt from income-tax.

In all cases where rent-free houses form part of the perquisites of an employee, the cash value of such a house to the occupier should, in no case, be deemed to be more than 10 per cent. of the salary of the employee.

The "Delhi moving allowance" and "Delhi Camp allowance" which are granted to the members of the office establishments of the Army Headquarters and of certain civil attached offices of the Government of India, during the period of their stay at Delhi, and the Simla House-rent Allowance granted under Rule 19 of the Simla Allowances Code and the value of rent-free quarters in lieu thereof, fall under example (*c*) above, and are exempt from the payment of income-tax special allowances granted solely to meet the higher cost of living in a station, such as compensatory local allowances and the Cutch exchange compensation allowance are liable to the payment of tax. (Income-tax Manual, para. 20.)

Wholly and necessarily—

The words 'wholly and necessarily' are stricter than the word 'solely' used in sections 10 (2) (ix), 11 (1) and 12 (1). That is to say, while in respect of income from business, profession or other sources, a deduction may be made on account of expenditure wholly incurred for the purpose of earning the income, in the case of salaried persons a deduction may be made only if the allowance is given for meeting expenditure which is not only wholly incurred in the performance of the person's duties but also *necessarily* incurred.

Expenses—

Means actual disbursements, not allowances for loss of time (*Jones* v. *Comorthen*).[1] The position is made clear, in the subsection, by the word "incurred". "Incurred" can only mean that there has been, or would be, an actual outgo, and notional expenditure cannot be 'incurred' except by express provision to that effect. Actual outgo, however, need not be in cash; it will all depend on the method of accounting adopted by the assessee.

Perquisite—

The word dates from feudal times, and meant casual income arising to a feudal chief (see Stroud). The meaning of the word was considered in *Tennant* v. *Smith*[2] which decided that a 'perquisite' should be capable of conversion into money before it can be taxed. This was the law in India also till 1922, and there was a clause in the corresponding section in the Act of 1918 exempting 'perquisites not capable of conversion into money'. This was given up in 1922. Doubts however were felt as to the meaning of section 7 in the present Act, and the explanation under it was added to remove them; see notes under section 7 (1).

(1) 1 O. L. J. Ex. 401.
(2) (1902) A. C. 150; 3 Tax Cases 158.

In *MacDonald* v. *Shand*[1] in which the question was whether a 'perquisite' should be taxed on the year's income as part of salary or on an average of 3 years (this question cannot arise in India), Lord Birkenhead said : "Infinite disputation is possible as to what, in different contexts, may be the proper connotation of a term such as 'perquisite'. In one context it may have a bad or an irregular connotation; in another it may be normally ranged under payments which are both frequent and regular in commercial transactions."

Uniform—Grant—In lieu of—

A detective-sergeant in the employment of a Municipal Corporation, was assessed on his salary which included a cash allowance given to him for clothing in lieu of free supply of uniform. The clothing which the officer must purchase with the cash allowance was specified, and was subject to the approval of a superior officer. The allowance for clothing was not regarded as income for superannuation purposes, and, apart from this allowance, detective officers received the same rates of pay as uniformed officers. *Held,* that the allowance was a payment accruing to the assessee by reason of his office and was assessable to income-tax; *Fergusson* v. *Noble.*[2] The Court suggested, hower, that it would only be fair to permit such detectives to deduct from their income the expenditure incurred by them in making clothes suitable for their duties, and this is reported to be actually allowed in the United Kingdom in practice, though it cannot be claimed legally.

Provident Scheme—Employee's Contribution—

A sum of £35 was placed to the credit of the assessee—a teacher in Dulwich College, under the Provident Scheme for the Assistant Masters of the College. Of this sum, no part was payable until the assessee left the College, or until his decease; he could not raise money on it; and as regards one moiety, payment was contingent on a certain length of service and on good conduct. *Held,* that the whole sum was a taxable addition to the assessee's salary.[3]

Boarding—Cost of—Deduction from wages—

A man and his wife were employed at an asylum at separate fixed salaries payable weekly, but were given board, lodging, etc., the necessary deductions being made from their wages.

(1) 8 Tax Cases 420.
(2) 7 Tax Cases 176.
(3) *Smyth* v. *Stretton,* 5 Tax Cases 36.

Held, that the assessees should be assessed on their gross income.[1]

Per Rowlatt, J.—"These (*i.e.*, cases like *Tennant* v. *Smith*) are the cases in which there is a fixed salary paid plus something else. (But) if we get a case where a person is paid a salary and . . . . out of that salary has to pay a counter amount to secure himself some necessaries . . . . there is no relevance in the question whether what he gets by the counter payment can be disposed of for money. . . . . He has been paid a salary, and what he does with the salary is immaterial."[2]

Clergyman—Necessary expenses—

A minister of the Church of Scotland was allowed to deduct—

(1) expenses actually incurred in visiting the members of his congregation living beyond the limits of his parish;

(2) travelling expenses incurred in the discharge of duties imposed on him by his ecclesiastical superiors;

(3) cost of stationery; and

(4) communion expenses; but not the cost of books or the rent of the part of his house used for his work.[3]

Clergyman—Expenses of removal from one curacy to another—

The expenses incurred by a curate removing from one curacy to another which he had taken up, were held not to be expenses incurred wholly, exclusively and necessarily in the performance of his duties as a curate, and were, therefore, inadmissible as deductions in arriving at his liability to income-tax.[4]

Motor-cycle—Cost of—For going to place of work—

A storekeeper employed by a shipbuilding company contended that, owing to the abnormal shortage of houses in that town, he was compelled to take a house at some distance outside, and claimed to deduct from his salary the expenses of maintaining a motor-cycle to get to his work. The General Commissioners on appeal allowed the deduction sought; but the Crown appealed against this. *Held*, that the expenses in question were not incurred in the performance of the duties of the office, and that the deduction claimed was not admissible.[5]

Domestic servant—To take place of mistress—

A man and his wife were appointed master and mistress of a school on a joint salary. The master claimed a deduction of

(1) *Tennant* v. *Smith*, 3 Tax Cases 158, distinguished.

(2) *Cordy* v. *Gordon*, 9 Tax Cases 304.

(3) *Charlton* v. *Commissioners of Inland Revenue*, C. S. 1890—27 Sc. L. R. 647.

(4) *W. Friedson* v. *The Rev. F. H. Glyn-Thomas*, 8 Tax Cases 302.

(5) *Andrews* v. *Astley*, 8 Tax Cases 589.

£30 in respect of the cost of a domestic servant employed to carry on the duties of his household while his wife was engaged at the school. *Held,* that this was not an expense incurred in the performance of the duties of the offices of master and mistress of the school.[1]

Clergyman—Expenses of—

A clergyman claimed deduction in respect of his expenditure on (1) Horse and Carriage, (2) Communion Elements, (3) Process of Augmentation, and (4) Pulpit Supply during holidays. The Commissioners had only allowed so much of the amounts claimed under heads (1) and (2) as they were satisfied had in fact been incurred "wholly, exclusively and necessarily in the performance of his duty", and had altogether disallowed the amounts claimed under heads (3) and (4). *Held,* as regards (1) and (2) that the amount allowable was a question of fact, and that the finding of the Commissioners thereon was final, and, as regards (3) and (4) that the allowance had been rightly refused.[2]

Recorder—Travelling expenses of—

A member of the Bar who resided and practised in London was appointed as Recorder of Portsmouth. He claimed as deductions from his assessable income the expenses incurred by him in travelling from London to Portsmouth and back, and hotel expenses at Portsmouth. *Held,* that the deductions were inadmissible.

Per Lord Chancellor Cave.—" . . . They are incurred, not because the appellant holds the office of Recorder of Portsmouth, but because, living and practising away from Portsmouth, he must travel to that place before he can begin to perform his duties as Recorder, and, having concluded those duties, desires to return to his home. They are incurred not in the course of performing those duties but partly before he enters upon them, and partly after he has fulfilled them. . . . .

" A man must eat and sleep somewhere, whether he has or has not been engaged in the administration of justice. Normally he performs those operations in his own home, and if he elects to live away from his work so that he must find board and lodging away from home, that is, by his own choice, and not by reason of any necessity arising out of his employment; nor does he, as a rule, eat or sleep in the course of performing his duties, but either before or after their performance. . . . . ."

Per Lord Blanesburgh.—" . . . . Undoubtedly its most striking characteristic is its jealously restricted language, some of it repeated apparently to heighten its effect. . . . . ."[3]

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(1) *Bowers* v. *Harding,* 3 Tax Cases 22.

(2) *Jardine* v. *Gillespie,* 5 Tax Cases 263.

(3) *Ricketts* v. *Colquhoun,* 10 Tax Cases 118.

Boarding—Cost of—

A was entitled to pay at £30 plus free board, lodging, washing and uniform valued at £40 per annum. Later on, the free allowances with the exception of the uniform were abolished, and an increased rate of pay given, but the cost of food, etc., was deducted from the pay every week. *A* claimed that the board, lodging, etc., were not convertible into money and that only the net money received after deduction for food, etc., should be taxed. The General Commissioners held that *A* had not entered into any fresh contract for service when the method of remunerating him was changed and that his claim was correct. *Held,* that the Commissioners were wrong and that the gross salary should be taxed.[1]

Per Rowlatt, J.—"If a person is paid a wage with some advantage thrown in, you cannot add the advantage to the wage for the purpose of taxation unless that advantage can be turned into money. . . . . But when you have a person paid a wage with a necessity—the contractual necessity if you like—to expend that wage in a particular way, then he must pay tax upon the gross wage, and no question of alienability or inalienability arises . . . . the question is whether he is paid a wage, part of which he has to expend in a particular way by way of counter account, or whether it is that he receives as his wages the net sum after allowing these amounts. . . . ."[2] (Confirmed by the Court of Appeal.)

Perquisites—Not capable of conversion into money—Free residence—Value of—Whether income—

A banking company assigned to its agent, as a residence, a portion of the bank premises occupied by them, in respect of which they were assessed to income-tax. The agent was required to reside in the buildings as the servant of the bank, and for the purpose of performing the duty which he owed to his employers. *Held,* that the value of the residence was not an emolument of office in respect of which the agent was chargeable with income-tax; and was not to be included in estimating the total amount of the agent's income, for the purposes of a claim of abatement.[3]

A Minister of the Free Church of Scotland claimed that the annual value of the manse occupied by him which was vested in trustees and which he could not let was not to be taken into account in calculating his total income for the purposes of his

(1) *McLoughlin* v. *Machon*, 5 A. T. C. 381 (C. of A.).
(2) *Cordy* v. *Gordon*, 9 Tax Cases 304; *Bell* v. *Gribble*, 4 Tax Cases 522, followed.
(3) *Tennant* v. *Smith*, 3 Tax Cases 158 (H. of L.).

abatement. *Held,* that the annual value of the manse did not form part of his income for such purposes.[1]

(These decisions are not applicable to India in their entirety, in view of the explanation to section 7 (1); *see* notes on that section....).

In another case, in which also, a minister of the Established Church claimed that the annual value of his manse was not to be taken into account in calculating his total income for the purpose of his abatement but he could let the manse it was held that the annual value of the manse formed part of his income for such a purpose; and *M'Dougall* v. *Sutherland* was distinguished.[2]

(*vii*) Any receipts, not being receipts arising from business or the exercise of a profession, vocation or occupation, which are of a casual and non-recurring nature, or are not by way of addition to the remuneration of an employee.

History—

Section 4 (3) (*vii*) was introduced at the instance of the Select Committee, in 1918, to remove doubts. There was no express provision under the previous law, *i.e.*, of 1886, except to a certain extent indirectly, in the definition of 'salary', and there are no decisions on the subject under that Act. In practice, such income was most probably not taxed, considering the imperfect administrative machinery at that time.

Casual gains—

In order to obtain exemption as "casual", profits must comply with two conditions—

(1) they must not be the proceeds of a profession, vocation or employment, or arise from business, that is, from "any venture or concern in the nature of trade, commerce or manufacture." [*See* section 2 (4)], and

(2) they must not be annual.

Both these conditions must be fulfilled. The exemption also is specifically not to apply to any gratuity to an employee for services rendered, so as to avoid the possibility of any ambiguity in connection with the use of the word "gratuity" in section 7 (1). The following are illustrations of the effect of the provisions of section 4 (3) (*vii*) :—

(1) *M'Dougall* v. *Sutherland,* 3 Tax Cases 261.
(2) *Corke* v. *Fry,* 3 Tax Cases 335.

(1) *A* purchases a house with a view to re-selling it at a profit. His profits from the transaction are liable to income tax (even although it be an isolated transaction). *B* purchases a house for his own residence, and later on, sells it at a profit. His profit is not liable to the tax.

(2) *A* wins a prize in a lottery, or a bet on the race-course. His receipts therefrom are not taxable. *B* is a book-maker. His profits from betting are taxable.

(3) *A* is a professional beggar. His receipts from mendicancy are not exempted from the tax by this sub-section.

(4) *A* makes a practice of speculating in the purchase and sale of shares. His profits therefrom are liable to the tax. *B* purchases Indian War Loan 1929-1947 at 95 redeemable at par. The premium received on redemption after a period of years is not liable to the tax. On the other hand, the yield from Treasury Bills, arising from their issue at a discount and repayment at par after 12 months or some shorter period is liable to the tax under section 12, though, as this yield is not interest, the tax is not deducted at the source under section 18 (3).

(5) A man writes a book. His receipts from its sale are taxable.

(6) Lump sum legacies are exempt; annuities granted under a will are not exempt. (Income-tax Manual, para. 21.)

Casual—

Condition (2) in the above, is based on the English law. 'Casual' in the Indian Act, does not mean the same as "not annual". According to Murray's New English Dictionary, 'casual' means—

> "subject to, depending on or produced by chance; accidental fortuitous; occurring or coming at uncertain times; not to be calculated on, uncertain, unsettled, occurring or brought about without design or premeditation, coming up or presenting itself 'as it chances.'"

As to the meaning of the word 'annual', however, see *Ryall v. Hoare* cited *infra.*

Non-recurring—

As to the meaning of the word 'non-recurring' *see* decisions cited *infra,* and particularly *In re Chunilal Kalyan Das.*[1] There is nothing in the Indian law to prevent receipts recurring within the same year but not arising out of a business, vocation, etc., being taxed, even though the receipts may not recur

(1) 1 I. T. C. 419.

beyond the year; and the above instruction, in the Income-tax Manual, perhaps goes beyond the law in exempting such income.

Continuity of transactions—

Example (2) in the Income-tax Manual above. Even an outsider—not a book-maker—can be taxed if the transactions are so continuous as to suggest that betting is a regular occupation of the person, or if the profits from betting come to him regularly—see however *Graham* v. *Green* cited below.

Example (5).—This is based on the assumption that a person who writes a book exercises the vocation of authorship. But a person who writes a book, or invents machinery once in his lifetime, and sells the copyright or patent outright for a lump sum, cannot be taxed on the receipts, because that would be a capital receipt. But if the person writes more than one book, or invents more than one appliance or machine, or if the book or invention is such that it can be reasonably inferred that he could not have done the work except as part of his normal profession or vocation, the income would clearly be taxable.

Profession—

Per L. J., Scrutton in *Inland Revenue Commissioners* v. *Maxse*.[1]

"It seems to me, as at present advised, that a profession, in the present use of language, involves the idea of an occupation requiring purely intellectual skill or manual skill, controlled, as in painting and sculpture or surgery, by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production or sale or arrangements for the production or sale of commodities. . . . It appears to me clear that a journalist whose contributions have any literary form, as distinguished from a reporter, exercises a 'profession'; and that the editor of a periodical comes in the same category. It seems to me equally clear that the proprietor of a newspaper or periodical, controlling the printing, publishing and advertising but not responsible for the selection of the literary or artistic contents, does not exercise a 'profession' but a trade or business. . . ."

Occupation—

'Occupation' means the 'Trade or calling by which a person seeks his livelihood'[2] or the business in which he is usually engaged to the knowledge of his neighbours (*ibid*) and the statement of which would be 'sufficient to identify him to persons who have had dealings with him'.[3] (The above with reference to the Bills of Sale Acts). Under the Libel and Registration Act, when

(1) (1919) 1 K. B. 647, 12 Tax Cases 41.
(2) *Luckin* v. *Hamlyn*, 31 L. T. 366.
(3) *Throssell* v. *Marsh*, 53 L. T. 321.

applied to a person, it means his trade or following (Stroud). In interpreting restrictive covenants, it has been held that teaching or carrying on a school is a 'calling', notwithstanding that the calling may be under an illegal organisation, *e. g.*, Society of Jesus.[1]

Vocation—

"I do not think 'employment' necessarily means a case in which a person is set to work by other men to earn money. A man may employ himself in order to earn money in such a way as to come within that definition, but I think the word 'vocation' is a still stronger word. It is admitted to be analogous to the word 'calling' which is a very large word: it means the way in which a man passes his life and it is a very large word indeed. . . . In my opinion, if a man were to make a systematic business of receiving stolen goods . . . . the Income-tax Commissioners would be quite right in assessing him. . . . There is no limit as to its being a lawful vocation."[2]

"'Vocation' and 'calling' are synonymous terms, and if anybody were asked what was the calling or vocation of these gentlemen, the answer would be 'professional book-makers'. . . . ."[3]

Remuneration —

Is a wider term than salary (see Stroud). It means a 'quid pro quo' for service rendered. If a person was in receipt of a payment or a percentage or any kind of payment, which would not be an actual money payment, the amount he would receive annually in respect of this, would be 'remuneration'.[4]

Law in the United Kingdom—

The United Kingdom law is as below. There is no specific exemption in the Acts in the United Kingdom, as in India, of casual income, but the profits may be taxed only if (i) they arise from a 'trade'—Schedule D, Case I; or (ii) are *annual* profits or gains from other sources—Schedule D, Case VI; or (iii) arise from a vocation, occupation, profession or employment—Schedule E or Schedule D, Case II. (Other items in the Schedules are hardly relevant for the purpose).

'Trade' means, for this purpose, practically the same as 'business' under the Indian law. Tax under Case I, Schedule D, was till recently levied on an 'average' basis of 3 years, and set-off is also allowed of losses in other trades in the same year. But under Case VI, neither concession is allowed.

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(1) *Galwey* v. *Barden*, (1899) I. L. R. 514.
(2) Per Denman, J., in *Partridge* v. *Mallandaine*, 2 Tax Cases 129.
(3) Per Hawkins, J., *ibid*
(4) Per Blackburn, J., in *R.* v. *P. M. G.* 1 Q. B. D. 663.

Whether particular transactions constitute a 'trade' or not, has been held to be a question of fact. In *Graham* v. *Green*[1] (cited below)—the General Commissioners held that the profits from backing horses, were in the circumstances of that case, liable to income-tax. Rowlatt, J., reversed the decision, and the Crown did not appeal. In *Stubbs* v. *Cooper*[2] (cited below)—the Special Commissioners held that the profits from speculating in cotton futures, were not, in the circumstances of that case, liable to income-tax—whether under Case I or VI;—not liable under Case I, because there was not sufficient continuity in the business to constitute them into a 'trade'; nor under Case VI because they were pure gambling transactions, *i.e.,* irregular, and not recurring at intervals. Rowlatt, J., reversed the finding, and held that the profits were from trade, (Case I) but the Court of Appeal (the M. of R. dissenting) reversed the decision of Rowlatt, J., on the ground that the question was one of pure fact. As regards the second part of the finding of the Commissioners, which involved a question of law, the Court of Appeal held that the profits were taxable under case VI as 'other annual profits' *i.e.,* not from trade. (The M. of R. considered that a question of law was involved in the finding as to 'trade', and that Rowlatt, J., rightly reversed the decision of the Special Commissioners). It was observed in this case :

Per Atkin, L. J.—"I think that the principle, in respect of wagering is this, that it takes two parties to make a bet."

But where a cotton-broker enters into a speculative transaction in futures with a cotton dealer, at all events one of the parties is not betting, and the transactions are not therefore purely wagering transactions, as they rest upon "real and enforceable contracts in which the differences could have been sued for, on one side or the other." The distinction sought to be made is not very clear. The real distinction evidently is not that it takes two persons to make a betting contract, but that a betting contract is one which cannot be enforced in law. If that is so, *i.e.,* assuming that it is a relevant consideration in determining whether the transactions constitute a 'trade' or 'business', profits from betting cannot be taxed except under the head 'professional earnings' as profits and gains from a profession, as in the case of a book-maker. Other profits on speculative transactions would be taxed under

(1) 9 Tax Cases 509.
(2) 10 Tax Cases 29.

Case I or VI, according as the transactions constituted a 'business' or not.

As to how far speculative transactions constitute 'trade', Atkin, L. J., said :

"For my part I see some difficulty in trying to form an opinion of a trade which consists of entering into transactions which would merely result in differences, and when the supposed trader never intends to get possession of any commodity so that he may in fact have the disposal of it by himself or to any third party."

See also the notes under 'business'—Section 2 (4).

The meaning of the word 'annual' as used in the English Income-tax Act schedules with reference to 'annual profits and gains', was discussed in great detail by Rowlatt, J., in *Ryall* v. *Hoare* cited *infra.*

Rewards—Examinations—Prizes, etc.—

A somewhat difficult case, though of no importance from the fiscal point of view, is the taxation of rewards granted by an employer to his employees for passing examinations, etc., or fees paid to examiners, etc. That such receipts are, generally speaking, casual and non-recurring is obvious, though, in respect of fees from examinations, cases may and do arise, in which such fees are recurring. Assuming that the income in question is casual and non-recurring, it is often a difficult question to decide whether the rewards or fees arise from a profession or occupation. If, for instance, the passing of an examination is obligatory, the income undoubtedly accrues by virtue of the assessee's office, and is therefore taxable as salary. If, on the other hand, the passing of the examination is optional, it may still be income arising from his profession. It is irrelevant for the purpose whether the income is of such a nature that the recipient can sue and recover it or not. The point is that the income should be by virtue of the office or profession. This, of course, is essentially a question of fact. Thus, even if the examination was optional, it still might be that the reward received by the examinee, arose out of his office, if a person not holding the office would not be eligible for the reward.

Rewards for arresting or tracing offenders, would not be taxable, if paid to a person whose ordinary duty was not that of arresting or tracing offenders, but if paid to a man whose main duty was that, for example, to a Police Officer, or an Excise or

(1) 8 Tax Cases 521.

tax paid by every honest trader. Section 6 (4) provides the head of income chargeable in respect of business. The mere fact that the business is speculative, or even gaming and wagering within the meaning of that expression, does not make it any the less business. For example, supposing the question was one of profit made by a book-maker, as to whose business there can be no doubt whatever that it is entirely gaming and wagering. Section 11 provides that the tax shall be payable under the head of professional earnings in respect of the profits of any vocation followed by the assessee. In the year 1886 the English Courts decided, and the decision has never been called in question, that a book-maker attending a race-course was carrying on a vocation.[1] Where both the word 'business' and 'vocation' are used, it may be appropriate to describe a book-maker's business as a vocation, but the greater includes the less, and it is clearly included in the word 'business' in our opinion. The same view seems to have been taken in the text books on the subject with regard to the vocation of singer or prostitute, and the Calcutta High Court in the case of *Birendra Kishore Manikya* v. *Secretary of State for India*[2] held that illegal cesses were assessable to income-tax. No doubt a burden is placed on the Income-tax Officer to discover how far losses returned by assessees may be genuine, or to what extent an assessee may have attempted to conceal gain, but that is what the Department is there for. Although it is not strictly relevant, we may point out that any other view would result in an enormous burden being placed upon the income-tax authorities, namely, of deciding in every single transaction which appeared in the books of any assessee in their jurisdiction to be of a speculative nature, whether it was a gaming transaction within the meaning of the Contract Act, and therefore against public policy. That question is an extremely difficult question to decide in many cases. A large number of merchants and other people carry on extensive business of a speculative nature, which is not hit by the section in the Contract Act with regard to gaming, because, although the transaction may result in differences, the legal effect of the contract may be to entitle the party to actual delivery. It is none-the-less speculative in character, and anybody concerned with the daily business of the courts knows how difficult it is sometimes to ascertain whether a speculative transaction is really a gaming one or not. All such transactions, in our opinion, are business, and the profits arising therefrom are taxable under this Act."

Betting—Book-maker—Profits of—

A person who attends races, and systematically bets, is liable in respect of the profits he derives from the vocation of betting, *i.e.*, that of a book-maker.[1]

On the other hand, in the case of a person whose sole means of livelihood was betting on horses, from his private residence, with book-makers at starting prices, it was *held* that the earnings

(1) *Partridge* v. *Mallandaine*, 18 Q. B. D. page 276.
(2) 1 I. T. C. 67.

were neither profits nor gains.[1] The *ratio decidendi* was that there must be a certain amount of organisation before there could be profits or gains. The question is arguable, and the judgment of Rowlatt, J. is reproduced below almost *in extenso*.

Per Rowlatt, J.—"The question arises under Case II and under Case VI of Schedule D. It arises under Case VI upon the question whether the winnings on his bets, as bets, are profits or gains within the meaning of that case. It arises under Case II on the question as to whether, assuming the winnings from the bets themselves are not profits or gains, the aggregate of his winnings as the result of his sustained and continued action, are the profits or gains of a vocation within the meaning of Case II, or possibly it might have been put, a trade or adventure within the meaning of Case I; it is the same question, really.

"Looking first at Case VI, one is faced with the difficult question of what is profit or gain. I asked the Solicitor-General to tell me what was the essential characteristic of a profit or gain, and the only answer which I was able to obtain from the Solicitor-General was that it was a question of fact, which seems to me merely to be a polite way of saying that he had no observation to offer on the point.

"My attention, of course, was drawn to my decision in *Ryall* v. *Hoare*,[2] which was the case of a gentleman who had guaranteed an overdraft for a company of which he was a director; he got a commission for it, and that is the only time in his life he ever did anything of the sort. The question before me there, was not whether a commission paid to a man for a service of this kind, was a profit or gain in itself, which it obviously was for commercial services rendered, but whether it was an *annual* profit or gain. In the course of my judgment, I said that a mere receipt by finding an object of value, or a mere gift, was not a profit or gain, and I hardly feel much doubt about that. I further said that the winning of a bet did not result in a profit or gain. Until I am corrected, I think I was right in that. Whether it is a gift, or whether it is a finding, there is nothing of which there is a profit. There is no increment, there is no service, there is merely the picking up of something either by the will of the person who had it before, or because there is no person to oppose the picking up.

"When you come to the question of a bet, it seems to me, the position is substantially the same. What is a bet? A bet is merely an irrational agreement that one person should pay another person something on the happening of an event. *A* agrees to pay *B* something if *C*'s horse runs quicker than *D's* or if a coin comes one side up rather than the other side up. There is no relevance at all between the event and the acquisition of property. The event does not really produce it at all. It rests, as I say, on a mere irrational agreement.

"So much for Case VI. But then there is no doubt that if you set on foot an organised seeking after emoluments which are not in them-

(1) *Graham* v. *Green*, 9 Tax Cases 311.
(2) 8 Tax Cases 521.

Opium Officer or a Customs Officer, these rewards would undoubtedly be taxable, as they would arise from the office or profession. A prize given for an essay would not be taxable but not so the premia received by, say, an architect, who frequently tendered plans invited by public competition. Similarly, fees for setting or valuing examination papers, would clearly be taxable if such duties were part of the assessee's professional or other duties. Even if it was not part of his official duties, a person who is an expert in a subject, and who is frequently called upon to examine in it, would still be taxable, but the tax would be not a part of 'salary', but 'income from other sources'. Examples of this would be a professor in a college setting papers for a University, or a lawyer setting papers in law. Border-line cases are easily conceivable, for example, a Government servant, say, a policeman setting a paper for a University in a subject like Mathematics or History, for a number of years in succession. In such a case, the presumption would be that he was an expert in that particular subject, and exercised the vocation of an examiner. Fees for giving expert evidence are clearly taxable, as they undoubtedly arise from the exercise of a profession. Similarly, fees paid to a Government servant for doing work for local bodies, which are first credited to Government, and then paid to the officer, are clearly taxable as part of the salary, and so also honoraria paid by Government to its officers.

Gifts—Recurring—

The position of a recurring voluntary gift is different in the United Kingdom and in India. In the former country two conditions are necessary before such income can be exempted :—

(1) it should not arise from a profession, vocation or business;

(2) it should not be annual profits or gains. Condition (1) is the same in India also, but (2) is different, the corresponding condition being that it should be 'casual and non-recurring'; but it need not be 'profits or gains' to make it liable to tax though it must be income and not 'capital'. The word used is 'receipts', not 'profits or gains'. An allowance granted by a father to his son, would clearly not be taxable under the United Kingdom law, as both the conditions above referred to, would be satisfied. Such an allowance, though 'annual', would not be 'profits or gains'. In India, on the other hand, the second condition of exemption would not be satisfied, as the gift would be

'receipts' or 'income' though not 'profits or gains', and it would not be non-recurring. 'Receipts' and 'income' are wider expressions than 'profits or gains.' In practice, however, it is doubtful if Income-tax Officers tax such gifts.

Legacies—

During the discussion in the Assembly when the present Act was passed, it was suggested that legacies should be expressly exempted, Mr. G. G. Sim replied on behalf of Government as below :

"Sir, this point was discussed in the Joint Select Committee, and they were advised by the legal authorities consulted that legacies were clearly covered by sub-clause (3) (vii) of the Bill. The insertion of the word 'legacies' would, I think, throw a doubt on the question of whether sums similar to legacies, such as gifts, are also included if they are not specifically mentioned. I am not a lawyer, Sir, but I would abide by the advice which was given by my lawyers."

The above refers to lump sum legacies; as regards recurring payments under wills, see section 12. Such payments are clearly taxable both in India and in the United Kingdom, though the machinery of taxation is different in the two countries.

Decisions—

The decisions set out below have been grouped under three heads:—(1) speculative or unlawful transactions; (2) isolated transactions; (3) profits from employment, vocation, etc. There is, however, a considerable amount of overlap as between these three classes. Similarly there is an overlap between these decisions and those cited under section 2 (4) as to what constitutes 'business', under section 7 as to what constitutes 'perquisites' or additions to salary, and under section 3 as to the distinction between Capital and Income. The rulings set out under these three sections should therefore be also referred to.

Speculative transactions—Profits from—

See *In the matter of Messrs. Chuni Lal Kalyan Das of Agra.*[1]

"There is no ground for saying that the profits arising from an illegal business are not taxable. There is not a word in the Act to suggest anything of the kind, and it is a fallacy to say because the taxing authority levies from a person who is carrying on a profitable business, but an improper and illegal business or profession that therefore the authorities are countenancing such a profession. They are doing nothing of the kind. Their permission is not required and is not given, and cannot be withheld to a person who chooses to carry on an illegal business, but the tax upon the profit arising therefrom has to be paid in common with the

(1) 1 I. T. C. 418.

selves profits, you may create, by way of a trade or an adventure or a vocation, a subject matter which does bear fruit in the shape of profits or gains. Really a different conception arises, a conception of a trade or vocation which differs in its nature, in my judgment, from the individual acts which go to build it up, just as a bundle differs from odd sticks. You may say, I think, without perhaps an abuse of language, there is something organic about the whole, which does not exist in its separate parts.

"It is said that this gentleman, by continually betting with great shrewdness and good results, from his house or from any place where he could get access to the telegraph office, had set up a vocation. That is contended by the Revenue on the facts of his case, and certainly the contention is one which, if sound, has very startling results; because a loss in a vocation or a trade or an adventure can be set off against other profits, and we are face to face with this result, that a gentleman earning a profit in some recognised form of industry but having the bad habit of frequently, persistently, continuously and systematically betting with bookmakers, might set off the losses by which he squandered the fruits of his industry, for income-tax purposes, against his profits—a very remarkable result indeed, and one, I am afraid, of very wide application. We have allowances to a man because of the family he has to support, and we are now threatened with a further allowance in respect of the loss which he makes by habitual betting. It certainly sounds very remarkable, and entitles a person, when he wastes his earnings by betting, to make the State a partner in his gambling. However, the question must be faced.

"As I have said, there is no doubt that you might create a trade by making an organised effort to obtain emoluments which are not in themselves taxable as profits, and the most familiar instance of all, of course, is a trade which has for its object the securing of capital increment. A person who buys an object which subsequently turns out to be more valuable, and then sells it, does not thereby make a profit or gain. But he can organise himself to do that in a commercial and mercantile way, and the profits which emerge are taxable profits, not of the transaction, but of the trade. In the same way, he may carry on the same trade or part of the trade by selling things which he has not got and buy them when the price has fallen. That is a capital accretion, only the operations are reversed. He sells first and buys afterwards And in that way he may make losses, or he may make profits. If he makes losses, the losses cannot be said to be the results of the individual acts. They are the results of the trade as a whole. Test it in this way. A person may organise an effort to find things. He may start a salvage or exploring undertaking, and he may make profits. The profits are not the profits of the findings, they are the profits of the adventure as a whole. Test it in this way. He may make a loss. You cannot say that the loss was due to the failure to find. The loss is due to the trade. That tests it very well, because it shows the difference between the trade as an organism, and the individual acts.

"So much is clear, I think, about the cases of making a trade or a vocation or an adventure, of obtaining differences in prices or obtaining things which are the subject of finding. The trade or vocation which has to do with differences in prices may be popularly spoken of as gambling, there is no intention really to accept or deliver the article. But they are operations in relation to the differences of prices of commodities, and there is an element of fecundity in those, and indeed, those operations form the subject of a great deal of trade.

"Now we come to betting, pure and simple. (I do not mean to say that mercantile bargains are tainted with the element of gambling). It has been settled that a book-maker carries on a taxable vocation. What is the book-maker's system? He knows that there are a great many people who are willing to back horses, and that they will back horses with any—body who holds himself out to give reasonable odds as a book-maker. By calculating the odds in the case of various horses over a long period of time, and quoting them so that, on the whole, the aggregate odds, if I may use the expression, are in his favour, he makes a profit. That seems to me to be organising an effort in the same way that a person organises an effort if he sets out to buy himself things with a view to securing a profit by the difference in what I may call their capital value in individual cases.

"Now we come to the other side, the man who bets with the book-maker, and that is this case. These are mere bets. Each time he puts on his money, at whatever may be the starting price. I do not think he could be said to organise his effort in the same way as a book-maker organises his. I do not think the subject matter from his point of view is susceptible of it. In effect all he is doing is just what a man does who is a skilful player at cards, who plays every day. He plays to-day and he plays to-morrow and he plays the next day and he is skilful on each of the three days, more skilful on the whole than the people with whom he plays, and he wins. But I do not think that you can find, in his case, any conception arising in which his individual operations can be said to be merged in the way that particular operations are merged in the conception of a trade. I think all you can say of that man, in the fair use of the English language, is that he is addicted to betting. It is extremely difficult to express, but it seems to me that people would say he is addicted to betting, and could not say that his vocation is betting. The subject is involved in great difficulty of language, which I think represents great difficulty of thought. There is no tax on a habit. I do not think 'habitual' or even 'systematic' fully describes what is essential in the phrase 'trade, adventure, profession or vocation'. All I can say is that in my judgment the income which this gentleman succeeded in making is not profits or gains."

Unlawful business—

Per Scrutton, L.J.—"I rather think that Mr. J. Denman's language is used in a case as to betting which was invalid or unenforceable, not illegal. If he (Denman, J. in *Partridge* v. *Mallandaine*[1]) meant to say that the Income-tax Acts recognise illegal businesses in the sense of business which it was not legal to carry on, because they were punishable,

(1) 2 Tax Cases 179.

I at present very much doubt whether any such extension of the Acts is possible.''[1]

Profits from illicit liquor traffic—

In an appeal to the Judicial Committee of the Privy Council from the judgment of the Supreme Court of Canada regarding the assessability of profits derived within Ontario from operations in illicit traffic in liquor which were prohibited by provincial legislation in that respect, Viscount Haldane delivering the judgment of the Board referred to the above remarks of Scrutton, L. J. in *Von Glehn's case* and refused to assent to the suggestion that Income-tax Acts are necessarily restricted in their application to lawful businesses only. So far as Parliaments with sovereign powers are concerned, they need not be so. The question is never more than one of the words used. It would not be appropriate to impart any assumed moral or ethical standard as controlling the literal interpretation of the language employed. It was ruled therefore that profits from 'boot-legging' were taxable.[2]

Illegal gratification—Profits from—

In India, an assessee—a Bank cashier who received commission for recommending constituents to the Bank—demanded a reference to the High Court in respect of the assessability of the profits from illegal gratification, but dropped the case when the Commissioner did actually make the reference.

Isolated transactions—Profits from—

The assessee who was a cloth and grain merchant received a commission for the sale of certain cotton mills.

Per Walsh and Ryves, JJ.—" The question is whether that sum is a receipt, not arising from business or the exercise of a profession, vocation or occupation, which was of a casual and non-recurring nature. . . . In our view the passage beginning with the word 'not' and ending with the word 'occupation' is an exception upon an exception, that is to say, the word 'which' relates only to receipts which are not receipts arising from business or the exercise of a profession, vocation or occupation. If the argument on behalf of the assessee were adopted, the result would be to strike out that qualifying passage from the section, and to make all receipts, whether arising from business or not, which are of a casual and non-recurring nature, within the exemption. We therefore hold that a receipt arising from business or the exercise of a profession, vocation or occupation, does not come within the exception.

(1) *Commissioners of Inland Revenue* v. *Von Glehn & Co.*, (1920 2 K.B. 553; 12 Tax Cases 232.

(2) *Canadian Minister of Finance* v. *Smith* 6 A.T.C. 621; 1927 A.C. 193; 42 T.L.R. 734.

"The next question is whether . . . . this was a receipt arising from business or the exercise of an occupation. The particular transaction is certainly one of the business of a broker. and it comes within the definition of business. The definition of the word 'business' as used in section 2, sub-section (4) places the matter beyond doubt. The word 'business' is there defined as including any adventure, and it is not possible to exclude from the expression 'adventure,' indeed, successful adventure, the negotiation of a sale of a large mill which resulted in a commission payable to the value of Rs. 75,000.

"In our view this transaction, although an isolated transaction, was not of a casual or non-recurring nature. To some extent the discussion of this question overlaps the question whether a particular receipt is a receipt arising from business or the exercise of a vocation. In taking the view we do, we found ourselves mainly upon the use of the word 'nature' in the exemption. The word is not 'occurrence'. If the language were 'a casual or non-recurring occurrence' there would be much to be said for the contention of the assessee. But the expression 'nature' appears to us to be a word used independently of the accident of the event happening in fact once only or more often in a fortunate year. It connotes a class of dealing which might occur only once, but which might occur several times. Now the adventure of a businessman who is enabled through his business associations to negotiate a large transaction and thereby to earn a heavy commission, may undoubtedly be in fact non-recurring in the sense that so successful an adventure would not be likely to occur again. But, on the other hand, it is a class of transaction which might occur to any such businessman once only or half a dozen times again, during the course of the year. The Government Advocate put what may be said to be a decisive illustration of the true meaning of the word 'nature' when he pointed out that if you sold your own house at a profit, although the question would also arise as to whether the result of that transaction was a profit at all but rather only enhanced capital it would in any discussion as to whether it was brought within this exemption undoubtedly be a transaction of a non-recurring nature. You could not do it twice. But if, on the other hand, you engaged in a solitary transaction of bringing two of your friends together, and negotiated the sale of the house of one of them to the other, and thereby earned a commission, you would, in our opinion, be carrying out a transaction which although casual in fact, would not be of a non-recurring nature, because, having done so one with success, you might be asked by some vendor to do it again. Our answer therefore . . . . is that the particular profit in question was not of a casual and non-recurring nature within the meaning of the section."[1]

The assessee, a banker and money-lender, remitted from Madras sums aggregating over 4 lakhs of rupees to Penang, such sums being invested there in Straits Settlements dollars, and ultimately reconverted into rupees and remitted back to Madras.

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(1) *In re Chunni Lal Kalyan Das*, 1 I.T.C. 419.

The remittances were made on eight occasions within a period of four months in 1919 and the retransfer to Madras was on thirteen occasions covering a period of four months from the end of 1920 to the beginning of 1921. Owing to the fluctuations in exchange which varied between 83 and 175 rupees per hundred dollars, the assessee made a profit of a considerable amount on the transaction. He was assessed to income-tax on that profit.

Per Sir Walter Schwabe, C. J. (*Coutts Trotter, J.*, concurring).—"The question to be considered . . . . is whether a particular receipt is properly brought into account or omitted in arriving at the profit of a business. If the transactions are business transactions, and result in a profit or loss made in the carrying on of the business, they must be brought into account; otherwise not. The questions which have arisen for decision have been whether particular transactions form part of a business carried on by the assessee. They need not be part of some already established business but they must together form a business. If the transactions form part of the ordinary business of the assessee the profits or losses on them must, of course, be brought into account. But where the transactions are outside the scope of the ordinary business of the assessee it is often a difficult question to decide whether or not they are to be treated as subject to income-tax. Profits may be made by the realisation of security or by the sale of land or moveable property and, in the case of one man they may be merely successful realisations of assets or alterations of investments, while in the case of another man they may form part of the income of a business. To give a simple illustration, a Barrister might buy a picture and at a later date when the works of the particular artist were in demand, sell that picture and realise a profit. No income-tax would be payable on this profit. If a picture-dealer bought a picture, and on the same events happening, sold it at a profit, that profit would be a profit earned in his business and would be liable to income-tax. So, too, profits made on an isolated speculation are not liable to income-tax, but those made in speculation of a similar kind as a part of business would be liable. A difficult question may, however, arise as to whether the transactions are of such frequency as to amount to carrying on a business. The distinction is well illustrated by the cases of *California Copper Syndicate Company, Limited* v. *Harris*[1]; *Hudson's Bay Co.* v. *Stevens*.[2] (Reference was also made to *Commissioners of Taxes* v. *Melbourne Trust Company*[3]; *Beynon & Co.* v. *Ogg*.[4])

"Turning to the facts of the case, the assessee was a dealer in money, and had by reason of his dealings with the Straits Settlements, facilities at hand for dealings in exchange between Madras and the Straits Settlements. He had at Penang agents, themselves bankers, who were in

(1) 5 Tax Cases 159.
(2) 5 Tax Cases 424.
(3) (1914) A.C. 1001.
(4) 7 Tax Cases 125.

the habit of collecting for him outstandings in his money-lending business, and as and when required, remitting them to India, and in the process, converting dollars into rupees. During the periods in question in this case, he got regular information by letter and cable from these agents as to the movements of exchange in the Straits Settlements. He sent large sums of money extending over a period of four months. At first the market went against him, and he sent increasing quantities of rupees, no doubt, with a view to averaging the cost of the dollars. The dollars were, by arrangement with the agents, left on deposit carrying interest, a fact not in itself conclusive, and when he got them back, by reason of the increase in the value of the rupee, he was able to realise by degrees an increasing profit. Taking all these facts into consideration, I think that the right inference to be drawn is that in this case those dealings in exchange had become part of the assessee's banking business, and I think too, that even looked at apart from his ordinary business, he did not enter into these transactions as an isolated investment of capital or speculation, but as a business of a dealer in exchange."[1]

The assessee consented to be appointed under a power-of-attorney to dispose of cotton bales for and on behalf of a firm that had got into difficulties to pay what was due to several Mucadams and Banks, and after deducting from the net sale proceeds of the cotton bales all his costs, charges and expenses in respect thereof and his remuneration, to distribute the balance amongst the several persons and firms whose names had already been submitted by the firm to the assessee. Under that power-of-attorney the assessee sold over 100,000 bales which realized about Rs. 1,63,00,000 and received his remuneration Rs.1,88,750. The assessee claimed exemption for this sum under section 4 (3) (*vii*) of the Income-tax Act.

Per Macleod, C. J.—" . . . . . . It has been argued for the assessee that these receipts did not arise from business; that 'business' connotes continuity, and that only the receipts arising from a business which is carried on continuously can be assessed. But the section refers to receipts arising from 'business' and not to receipts arising from 'a business.' The definition of business in section 2 (4) is as follows:—'Business' includes 'any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture,' and consequently, it is not necessary that the receipts should arise from a business continuously carried on during the year to make them liable to assessment. Even if they arise from a single adventure in business they would be liable to be taxed.

"Now it seems clear that the profession or occupation of the assessee being that of a cotton merchant, any receipts arising from the buying and selling of cotton would be considered as arising from trade or commerce, and the argument that receipts from an extraordinary transaction

(1) *Board of Revenue v. Arunachalam Chettiar*, 1 I.T.C. 238.

connected with business, such as the one in this case which has only occurred owing to exceptional circumstances, and which would not be likely to occur again for many years, can be placed in the same category as receipts entirely disconnected with business or the profession or vocation or occupation of the assessee which might be considered of a casual and non-recurring nature, cannot be accepted.

"We are clearly of opinion, therefore, that the remuneration earned by the assessee. . . . must be considered as receipts arising from business, and therefore, liable to taxation.[1]

Three individuals—members of firms in the wine trade—formed themselves into a syndicate by oral agreement and purchased as a speculation—and apart from their firms—a large quantity of brandy from the Cape Government in a single transaction. The bulk of the brandy was shipped to England, where it was sold, after blending, by the firms to which the three individuals belonged, acting on behalf of the syndicate. *Held,* that there was evidence on which the Commissioners could find that there was a trade.

" . . . . It is quite clear that these gentlemen did far more than simply buy an article which they thought was going cheap, and resell it. They bought it with a view to transport it, with a view to modify its character by skilful manipulation, by blending, with a view to alter, not only the amounts by which it could be sold as a man might split up an estate, but by altering the character in the way it was done up so that it could be sold in smaller quantities. They employed experts—and were experts themselves—to dispose of it over a long period of time. When I say over a long period of time I mean by sales which began at once but which extended over some period of time. They did not buy it and put it away, they never intended to buy it and put it away and keep it. They bought it to turn over at once obviously, and to turn over advantageously by means of the operations which I have indicated. Now under those circumstances the Commissioners have held that they did carry on a trade, and I think it is a question of fact, and I do not think, by telling me all the evidence, that the Commissioners can make me, or indeed give me authority—because they cannot give me authority if I do not possess it by law—to determine the question of fact. . . . ."[2]

A wholesale agricultural machinery merchant who had never dealt in linen, bought the war surplus stock of aeroplane linen as a single transaction and made large profits in selling it. It was contended on his behalf that it was an isolated transaction not constituting a 'trade'. *Held* that it was 'trade'.

Per Rowlatt, J.—"Now he only made one purchase but that. . . . does not prevent the subject-matter being a trade; (then refers to

(1) *Sir Purshottamdas Thakurdas* v. *Commissioner of Income-tax, Bombay,* 2 I.T.C. 8.

(2) Per Rowlatt, J. in *Cape Brandy Syndicate* v. *Commissioners of Inland Revenue* [*upheld by Court of Appeal,* (1921) 2 K.B. 403 (C.A.)].

the *California Copper Case*[1] the *Cape Brandy Syndicate Case*[2] and *Beynon* v. *Ogg.*[3]) . . . . He bought this gigantic consignment of linen and he set to work to make people . . . . come in and buy it; to induce them . . . . he set to work and worked away at it and got offices, did this, that and the other . . . . and they bought it all and all this is profit. Why is not that a 'trade'?".

Per the M. of R.—"The Appellant's contention was that he had one speculation in the nature of a gambling transaction, and had not carried on a trade or business, for his own calling was that of a merchant engaged in the business of wholesale machinery . . . . a business which had no part in, or affinity to, the trade of linen. We agree with the Commissioners and Mr. Justice Rowlatt that this contention is untenable. The appellant entered upon this separate new trade or business or adventure for the purpose of realising profits or gains in it, and even if his purchase was made under a single contract, the realisation of his profit which was large, was accomplished by his setting up a trading organization. If it was maintained only till the 45,000,000 yards was disposed of, it was none the less characterised as a business while it was in being. Whatever view may be taken by the Courts upon such a point, it is a question of fact which it is for the Commissioners to determine. They had abundant material upon which to reach the conclusion that they did. . . . . It is not possible to lay down definite lines to mark out what is a business or a trade or adventure, and to define the distinctive characteristics of each; nor is it necessary, or wise to do so. The facts in each case may be very different, but it is the facts that establish the nature of the enterprise embarked upon."[4]

It was also argued on behalf of Mr. Martin that the profits were not "annual", but the Court of Appeal confirmed the interpretation of that word as given by Rowlatt, J. in *Ryall* v. *Hoare*.[5] (This point, however, does not affect the position in India, as in the law here the word "annual" is not used. The only use thereof is in the executive instructions in para. 21 of the Income-tax Manual). The House of Lords confirmed the judgments of the Lower Courts. Whether Martin traded was a question of fact, and the Commissioners had materials for arriving at a finding. Rowlatt, J's construction of 'annual profits' in *Ryall* v. *Hoare* as "profits or gains in any one year or in any year as the succession of years comes round" since the tax is levied for one year only at a time was approved. But both the Court of Appeal and Lord Sumner and Lord Carson, while agreeing with Rowlatt, J., in the particular case, did not support

(1) 5 Tax Cases 159.
(2) (1921) 2 K.B. 403 C.A.
(3) 7 Tax Cases 125.
(4) *Martin* v. *Lowry*, 5 A.T.C. 11.
(5) 8 Tax Cases 521.

all that he said. Lord Sumner pointed out that Rowlatt, J., was wrong in supposing that *Wylie* v. *Eccott*[1] was authority for the liability to tax of profits from letting houses occasionally; in that particular case the liability was admitted and the dispute was confined to the deductions to be made.[2]

"If it is desired to tax the difference between what a man has bought goods for or property for and sold them for, you can tax it only . . . . if you can say that what he did was a trade or adventure or concern in the nature of trade"—per Rowlatt, J. in *Pearn* v. *Miller*.[3]

A ship-repairer, a blacksmith and a fish merchant's employee, with no previous business association with each other, jointly bought a cargo steamer with a view to its alteration and sale. They altered it into a steam drifter and sold it at a profit. *Held*, that the purchase and sale was " an adventure in the nature of trade " and not a casual transaction.

Per Lord Sands.—"Having a picture cleaned, or a ship's boilers cleaned and the hull repainted (is not 'trade') but purchasing a quantity of pig iron and having it manufactured into steel or of gold-bearing ore and having the gold extracted by melting the ore (is 'trade')."

Per L. P. Clyde.—"If the venture was one consisting simply in one isolated purchase of some article against an expected rise in price and a subsequent sale, it might be impossible to say that the venture was 'in the nature of trade'. . . . the test is whether the operations . . . . are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made."[4]

Exchanges—Speculation in—By stone merchant—

The assessees who were stone, marble and granite merchants in England, made a contract with a firm for the supply to them of marble, and contemplated acquiring some of this marble in Italy. In order to facilitate their purchase of this marble later on, they bought Italian lire at once. The lire rose in value, and the assessees brought the money back in sterling; and the lire fell in value and the assessees converted the money again into lire. *Held*, that the profits on the lire were not taxable.

"I do not think it has anything to do with the profit of the contract itself (that of the supply of marble). It was . . . . a mere appreciation of something which they had got in hand."—Per Rowlatt, J. in *McKinlay* v. *Jenkins & Sons, Ltd.*[5]

(1) 6 Tax Cases 128.

(2) 11 Tax Cases 297.

(3) 11 Tax Cases 610.

(4) *Commissioners of Inland Revenue* v. *Livingston, Florence and Keith*, 11 Tax Cases 538.

(5) 5 A.T.C. 317.

In this case it was found as a fact by the Commissioners that it was no part of the company's business to speculate in the exchanges.

Clergymen—Voluntary gifts —From Congregation—

A gift of money, raised by voluntary subscription, and made annually to a minister of religion by his congregation, was held to be assessable.

Per the Lord Ordinary.—"It is true that it is a voluntary contribution by the parishioners, one which they are under no obligation to make, and which they may withdraw at any time. But still it is a payment made to the appellant, as their clergyman, and it is received by the appellant in respect of the discharge of his duties of that office."[1]

In a case in which the Queen Victoria Clergy Sustentation Fund made grants to a Clergyman in augmentation of the income of his benefice, it was held that the grants were assessable on the Clergyman as profits accruing to him by reason of his office. In this case the court considered the precise form of the application for the grant and of the resolution authorizing the grant. The decision was given in favour of the Crown on the ground that (1) no enquiry was made as to the *personal* means of the incumbent but only as to the income of the *benefice*, it being left to the incumbent to ask for the grant if he needed it and (2) if the benefice was vacant, the grant was divided beween the outgoing and incoming incumbents. It followed therefore that the income accrued by reason of the office. *Turner* v. *Cuxson*[2] was distinguished on this ground, that the grant in that case was as a *personal* gift of an eleemosynary character; and the principle underlying the decision in *In re Strong* was approved.

Per Collins, M.R.—"Now that judgment (the *Strong* case . . . .) is certainly an affirmation of a principle of law that a payment may be liable to income-tax although it is voluntary on the part of the persons who made it, and that the test is whether, from the standpoint of the person who receives it, it accrues to him in virtue of his office . . . . That seems to me to be the test: and . . . . the liability to income-tax is not negatived merely by reason of the fact that there was no legal obligation on the part of the persons who contributed the money to pay it."[3]

Clergymen—Annual grant to—From religious society—

A curate received from a religious society a grant renewable annually at discretion on certain conditions. The grant was

(1) *In re the Rev. George Walter Strong*, 1 Tax Cases 207.
(2) 2 Tax Cases 422.
(3) *Rev. G. N. Herbert* v. *J. A. McQuade*, 4 Tax Cases 489.

in recognition of faithful service as a clergyman, but not in respect of the particular curacy the clergyman held. *Held*, that it was not assessable to income-tax.[1]

Per Coleridge, C.J.—"Now here the payment is made, not for services in the parish at all, not by the persons whom he serves and not in respect of the particular services which he renders—but it is an honorarium paid by a society . . . . to a deserving man because he has done his duty well."[2]

In *Hue* v. *Miller*[3] the Crown which sought to assess a small grant of £15 made by a sustentation fund, gave up its claim.

Clergyman—Grants to—From congregation—

In a case in which the grants were to cease on the Minister's death or his resignation of the pulpit, *i.e.*, the grant was given on quasi-personal grounds, it was nevertheless held that the grants were assessable to income-tax, having regard to the facts of the case, *viz.* :—(*a*) the ability of the congregation to make adequate provision for their minister, (*b*) the fact that the minister had been regularly educated for that vocation, (*c*) the amount of his income.[4]

Clergyman—Easter offerings—From congregation—

A portion of a collection made in Church was given by way of 'Easter offerings' to an incumbent by reason of his office; but the gift would not have been made had not the recipient, besides being the incumbent, been also poor. *Held*, that the offerings were not given as an additional remuneration for services, but on account of personal poverty, and that, in these circumstances, they were not assessable to income-tax.[5]

The correctness of this decision was however doubted in *Cooper* v. *Blakiston*.[6] See per Lord Alverstone, C. J., in the Court of Appeal (upheld by the House of Lords).

"There are findings . . . . which have made me doubt whether the decision was exactly a strict application of the principle . . . but, looking at the case, I think it was a decision upon the particular facts of that case."

"Easter Offerings" were given to a Vicar by parishioners and others in response to an appeal made by the Bishop and

(1) *In re Strong*, 1 Tax Cases 207, distinguished.
(2) *Turner* v. *Cuxson*, 2 Tax Cases 422.
(3) Q.B.D. 1900.
(4) *Poynting* v. *Faulkner*, 5 Tax Cases 145. (C. of A.).
(5) *Turton* v. *Cooper*, 5 Tax Cases 138.
(6) 5 Tax Cases 347.

supported by the Churchwardens. The Offerings were mainly received through collections in Church, the residue consisting of sums sent to the Churchwardens or directly to the Vicar. *Held*, by the House of Lords that the Offerings were assessable to income-tax.

Per Buckley, L. J.—" The question is not what was the motive of the payment, but what was the character in which the recipient received it. Was it received by him by reason of his office?"

Per the Lord Chancellor.—" In my opinion, where a sum of money is given to an Incumbent substantially in respect of his services as Incumbent, it accrues to him by reason of his office. Here the sum of money was given in respect of those services. Had it been a gift of an exceptional kind, such as a testimonial, or a contribution for a specific purpose, as to provide for a holiday, or a subscription peculiarly due to the personal qualities of the particular clergyman, it might not have been a voluntary payment for services but a mere present.

" In this case, however, there was a continuity of annual payments apart from any special occasion or purpose, and the ground of the call for subscriptions was one common to all clergymen with insufficient stipends, urged by the Bishop on behalf of all alike. What you choose to call it matters little. The point is, what was it in reality?

" It was natural, and in no way wrong, that all concerned should make this gift appear as like a mere present as they could. But they acted straightforwardly, as one would expect, and the real character of what was done appears clearly enough from the papers in which contributions were solicited . . . . ."[1]

Saltpetre—Extraction of—Royalty from—

In a case in which the assessee allowed his tenants to extract earth containing saltpetre it was argued that (1) the income was casual and non-recurring, and (2) that the income arose from the sale of the earth and was therefore a capital receipt. As to (1) the Commissioner found as a fact that the receipts were recurring and the High Court accepted the finding as there was evidence for it. As to (2)—

" It is quite impossible to distinguish the rents or royalties, whatever they may be called, arising from this source, from the rent or royalties arising from the letting of coal or other minerals in the earth or income which arises from the produce of the earth, whether it be on the surface or whether it be beneath the surface, provided that it is not non-recurring or casual and provided that it is not in the nature of a sale".—Per Dawson Miller, C. J., in *Maharajah Guru, etc., Sahi* v. *Commissioner of Income-tax.*[2]

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(1) *Cooper* v. *Blakiston*, 5 Tax Cases 347.
(2) I.L.R. 6 Pat. 29; 2 I.T.C. 281.

Liquidation—Honorarium—Secretary without remuneration—

The assessee acted as Secretary of a Company without remuneration from the date of its incorporation until his appointment as Liquidator of the Company. When the liquidation of the Company was completed, there was a sum in hand, after discharge of all liabilities, which according to the Company's Memorandum of Association was divisible amongst the ordinary shareholders of the Company. By a unanimous resolution, these shareholders voted the sum in question, in equal shares to the Chairman of the Company, and to the assessee. The assessee contended that this payment was a voluntary gift, and that the whole of his duties as Secretary and Liquidator had terminated before the gift was made. *Held*, by the Court of Appeal, that the sum voted by the shareholders of the Company to the assessee did not accrue to him in respect of an office or employment of profit and that, therefore, he was not chargeable to income-tax in respect of the sum in question. It will be seen that in this case the motive of the payment was not altogether disregarded.

Per M. R. Sterndale.—" The argument was rather narrowed to this, that a voluntary payment cannot be a profit of the office after the office has terminated unless that office had been an office of profit beforehand. Now I cannot accept that as a broad proposition. It seems to me that there may very well be a payment in respect of an office which had been gratuitous up to its end but which still might be payment for the services of that office and therefore be a profit accruing by reason of the office. I do not think that a hard and fast line can be drawn. . . In *Duncan's Trustees* v. *Farmer*[1] Lord Dunedin says . . . . . ' My Lords, I confess I have never been able to see how it could possibly be said to be in respect of his office when the whole reason it was given to him was that he was no longer in the office.' At first sight that may seem to bear out the proposition that was contended for. I do not think that it does because it will be seen that the noble Lord was speaking of the facts of that case . . . . an annuity was granted to a Minister of the Church . . . . . on retirement through ill-health and therefore it was given to him as a sort of compassionate allowance and could not be obtained except when he had resigned his cure. Therefore I do not think that proposition can be maintained. But the fact that the office is at an end is a fact of very, very great weight, and when you add to that that the payment is made, not by the employer, because it was not made and could not be made here by the Company which was the employer but by other persons—in this case it was the shareholders individually—the facts still more point to it not being a payment for services or a profit accruing by reason of the office . . . . To my mind that points . . . . . to something in the nature that is spoken of by Lord Loreburn in *Cooper* v.

(1) 5 Tax Cases 417.

Blackiston.[1] "In my opinion, where a sum of money is given to an incumbent substantially in respect of his services as incumbent, it accrues to him by reason of his office. Here the sum of money was given in respect of these services. Had it been a gift of an exceptional kind, such as a testimonial or a contribution for a specific purpose as to provide for holiday or a subscription peculiarly due to the personal qualities of the particular clergyman, it might not have been a voluntary payment for services but a mere present."[2]

Bonus—Commission—Addition to fixed salary—

The appellant, whose remuneration as general manager of a limited company consisted partly of a fixed annual salary and partly of a commission or bonus on the company's net profits, had been assessed to Income-tax on the basis of the total amount of salary and commission or bonus received or receivable by him from the company in respect of each of those years. *Held,* by the House of Lords that the commission or bonus on net profits, fell within the definition of the expression "perquisites", and was properly assessable.[3]

Overdrafts—Guarantee of—Commission for—

The bankers of a company refused to allow its overdraft to be increased except upon the joint and several personal guarantee of its directors, of whom the assessees were two. In consideration of such guarantee, the company granted to each of the directors a commission of two per cent. of the whole amount guaranteed. The original guarantee was for one year only, but, similar circumstances arising in the following year, the directors renewed their guarantee (for a still greater amount) for a further year, and were granted commission thereon at the same rate as before. The assessees contended that the commissions arose from casual, unsought and exceptional transactions and were not chargeable to Income-tax. *Held,* that the commissions were annual profits or gains within the meaning of Case VI of Schedule D, and had been properly assessed to Income-tax thereunder.

Per Rowlatt, J.—"It was not in the line of business of either of them to give a guarantee, and one of them. at any rate, who is a solicitor, had never done it before, and probably will never do it again; they did it unwillingly. . . . . it seems to me that, on the view of the facts taken by the Special Commissioners, by which, of course, I am bound, I must treat this case as just on the same footing as if a person, not connected with business at all, received a commission from another person, also not connected with

(1) 5 Tax Cases 347.
(2) *Cowan* v. *Seymour,* 7 Tax Cases 372.
(3) *M'Donald* v. *Shand,* 8 Tax Cases 420.

business, for doing him the favour of guaranteeing his account at a bank. Now, under those circumstances, is this commission an "annual profit or gain" within the meaning of the case? One may rule out two classes of emoluments from this description. In the first place, it is quite clear that anything in the nature of a capital accretion, is outside the words "profits or gains" as used in these Acts; that, of course, follows from the scope of the Act, and it is sanctified by the usage now of a century. That rules out, of course, the well-known case of a casual profit made upon an isolated buying and selling of some article; that is a capital accretion, and unless it is merged with other similar transactions in the carrying on of a trade, and the trade is taxed, no tax is exigible in respect of a transaction of that kind. "Profits or gains" mean something which is in the nature of interest or fruit, as opposed to principal or tree. The other class of case that one can rule out is that of gifts. A person may have an emolument by reason of a gift *inter vivos* or testamentary, or he may acquire an emolument by finding an article of value or money, or he may acquire it by winning a bet. It seems to me that all that class of cases must be ruled out, because they are not profits or gains at all. Without pretending to give an exhaustive definition, I think one may take it as clear that where an emolument is received, or, rather, where an emolument accrues, by virtue of some service rendered by way of action or permission, or both, at any rate that is included within the words "profits or gains." But the question is whether in this case it is an "annual profit or gain." Now, what is the meaning of the word "annual"? It may mean, and perhaps its most obvious meaning is "annually recurring," like the seasons; or if not recurring in perpetuity like the seasons as a matter of nature, "annually recurring" in the ordinary way for a considerable space of time; or it may conceivably mean "lasting only for a year," as you speak of an annual plant; but I do not think that is really a very true meaning of the word "annual," because I think when you speak of an annual plant what is in your mind is the necessity of annual sowing; the plant is not annual; it is the sowing that is annual. At any rate, that is a possible meaning of the word "annual." Thirdly, it might mean "calculated with reference to a year"; that is, like interest of so much per annum. If there is anything in the suggestion that "annual" means or includes "lasting for a year," I must point out that this guarantee did last for a year, and it was renewed for another year; but there is nothing in that, because it was renewed *de novo* and did not run on; it was a transaction for a year twice repeated. Those are three possible meanings of the word "annual," but I do not think any of them is applicable in this particular case dealing with Income-tax. One is not left entirely without guidance, at any rate as a matter of practice. Take the case of letting a furnished house. It is inveterate now that the letting of a furnished house for a few weeks in one year, will attract Income-tax, under this Case, upon the profit made by the letting. That is the inveterate practice, and although it has never been ruled upon, in principle, by the Courts, it has been tacitly assumed by the Courts in Scotland, and it seems to me out of question that a Co t of First Instance, at any rate, could possibly say that that is wrong. Now, that is not recurring yearly, and it does not last for a year, and it is not calculated with reference to a year, because it is calculated with reference to the amenities of a few particular weeks. Again, take the case of a person who is appointed to perform some services, which might possibly be by way of an office, a person appointed, not carrying on any trade or any business, but who happens to be appointed—as a retired Judge was appointed some years ago to hold a very important arbitration in connection with the London water—appointed with a lump sum remuneration to do a particular piece of work, or, to take a humbler instance, which is more familiar perhaps to us here, the case of a Judge's Marshal, who gets a little appointment for a week or two, in the experience of everybody (many, certainly, who hear me now) he suffers a deduction of income-tax when his modest emolument is paid to him. It may be that he would be the holder of an office but both those cases are cases of offices, and they do not help the matter, because the tax on an office is laid upon the annual amount of the profits. Now, recognizing that position, it seems to me that 'annual' here can only mean 'in any year,' and that the 'annual profits or gains' means 'profits or gains in any year as the succession of the years comes round.' That being the position in which I think I am, this litigation seems to me to raise the whole question of casual profits. I have already referred to the furnished house illustration. During the course of the argument, I am afraid, I troubled Counsel by putting a great number of other instances, some of which were perhaps trivial, and some may have been far-fetched; one does not advance the argument, of course, by putting instances, but for myself I like to try and visualise the scope, in practice and the region of fact, of any proposition to which one is about to assent; but, of course, there is an instance which is particularly familiar at the present moment, perhaps, which I do not think we did speak of during the argument, and that is the case of casual authorship. Now, a man may carry on no business and no profession; he may not be a journalist, he may not be an author, but he may be called upon to write an article for a paper for reward. He may find that there would be a demand for a single book from his pen, as a traveller, a soldier, a sailor or a statesman, or what not. Now, it seems to me that all cases of that kind, like this case of these gentlemen who gave this guarantee, are instances of casual profits which cannot in any way be distinguished from the profit which is obtained by a man who lets his house furnished."[1]

Compensation for loss of office—Whether profits from office—

A firm of ship managers were employed as such by a steamship company and remunerated by a percentage of the company's annual net profits. The company went into voluntary liquidation and transferred £50,000 of 5 per cent. bonds to the firm as 'compensation for loss of office'. *Held*, that on the findings of the Commissioners as to the nature of the payment, which there was evidence to support, the said sum was not a 'profit' liable to income-tax.

(1) *Ryal v. Hoare & Honeywill*, 8 Tax Cases 521.

Per Rowlatt, J.—"I think everybody is agreed . . . . that in cases of this kind the circumstance that the payment in question is a voluntary one does not matter. . . . You must not look at the point of view of the person who pays and see whether he is compellable to pay or not; you have to look at the point of view of the person who receives, to see whether he receives it in respect of his services . . . . or in respect of trade. . . . . If it was a payment in respect of the termination of their employment . . . . I do not think that is taxable as profit. . . . . A payment to make up for the cessation for the future of annual taxable profits is not itself an annual profit at all. . . . . I should not have thought that either damages for wrongful dismissal or a payment in lieu of notice at any rate if it was for a longish period—I will not say a payment in lieu of notice, I will say a voluntary payment in respect of breaking an agreement which had some time to run—would be taxable profits. But at any rate it does seem to me that compensation for loss of an employment which need not continue but which was likely to continue is not an annual profit within the scope of the income-tax at all."[1]

Commission—Casual—Addition to salary—

An Incorporated Accountant who was Secretary and Director of a Company received a salary as such. He negotiated a sale of a branch of the company's business, and received £1,000 as commission for his services in negotiating the sale. *Held,* that the £1,000 was part of the profits from his office.

Per Rowlatt, J.—"If an officer is willing to do something outside the duties of his office, to do more than he is called upon to do by the letter of his bond, and his employer gives him something in that respect, that is a profit; it becomes a part of his office which is enlarged a little so as to receive it."[2]

Addition to salary—Inspection fees—To Director—

The appellant was the chairman of a British Company. In addition to his ordinary fees, he was allowed a certain remuneration for inspecting the company's agencies in China and negotiating with the Chinese Government. *Held,* that the additional remuneration was part of the appellant's profits as chairman, notwithstanding its being given for work done abroad.

Per Rowlatt, J.—"There appears to be no power for a Director to divide himself into two and to be a Director in China as well as a Director in England so as to be capable of being regarded as filling two severable capacities."

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(1) *Chibbett* v. *Joseph Robinson & Sons* and *Commissioners of Inland Revenue* v. *Joseph Robinson & Sons*, 9 Tax Cases 48.

(2) *Mudd* v. *Collins*, 9 Tax Cases 297.

Per the M. of R.—"If it is entirely a question of fact then the facts are found by the Commissioners. If . . . . it is in part a question of law, I do not differ from the Commissioners and I do not think that they have misdirected themselves."[1]

Casual profits—Rope manufacturer—Under-writing oil shares—Profits from—Taxable—

The assessee, whose ordinary business was that of a rope-manufacturer, underwrote 15,000 shares in an Oil Company for which he received a commission. It was contended on his behalf that the profits arose from an isolated transaction and were therefore of the nature of capital receipts. *Held,* by Rowlatt, J., following *Ryall* v. *Hoare,*[2] that the profits were taxable.[3]

Professional cricketer—Benefit match—Receipts from—

The assessee was a professional cricketer. A match was played for his benefit, and, in accordance with the rules of the club which employed him, the net proceeds of the match and certain other sums obtained by public subscription were invested in the name of the trustees of the club. After a few years the investments were realised, and the proceeds made over to the assessee who, with the consent of the club, bought a farm. It was admitted by the Crown that the receipts from public subscriptions were not taxable but that the gate money was, on the ground that it was a perquisite of his employment as a professional cricketer. It was held by Rowlatt, J., that the gate-money was not taxable. The *ratio decidendi* was that such receipts come to a man only once in a lifetime, and were really of the nature of an endowment, that there was really no difference between the gate-money and the other public subscriptions, and that the assessee had no control over the money except with the consent of the club. This decision was reversed by the Court of Appeal (Sargant, L. J., dissenting), but the House of Lords restored Rowlatt, J.'s judgment (Lord Atkinson dissenting).[4]

In *Davies* v. *Harrison*[5], in which a professional footballer was given a benefit on transfer from one club to another, it was held that the benefit was liable to tax, the case being distinguished from *Reed* v. *Seymour*[4] on the ground that, having regard to the

(1) *Barson* v. *Airey*, 5 A.T.C. 65.
(2) 8 Tax Cases 521.
(3) *Lyons* v. *Coucher*, 5 A.T.C. 226.
(4) *Reed* v. *Seymour*, 11 Tax Cases 625.
(5) 6 A.T.C. 536.

rules of the clubs and the league controlling the clubs, the benefit was really a business arrangement, being a pre-arranged reward for service and not a voluntary gift or compensation for loss of employment.

(*viii*) Agricultural income.

See notes under section 2 (1).

Exemptions generally—United Kingdom Law—

Under the English Acts, there is no provision corresponding to section 60 of the Indian Act giving power to the executive Government to grant exemptions; and whatever provisions there may be for exemptions are in the Acts themselves. The notes under the foregoing sub-sections of this section have referred to the corresponding provisions under the English law under each head. But there are certain exemptions under the English law which have no counterparts here. These are the exemption of Friendly Societies, Savings Banks, Trade Unions, Industrial and Provident Societies (corresponding to Co-operative Societies here—but the English Societies enjoy greater concessions than those given to Co-operative Societies in India under section 60), National Insurance Funds, Unemployment Schemes, and Superannuation Funds (about this however see notes under section 10). All exemptions in the United Kingdom have to be claimed from the Special Commissioners who are an official body —see notes under section 5.

CHAPTER II.

INCOME-TAX AUTHORITIES.

Income-tax authorities.

5. (1) There shall be the following classes of Income-tax authorities for the purposes of this Act, namely :—

(*a*) The Central Board of Revenue,

(*b*) Commissioners of Income-tax,

(*c*) Assistant Commissioners of Income-tax, and

(*d*) Income-tax Officers.

* * * * *[1]

(1) Repealed by the Central Board of Revenue Act, 1924 (IV of 1924).

(3) There shall be a Commissioner of Income-tax for each province who shall be appointed by the Governor-General in Council after consideration of any recommendation made by the Local Government in this behalf.

(4) Assistant Commissioners of Income-tax and Income-tax Officers shall, subject to the control of the Governor-General in Council, be appointed by the Commissioner of Income-tax by order in writing. They shall perform their functions in respect of such classes of persons and such classes of income and in respect of such areas as the Commissioner of Income-tax may direct. The Commissioner may, by general or special order in writing, direct that the powers conferred on the Income-tax Officer and the Assistant Commissioner by or under this Act shall, in respect of any specified case or class of cases, be exercised by the Assistant Commissioner and the Commissioner, respectively, and, for the purposes of any case in respect of which such order applies, references in this Act or in any rules made hereunder to the Income-tax Officer and the Assistant Commissioner shall be deemed to be references to the Assistant Commissioner and the Commissioner, respectively.

(5) The Central Board of Revenue may, by notification in the Gazette of India, appoint Commissioners of Income-tax, Assistant Commissioners of Income-tax and Income-tax Officers to perform such functions in respect of such classes of persons or such classes of Income, and for such area, as may be specified in the notification, and thereupon the functions so specified shall cease, within the specified area, to be performed, in respect of the specified classes of persons or classes of income, by the authorities appointed under sub-sections (3) and (4).

(6) Assistant Commissioners of Income-tax and Income-tax Officers appointed under sub-section (4) shall,

for the purposes of this Act, be subordinate to the Commissioner of Income-tax appointed under sub-section (3) for the province in which they perform their functions.

Income-tax Authorities—

(1) The Central Board of Revenue is appointed by the Governor-General in Council. Its specific powers are mentioned in the various sections, *e.g.*, sections 2 (6), 2 (11) (*b*), 5 (5), 18 (6) and 59 (and 64). Rules for carrying out the purposes of the Act are made by the Central Board of Revenue which also issues instructions regarding the interpretation of the provisions of the Act and the rules, and is entrusted with the general administration of the Act.

(2) The head of the Income-tax Department of a province is the Commissioner of Income-tax who is appointed by the Governor-General in Council. The rest of the income-tax staff in a province are subordinate to him and they are appointed and dismissed by him. His power of appointment and dismissal of Assistant Commissioners and Income-tax Officers is, under section 5 (4), "subject to the control of the Governor-General in Council" who exercises this control through the local Government under the provisions of the following order :—

" The Governor-General in Council desires to utilise the agency of the Governor in Council of each Governor's province in the following matters only in relation to income-tax :—

(*i*) the appointment by a Commissioner of Income-tax of any person to the substantive post of Assistant Commissioner of Income-tax or Income-tax Officer shall be subject to the previous approval of the Governor in Council.

For the promotion of an Income-tax Officer or appointment of an officer of a Provincial Civil Service to the post of Assistant Commissioner of Income-tax, the Commissioner of Income-tax should consult the local Government and submit his nomination (of the Officer approved by the local Government) to the Public Service Commission through the Central Board of Revenue.

(*ii*) Any Assistant Commissioner of Income-tax or Incom tax Officer who has been dismissed or removed from office or whose increment of pay has been withheld by the Commissioner of Income-tax shall have a right of appeal to the Governor in Council.

While as regards the appointment or dismissal of such officials the Commissioner is subject to the control of the local

Government, he has full power to specify the functions to be performed by each official and the areas, persons and classes of income in respect of which these functions may be exercised.

The specific powers conferred upon him in regard to income-tax assessments are specified in sections 28 (1), 32, 33, 37, 54 (2) second proviso, 64 (3) and 66 of the Act. In particular he is vested with power under section 33 to review any orders passed by any income-tax official, and he alone may, under section 66 of the Act, state cases for the opinion of a High Court.

(3) The functions of Assistant Commissioners of Income-tax are mainly appellate, but they also exercise supervision over the work of the Income-tax Officers. The particular powers conferred on them by the Act are set out in sections 28 (1), 30 (2), 31, 37, 38, 39, 42 (2) and 53.

(4) Income-tax Officers are the assessors. While section 64 of the Act specifies the particular Income-tax Officers by whom assessments shall be made, *i.e.*, prescribes that assessments shall be made in the case of a business by the Income-tax Officer of the area where the principal place of business is situated and in all other cases by the Income-tax Officer of the area in which the assessee resides, sub-section (4) of that section provides that every Income-tax Officer shall have all the powers conferred by or under the Act on an Income-tax Officer in respect of any income, profits or gains accruing or arising or received within the area for which he is appointed. This particular provision was inserted mainly in order to permit of enquiries being made into the profits of a branch business by the Income-tax Officer of the place in which the branch is situated and in order to enable every Income-tax Officer to make enquiries regarding all income, profits and gains arising or accruing within the area to which he is posted, even though the assessment in respect of the particular income, profits or gains may not be made by him. Income-tax Commissioners should therefore secure by issuing instructions or otherwise that there is no overlapping in this matter and that the same person is not assessed to income-tax by more than one Income-tax Officer but should at the same time secure that all Income-tax Officers should give the utmost assistance to the assessing Income-tax Officer in regard to any property, income, profits or gains within their respective areas which are liable to assessment elsewhere.

While it is intended that the work of making assessments, of hearing appeals and of passing orders in review shall ultimately be carried out by separate officials known as the Income-tax Officer, the Assistant Commissioner and the Commissioner, as a complete wholetime staff for income-tax work has not yet been appointed in many of the provinces, section 5 (4) makes provision for the continuance, until such wholetime staff is engaged, of the existing system under which individual officers exercise the powers of an assessing authority in respect of particular classes of income and of an appellate authority in respect of others, while the reviewing authority is in certain cases also the appellate authority.

While the income-tax staff will as a rule be appointed in provincial cadres, there are certain classes of cases for which it may be advisable that assessments should be made by an all-India staff. Such, for example, are the cases of military officers and of officers of other departments serving directly under the Government of India who are liable to transfer from one province to another; and there may be other cases such as the assessment of railway companies which at any time it may be considered advisable should be dealt with by a special officer for the whole of India. Sub-section (5) of this section has been inserted to make provision for the appointment of special officers in such cases. (Income-tax Manual, para. 22.)

The following schedule shows the notifications issued by the Central Board of Revenue under section 5 (5) and the officers appointed thereby to perform all the functions of an Income-tax Officer, Assistant Commissioner of Income-tax and Commissioner of Income-tax in respect of specified persons :—

SCHEDULE.

No. and date of Notification.	Serial No.	Persons.	Officer appointed to perform the functions of—		
			Income-tax Officer.	Assistant Commissioner of Income-tax	Commissioner of Income-tax.
1	2	3	4	5	6
No. 40—I.T., dated 12-11-'27.	1	Post and Telegraph employees residing in the province of Bihar and Orissa.	Income-tax Officer, Miscellaneous Salaries Circle, Calcutta.	Assistant Commissioner of Income-tax, Calcutta.	Commissioner of Income-tax, Bengal.
No 7—I.T., dated 15-2-'28.	2	Employees of the Bengal and North-Western Railway.	Income-tax Officer, Gorakhpur.	Assistant Commissioner of Income-tax, Benares.	Commissioner of Income tax, United Provinces.
	3	Persons, excluding pensioners and persons employed in Army factories, payable from Army estimates through the Controller of Military Accounts, Eastern Command, Meerut and Lucknow districts, Meerut.	Income-tax Officer, Military Circle, Meerut.	Assistant Commissioner of Income-tax, Meerut.	Do.
	4	Employees of the Assam Bengal Railway.	Income-tax Officer, Chittagong.	Assistant Commissioner of Income-tax, Dacca.	Commissioner of Income-tax, Bengal.
	5	Employees of Messrs. Ralli Brothers resident in Bengal or Bihar and Orissa.	Income tax Officer, Calcutta District, III A.	Assistant Commissioner of Income-tax, Headquarters (at Calcutta).	Do.
	6	Employees of the Imperial Tobacco Company, Ltd., and the Indian Leaf Tobacco Development Company residing in Bengal or Bihar and Orissa or Assam.	Income tax Officer, Calcutta District, V A.	Assistant Commissioner of Income-tax, Calcutta.	Do.
	7	Employees of the Bengal Nagpur Railway.	Income-tax Officer, Railway Salaries Circle, Calcutta.	Do.	Do.

No. and date of Notification.	Serial No.	Persons.	Officers appointed to perform the functions of— Income-tax Officer.	Assistant Commissioner of Income-tax.	Commissioner of Income-tax.
1	2	3	4	5	6
	8	Employees of the East Indian Railway except those of the Central India Coal-fields Railway.	Income-tax Officer, Railway Salaries Circle, Calcutta.	Assistant Commissioner of Income-tax, Calcutta.	Commissioner of Income-tax, Bengal.
	9	Employees of the Peninsular Tobacco Company Ltd.	Income-tax Officer, Calcutta District, V A.	Do.	Do.
	10	Officers of the Women's Medical Service and of the Junior Branch of the same.	Income-tax Officer, Simla.	Assistant Commissioner of Income-tax, Ambala.	Commissioner of Income-tax, Punjab.
	11	Employees of the Madras and Southern Mahratta Railway except those under the audit of the Audit Officer, Railway Collieries, Calcutta.	Income tax Officer, 4th Circle, Madras.	Assistant Commissioner of Income tax, Central Range, Madras.	Commissioner of Income-tax, Madras.
	12	Military employees under the audit of the Controller of Military Accounts, Poona and Southern Command, Poona.	Income-tax Officer, Poona District.	Assistant Commissioner of Income-tax, Central Division, Poona.	Commissioner of Income-tax, Bombay.
	13	Government servants under the audit of the Accountant General, Central Revenues, the Military Accountant-General, the Deputy Accountant-General, Posts and Telegraphs, Delhi, and Audit Officer, Indian Stores Department.	Income-tax Officer, Salary Circle, Delhi.	Assistant Commissioner of Income tax, Delhi.	Commissioner of Income-tax, Delhi.
	14	Non-Enemy Nationals paid through the Controller, Local Clearing Office (Enemy Debts).	Do.	Do.	Do.
	15	Employees of the North-Western Railway except those under the audit of the Audit Officer, Railway Collieries, Calcutta.	Income-tax Officer, Railway Salary Circle, Lahore.	Assistant Commissioner of Income-tax, Lahore.	Commissioner of Income-tax, Punjab.

16	Employes of the Bombay, Baroda and Central India Railway Company and the Great Indian Peninsular Railway Company except those under the audit of the Audit Officer, Railway Collieries, Calcutta.	Income-tax Officer, Salary Branch, Bombay City.	Assistant Commissioner of Income-tax, Bombay City.	Commissioner of Income-tax, Bombay.
17	Government servants under the audit of the Deputy Accountant-General, Posts and Telegraphs, Nagpur.	Income-tax Officer, Salary Circle, Nagpur.	Assistant Commissioner of Income-tax, Southern Charge, Nagpur.	Commissioner of Income-tax, Central Provinces and Berar.
18	Employes of the Eastern Bengal Railway.	Income-tax Officer, Railway Salaries Circle, Calcutta.	Assistant Commissioner of Income-tax, Calcutta.	Commissioner of Income-tax, Bengal.
19	Residents outside British India applying for refund of income-tax under Section 48 of the Indian Income-tax Act, 1922.	Income-tax Officer, Non-Residents Refunds Circle, Bombay.	....	Commissioner of Income-tax, Bombay.
20	Share-holders residing outside British India of a Company when the income of the non-resident share-holders arises in more than one British Indian Province.	Do.	Assistant Commissioner of Income-tax, Bombay City.	Do.
21	Employes of the American United Presbyterian Mission, residing in the United Provinces, the Punjab and the North-West Frontier Province.	Income-tax Officer, Gujranwala	Assistant Commissioner of Income tax, Lahore.	Commissioner of Income-tax, Punjab.
22	Employes of all Railway Collieries who are under the audit of the Audit Officer, Railway Collieries, Calcutta.	Income-tax Officer, Railway Salaries Circle, Calcutta.	Assistant Commissioner of Income-tax, Calcutta.	Commissioner of Income-tax, Bengal.
23	Employes of the Central India Coalfields Railway.	Income tax Offier, Ranchi.	Assistant Commissioner of Income-tax, Ranchi Range.	Commissioner of Income-tax, Bihar and Orissa.
24	Employes of the Rajputana Minerals Company, Ltd.	Income-tax Officer, Salaries, Bombay.	Assistant Commissioner of Income-tax, Bombay City.	Commissioner of Income-tax, Bombay.
No. 11-I.T., dated 31-3-28. 25	All persons assessed under Section 44-C.	Income-tax Officer, Non-residents Refunds Circle, Bombay.	Assistant Commissioner, Bombay City.	Commissioner of Income-tax, Bombay.

Previous law—

Sub-sction (2) was as below: The Board of Inland Revenue shall consist of one or more persons appointed by the Governor-General in Council.

The Central Board of Revenue has now taken over the functions of the Board of Inland Revenue. Its constitution is governed by the Central Board of Revenue Act (IV of 1924) and the rules thereunder. It deals at present with the principal central heads of revenue, *viz.*, Customs, Taxes on Income, Salt, Opium, and (to the extent that the Central Government is concerned) Stamps and Excise.

The arrangements for the collection and administration of income-tax have undergone radical alterations since 1886. In those days the revenue was small and the arrangements were comparatively simple. The different schedules were water-tight, and the tax under ' salaries ' and ' interest on securities ' was finally collected by the persons disbursing the income. The Collector assessed the income of Joint Stock Companies after calling for the returns and accounts; and there was no provision for revision except by the Commissioner of the Division and that too if the tax exceeded Rs. 250. ' Other income ' was assessed summarily if the income was below Rs. 2,000 and after notice to the assessee in other cases. The assessee could petition the Collector for revision and again go up to the Commissioner if the tax exceeded Rs. 250. The tax was collected by the Land Revenue officials working under the Local Government. The tax was divided in fixed proportions between the Local and the Central Governments.

In 1916 a system of calling for returns of income in all cases was introduced and summary assessments were given up.

In 1918 rights of appeal were allowed in all cases. A limited right of reference to the High Court was also given but as far as possible the agency of the Local Government was continued for administering the tax.

Then came the Reforms scheme with its separation of finances and functions between the Provincial Governments and the Central Government. Meanwhile, the working of the 1918 Act had shown the need for revising the Act, and a committee was appointed by the Government of India in 1921. This committee—the All-India Income-tax Committee of 1921 (*see* Appendix VII)—recommended the appointment of experts as Income-tax Officers, and the administration of the Department by a Central

Board of Revenue (which was called at first the Board of Inland Revenue) assisted by wholetime Commissioners and a number of Assistant Commissioners for each province. The Government of India accordingly took over the administration of the Department directly in their own hands through their Board of Revenue.

United Kingdom Law--

The machinery for the assessment, collection and administration of income-tax in England is very complicated. The Board of Inland Revenue are by Statute specifically entrusted with the care and management of income-tax, and are given power to do—

"All such acts as may be deemed necessary and expedient for raising, collecting, receiving and accounting for the tax or the like in as full and ample a manner as they are authorized to do, with relation to any other duties under their care and management "—

(Income-tax Act, 1918, section 57). (In the Income-tax Acts the Board of Inland Revenue are referred to as the Commissioners of Inland Revenue); but the Board of Inland Revenue have ordinarily nothing to do with assessments or appeals against assessments. This work is entrusted, broadly speaking, to two bodies of Commissioners, known respectively as (*a*) Commissioners for general purposes, or District Commissioners, and (*b*) Special Commissioners. District Commissioners are scattered throughout Great Britain in divisions of varying sizes. All of them are non-officials. The Special Commissioners have their offices in London, and occasionally hold meetings elsewhere. They are all officials. Ireland is under the jurisdiction of the Special Commissioners. In addition to these two bodies there is a third body of persons known as Additional Commissioners who are appointed by the General Commissioners for the division. These Additional Commissioners make the initial assessments under Schedule D, and appeals are heard by the General Commissioners. In some divisions a small group of the General Commissioners make the initial assessments, and the rest of the Commissioners hear the appeals. In Ireland there are no Additional Commissioners, their place being taken by the Inspector of Taxes.

Each body of Commissioners has a clerk who is appointed by them. There is an Inspector of Taxes, a civil servant appointed by the Board of Inland Revenue. He has no statutory authority, not even to demand the production of any accounts or documents; but he is really, in practice, the power behind the Commissioners. In addition there are Assessors appointed by the Commissioners, and also Collectors of Taxes similarly appointed by them. In practice, however, the two offices are held by the same individual. It would appear that the Assessors' duties are now-a-days confined only to issuing the forms of returns, and that the Inspector of Taxes has, to all intents and purposes, taken over the entire duties of the Assessors.

Super-tax can be assessed only by the Special Commissioners. The same body also assesses railways, foreign and colonial dividends paid in the United Kingdom, and also deals with refunds. It is also open to a tax-payer under Schedule D to have his case assessed by, or, if an appeal, heard by the Special Commissioners instead of the General Commissioners.

As already observed, the administrative machinery in England is much too complicated to admit of a brief description, but an important feature should be mentioned. Broadly speaking, where the assessment is made or appeal is heard by the General Commissioners or by the Special Commissioners, the procedure is somewhat like that of a Court, and, along with the assessee, the Inspector of Taxes also is heard on behalf of the Revenue. From the appeal of the Special or the General Commissioners, as the case may be, a reference lies to the High Court on questions of law. It will be seen that the Commissioners of Inland Revenue have nothing to do directly with the assessments, the Inspector of Taxes representing them before the assessing Commissioners. In recent years, however, limited powers have been given to the Board of Inland Revenue to decide cases, for example, whether a particular person is ordinarily resident in the United Kingdom or not.

CHAPTER III.

TAXABLE INCOME.

Heads of income chargeable to income tax.

6. Save as otherwise provided by this Act, the following heads of income, profits and gains, shall be chargeable to income-tax in the manner hereinafter appearing, namely:—

(i) Salaries.

(ii) Interest on securities.

(iii) Property.

(iv) Business.

(v) Professional earnings.

(vi) Other sources.

History—

In the Act of 1886, Income was taxed under four separate schedules—Salaries, etc.; Interest on Government securities; Profits of Joint Stock Companies, and other Income. In the 1918 Act, the present six-fold classification was introduced, but the wording was slightly different as below :—

(iii) Income derived from house property;

(iv) Income derived from business;

(vi) Income derived from other sources;

and a decision of a Court[1] confined (iii) only to residential house property. The Act was therefore amended in 1920. It will be seen that (iii) in the present Act is wider, and extends not only to residential house property but to all buildings and (appurtenant) lands not used for business—see sections 9 and 10. Another change made in 1922 was the substitution of the word ' heads ' for ' classes '. The words " profits and gains " were also added in 1922.

Scope of section—

Section 6 merely sets out the different sources of income; the manner of taxing each head, or rather the method of computing income under each head is explained in the following sections. As to the nature of the income falling under each of the categories set out in this section, see the notes under sections 7 to 12.

It is arguable, though probably not correct to hold, that by the substitution of the word 'heads' for 'classes' the categories enumerated in the Section have ceased to be exhaustive; and that income from ' business connection '—*vide* section 42—is taxable as a separate category, over and above the six categories in section 6. See notes under section 42 as to the meaning of " business connection ".

United Kingdom Law—

The corresponding provision in the United Kingdom law is the Schedules—which are far more complicated, and hardly so well arranged, as will be seen below.

In the United Kingdom the tax is charged under five Schedules as below : —

Schedule A—

In respect of the property in all lands, tenements, hereditaments, and heritages in the United Kingdom: This is known

(1) *Rowe & Co. v. Secretary of State*, 1 I.T.C. 161.

as the 'property' or the owners' tax, and covers not only lands and buildings but also mines, gas-works, water-works, salt-springs, docks, railways, fisheries, roads, markets, fairs, tolls, bridges, ferries, etc. Needless to say, it also includes agricultural lands. It will be seen that this Schedule partly covers the following heads under the Indian law, *viz.*, Property, Business and Other sources. There are elaborate rules as to how a property shall be valued, what deductions may be allowed, which persons may be charged, and so forth. These rules, however, are not of much interest to us in India.

Schedule B—

In respect of the occupation of all lands, tenements, hereditaments, and heritages in the United Kingdom : This is known as the occupiers' tax. There is no corresponding tax in India.

Schedule C—

In respect of all profits arising from interest, annuities, dividends, and shares of annuities payable out of any public revenue : This corresponds to a part of the tax on Securities in India under section 8.

Schedule D—

In respect of—

(*a*) The annual profits or gains arising or accruing—

(i) to any person residing in the United Kingdom from any kind of property whatever, whether situate in the United Kingdom or elsewhere; and

(ii) to any person residing in the United Kingdom from any trade, profession, employment or vocation, whether the same be respectively carried on in the United Kingdom or elsewhere; and

(iii) to any person, whether a British subject or not, although not resident in the United Kingdom, or from any trade, profession, employment, or vocation exercised within United Kingdom; and

(*b*) All interest of money, annuities, and other annual profits or gains not charged under Schedule A, B, C or E, and not specially exempted from tax; in each case for every twenty shillings of the annual amount of the profits or gains.

Tax under this Schedule shall be charged under the following cases respectively; that is to say—

Case I.—Tax in respect of any trade not contained in any other Schedule;

Case II.—Tax in respect of any profession, employment, or vocation not contained in any other Schedule;

Case III.—Tax in respect of profits of an uncertain value and of other income described in the rules applicable to this Case;

Case IV.—Tax in respect of income arising from securities out of the United Kingdom, except such income as is charged under Schedule C;

Case V.—Tax in respect of income arising from possessions out of the United Kingdom;

Case VI.—Tax in respect of any annual profits or gains not falling under any of the foregoing Cases, and not charged by virtue of any other Schedule;

and subject to and in accordance with the rules applicable to the said Cases respectively.

This is the most important of the Schedules, and covers the heads, Business, Professional earnings, a part of Securities and a part of 'Other sources' under the Indian law.

Schedule E—

In respect of every public office or employment of profit, and in respect of every annuity, pension, or stipend payable by the Crown or out of the public revenue of the United Kingdom other than annuities charged under Schedule C. This covers a part of the head 'Salaries' under the Indian law, the other part, that is to say, salaries paid by private employers, etc., being included in Schedule D.

Under each Schedule there are elaborate rules as to computation, deductions, etc., and a reference to these rules and to the extent that they can be followed in India, is made under the corresponding sections in the Indian Act.

Income-tax is a single tax—

In *London County Council* v. *Attorney-General*[1] it was contended on behalf of the Inland Revenue that the Income-tax on property was totally distinct from Income-tax on profits, etc., a separate tax so to speak, and that there was nothing to prevent the same income being taxed twice over in the hands of the same person. This view had been sometimes upheld by Courts, but the House of Lords overruled it.

Per Lord Macnaghten.—Income-tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else. It is one tax, not a collection of taxes essentially distinct. There is no difference in kind between the duties of income-tax assessed under Sche-

(1) 4 Tax Cases 265.

dule D and those assessed under Schedule A or any of the other Schedules of charge. One man has fixed property, another lives by his wits, each contributes to the tax if his income is above the prescribed limit. The standard of assessment varies according to the nature of the source from which taxable income is derived. That is all . . . . . In every case the tax is a tax on income, whatever may be the standard by which the income is measured . . . . . But to read the enactment as imposing a double duty (on the same person and on the same item) would be contrary to the whole scope of Income-tax legislation and whimsical in the highest degree."

The above remarks apply *a fortiori* to India. In the United Kingdom, there are no provisions like section 18 (5) of the Indian Act which says that tax paid at source shall be 'credited' to the account of the assessee nor a rule like Rule 27. Nor is 'set off' allowed in the United Kingdom as between different sources of income. It is allowed for all practical purposes only under Schedule D, and even so in respect of trading profits and losses only. These provisions in the Indian law show even more conclusively than in the United Kingdom that the tax is a single tax on income. A further point is that assessees in the United Kingdom are not allowed to deduct interest on borrowed capital, salaries paid to employees, etc., from profits. The assessee has to pay tax on the gross profits, but is legally entitled to deduct the Income-tax from the persons to whom he pays salaries, interest, etc. In other words, it is only by implication that the United Kingdom laws exclude from taxation what are, strictly speaking, not the assessee's income but payments due to others. On the other hand, the Indian law expressly excludes most such payments from income, *e.g.*, interest on debentures, interest on borrowed capital, etc. The general scheme of the Indian Act is to tax the assessee's net income. The idea of the sources of tax being water-tight as against each other, is more repugnant to the Indian law than to the United Kingdom law, and the same income cannot be taxed twice over in the hands of the same person on the ground that it appears in two sources. The most common instances of such cases are when income from property or interest on investments enters into 'Business.' The assessee cannot be taxed on property as such, and again on that portion of the business profits which includes income on property which has already been taxed; and there is express provision for this. As regards investments, the position is clear as regards Insurance Companies, and Rule 27 says that the tax on the excess of income from investments deducted at source over the net profits of the Company ascertained actuarially (or by estimate), shall be refunded. In respect of other Companies the position is not so clear, though Section 18 (5) evidently means that if the income from investments exceeds the net profits of the business, the excess shall be refunded. The position becomes complicated when the only business is that of investments with borrowed capital. See notes under sections 8 and 10.

Double taxation—Presumption against—

Per Lord Justice Brett in *Gilbertson* v. *Fergusson.*[1]—

"Now it may be true that there are no specific words in this statute which point out that the Government are not to receive the tax twice over, but it would be so clearly unjust and obviously contrary to the meaning of the statute that the Government should have the tax payable twice over by the same person in respect of the same thing, that I should say it was a necessary implication that it could not be right."

This principle has been followed in all subsequent English decisions. There is, of course, no double taxation if different persons are taxed in respect of what may seem the same income at first sight.

" Money passes through the hands of a great number of people . . . . you have received your money and have paid Income-tax upon it, and then you pay it out again to other people and they make a profit out of it and they pay Income-tax upon it again."[2]

Per Lord Macnaghten in *Attorney-General* v. *London County Council.*[3]—

"Speaking generally, all income is chargeable, but chargeable only once. Income is brought into charge at its source and the burden is then distributed among the recipients of the income who bear their share, in just proportion."

The concluding part of this dictum is not of much interest in India. In the United Kingdom the person who is taxed in the first instance is refused some deductions from the taxable income on account of payments made to other persons, but is legally authorized to deduct income-tax from the payments that he makes to his creditors, and thus reduce his own share of income-tax. In India the position is different. See notes under section 18.

"There could be double taxation if the Legislature distinctly enacted it, but upon general words of taxation, and when you have to interpret a Taxing Act you cannot so interpret it as to tax the subject twice over to the same tax. But it all depends on its being the same tax and . . . . . there is nothing to prevent either one Legislature or two Legisla-

(1) 1 Tax Cases 501.
(2) *Per Grantham, J.* in *Leeds Building Society* v. *Mallandaine*, 3 Tax Cases 577.
(3) 5 Tax Cases 242.

tures, if they have jurisdiction over the subject-matter, imposing different taxes on the same subject-matter."[1]

Double Taxation—

Per Mukerjee, J. in *Manindra Chandra Nandi* v. *Secretary of State.*[2]—

"It may be conceded that Courts always look with disfavour upon double taxation, and Statutes will be construed, if possible, to avoid double taxes: see the observations in *Carr* v. *Fowle.*[3] To the same effect are the observations of Chief Justice Waite in *Tennessee* v. *Whitworth*[4] in which that learned Judge, in delivering the unanimous opinion of the Supreme Court of the United States, remarked as follows:—

'It is no doubt within the power of a State to subject a corporation to double taxation. Double taxation, however, is never to be presumed. If property is taxed once in one way, it would ordinarily be wrong to tax it again in another way, when the burden of both taxes falls on the same person. Sometimes tax laws have that effect, but if they do, it is because the Legislature has unmistakably so enacted. All presumptions are against such an imposition.'

But when the Legislative intent is clear and unmistakable, effect must be given to the statutory provisions on the subject. The question of double taxation is one of expediency for the consideration of the Legislature; it cannot be affirmed, as a matter of law, that double taxation is forbidden: see the decision of the Supreme Court of the United States in *Davidson* v. *New Orleans,*[5] *New Orleans* v. *Houston*[6]; see also *Reclamation* v. *Hagar*[7] and *United States* v. *Benzon.*[8] It must be held consequently that the royalty received by the plaintiff, is liable to be assessed with cesses, as it is part of the net annual profits from the mine, and it is also liable to be assessed with income-tax, inasmuch as it is taxable 'income' within the meaning of the Income-tax Act."

Again in the *Raja Probhat Chandra Baru's Case*[9] per Rankin, J.—

"Some reference was also made to what has been called a 'presumption against double taxation.' In *Manindra Chandra Nandi* v. *Secretary of State,*[2] royalties from a coal mine were held liable both to cess under the Cess Act, 1880, and to income-tax under the Act of 1886, but it was said that 'it may be conceded that Courts always look with disfavour upon double taxation, and statutes will be construed if possible to avoid double taxes.' Reference was made to certain dicta of American Courts and to

(1) *Per Channel, J.* in *Stevens* v. *The Durban, etc., Mining Company,* 5 Tax Cases 402.
(2) 34 Cal. 257.
(3) (1893) 1 Q.B. 251.
(4) (1886) 117 U.S. 139.
(5) (1877) 96 U.S. 97.
(6) (1886) 119 U.S. 265.
(7) (1880) 6 Sawyer 567; 4 Fed. Rep. 366.
(8) (1865) 2 Cliff 512; 24 Fed. Rep. 1112.
(9) 1 I.T.C. 414.

the English case of *Carr* v. *Fowle.*[1] But the only observation in this case was to the effect that the statute presumably did not intend that a vicar should in effect pay the same tax (land tax) twice on the same hereditament. This is plain enough. Thus the income-tax is one tax, and income assessed under one Schedule cannot be assessed all over again under another. That there is any legal presumption of a general character against 'double taxation' in any wider sense is a proposition to which I respectfully demur as a principle for the construction of a modern statute. In *Manindra Chandra Nandi* v. *Secretary of State*[2] it did not avail to cut down clear though absolutely general language."

Holding Companies—Taxation of—

It should be mentioned in this connection that the taxation to super-tax of dividends received by holding companies does not involve any double taxation. The super-tax paid by companies in India is not in any sense paid on behalf of the shareholder—see section 14; it is really of the nature of a corporation tax on profits, and it follows therefore that the super-tax paid—as a company—by a holding company in respect of dividends from another company, does not involve double taxation. Double taxation can arise only if the *same* person is taxed twice in respect of the same income.

Can the Crown choose the head under which to tax?—

Whether it is open to the Crown to recover tax at its discretion under a particular source of income when the assessee has income from more than one source, is a somewhat difficult problem. The law in the United Kingdom was laid down in several decisions :—*Norwich Union Fire Insurance Co.* v. *Magee*[3]; *Revell* v. *Edinburgh Life Insurance Co.*[4]; *Liverpool & London & Globe* v. *Bennett*[5], and it is now recognised that the Crown has the right to choose the source under which the income may be taxed. The problem arises in respect of investments in the course of business, chiefly that of Insurance Companies. The Crown can tax either the investments (*less* a deduction for expenses of management—for which there are special provisions) or the net profits of the business including the investments.

The position in India is different. In the case of Insurance Companies, Rule 27 makes the position clear beyond doubt. If the interest on investments of such a company exceeds the profits of the company actuarially ascertained (or correspondingly under

(1) (1893) 1 Q.B. 251.
(2) 34 Cal. 257, 287.
(3) 3 Tax Cases 457.
(4) 5 Tax Cases 221.
(5) 6 Tax Cases 327.

Rules 25 *et seq.*), the excess income-tax paid on the interest at source is refunded to the company. The Crown, therefore, has no right to choose the source under which it will tax the company. As regards other assessees, the position depends entirely on the meaning of section 18 (5). The words "Credit shall be given to him therefor in the assessment, if any, made for the following year under the Act" would seem to imply no such option in India, as in the United Kingdom, to the income-tax authorities. "Credit shall be given" can only mean that the payment is a provisional payment, the final liability depending on something else. Section 18 does not determine the final liability. It is only a 'machinery' section, and arranges for the provisional collection of taxes at source. The words, as they stand, do not authorize the Crown to refuse to refund the tax collected under section 18 (5), if the 'total income' of the assessee is less than the income from interest on securities or salaries. Besides, the assessment is made with reference to 'total income' (sections 22 and 23), and 'total income' is defined in section 16. Under section 24, set-off is allowed as between the different sources of income. It is clear from these provisions and section 48 (3) that if the interest on investments made by an assessee, is in excess of his 'total income' (after set-off), the tax deducted at source on the interest on investments is partly or wholly refundable. In the United Kingdom, the right of set-off is restricted. It is allowed, generally speaking, only in respect of 'Schedule D,' and even so, only in respect of 'trading'. In India, on the other hand, the law allows set-off in respect of *all* sources of income.

Salaries.

7. (1) 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 received by him in lieu of, or in addition to, any salary or wages, which are paid by or on behalf of Government, a local authority, a company, or any other public body or association, or by or on behalf of any private employer:

[1]*Explanation.*—The right of a person to occupy, free of rent, as a place of residence, any premises provided by

(1) Inserted by the Income-tax (Amendment) Act, 1923 (XV of 1923).

his employer, is a perquisite for the purposes of this sub-section.

Provided that the tax shall not be payable in respect of any sum deducted under the authority of Government from the salary of any individual for the purpose of securing to him a deferred annuity or of making provision for his wife or children, provided that the sum so deducted shall not exceed one-sixth of the salary.

(2) Any income which would be chargeable under this head if paid in British India shall be deemed to be so chargeable if paid to a British subject or any servant of His Majesty in any part of India by Government or by a local authority established by the Governor-General in Council.

History—

For corresponding provisions in the 1886 Act, see sections 3 (4), 3 (5), 7, 8 and 9.

In the 1918 Act, the 'explanation' clause did not exist. There was another proviso, under the first sub-section, which exempted the salaries of soldiers drawing less than Rs. 500 per mensem, which exemption was cancelled in 1920. Also, the section did not extend to salaries paid by all private employees—see paragraph 23 of the Income-tax Manual cited below.

Salaries—(*Section* 7).—"The income taxable under this head includes not only fixed salaries or wages and annuities or pensions, but also any fees, commissions, perquisites or profits received in lieu of, or in addition to, salaries or wages which are paid to an employee by or on behalf of any employer. Under the Act of 1918, the income chargeable under this head applied only to 'salaries' in the above sense when paid by or on behalf of Government, a local authority or company, any other public body or association or by or on behalf of any private employer who had entered into an agreement with the Income-tax Officer to recover the tax on behalf of Government, but under the present Act, it applies to all salaries paid by or on behalf of every private employer, the obligation to deduct income-tax from salaries being, under section 18 (2) of the Act, an obligation on every employer." (*Income-tax Manual*, para. 23.)

Residences—Value of—Explanation—

The 'explanation' in sub-section (1) was introduced in 1923. Under the Act of 1918 [section 3 (2) (*ix*)] 'a perquisite or benefit which is neither money nor reasonably capable of being converted into money' was exempt from taxation. This was merely a reiteration of the English law as expounded by the House of Lords in *Tennant* v. *Smith.*[1] In 1922 it was definitely decided to abandon this position, as it led to inequalities in assessments. See the Statement of Objects and Reasons of the Amending Bill and the Report of the Select Committee. The intention, therefore, was to tax perquisites and benefits that possessed a money value, whether or not they were in fact capable of conversion into money. But the wording of section 7 did not fully carry out this intention. Whatever the meaning of the word 'received' in section 7 (1). though it is evidently used here as the correlative of 'paid' the word 'paid' clearly connotes a payment in money; and in no sense could it be said that a rent-free residence was 'paid' to a person. Hence the introduction of an 'explanation' clause.

Perquisites—Other than residences—

The position regarding benefits other than free residences, *e. g.,* free medical advice, free conveyance for other than official duties, free board, etc., is evidently governed by the principle of *Tennant* v. *Smith.*[1] Such benefits are not reasonably capable of conversion into money, and they are no more 'paid' than free residences. These benefits are therefore not taxable; but the question is not of much importance.

Residence—Value of—Limitation—

By executive orders (*Vide* para. 20 of the Income-tax Manual) it has been arranged that when a rent-free residence or residences form part of the perquisites of an employee, the money value of the perquisite should not be taken at more than 10 per cent. of the salary of the employee. The 10 per cent. is calculated on the salary and not on his 'total income'.

Salaries—Tax on—Collection of—

As to how taxes are collected on 'salaries', see section 18; as regards the annual returns to be furnished by employers, see section 21; and as regards refunds, see section 48.

Meaning of words—

Salary.—"Signifies a recompense or consideration given unto any man or his pains bestowed upon another man's business." (Terms *de la ley*) (Stroud).

(1) (1892) A. C. 150; 3 Tax Cases 158.

Wages.—"Though this word might be said to include payment for any services, yet in general the word 'salary' is used for payment of services of a higher class, and 'wages' is confined to the earnings of labourers and artisans."[1]

"Wages then are the *personal* earnings of labourers and artisans." (Stroud.)

This distinction between salary and wages is of no importance in India, as the law does not prescribe different arrangements for the taxation of salaried persons and wage-earners as the United Kingdom law does. In the United Kingdom the question has been one of importance; for a discussion see *G. W. Railway* v. *Bater.*[2]

Annuity.—" A yearly payment of a certain sum of money granted to another in fee for life or years charging the person of the granter only " (Co. Litt. 144-*b*) (Stroud).

But in this context it simply represents a recurring annual payment.

Pension.—Is really deferred pay or a compensation for past services, etc.; and is usually distinguished, in India at any rate, from 'gratuity', the latter denoting lump sum payments while the former denotes periodical recurring payments.

Fees.—Here evidently refer to fluctuating payments depending on the work done as distinguished from salaries, etc., which are fixed with reference to a period of time.

Commissions.—Hardly require any elucidation.

Perquisites.—See notes under section 4 (2) (*vi*).

Received.—"Income under this head is always included in the income of the year in which it is received irrespective of the period in respect of which it was earned, with the solitary exception that where an officer of Government takes an advance of pay, the tax is not chargeable on the advance, but the tax is charged on the full salary of the month in which the advance is recovered by deduction without any regard to the deduction. A portion of a salary withheld under the orders of a Court is liable to tax." (*Income-tax Manual*, para. 23.)

In this connection see the words " which are *paid* by or on behalf of Government, etc., ... " and the absence of any interpretation clause as in sections 10 to 13. Section 13 does not apply to salaries, *i.e.*, the method of accounting followed by the recipient of the salary does not affect the computation.

(1) *Per Grove, J.* in *Gordon* v. *Jennings*, 51 L. J. Q. B. 417.
(2) (1921) 2 A. C. 1; 8 Tax Cases 231.

Honoraria—

Honoraria or fees paid to Government servants by local bodies or private persons, companies, etc., for professional work, the whole of which is in the first instance credited to Government, after which the whole or part is drawn under proper sanction by the Government servant concerned on a bill, should be taxed as salary by deduction at source. They are obviously fees, commissions, or perquisites received in addition to salary and paid by or on behalf of Government [section 7. (1)].

Place of payment—Immaterial—

The expression "paid by Government, etc." does not mean paid in India. The tax is chargeable irrespective of the place of payment, even though such place be not merely outside British India but outside India. It will be sufficient if the income clearly accrues or arises in British India. The second sub-section applies to income which is neither paid in British India nor accrues or arises in British India. See also the amendment to section 18, sub-section 2 (*a*), introduced in 1925.

Salary, etc., need not be monthly—

The law says nothing as to the intervals at which salaries, etc., need be payable. If the pay is, say, annual, and advances are given from time to time, such advances cannot be taxed. An 'advance' is of a capital nature and therefore not taxable. On the other hand if the so-called advances are really payments in instalments, they would be taxable.

Perquisites of office—

As to what are or are not perquisites of an office that are "received in lieu of or in addition to salary, etc." see the decisions set out under section 4 (3) (*vii*).

Salaries—Pensions paid by Foreign Governments—

The salary paid by a Foreign Government or an Indian State cannot fall under this section. Such a State is not Government (see General Clauses Act), nor a local authority (*ibid*), nor a company [see section 2 (6)], nor a public body or association, nor a private employer. It would be a straining of words to say that a foreign State was a public body or a private employer. Such 'salaries' are income under 'other sources' under section 12 though with some straining they may be considered to be income from a profession under section 11. In either case deduction of tax cannot be made at source; and the Income-tax Officer can only recover the tax after assessing the income at the end of the year.

Annuities—Not paid by employer—

This section does not apply to annuities other than those paid by Government, etc., or a private employer. Such annuities, *e.g.*, under a will or paid by an Insurance Company fall under 'income from other sources'—section 12, and the tax on such annuities cannot be deducted at source under section 18.

United Kingdom law—

The law in the United Kingdom about the taxation of salaries is as below. Tax under Schedule E is charged

"in respect of every public office or employment of profit" and "in respect of every annuity, pension or stipend payable by the Crown or out of the public revenue of the United Kingdom other than annuities under Schedule C."

As to what constitutes 'public' office there has been much dispute—see *Great Western Railway* v. *Bater*[1]; and in respect of an office which is not 'public' the tax is levied under Schedule D on the employer who is permitted to retain the tax on account of 'annual payments paid out of profits'. Also the tax under Schedule E is on an annual basis, whereas under Schedule D it was till recently on the basis of an average of three years.

As regards the difference between India and the United Kingdom—in the taxation of perquisites not capable of conversion into money—see the notes regarding the Explanation under sub-section (1).

Proviso—Deductions—

"The proviso to sub-section (1) applies only to compulsory deductions made under the authority of Government, and not to compulsory deductions made by other employers (see paragraph 18, cited under section 4 (3) (iv). The amount exempted under this proviso has, however, to be taken into account under section 16 (1) in computing the total income of an assessee for the purposes of determining whether he is liable to tax and the rate at which he is to be assessed. An assessee, for example, who has a salary of Rs. 180 per mensem or Rs. 2,160 per annum and from whose salary a compulsory deduction is made by the authority of Government of Rs. 300 per annum of the nature referred to in this proviso, is liable to pay income-tax on Rs. 1,860 at the rate applicable to an income of Rs. 2,160.

(1) (1921) 2 A. C. 1; 8 Tax Cases 231.

"Under section 58 of the Act this proviso does not apply to super-tax, that is, no allowance of this is made for super-tax purposes." (*Income-tax Manual*, para. 23.)

Under the General Clauses Act (X of 1897) 'Government' includes Local Governments : deductions made under the orders of Local Governments are also therefore entitled to this exemption.

Deductions from salaries—United Kingdom Law—

The corresponding provision in the United Kingdom is as below :—

"Any person . . . . who is under any Act of Parliament liable to the payment of an annual sum or to the deduction of an annual sum from his salary or stipend in order to secure a deferred annuity to his widow or a provision to his children after his death . . . . shall be entitled to deduction of the amount of the annual premium, etc."

The one-sixth limit applies as here and is subject not only to the same conditions, *i.e.,* including insurance premia paid (section 15) but to others—See notes under section 15.

It will be noticed that in the United Kingdom a deduction is not admissible on account of a deferred annuity for the assessee himself, though it is allowed if the contract is with a company. The reason probably is that there is no case in which an Act of Parliament prescribes such deductions in order to secure deferred annuities for the assessee himself.

Private provident funds—

As regards deductions on account of private provident funds, see notes under section 4 (3) (*v*).

A payment made on retirement, etc., to an employee from a private provident fund, that has been formed into a Trust, cannot be regarded as a payment of salary within the meaning of section 7 (1) of the Indian Income-tax Act (XI of 1922) because the trust is not the employee's employer. Such a payment is therefore not liable to taxation by deduction of tax at source.

Salaries—Exemption—

For classes or portions of 'salaries' which are entirely exempt from tax, see exemptions under section 60.

Salaries paid in India but outside British India—

Section 7 (2).—This sub-section makes chargeable, under this head, salaries paid from Indian revenues to Government employees in any part of India, and salaries paid by a local authority established in exercise of the powers of the Governor-General in Council. All servants of Government or of such local authorities are, therefore, liable to pay tax on their salaries if they are employed in any part of India, and irrespective of their nationality.

The words "or any servant of His Majesty" in this sub-section were inserted in the Act of 1918 so as to bring all servants of the Crown, whether British subjects or not, within the purview of this sub-section, on the ground that it seemed unnecessary to give to persons who were not British subjects specially favourable treatment which was not accorded to British subjects.

The pay of officers whose services have been lent to, and whose salaries are paid by, Indian States are not chargeable to income-tax under this section unless they are drawn or received in British India; but the leave allowances and pensions of such officers are, leaving the question of the place of their payment aside, chargeable to income-tax. The Government of India recover contributions at fixed rates from the Indian States to meet the cost of leave allowances and pensions of officers in foreign service, and make themselves responsible for paying the leave allowances and pensions of their employees earned in foreign service. (*Income-tax Manual*, para. 24.)

Object of sub-section (2)—

This sub-section is necessary because otherwise the salaries would not be taxable, as they neither accrue nor arise in British India nor are received therein—see notes under section 4 (1) regarding the meaning of the word 'accrue' or 'arise'. This sub-section makes it clear that the exemption under section 60 exempting salaries of officers on deputation abroad who also receive their salaries abroad, is superfluous.

Endowed income—Whether salary—

In *Secretary of State* v. *Mohiuddin Ahmad*[1] the facts of which were peculiar, it was held that the Superior of a *khankha* (a kind of monastery) was the owner of the income from the endowment, and not the recipient of a salary therefrom. The income in question was wholly agricultural and therefore exempt in the hands of the recipient, but if the Superior had been treated as a salaried employee he would have been taxable.

Salaries—Paid free of tax—

A Railway Company had been assessed to income-tax under Schedule E in respect of all offices or employments of profit held

(1) 27 Cal. 674; 1 I.T.C. 4.

under the company. In pursuance of a contract with its officers the company did not exercise its statutory right to deduct on payment of the salaries the tax in respect thereof payable by the company, and the Schedule E assessment had accordingly been made upon the company in a sum representing the amount of salaries actually paid *plus* the amount of income-tax thereon borne by the company on behalf of its officers. *Held,* that the contract to pay the salaries free of income-tax constituted in effect an agreement to pay the salaries *plus* the tax thereon and that the Schedule E assessment upon the company had been correctly computed by reference to the amount of salaries actually paid *plus* the tax thereon borne by the company.[1]

In a later case it was held that the income-tax paid by the employer on an employee's salary—even though under no legal obligation to do so—is part of the employee's emoluments for purposes of income-tax.[2]

Salaries etc., paid outside India—

Under exemptions .... (granted under section 60) leave allowances or salaries paid in the United Kingdom to, or drawn from any Colonial treasury by, officers of Government on leave or duty in the United Kingdom or in a Colony and the pensions of officers of Government residing out of India, which are paid in the United Kingdom or are drawn from any Colonial treasury, are exempt from tax. Similarly under exemptions 19-A and 21-A—

Leave salaries or leave allowances paid in the United Kingdom or in a Colony to officers of local authorities or to employees of companies or of private employers on leave in the United Kingdom or in a Colony and pensions paid in the United Kingdom or in a Colony to officers of local authorities, or to employees of companies or of private employers, provided such officers or employees are residing out of India, are exempt from tax. Vacation salaries paid in the United Kingdom or in a Colony to Judges of High Courts or of Chief Courts, to Judicial Commissioners or to other officers of Government when on vacation therein are also exempt from tax—*vide* exemption No. 19-B in paragraph 16.

Pay and allowances drawn by officers from Indian revenues, which are earned by them by service outside India, are not liable to the tax unless they are drawn or received in India. (*Income-tax Manual,* para. 25.)

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(1) *The North British Railway Company* v. *Scott,* 8 Tax Cases 332.
(2) *Hartland* v. *Digginés,* 5 A. T. C. 117.

Interest on securities.

8. The tax shall be payable by an assessee under the head "Interest on securities" in respect of the interest receivable by him on any security of the Government of India or of a Local Government, or on debentures or other securities for money issued by or on behalf of a local authority or a company:

Provided that no income-tax shall be payable on the interest receivable on any security of the Government of India issued or declared to be income-tax free:

Provided, further, that the income-tax payable on the interest receivable on any security of a Local Government issued income-tax free, shall be payable by that Local Government.

History—

See section 13 and Second Schedule, Part III in the Act of 1886 and section 7 of the 1918 Act. The reference to the securities of a Local Government, including the proviso, is new; formerly, Local Governments did not issue securities.

Scope of Section—

The interest chargeable under this section is the interest only on securities of the Government of India or of a Local Government or on debentures or other securities for money issued by or on behalf of a local authority or company. It does not include the interest on debentures issued by firms, associations, clubs, or individuals the interest on which is chargeable under section 10 or 12.

With reference to the first proviso the Government of India War Bonds, 1920, 1921, 1922, 1923, 1925 and 1928, 5 per cent. loan 1945-55, Five-year 6 per cent. Bonds, 1926, Five-year 6 per cent. Bonds, 1927, Ten-year 6 per cent. Bonds, 1930, Ten-year 6 per cent. Bonds, 1931, Ten-year 6 per cent. Bonds, 1932 and Ten-year 5 per cent. Bonds, 1933, have been issued income-tax free.

The second proviso to this section prescribes that, where a Local Government issues any securities as income-tax free, the income-tax on the interest thereon shall be payable by that Local Government. So far as investors are concerned, therefore, securities issued income-tax free, whether by the Government of India or by Local Governments, stand on exactly the same footing, that is, income-tax is not payable on the interest received therefrom by the assessee, but the interest received therefrom is taken into account under section 16 (1) of the Act in determining the total income of the assessee for the purpose of deciding whether he is liable to income-tax and also for determining the rate at which he shall pay income-tax on his other income. The same remarks apply to Government securities purchased through the Post Office and held in the custody of the Accountant-General, Posts and Telegraphs (see exemptions under section 60). Super-tax is, however, payable by the recipient in respect of such interest, since, under section 58 of the Act, the provisos to this section do not apply to super-tax. (*Income-tax Manual,* para. 26.)

Exemptions—

For interest on other securities, which are entirely exempt from tax, see items (6), (7), (8) and (17) of the exemptions under section 60.

For interest on securities held by Provident Funds, etc., see notes under section 4 (3) (*iv*).

For interest on securities held by Charities, see notes under section 4 (3) (*i*) and (*ii*).

For interest on securities held by a Co-operative Society, see exemption under section 60.

Taxation at Source—

As in respect of salaries, so in respect of securities, income-tax on interest on securities is chargeable at source, *i.e.*, at the time the interest is paid. The person paying the interest is personally responsible to the Crown for collecting the tax and making it over (section 18). Super-tax is not deductible 'at source' even though the interest disbursed by the same person to a single individual may exceed Rs. 50,000.

The special provisions in section 57 apply only to profits of partners and dividends by companies.

As regards refunds, see section 48.

Tax-free securities—

These are not tax-compounded securities in the sense that the receiver of interest is credited with a notional payment of income-tax. The owner therefore is not entitled to any refund under section 48 (small incomes relief) or 49 (double-tax relief) in respect of such tax constructively paid by him; not even in respect of tax-free securities issued by a Local Government, though the tax in such cases is paid to the Government of India by the Local Government. No agency is recognized in respect of such payments of tax as though they were paid on behalf of the owner of the securities. This payment of tax is a matter entirely between the two Governments with which the holder of the securities is not concerned.

Debenture—

"No one seems to know exactly what 'Debenture' means." (Buckl, 192, citing *British India Steam Navigation Co.* v. *Inland Revenue*[1] in which Grove, J., said,—This is "a word which has no definite signification in the present state of the English language" *Re Florence Land Co. Ex parte Moor.*[2] It should rather be said that no one has yet laid down an exhaustive definition of a Debenture. The British India Steam Navigation Co.'s case shows that it is not true to say that a Debenture is necessarily an obligation under seal, or a charge on any property. *Faute de mieux,* it is suggested that, a Debenture is a written Obligation or Acknowledgment in an impersonal form, and with conditions more elaborate than those of a Promissory Note, given by or for a Corporation or a Company to secure a sum of money. Thus, in the British India Steam Navigation Co.'s case, Lindley, J., said—" Now, what the exact meaning of 'Debenture' is I do not know. I do not find any particular definition of it, and we know that there are various classes of instruments called 'Debentures'. You may have Mortgage Debentures, which are charges of some kind on property; you may have Debentures which are Bonds; you may have a Debenture which is nothing more than an Acknowledgment of debt; you may have an instrument, like this, which is something more—It is a statement by two Directors that a Company will pay. I think any Instruments of that sort may be Debentures". So in *Brown* v. *Inland Revenue*,[3] Charles, J., said—" A Debenture, though never, I believe, legally defined, is included under one or other of the three descriptions laid down by Bowen, L. J., in *English and Scottish Trust* v. *Brunton*,[4] as,—' (1) a simple Acknowledgment, under seal, of the debt; (2) an Instrument acknowledging the debt and charging the property of the Company with repayment; (3) an Instrument acknowledging the debt, charging the property of the Company with repayment, and further restricting the Company from giving any prior charge.' " (Stroud).

(1) 50 L. J. Q. B. 517; 7 Q. B. D. 165.
(2) 48 L. J. Ch. 137; 10 Ch. D. 530.
(3) 64 L. J. M. C. 211.
(4) (1892) 2 Q. B. 700; 62 L. J. Q. B. 136.

Other Securities for money—

There is no definition of this expression. Generally speaking, a 'security' is anything that makes money more assured in its payment or more readily receivable, as distinguished from a mere I. O. U., which is only evidence of a debt. In its most general sense the expression would include Bank notes, Bills of Exchange, Promissory notes and cheques.

Mortgages are securities for money.[1] It does not include Bank stock (*Ogle* v. *Knipe*) nor shares in a company.[2] It would include a Life policy.[3] Bonds[4], Bills of Exchange, Cheques and Promissory notes if complete (*Barry* v. *Harding*) J. and L. a. T. 472, *R.* v. *Hart*,[5] *Goldsmind* v. *Hampton*.[6] (Stroud).

In this section of the Indian Income-tax Act the expression 'securities for money' should evidently be construed *ejusdem generis* with debentures, *i.e.*, as referring to securities in the nature of debentures. It would not therefore include a life policy or cheque on neither of which, by the way, would interest ordinarily be payable—nor bills of exchange nor promissory notes (on neither of which would interest be paid at fixed recurring periods, which is evidently the generic feature contemplated by the section). The expression evidently refers to bonds in the nature of debentures, and would clearly not include Bank deposits. See however dicta cited below.

United Kingdom law—

Under the United Kingdom law it is a matter of much importance—especially when the income arises abroad to a resident—whether the income is from 'securities' or not. The question therefore has often been raised what are 'securities'.

" Shares in a company are not 'securities' but portions of its capital."[7]

" The holding of shares in a foreign corporation entirely situated and carrying on business in a foreign country, comes unquestionably under Rule 5 (Case V)"—*Per Fletcher Moulton, L. J.* in *Gramophone*

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(1) *Dicks* v. *Lambert*, 4 Ves. 725; *Ogle* v. *Knipe*, L. R. 8 Eq. 434.

(2) *Huddleston* v. *Gouldsbury*, 10 Bea. 547; *Re Maitland*, 74 L.T. 274; *M'Donnell* v. *Morrow*, 23 L. R. Ir. 591.

(3) *Lawrence* v. *Galsworthy*, 3 Juv. N. S. 1049.

(4) *Dicks* v. *Lambert*, *supra*; *Mainland* v. *Upjohn*, 41 Ch. D. 142.

(5) 6 C. & P. 106.

(6) 5 C. B. N. S. 94.

(7) *Per Wright, J.* in *Bartholomay Brewing Company* v. *Wyatt*, 3 Tax Cases

and Typewriter Company v. *Stanley.*[1] The point in this case was that if it was "securities" it fell under Case IV whereas otherwise it fell under Case V.

The point was again raised in *Singer* v. *Williams.*[2]

Per Lord Shaw.—" The word 'Securities' has no legal signification which necessarily attaches to it on all occasions of the use of the term. It is an ordinary English word used in a variety of collocations; and it is to be interpreted without the embarrassment of a legal definition and simply according to the best conclusion one can make as to the real meaning of the term as it is employed in, say, a testament, an agreement or a taxing or other statute as the case may be."

Per Lord Wrenbury.—" A ' security '. I take it, is a possession such that the grantee or holder of the security holds as against the grantor a right to resort to some property or some fund for the satisfaction of some demand, after whose satisfaction the balance of the property or fund belongs to the grantor. There are two owners and the right of the one has precedence of the right of the other. A share in a Corporation does not answer the above description. There are not two owners, the one entitled to a security upon something and the other entitled to the balance after satisfying the demand. A share confers upon the holder a right to a proportionate part of the assets of the Corporation; it may be a proportionate part of its profits by way of dividend or it may be a proportionate part of its distributive assets in liquidation. There is no owner other than himself."

Per Viscount Cave.—" The normal meaning of the word ' securities ' is not open to doubt. The word denotes a debt or claim the payment of which is in some way secured. The security would generally consist of a right to resort to some fund or property for payment; but I am not prepared to say that other forms of security (such as a personal guarantee) are excluded. In each case however where the word is used in its normal sense some form of secured liability is postulated. No doubt the meaning of the word may be enlarged by an interpretation clause contained in a statute . . . . but in the absence of any such aid to interpretation I think it clear that the word 'securities' must be construed in the sense above defined, and accordingly does not include shares or stock in a company."

Receivable—

It will be noticed that the word used in this section is ' receivable ' and not the past tense ' received ' like the word ' paid ' in section 7. It will also be noticed that section 13 does not apply to income under this head; that is to say, the method of accounting followed by the assessee does not affect his liability under this head of income. The question therefore arises whether having regard to the word ' receivable ' the income under

(1) 5 Tax Cases 358.
(2) 7 Tax Cases 419.

this head should be taken into account in the year in which the interest in question accrues and becomes payable to the assessee or in the year in which it is actually paid to him. It will be seen from sections 18 and 19 that the Act contemplates, so far as income from this head is concerned, the deduction of tax at the time of payment only, and that such deduction is advance deduction in respect of an assessment to be made in the subsequent year. It would seem therefore that the word 'receivable' must be construed as equivalent to 'received'. If it is not so construed, there is no machinery to recover the tax, inasmuch as section 19 will not apply as it cannot be stated that income-tax has not been deducted in accordance with the provisions of section 18 until and unless the interest itself has been actually paid.

Income from securities—Set off—

Where a Bank or other concern engaged in business similar to that of a Bank receives deposits or loans in the course of its business and invests the money so borrowed as occasion arises, it should be allowed in computing its liability to income-tax to set off the entire interest on such borrowings against its entire income liable to tax. No attempt should be made, for example, to allocate a proportion of the borrowed money to investments in tax-free securities and to set off the interest on such proportion against the tax-free securities instead of against the taxable income.

But (as an exception to the foregoing) in the rare cases in which there is definite proof (not a mere inference) that a certain sum was specifically borrowed by a Bank or similar concern for the purpose of investment in tax-free securities and has been so invested, the interest on the money so borrowed should be set off against the interest on the tax-free securities and not against the income liable to income-tax.

Assessees other than Banks or similar concerns may set off interest on money borrowed specifically for investment in taxable securities or shares, and so invested, against their income liable to tax taken as a whole, and not merely against the interest on such securities or the dividends on such shares. In all such cases there must be clear proof and not a mere inference that the money was specifically borrowed for such investment and actually invested. They cannot be allowed to set off against their income liable to tax interest on money borrowed for investment in tax-free securities and so invested. (*Income-tax Manual*, para. 26).

This concession has been given by executive orders in accordance with a promise given when the Act of 1922 was passed. It is a concession outside the law. Under each category of income—sections 7 to 12—the law sets out what deductions may be made in arriving at the taxable income; and no deductions are contemplated in respect of interest on securities.[1] It therefore follows that no deduction can be allowed under this head, and that whatever set-off may be made under section 24, such set-off can only take into account the income worked out under each head of income in accordance with the rules regulating that head of income. This view is confirmed by the decision of the Madras High Court in *C. I. T.* v. *M. Ar. Ar. Arunachalam Chettiar*[2] in which that Court decided that a set-off as between different businesses should be made under section 10 and not under section 24 which contemplated set-off only between the final result under different heads (as set out in section 6) as worked out under sections 7 to 13.

The position of an assessee holding securities as an ancillary or necessary part of his business is distinguishable. It is possible to hold that in such cases the interest from securities should be credited to profits, and the cost of money borrowed (which in most cases could not be identified) debited to the Profit and Loss account, and the assessee taxed on his profits under section 10, the tax collected on the securities being credited to him as an advance payment of tax. The position, however, is obscure. The cases in which it would be possible to take up such a position with the least objection would appear to be those of Banks, but even in regard to them the Bombay High Court ruled *In re Tata Industrial Bank*[3] that the depreciation of securities could not be allowed as a loss of profits. A similar view was taken by the Punjab High Court in regard to the *Punjab National Bank*.[4] That is to say, the securities do not form the stock-in-trade or the 'circulating capital' of a Bank, but part of its fixed capital or investments. But the law does not prevent the interest on money borrowed for fixed capital, *e.g.*, buildings or plant, being charged as a deduction necessary for earning the profits, and

(1) *Maharaja, etc., Sahi.* v. *Commissioner of Income-tax*, 6 Pat. 29; 2 I. T. C. 281.

(2) 1 I. T. C. 278.

(3) 1 I. T. C. 152.

(4) 2 I.T.C. 184.

there is therefore similarly nothing to prevent a Bank or similar business claiming to treat the income from investments as part of the income from business and as a necessary consequence to set off the interest on money borrowed as a necessary item of expenditure to earn the profits. The fact that the depreciation of the securities cannot be taken into account is no reason why the interest on sums borrowed for buying the securities should not be set-off. But the investments should be necessary for the business and an integral part thereof.

In the United Kingdom, the Crown has the right to choose under which head of income it shall tax an assessee (see notes under section 6). At its option the Crown can tax either the income from investments or the profits of the business (of course after including the income from investments and setting off the expenditure necessary for earning it). And in the case of companies like Insurance companies whose main source of income is from investments, an allowance is made for expenses of management if they are taxed finally on their income from investments as in most cases they are. The law and practice in the United Kingdom do not therefore form a safe guide for interpreting the Indian law in this respect.

Property.

9. (1) The tax shall be payable by an assessee under the head "Property" in respect of the *bona fide annual* value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of his business, subject to the following allowances, namely :—

(i) where the property is in the occupation of the owner, or where it is let to a tenant and the owner has undertaken to bear the cost of repairs, a sum equal to one-sixth of such value ;

(ii) where the property is in the occupation of a tenant who has undertaken to bear the cost of repairs, the difference between such value and the rent paid by the tenant up to but not exceeding one-sixth of such value ;

(iii) the amount of any annual premium paid to insure the property against risk of damage or destruction ;

(iv) where the property is subject to a mortgage or charge or to a ground rent, the amount of any interest on such mortgage or charge or of any such ground rent ;

(v) any sums paid on account of land-revenue in respect of the property ;

(vi) in respect of collection charges, a sum not exceeding the prescribed maximum ;

(vii) in respect of vacancies, such sum as the Income-tax Officer may determine having regard to the circumstances of the case :

Provided that the aggregate of the allowances made under this sub-section shall in no case exceed the annual value.

(2) For the purposes of this section, the expression "annual value" shall be deemed to mean the sum for which the property might reasonably be expected to let from year to year :

Provided that, where the property is in the occupation of the owner for the purposes of his own residence, such sum shall, for the purposes of this section, be deemed not to exceed ten per cent. of the total income of the owner.

[*Rule* 7. Under section 9 (1) (vi) of the Act, the sum to be allowed in respect of collection charges shall not exceed 6 per cent. of the annual value of the property.]

Property and business—

As to when income from property may be income from business, see *In re Kaladan Suratee Bazar*[1] and *Mangalagiri Factory* case[2] [under section 10 (2) (*vi*)]. But, even so, the computation of income from property should be calculated under section 9, and not under section 10. *Generalis specialibus non derogant.* Income derived from 'property' is a specific category, and the mere fact that the owner of a 'property' is a company incorporated for the purpose of ordinary 'property' will not make the income one derived from 'business'.[3]

(1) 1 I. T. C. 50.
(2) 97 I. C. 850; 2 I. T. C. 251.
(3) *In re Commercial Properties, Ltd.*, unreported.

History—

Under the Act of 1886, income from house property was taxable under "Other income", and there was no provision in the Act as to what deductions could be made. There was also a special section (section 24) as regards occupying owners. These persons were assessed at five-sixths of the annual value of the house.

In the 1918 Act, the corresponding section covered only house property, *i.e.*, property fit for human habitation or residential purposes, and did not cover other buildings or lands appurtenant to any buildings. Under that Act, income from such buildings and all lands was brought under 'other sources'. Nor was there a proviso limiting the allowances to the 'annual value' of the property.

The change in 1922 is explained in para. 27 of the Income-Tax Manual reproduced below :—

Property—

[*Section* 9].—The tax is payable under this head in respect of property consisting of any building or lands appurtenant to a building by the owner of such property. Lands not attached to a building are not chargeable under this section. The income derived from vacant lands let out in urban areas for the purpose, *e.g.*, of storing material, is chargeable to the tax under section 12.

Buildings or lands occupied by the owner thereof for the purposes of his own business are not liable to the tax under this head. This particular provision was inserted in order to avoid the unnecessary complications in previous Acts under which the annual value of such property was liable to the tax under this head, and a corresponding deduction was allowed to the owner under the head "business" (section 10).

It is to be noted that it is only the owner who is liable to pay tax under this head. Where a person derives an income from house property which he holds on lease, such income is chargeable under section 12—"other sources". (*Income-tax Manual*, para. 27.)

United Kingdom law—

A part of Schedule A and the rules in the English Act roughly corresponds to this section. But the difference is so great that it is hardly worth while summarising the provisions of the English law here. Schedule A of the English Act applies not only to buildings and connected lands but to all kinds of lands (including agricultural), railways, docks, harbours, sewers of local authorities, embankments, mines, collieries, etc. The detailed provisions in the English law, therefore, are useless for construing this section of the Indian Act. Also, even in respect of buildings, the English Act applies to premises used for the owner's business. In this respect it is somewhat like the Indian Act of 1918. In the following notes under this section, occasional reference has been made to the corresponding English provisions, wherever such reference has been considered useful.

Property—Definition of annual value—

[*Section* 9 (2)].—The tax is, under the head "property," chargeable in respect not of any actual rental or cash received, but of the "*bona fide* annual value." The *bona fide* annual value of a building is the full market value at which the building could be let from year to year irrespective of any charges by way of municipal rates or taxes thereon. It, therefore, differs from the actual annual rent payable on a long term lease or the actual rent payable on a yearly lease under a privileged rental or with tenant's liability to pay owner's rates or taxes. The only limitation on taking the full market value is that in cases where the property is in the occupation of the owner for the purposes of his own residence the "annual value" is restricted to a maximum of 10 per cent. of the "total income" of the owner. The phrase "total income" in this definition has the meaning given to it in section 2 (15) of the Act, *viz.*, income, profits and gains of such owner from all sources to which the Act applies and, therefore, does not include income derived from any of the sources specified in section 4 (2) of the Act, (such as, for example, "agricultural income"), which are exempt from the tax. (*Income-tax Manual*, para. 28.)

Deductions allowed in respect of property—

It is to be particularly noted that no deductions are permissible on account of any municipal or local rates or taxes in respect of property. Nor can any allowance be made for brokerage for raising loans on mortgages and legal charges relating thereto, since such charges are in the nature of capital charges. The only deductions from the "annual value" permissible are those specified in section 9 (1). Where an assessee is the owner of several items of property within the meaning of section 9 (1), the allowance admissible under that section should be worked out with reference to the annual valuation of the property taken as a whole and not item by item.

Ordinarily, no expenditure is allowed as a deduction in calculating income for the purpose of the Act except such expenditure as has been incurred solely for the purpose of earning that income. Under clause (*iv*) of sub-section (1) of section 9, there is no such restriction, so that a property owner is entitled to set off, against the annual value of property, the interest payable on a mortgage or other charge upon the property irrespective of the purpose for which the encumbrance was created.

The proviso to sub-section (1) of section 9 has no application to interest on money borrowed for business purposes even though such money may have been borrowed on the security of the assessee's property. (*Income-tax Manual*, para. 29.)

Proof of expenditure where deductions are claimed in respect of "property"—

The allowance on account of repairs, [*viz.*, one-sixth of the annual value in the case specified in clause (*i*), and in the case specified in sub-clause (*ii*), the amount permitted by that clause] is a fixed allowance which should be granted without proof of the actual expenditure in any year and irrespective of the amount of such expenditure. It should also be allowed in full even when an allowance is given for " vacancy " under section 9 (1) (*vii*). The allowances on account of the annual premium paid to insure the property against risk of damage or destruction or on account of annual charge or ground rent or land revenue or of collection charges must be supported by proof of the actual expenditure. Interest that has fallen due on a mortgage should, however, be allowed as a deduction even though it may not have been actually paid. (*Income-tax Manual*, para. 30.)

Bona fide annual value—

The words ' *Bona fide* ' are otiose, the expression ' annual value ' having been defined by sub-section (2). ' *Bona fide* ' merely repeats the idea of the word ' reasonably ' in that subsection. A decision on ' *bona fide* ' or ' reasonable ' value is necessarily a decision on a pure question of fact, and no civil court can interfere with the decision of the Income-tax authorities unless the decision is arrived at without any evidence. See however *Stocks* v. *Sulley*, cited below.

Land—

Would evidently include ponds, etc., if they are ' appurtenant ' to the buildings. ' Appurtenant ' means usually enjoyed with or occupied with—see *Bayley* v. *G. W. Railway*,[1] *Ongley* v. *Chambers*.[2] (Stroud).

'Building'—

" What is a building is a question of degree and circumstance; its ordinary and usual meaning is a block of brick or stone work covered by a roof"—per Lord Esher M. R. in *Moir* v. *Williams*.[3]

In restrictive covenants, various questions may arise as to what constitutes a 'building', but for the purpose of Income-tax, the word must obviously be construed in the sense of a structure possessing "annual value".

'Of which he is the owner'—

Should evidently be construed as 'of which he was the owner *during the previous year*', the previous year being understood of course with reference to section 2 (11). The present tense in 'is' has no specific reference to the point of time at which the tax is assessed. Section 9 is primarily a section of computation, the liability to tax being determined by sections 3 and 4 The liability to tax will therefore not cease merely because since the close of the 'previous year' the assessee has ceased to own the property.[4]

This section excludes only the buildings, etc., used for the owner's business; if it is let for some one else's business the owner would be taxable under section 9. If it is used for the owner's business, no tax is levied under this section; but no deduction is made from the business profits taxed under section 10.

Owner—

" It must be presumed that the Legislature was aware that the expressions "owner", "ownership" and the verb "to own" in its various tenses, have been frequently used in Acts of a similar nature, and further that they can be and are used in various meanings in different Acts, in some of which they have been specially defined for the purposes of particular sections. Nevertheless, the expression has not been defined for the purposes of this Act. It may have the narrow and technical meaning of the full ultimate and legal owner, but if this was intended, it could easily have been expressed, and the failure to do so points to it not having been so intended."[5]

In *Eglington* v. *Norman*[6] the expression was defined as

(1) 26 C.L.D. 434.
(2) (1824) 8 Moore C.P. 665.
(3) (1892) 1 Q.B. 264.
(4) *Beharilal Mullick* v. *Commissioner of Income-tax*, 2 I.T.C. 328.
(5) *The Burma Railways Company* v. *The Secretary of State for India*, 1 I.T.C. 140.
(6) 46 L.J.Q.B. 559.

"The person in whom (with his or her assent) it (the property) is for the time being beneficially vested, and who has the occupation or control or usufruct of it, *e.g.,* a lessee is during the term the owner of the property demised."

But in the context in section 9 here, a distinction is implied between an 'owner' and a 'tenant'; and though a person may be owner in relation to his tenants while being a tenant himself in relation to the owner (or a superior tenant), it would appear from the general structure of the section—which merely contemplates the taxation of the annual value (subject to certain deductions)—that it is intended to tax only one person, that is, the ultimate owner. The appropriate arrangement is therefore to tax only the ultimate owner as the owner under section 9, and to tax the intermediate tenants as receiving income from 'other sources' under section 12—if the circumstances are such that the intermediate persons cannot be taxed under section 10 (Business).

Limited ownership—Taxable—

"There may be cases, as, for instance, the case of a person who receives an allowance from his father, where the sum is certainly not assessable under any clause of the Income-tax Act, and yet it represents income which the man is free to expend as he pleases. And, conversely, there are such cases as that of a person who has a life-rent of a house under a trust or settlement, which he is, by the terms of the deed, precluded from letting. There again his right is not value in money, because he cannot let it, and yet he could undoubtedly be subject to assessment under schedule A, and without relief from any other party." Per Lord McLaren in *Corke* v. *Fry*.[1]

The first half of Lord McLaren's dictum is of doubtful applicability to India—*see* notes under section 4 (3) (vii)—Casual income—but the second half is evidently applicable. There is nothing to prevent the owner of a limited interest in property, being taxed under section 9. *See also* notes under section 40 as to the taxation of trustees.

Repairs—

[*Section* 9 (1) (*i*)].—The allowance to be made on account of repairs, has nothing to do with the period for which the house has been occupied. The allowance is also a fixed sum, namely, 1/6th of the annual value, and it can neither be reduced nor increased by the Income-tax Officer. Similarly, under clause (ii) of section 9 (1) where the tenant has undertaken to bear the cost of repairs, the allowance is also a fixed amount, being the difference between the annual

(1) 3 Tax Cases 335.

value of the house and the rent paid by the tenant, subject to a maximum of 1/6th of the annual value.

In the United Kingdom, only the actual cost of the repairs is allowed.

Property—Insurance deductions—

[*Section* 9 (1) (*iii*)].—The only insurance deduction permissible is the amount of the annual premium paid to insure the property against risk of damage or destruction. In some cases owners insure against loss of rent. Where an owner asks for an allowance on account of the annual premium for such insurance it should be allowed if such owner agrees to pay tax on any amount recovered from the insurance-company. Where no such allowance is claimed or allowed, tax is not to be charged on the amount recovered from the insurance company. (*Income-tax Manual*, para. 31.)

Annual premium—

It is not usual to enter into contracts for fire, etc., insurance for long periods, but if a person entered into such a contract and paid a lump sum premium for a longer period than one year, only the premium for one year could be deducted from the income. See however the meaning of the word 'annual' in annual profits discussed by Rowlatt, J., in *Ryall* v. *Hoare*[1]; also see sections 10 (2) (*iv*) and 15 in which the word 'annual' does not appear. The omission of the word "annual" in S. 10 (2) (*iv*) is probably accidental.

Damage or destruction—

From any cause whatever, *e.g.*, fire, earthquake, lightning or civil commotion. 'Damage' means a partial injury to the property whereas 'destruction' is complete damage.

Insurance against loss of rent is not covered by the law; and the provision in paragraph 31 of the Income-tax Manual is *ex gratia*.

Mortgage, ground rent, etc.—

[*Section* 9 (1) (*iv*)].—The question arises, under this clause of the sub-section, whether, when the property is subjected to a mortgage or charge, the amount of interest to be allowed as a deduction should be the interest that has accrued, or the interest that has been actually paid during the year. In respect of premiums paid for insurance or on account of land revenue, the word 'paid' has been used in clauses (*ii*)

(1) 8 Tax Cases 521.

and (*v*); and it would seem, from the absence of the word 'paid' in clause (*iv*), that a charge or interest on mortgage may be deducted when it has *accrued*—even if it has not been paid.[1]

As the section stands, there is nothing to prevent an assessee, who has borrowed money for business purposes by a mortgage upon his property, from claiming the interest as a deduction under this clause. The purpose for which the mortgage or charge was created is irrelevant.

The framers of the Act presumably followed the English practice, and proceeded under the assumption that ordinarily property in India is either bought or built with capital borrowed by a mortgage of the property. They have also overlooked the fact that under the English law all assessees can shift the tax on interest on loans, for whatever purpose raised, to the lenders. The result therefore has been to place the owners of 'property' in India in a more favourable position than other classes of assessees.

Annual value— Cannot be negative—

If the interest payable exceeds the annual value of the property, the excess cannot apparently be claimed as a business expense under section 10 (2). While section 24 no doubt permits an assessee to set off losses under one source of income against profits under another, it is clear from the proviso to section 9 (1) that the law does not contemplate the possibility of the income from house property being ever a negative figure.

This clause really sets out the principle of *L. C. C.* v. *Attorney-General*[2]—cited under section 3.

Property—Collection charges—

[*Section* 9 (1) (*vi*)].—As regards collection charges, Rule 7 fixes 6 per cent. of the annual value of the maximum amount permissible. Where a house has remained vacant for a period, this maximum, of course, would never be reached, and in many cases there will be no collection charges. The *maximum* amount permissible should be reduced in all cases where a house has remained vacant for a period to 6 per cent. of the annual value as diminished by the amount allowed in respect of vacancies. Proof must always be given of the collection charges having been incurred. Rule 7 simply provides that, where there is proof of collection charges, such charges may be allowed subject to the provision that in no case shall the amount allowed on account of col-

(1) *Beharilal Mullick* v. *Commissioner of Income-tax*, 54 Cal. 636; 2 I.T.C. 328.
(2) (1901) A.C. 26.

lection charges, exceed 6 per cent. of the annual value. (*Income-tax Manual*, para. 32.)

Property—Allowance in respect of vacancies—

[*Section* 9 (1), (*vii*)].—No fixed rule can be laid down regarding the allowance to be granted in respect of vacancies under clause (*vii*). Property is taxed on the "annual value" which, as noted above, is the commercial rent of a house—the rent which it would fetch if let by the year. Where the property is let at an annual rental corresponding to the annual value, it would be fair to allow a proportionate deduction corresponding to the period of the vacancy, that is, if it were vacant for half the year, half the annual value might be allowed. Property may be let on short lease for a period less than one year, and fetch a rent for that period far in excess of what has been fixed as the "annual value," and in such cases no allowance obviously can be given. Where a claim is made on account of vacancies, the owner should be asked to state what the actual rental was that he had received for the period of the year during which the property was let, and the amount allowed on account of vacancies should, under no circumstances, exceed the amount by which the rent received falls short of the annual value. There can, of course, be no allowance in connection with any property which is reserved by the owner for his private occupation. A claim on account of vacancies can only be entertained in connection with property that is usually let. (*Income-tax Manual*, para. 33.)

As regards the scope of the sub-section, see Coutts Trotter, C. J., in *In re Sri Krishna Chandra Gajapati Narayana Deo.*[1]

"The manual says outright that the sub-section only applies to property which is usually let to a tenant. We do not think it necessary to decide whether that is correct or not and whether a man who had a house that he never let but who dismantled it and locked it up for the year would or would not be assessable."

Under Rule 4, No. VII, Schedule A of the English Act, a vacant house is automatically exempt for the period of vacancy.

As to what constitutes 'vacancy'—the expression used in the English Act being 'unoccupied'—there are no decisions under the Income-tax Acts. We have, therefore, to seek guidance from decisions under other Acts. In *Queen* v. *The Assessment Committee of St. Pancras*[2], which was a rating case, it was held that the test of occupancy was not actual habitation or residence but

(1) 2 I.T.C. 104.
(2) (1877) 2 Q.B.D. 581.

the state of the house which permits of its being inhabited or resided in at any time.

Per Lush, J.—" If, however, he (the owner) furnishes it (the house) and keeps it ready for habitation whenever he pleases to go out, he is an occupier though he may not reside in it one day in a year."

Again, under the Inhabited House Duty Act, the same question was raised in *Smith* v. *Dauney*.[1] In this case the assessee paid the income-tax on the property under Schedule A but disputed the liability to Inhabited House Duty. It was held that the words 'habited' and 'occupied' meant the same thing, and that the house in question which was furnished ready for use, was assessable to the Inhabited House Duty, even though it was not dwelt in or slept in by any person during the year in question. The only Indian case in which this point was raised was that of *Sri Krishna Chandra Gajapati Narayana Deo*[2] in which the Madras High Court held—

Per Coutts Trotter, C. J.—" If a man owns a house ready for his own occupation, ready for him to live in when he chooses to do so . . . ., he is assessable."

The Court followed *R.* v. *St. Pancras Committee.* Emphasis, however, should be laid on the fact that as the law stands, absolute discretion is given to the Income-tax Officer as to the allowance to be made in respect of vacancies, and it is only if the discretion is exercised in an unreasonable manner that any question of law could arise.

The allowance made for vacancies does not affect the allowances under the other clauses of this sub-section; and it would not be right for the Income-tax Officer to take into account the allowances made under the other clauses, when he has to fix a deduction on account of vacancies.

Other deductions inadmissible—

No other deductions can be permitted beyond those set out in sub-section (1). Thus, expenses incidental to the raising of a loan or mortgage, local rates or taxes, expenditure on structural alterations, depreciation whether on the building or on its furniture or fittings, cannot be allowed as deductions. In the United Kingdom various deductions are allowed, *e.g.*, expenditure on embankments, drainage, etc., but such allowances cannot be made under the Indian Act.

(1) 5 Tax Cases 25.
(2) 2 I.T.C. 104.

See also *Wylie* v. *Eccott*[1] set out under section 10.

Property—Limitation of total allowance—

[*Section* 9 (1)].—The proviso to section 9 (1), that the aggregate of the allowances made under that sub-section shall in no case exceed the annual value, was inserted owing to the new provision in section 24 providing for the set-off of losses under one head against income, profits or gains under any other head. Instances have occurred of buildings situated in extensive grounds or on valuable sites being mortgaged for sums the interest on which is far in excess of the "annual value". The result of this proviso is that the annual value of the property belonging to an assessee, can in no case be reduced to a *minus* sum owing to the allowances, and that there can be no loss under this head to be set against income, profits or gains under any other head. (*Income-tax Manual,* para. 34.)

Set-off between one property and another—

Section 9 does not contemplate the computation of income with reference to each separate building or group of buildings but only with reference to the assessee's taxed property as a whole. An assessee is therefore entitled to set-off the excess of the allowances permitted in clauses (*i*) to (*vii*) of sub-section (1) over the annual value of a particular building or buildings, against the income from other buildings of which he is the owner.

"Annual Value"—Property occupied by owner—

In reckoning total income under section 16, the annual value of the house which the owner himself occupies should not exceed 10 per cent. of the total income. By annual value here is clearly meant *gross* annual value before making the various deductions permitted under section 9 (1), and not the *nett* annual value after these deductions have been made.

Proviso —Effect of—

An important effect of the proviso under sub-section (2) is that if the taxable income is only from property, no tax can be levied. The result of this proviso is to place the landed interests at a considerable advantage. A rich zemindar owning a lot of landed property but with not much income from non-agricultural sources, will be very lightly taxed in respect of his house property, whereas a person with equal or possibly less

(1). 6 Tax Cases 128.

aggregate income from non-agricultural sources, would be taxed very much more heavily in respect of his house property. This, however, is part of the anomalies inevitable in a system of taxation that excludes an important source of income like agriculture.

Reasonably—

"It would be unreasonable to expect an exact definition of the word. Reason varies in its conclusions according to the idiosyncracy of the individual, and times and circumstances in which he thinks. The reasoning which built up the old scholastic logic, sounds now like the jingling of a child's toy. But mankind must be satisfied with the reasonableness within reach; and in cases not covered by authority, the verdict of a jury (or the decision of Judge sitting as a jury) usually determines what is reasonable in each particular case, but frequently reasonableness 'belongeth to the knowledge of the law', and therefore to be decided by the justices. . . . ." (Co Lete 56 B)—

Under the English Acts, there are elaborate rules regarding the ascertainment of 'annual value', but these are of no assistance in understanding the Indian law. Reference however may be made to cases of rating, the general principles of which will presumably apply to valuations for income-tax purposes also. That is, the Income-tax Officer should value the property with due regard to the environment, the nature of the building, its amenities both internal and external, and so forth, and not merely with reference to its bare ground and its four walls and the roof. See *L. C. C.* v. *Erith Churchwardens*[1]; *Mersy Docks and Harbour Board* v. *Birkenhead Assessment Committee*[2]; *Kirby* v. *Hanslet Union Assessment Committee*[3], all rating cases.

"Whatever is fixed to the realty so as to pass landlord's fixtures in a demise of the premises must be taken to be part of the premises for the purpose of ascertaining its rateable value."—Per Blackburn, J. in *Childley* v. *West House*.[4]

"Things which are on the premises to be rated, and which are there for the purpose of making, and which make the premises fit as premises for the particular purpose for which they are used, are to be taken into account in ascertaining the rateable value of such premises ....It seems to me that when things are brought into that category they would pass by a demise of premises as such between landlord and tenant."—Per Lord Esher, M. R., in *Tyne Boiler Works* v *Tynemouth*.[5]

(1) (1893) A.C. 562.
(2) (1901) A.C. 175.
(3) (1906) A.C. 43.
(4) (1874) 32 L.T. 48[illegible].
(5) (1886) 18 Q.B.D. 8[illegible].

See also the following cases :—*Stock* v. *Sulley infra,* and *Gundry* v. *Dunham* set out under section 23.

Under the United Kingdom law, insurance premia paid on property cannot be deducted in full in all cases, and an attempt was therefore sought to be made in *Turner* v. *Carlton*[1] in which the lessor agreed to pay the insurance premium, to deduct this premium from the rent before ascertaining the annual value. The case was thrown out on other grounds, but Channell, J., incidentally expressed the opinion that the deduction was not admissible. This case, however, cannot apply in India, where under section 9 (1) (*iii*), the annual premium paid for insurance against damage or destruction can be deducted so long as the total deductions do not exceed the annual value.

Evidence of municipal valuations—

Though the annual value is a question of fact entirely for the Income-tax Officer to decide, the value adopted by local bodies for rating purposes would have a high evidential value. See *Gundry* v. *Dunham* set out under section 23; but the municipal valuation would not bind the Income-tax Officer.

" Annual value is but an hypothetical sum arrived at in a certain manner."—*Per Buckley, L. J.*

It is ' not an actual but an hypothetical sum.'—*Per Kennedy, L. J.*, in *R.* v. *Special Commissioners ex-parte Essex Hall.*[2]

In the words of the English Poor Law statutes, it is the " rent at which hereditament might reasonably be expected to be let from year to year free of all usual tenant's rates and taxes and to the commutations, tenth charge if any."

Tenant's taxes—

Annual value should evidently be based on the assumption that the tenant pays the municipal and other taxes that under the local law or custom he is expected to pay. Where therefore as a matter of convenience the landlord pays the occupier's taxes, and includes them in the rent, the annual value should be based on the net rent and not the gross.

Method of accounting under this section—

There is no provision in section 9, as in sections 10 to 12, contemplating maintenance of accounts by the assessee alternatively on the ' mercantile ' or some other system; but this is not a matter of any practical importance.

(1) 5 Tax Cases 395.
(2) 5 Tax Cases 636.

Annual value—Evidence—Lease—Not conclusive—

A mother granted to her son a lease of a public house at a rent of £19 10*s*., such lease, dated 2nd May, 1898, being in continuation of one dated July, 1889. The Commissioners considered that they were not bound to accept either lease in the circumstances as conclusive evidence of the annual value of the premises, and fixed such value at £40. The Court affirmed the determination of the Commissioners.[1]

Business.

10. (1) The tax shall be payable by an assessee under the head "Business" in respect of the profits or gains of any business carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely :—

[*For Sub-clauses see later.*]

(3) In sub-section (2), the word "paid" means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section.

Previous law—

Under the Acts before 1918, there were no provisions as to the method of computing income from business. It is the high income-tax rates introduced during and after the War that necessitated the incorporation of these provisions in the Act. The provisions introduced in 1918 are much the same as the present ones; and the detailed changes are set out in the notes under each clause of sub-section (2). Sub-section (3) is entirely new, being connected with section 13 which is also new.

United Kingdom law—

This section corresponds to a part of Schedule D and the Rules thereunder, as well as some of the General Rules. That schedule and the rules are needlessly complicated, and cover the ground covered by sections 10 to 13 of the Indian Act. Under each clause, the corresponding provisions in the United Kingdom law have been referred to.

(1) *Stocks* v. *Sulley*, 4 Tax Cases 98.

Sub-section (1)—Assessee—

See notes under section 24 and the case of *M. Ar. Arunachalam Chettiar*[1] as regards the position of a partner in a firm carrying on business.

Business—

See notes under sections 2 (4) (Business), 3 (Capital and Income and Mutual concerns and Destination of Profits), 4 (3) (*i*) and (*ii*) (Charities) and 4 (3) (*vii*) (Casual Profits).

Carried on—

Implies a repetition of acts, but as to whether any such repetition is necessary, see the rulings set out under sections 2 (4), 3 and 4 (3) (*vii*) referred to above. 'Carry on' implies a repetition or series of acts.[2] To carry on a business means primarily to carry on one's own business: therefore a salaried clerk does not 'carry on' business at the office of his employer.[3] A clerk in the Admiralty, for example, does not 'carry on business' at his office.[4]

As to the difference between 'trade exercised in the country' or 'business carried on in the country' on the one hand and 'business connection' on the other, see notes under sections 4 (1) and 42 (1).

Profits—

"Profits mean chargeable income and must be computed from the gross income after allowing for the sums paid and debited as detailed in sub-section (2).

"The assessing officer is not bound to allow any deduction for sums paid or debited other than those properly paid and debited as detailed in sub-section (2).

"Profits do not mean commercial profits but chargeable income." —*Per Macleod, C. J.*, in *In re The Tata Industrial Bank, Ltd.*[5]

"The Collector is not bound to make any other allowance [than those set out in section 10 (2)] in favour of the party nor is the party entitled thereto as of right."—*Per Shah, J.* (*ibid.*).

But gross income depends on the method of accounting, the valuation of stocks, etc., about which see below. Capital receipts are not income, profits or gains, and are therefore automatically excluded—see section 3.

As regards method of accounting, see section 13.

(1) 1 I.T.C. 278.
(2) *Per Brett, L. J.* in *Smith* v. *Anderson*, 50 L. J. Ch. 52.
(3) *Lewis* v. *Graham*, 20 Q.B.D. 784.
(4) *Buckley* v. *Harrow*, 19 L. J. Ex. 151.
(5) 1 I.T.C. 152; 46 Bom. 567.

Several businesses—

'Any' business means 'each and every' business. Therefore, if the assessee carries on several businesses, the profits of each business should be calculated under this section and added together before any set off is given under section 24. That section allows set-off between different *heads* of income as described in section 6. Within the *same* head of income, set-off is automatically admissible—see *M. Ar. Arunachalam Chettiar's case*[1] and also the notes under the proviso to sub-section (1) of section 9. It should be noted, however, that unabsorbed depreciation under section 10 (2) (*vi*) in respect of a particular business cannot be set off against the profits of other businesses carried on by the same assessee.

Sub-section (2)—

This sub-section explains how the profits shall be computed.

It will be seen that there is no definition of 'profits.' All that is stated is that only certain deductions are permitted in computing profits. Other deductions may not be allowed. Broadly speaking, the general principle is that no expenditure is allowed except what is necessary to earn the income taxed. Nor, with one exception, *viz.,* depreciation, is capital expenditure allowed even if necessary for earning the profits. But the amount of profits also depends on the valuation of stocks, the method of accounting employed, etc.

"In view of the fact that for the purpose of income-tax assessees have a right to be dealt with according to their own method of accounting I desire to guard myself from assuming that section 10 (2) is intended to be an exhaustive list of deductions which are permissible for the purpose of income-tax."—*Per Rankin, C. J.* in *Howrah Amta Ry. Co.* v. *Commissioner of Income-tax*[2]

How profits are to be computed (apart from the allowances referred to in this section) is not expressly stated anywhere. In the absence of such provision, and having regard to the wording of section 13, all that can be said is that the accepted principles and practice of accountancy should be followed and that the accounts should represent facts. See notes under section 13.

United Kingdom law—

The following dicta of Judges give the position under the United Kingdom law which is practically the same as in India. See also the dicta set out under section 3, as to what is 'income, profits or gains'.

(1) 1 I.T.C. 278.
(2) Unreported.

"The profits and gains of any transaction in the nature of a sale must, in the ordinary sense, consist of the excess of the price which the vendor obtains on sale over what it cost him to procure and sell, or produce and sell, the article vended, and part of that cost may consist of the sum he pays for the hire of a machine, or the services of persons employed to produce, procure or sell the article. . . . .

" . . . . The words ' profits and gains' are, where the context does not otherwise require, to be construed in their ordinary signification. I can see no reason for suggesting that this last-mentioned principle should not apply to the word ' capital ' when used in these statutes, and that it too, where the context does not otherwise require, should be construed in its ordinary sense and meaning."—Per Lord Atkinson in *Scottish North American Trust* v. *Farmer*.[1]

" . . . . . The profit of the concern . . . . surely would be all the net proceeds of the concern after deducting the necessary outgoings without which those proceeds could not be earned or received."—Per the Lord Chancellor in *Mersey Docks* v. *Lucas*.[2]

" Profit is the difference between the price received for goods sold and the cost."—Per M. R. Jessel and Brett L. J. in *Erichsen* v. *Last*.[3]

Now, profits . . . . . may be taken here to mean the surplus of income after defraying all, at least necessary expenses of making it."—Per Day, J., in *Last* v. *London Assurance Corporation*.[4]

" The profit of a trade or business is the surplus by which the receipts from the trade or business exceed the expenditure necessary for the purpose of earning these receipts."—Per Lord Herschell in *Russell* v. *Aberdeen Bank*.[5]

" ' Profits ' I read on authority, to be the whole of the incomings of a concern after deducting the whole of the expenses of earning them; that is what is gained by the trade."—Per Lord Fitzgerald (*ibid.*).

" It cannot of course be denied that, as a matter of business, profits are ascertained by setting against the income earned the cost of earning it, nor that as a general rule for the purpose of assessment to the income-tax profits are to be ascertained in the same way. . . . . Unless the context requires a different meaning, or the words appear to be used throughout the Act in another sense, I think that they (the words 'profits of gains') must be construed according to their ordinary signification. When we speak of the profits and gains of a trade we mean that which he has made by his trading. Whether there be such a thing as profit or gain can only be ascertained by setting against the receipts the expenditure or obligations to which they have given rise."—Per Lord Herschell in *Gresham Life Assurance Society* v. *Styles*.[6]

(1) 5 Tax Cases 705.
(2) 2 Tax Cases 28.
(3) 4 Tax Cases 424, 426.
(4) 2 Tax Cases 115.
(5) 2 Tax Cases 327.
(6) 3 Tax Cases 193.

" The word ' profits,' I think, is to be understood in its natural and proper sense—in a sense which no commercial man would misunderstand."—Per Lord Halsbury (*ibid.*).

" We must go . . . . by the words of the Act of Parliament, and we must not allow any item in favour of the person who is taxed, merely because it is an item which would probably find its way into a loss and profit account, between a man and his partners or kept for himself. There are a great many things that a prudent trader might treat as deductions because he wished to make a fund to provide against future accidents and things of that kind which are not dealt with at all by the Income-tax Acts."—Per Baron Pollock in *Rhymney Iron Co.* v. *Fowler.*[1]

" . . . . . In making out the balance-sheet to show what profit a trader has made under Schedule D, it is not to be worked out in the same way that the trader would make out his balance-sheet for his own information showing what profit or loss he has made."—Per Smith, J., in *Gillatt and Watts* v. *Colquhoun.*[2]

" . . . . . As little are they bound . . . . as the Income-tax Commissioners are bound . . . . . to take the balance-sheet of the company as the true measure of the income."—Per the Lord President in *Edinburgh Southern Cemetery* v. *Kinmont.*[3]

" But it is a very different question that is raised here as to whether, though that may be a very proper operation in a trader's balance-sheet, the sums which are received and which are proposed to be applied to redemption of capital can be properly regarded as profits under the Income-tax Acts. . . . . The profits in a proper trader's balance are a very different thing from profits as these have been defined under the provisions of the statute."—Per Lord Shand (*ibid.*).

" But the statute refuses to take an ordinary balance-sheet or the net profits thereby ascertained as the measure of the assessment, and requires the full balance of profits without allowing any deduction except for working expenses and without regard to the state of the capital account or to the amount of capital employed in the concern or sunk and exhausted or withdrawn."—Per the Lord President in *Coltness Iron Co.* v. *Black.*[4]

" It is plain that the question of what is or is not profit or gain must primarily be one of fact, and to be ascertained by the tests applied in ordinary business. Questions of law can only arise when . . . . some express statutory direction applies and excludes ordinary commercial practice, or where, by reason of its being impracticable to ascertain the facts sufficiently, some presumption has to be invoked to fill up the gap." —Per Lord Haldane in *Sun Insurance* v. *Clark.*[5]

(1) 3 Tax Cases 479.
(2) 2 Tax Cases 84.
(3) 2 Tax Cases 525.
(4) 1 Tax Cases 308.
(5) 6 Tax Cases 59.

"In determining the amount assessable to the tax, deductions are to be made from the gross profits of all the expenses incurred by the owner for the time being for the purpose of earning the profits. This indeed is involved in the very idea of profits."—Per Lord Finlay in *John Smith & Son* v. *Moore*.[1]

". . . . The law does not permit . . . . all deductions which a prudent trader would make in ascertaining his own profits. . . . . ."—Per Stirling, L. J. in *The Alianza Co.* v. *Bell*.[2]

[As to how far losses connected with a trade are necessarily incidental to the trade—see *Strong & Co.* v. *Woodfield*[3] set out under section 10 (2) (*ix*) *infra*.]

"The phrase 'capital exhausted' does not occur anywhere in the Income-tax Acts. It is taken from a passage in Mr. McCulloch on Political Economy where he says 'profits must not be confounded with the produce of industry primarily received by the capitalist. They really consist of the produce on its value remaining to those who employ their capital in an industrial undertaking after all their necessary payments have been deducted and after the capital wasted and used in the undertaking has been replaced. If the produce derived from an undertaking after defraying the necessary outlay be insufficient to replace the capital exhausted, a loss has been incurred; if the capital (?) is merely sufficient to replace the capital exhausted, there is no loss, but there is no annual profit, and the greater the surplus is, the greater the profit.' I do not feel at all inclined to dispute the sufficiency of this definition. . . . . But that is certainly not the scheme of the income-tax. . . . ."—Per Lord Blackburn in *Coltness Iron Co.* v. *Black*.[4]

"You must find new money in order to pay the expenses year by year, but then you do find money to pay the expenses year by year, and you get the receipts year by year, and the difference between the expenses necessary to earn the receipts of the year and the receipts of the year, are the profits of the business for the purposes of the income-tax."—Per M. R. Esher in *City of London Contract Corporation* v. *Styles*.[5]

"Of course the learned Master of the Rolls (Esher) does not mean there (in the above quotation) by receipts, money which is actually received; he means debts which you will receive, and which therefore on their face value require an allowance for bad debts."—Per Sterndale M. R. in *Hall & Co.* v. *Commissioners of Inland Revenue*.[6]

"Now in the case of a trade, it is well established that this balance (of profits and gains) is *prima facie* to be ascertained by deducting from the receipts of the trade the expenditure necessary to earn them. Until this has been done, it is impossible to determine whether there has been

(1) (1921) 2 A.C. 13; 12 Tax Cases 266.
(2) 5 Tax Cases 71.
(3) 5 Tax Cases 215.
(4) 1 Tax Cases 315.
(5) 2 Tax Cases 239.
(6) 12 Tax Cases 382.

any balance of profits at all. . . . . However, deductions which on ordinary practice and principles might be deducted, are restricted (by Rules).''—Per Lord Atkinson in *Usher's Case*.[1]

'' There can be no doubt that in the natural and ordinary meaning of language the income of a bank or trade for any given year would be understood to be the gain, if any, resulting from the balance of the profits and losses of the business in that year. That alone is the income which a commercial business produces and the proprietor can receive from it.''—Per the Privy Council in *Lawless* v. *Sullivan*,[2]

a case from New Brunswick, Canada, in which the Crown contended with success in the Lower Courts that gains only should be taken into account, the losses being ignored, in computing the income of an assessee. The Privy Council who overruled the decision of the Canadian Supreme Court held that there was nothing in particular in the taxing Act of New Brunswick which would justify the word 'income' being construed in any other sense than the natural one which is as quoted above.

'' The balance of the profits or gains of a trade is struck by setting against the receipts all expenditure incidental to the trade which is necessary to earn them and by applying in the computation the ordinary principles of commercial trading. In the present case the Commissioners have found that the possession and employment of the tied houses are necessary to enable the appellants to earn the profits on which they pay income-tax. I think it follows that expenditure reasonably incurred on or in connection with such house is an expenditure incidental to the trade and necessary to earn the profits taxed and would be set against the receipts of the trade in an ordinary commercial balance-sheet. No auditor could properly pass a balance-sheet unless such a deduction had been made. I agree, therefore, that unless there are subsequent statutory limitations disallowing the deductions or any of them, the deductions must be included in the balance-sheet and set against the receipts of the trade and that unless this is done the balance of profits or gains cannot be accurately computed.''—Per *Lord Parmoor*.[3]

'' The expression ' balance of profits and gains ' implies, as has often been pointed out, something in the nature of a credit and debit account in which the receipts appear on one side and the costs and expenditure necessary for earning these receipts on the other side. Indeed without such account it would be impossible to ascertain whether there were really any profits on which the tax could be assessed. But the Rule proceeds to provide that ''the duty shall be assessed, charged and paid without other deductions than is hereinafter allowed.'' The difficulty is that nowhere in the Act is there any express allowance or enumeration of deductions, the scheme of the Act being to prohibit certain deductions

(1) 6 Tax Cases 399.
(2) (1881) 6 A.C. 373.
(3) *Usher's Wiltshire Brewery* v. *Bruce*, 6 Tax Cases 399.

with certain exceptions. It has been suggested that the difficulty can be overcome by treating the exceptions from the prohibitions as implicitly allowed deductions. The better view however appears to be that where a deduction is proper and necessary to be made in order to ascertain the balance of profits and gains, it ought to be allowed, provided there is no prohibition against such an allowance in any of the Rules applicable to the case, and the decision of your Lordships' House in *Russell* v. *The Town and County Bank*,[1] and the speech of Lord Halsbury in *Gresham Life Assurance Society* v. *Styles*[2] clearly proceeded on this footing."—Per Lord Parker (*ibid.*).

"The questions of law raised are, and are only, whether on the construction of the Act, the deductions in debate through "disbursements or expenses, being money wholly and exclusively laid out or expended for the purposes of the trade" (*i.e.*, the brewer's trade) are nevertheless forbidden. If a subject engaged in trade were taxed simply upon "the full amount of the balance of profits or gains of such trade" there can be no doubt that, upon the facts found in this special case, he would be entitled to deduct all the items which are now in debate before arriving at the sum to be charged. To do otherwise would neither be to arrive at the balance, between two sets of figures a credit and a debit set, which balance is the profit of the trade nor to ascertain the profits of the trade, for trade incomings are not profits of the trade till trade outgoings have been paid and deducted. The direction to compute the full amount of the balance of profits must be read as subject to certain allowances and to certain prohibitions of deductions, but that a deduction, if there be such, which is neither within the terms of the prohibition nor such that the expressed allowance must be taken as the exclusive definition of its area, is one to be made or not to be made according as it is or is not on the facts of the case, a proper debt item to be charged against incomings of the trade when computing the balance of profits of it."—Per Lord Sumner (*ibid.*).

Business deductions—Irrecoverable Loans—

[*Section* 10 (2)].—Where an assessment is made of profits or income from a banking or money-lending business, loans which cannot be recovered should be deducted from the assessed profits of such business at the time when such loans can be definitely proved to be irrecoverable. For example, if a banker has lent out 5 lakhs of rupees and received Rs. 50,000 as interest, but has during the same year lost an irrecoverable loan of Rs. 25,000, he should be assessed on Rs. 25,000. Similarly, if the same banker receiving Rs. 50,000 as interest on his loans suffers a loss of an irrecoverable loan amounting to one lakh during the same year, the income to be assessed to income-tax from the money-lending

(1) 2 Tax Cases 321.
(2) 3 Tax Cases 185.

business in that year will be *nil*. These examples will apply whether the assessee had previously been assessed to income-tax or not.

This instruction will also apply to the assessment of other traders, where loans have been made in connection with the business and in which the loans are of the nature of the business and the loss is a true trading loss.

The irrecoverable loans in the sense referred to in this paragraph are sometimes confused with the "bad debts" described in paragraph 35, but they are of a totally different nature. Money lent out on interest is the stock-in-trade of a money lender or banker, and the loss of such stock-in-trade can clearly be regarded as a trading loss like the loss of the stock-in-trade of any other trader where the loss is not covered by insurance. In settling claims of this nature the question has always to be considered whether money-lending is, or is not, a part of the business of the trader in question. The investment of savings or occasional loans made to acquaintances cannot be considered to be loans made in the course of trading. (*Income-tax Manual*, para. 38.)

Business deductions—General—

While, as stated in paragraph 35, it is not possible, owing to the variety of accounting systems, to prescribe exhaustive lists of deductions that are or are not permissible in the case of all businesses, section 10 (2) contains a list of allowances that are permissible in the case of all businesses. The following is a list of the deductions that are not permissible in the case of any business, whatever the system of accounting may be that is adopted :—

reserves for "bad debts" or for "provident" or other funds or any other purpose such as the equalisation of profits or dividends;

expenditure of the nature of charity or presents;

expenditure of the nature of capital;

cost of additions to or alterations, extensions or improvements of, and of the assets of a business;

sums paid on account of income-tax or super-tax in India or elsewhere or any tax levied by any authority other than land revenue, local rates or municipal taxes in respect of the portion of the premises only which is used for the purposes of the business;

drawings or salaries of the proprietors or partners;

interest on the proprietors' or partners' capital including interest on reserve or other funds ;

private or personal expenses of the assessee ;

rental value of property owned and occupied by the owner of a business for the purposes of the business;

losses sustained in former years ;

any loss recoverable under an insurance or a contract of indemnity;

depreciation of any of the assets of the business other than the depreciation allowed under section 10 (2) (*vi*);

any expenditure of any kind which is not incurred solely for the purpose of earning the profit. (*Income-tax Manual*, para. 37.)

Onus on assessee—

The above paragraph in the Income-tax Manual merely explains the law. Deductions in order to be admissible should fall under one of the clauses of sub-section (2); and the examples given in the above paragraph of the Income-tax Manual do not fall under those clauses. Some of the examples are taken almost verbatim from the provisions of the United Kingdom law which is full of otiose provisions. For example, notwithstanding the fact that the United Kingdom law prohibits deductions on account of expenditure not wholly or exclusively laid out for earning the profits, it again explicitly prohibits the deduction of personal expenses, losses not connected with the trade, etc. As regards losses recoverable under an insurance or indemnity, see notes on section 10 (2) (*iv*) *infra*.

The onus of proving that a deduction is admissible falls on the subject. See *Rowntree and Co.* v. *Curtis*[1] and *Nopechand Magniram* v. *Commissioner of Income-tax*.[2]

(i) any rent paid for the premises in which such business is carried on, provided that, when any substantial part of the premises is used as a dwelling-house by the assessee, the allowance under this clause shall be such sum as the Income-tax Officer may determine having regard to the proportional part so used ;

(1) 8 Tax Cases 678.
(2) 2 I.T.C. 146.

(ii) in respect of repairs, where the assessee is the tenant only of the premises, and has undertaken to bear the cost of such repairs, the amount paid on account thereof, provided that, if any substantial part of the premises is used by the assessee as a dwelling-house, a proportional part only of such amount shall be allowed ;

Allowance on account of rent of business premises—

[*Section* 10 (2) (*i*)].—The allowance referred to in this clause, is only in respect of that portion of the premises in which the business is carried on, and the same limitation applies to all allowances relating to premises or buildings in clauses (ii), (iv), (v), (vi) and (viii). Where premises are owned by the owner of the business, no allowance of course is permissible since the owner is not liable to pay tax on the annual value of such premises, under section 9. Where the trader resides in a part of the business premises, the full rental cannot be set against the profits and the Income-tax Officer must, in each case, determine the portion of the rent that may so be set-off. (*Income-tax Manual*, para. 39.)

Allowances on account of repairs of business premises—

Where the assessee is himself the owner of his business premises, he is allowed as a deduction the amount spent on repairs each year on the portion of the premises used for the purposes of the business under section 10 (2) (v); where he is the tenant of the premises, he is, under section 10 (2) (ii), allowed the amount expended by him on repairs, if his lease requires him to execute repairs. Where the premises are occupied partly as a residence and partly for the purposes of a business, the same proportion of the disbursements on repairs should be permitted to be deducted as is taken in calculating the rent permissible under section 10 (2) (i). The phrase "current repairs" in Section 10, sub-section (2) (v) should be interpreted to mean, such repairs required to keep machinery, plant, etc., in serviceable condition, as are rendered necessary by ordinary wear and tear (as opposed to accidental or wilful damage or other unusual causes) and are of their nature recurrent (supposing that the owner displays reasonable care and prudence in keeping the asset, whatever it may be, in good order) at comparatively short intervals—say, at least once in two or three years. It also includes minor replacements (in respect of which it would be absurd to expect an entry to be made in a block account or similar record or in any records maintained for the purposes of calculating depreciation) and also mere adjustments of existing parts.

Expenditure on anything that, if it had been done when the asset was new, would have increased its capital value should be regarded as capital expenditure. (*Income-tax Manual*, para. 40.)

Rent of railway track—

In return for the grant of free land, a guaranteed income per mile and exemption from local cesses, a Railway Company agreed to share with a District Board in equal moieties the excess of profits over 4 per cent. of the capital. It was contended on behalf of the Railway that the payment of surplus profits to the Board was deductible from the taxable profits of the Railway either as the rent of the 'premises,' *i. e.*, the track, which was laid on the free land, or as a local rate on the 'premises' or as expenditure necessary to earn the profits. *Held*, that the payment to the Board was an appropriation of profits and not deductible from the Railway's taxable profits.[1]

Meaning of words—

'Premises' have been nowhere defined; but see notes under section 10 (2) (*viii*) *infra*.

'Substantial' is a vague, relative word; its meaning can involve questions only of fact.

'Dwelling-house', not necessarily a house actually dwelt in—

> "ordinarily comprises a building adapted for and capable of being dwelt in, and which is dwelt in whether by a care-taker or others although the larger part of it is used for trade or business."[2]

It should be noted however that under the Indian Law it is only if a *substantial* portion is used as a dwelling-house by the assessee, the Income-tax Officer can modify the allowance on account of rent. Even "Inhabited Dwelling-house" has been construed as equivalent to inhabitable dwelling-house, *i.e.*,

> "Ready to be slept in . . . . although on no single occasion during the year of assessment was it let or actually resided in."[3]

Previous law—

In the 1918 Act, the value of business premises was asses-

(1) *Howrah Amta Ry.* v. *Commissioner of Income-tax*, unreported.
(2) *Lewin* v. *George Newnes*, 90 L.T. 160.
(3) *Smith* v. *Dauney*, (1904) 2 K.B. 186; 5 Tax Cases 25.

sed under ' House property ' and a *per contra* allowance given as a business expense. This cumbrous arrangement which was based on the English model was given up in 1922.

(iii) in respect of capital borrowed for the purposes of the business, where the payment of interest thereon is not in any way dependent on the earning of profits, the amount of the interest paid ;

Explanation.—Recurring subscriptions paid periodically by shareholders or subscribers in such Mutual Benefit Societies as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause ;

Business—Allowance in respect of borrowed capital—

[*Section* 10 (2) (*iii*)].—The allowance under this clause can only be given where payment of the interest is not in any way dependent on the earning of the profits. It cannot be allowed, therefore, in respect of any borrowings the interest on which is not payable unless profits are earned, or the interest on which varies according to the amount of the profits earned. In all cases it will be a question of fact whether the payment of interest is or is not actually dependent on the earning of profits. No allowance can be made in respect of the share capital of companies or of the capital put into a firm by the partners; but a company is entitled to an allowance of the interest paid on its debentures, and a firm to an allowance of interest on money borrowed under a mortgage. On the other hand, a firm alleging that it has no independent capital and that it is working only on capital lent by the partners at a definite rate of interest which must be deducted from the earnings of the firm before its profits can be declared, is not entitled to allowance under this section unless definite proof is given that a particular partner has made a legal loan to the firm, *i.e.*, a loan under an instrument on which he can sue and under which interest at a fixed rate is to be paid to him annually irrespective of the earning of any profits. Similarly the share of profits given to Muhammadan depositors in lieu of interest on borrowed capital cannot be allowed as a business expense.

Salaries or commission paid to a partner can, under no circumstances, be treated as a business expense.

No rule has been made under the 'explanation' to this Clause defining what Mutual Benefit Societies are to have the benefit of the 'explanation'. It has been found that the 'explanation', if applied, is likely to give more trouble to the societies than the present procedure. Executive instructions have however been issued that in the case of such societies (which appear to be peculiar to the Madras Presidency) where the taxable income is Rs. 5,000 or under, and where the "shareholders" or "subscribers" reside within the limits of the circle of one Income-tax Officer, the company or society should not be assessed direct to income-tax, but the principal officer should furnish the Income-tax Officer with a list of the amounts paid out to subscribers showing the original subscriptions or capital invested and the interest thereon, and the Income-tax Officer should ascertain what particular recipients of these payments are liable to tax and should add the amount of interest that they have received to the income on which they would otherwise have been assessed, that is, he should assess the recipients direct. (*Income-tax Manual*, para. 41.)

'*Periodically*' excludes uncertain intervals.[1] Payments should be at fixed times and under antecedent obligation and not at variable periods at the discretion of individuals.

Previous law—

The explanation clause was inserted in 1922 primarily with reference to the Madras societies mentioned above, but as stated above no rule has been made.

United Kingdom Law—

Under the United Kingdom law no deduction can be made in respect of any annual interest or any annuity or other annual payment payable out of the profits or gains but the assessee is entitled to deduct and retain tax from the interest paid by him. If the interest is not 'annual', as for instance interest paid on overdrafts at the Bank, deduction is allowed. The question, therefore, whether interest is 'annual', is one of importance in that country, and there are a number of decisions on the subject. But they are of no help in elucidating the Indian Law. Similarly there are decisions as to what constitutes interest on 'Capital'—the leading case being that of *Scottish North American Trust* v. *Farmer*,[2] but these cases are not of help here because, under the Indian law, interest on capital borrowed for the purpose of the business

(1) *Jones* v. *Ogle*, 8 Ch. 192—*Under the English Appropriation Act.*
(2) 5 Tax Cases 693.

is a permissible deduction under section 10 (2) (*ix*) so long as such interest is not dependent on the earning of profits.

Interest on loans by Partners—

Interest on capital is not a permissible deduction even if the partnership deed stipulates the payment of interest on capital plus a share of the profits. Such an arrangement is only a method of sharing profits. But interest on deposits of partners is permissible if the deposits remain for definite periods and is not really capital for developing the business. That is to say, if the deposits are genuine deposits like deposits from customers, the interest can be deducted. The question is always a question of fact,[1] and ordinarily the presumption would be that the deposit was capital put in by the partner, and he would have to rebut the presumption by satisfactory evidence. It has been held that where a partner, as partner, lends *bona fide* to the partnership money beyond the initial capital at an agreed rate of interest, the interest on the loan should be deducted.[2] It is a question of fact whether the advance is a loan to the partnership or an increase in the capital of the firm.

Even if the loan be taken from other persons than partners, no deduction will be allowed on account of interest if the interest is in any way dependent on the earning of the profits. It will thus be seen that the provisions of the Income-tax law do not exactly correspond to those of the ordinary law of partnership. No interest will be allowed as a deduction on account of capital supplied by the partners (as distinguished from deposits or loans made by them which will be capital *borrowed*); and likewise, no matter who is the lender, if the interest is in any way dependent on the earning of profits, the interest cannot be deducted.

Partners—Salaries of—

The assessees were a firm consisting of 4 partners who shared in profits and losses in certain specified proportions. In connection with their assessment in 1920-21, they claimed before the Collector, among other expenditure, a sum paid to three of the partners as salaries. The claim was disallowed, but the assessees contended that if persons other than the owners of the firm had been employed for the work looked after by the owners, the salaries paid to those other persons would have been admissible as deduction from profits, and no distinction should have been

(1) *In re Lallamal Hardeo Das*, 1 I.T.C. 266.
(2) *A.L.S.P.P.L. Subramaniam Chetti* v. *Commissioner of Income-tax* (unreported.)

made because the payments were made to the owners themselves.

The Commissioner's reference to the High Court ran as below :—

"If the Company were a regular company and not a firm, there would no doubt be some force in the appellant's contention, but the practice in this presidency (and it is believed also in England) has always been to treat all drawings of the partners of a firm as a part of the profits whether they be described as interest, salary or profits. The reasons underlying this practice are probably as follows :—

(1) Where there are profits to divide, it is immaterial how the partners decide to allot them amongst themselves. The whole sum for allotment is Profit, and taxable as such, and any sum allotted to any one partner as salary does not become the less profit because of the method on which its appropriation is decided.

(2) Where there are no profits to divide, *e.g.*, in a year where losses occur notwithstanding any clause in the agreement to the contrary, it is impossible for the partners to pay themselves salaries except by advancing them out of their own capital. Such advances can only be recouped again out of earned profits which are taxable as such.

(3) If any other view be held of this problem it would be possible for any firm to allot the whole or more than the whole of its estimated profits in each year as so-called salaries to its partners, and show no profits for assessment. It is true that the salaries will themselves be taxable as such, but this will be at a lower rate, and a loss of revenue will occur.

(4) In this case the Agreement has been drawn up with the special intention of presentation in this reference, and must be viewed accordingly.

(5) In the present case, the amounts payable as salaries are Rs. 1,000 a month to one of the partners and Rs. 500 each to two other partners. It has not been suggested that the partners have any special qualification to justify such large rates, and it is quite arguable that these sums represent not salaries in the real sense of the term, but additional shares of profits of these three partners as compared with the share of the fourth and sleeping partner.

* * * * * * *

A Full Bench of the High Court decided that

"On the facts stated we have no hesitation in answering that the drawings of the partners, by whatever name they are described, are part of the profits and therefore taxable."—*Board of Revenue* v. *Vegaraju Venkatasubbaya Garu.*[1]

If however a particular partner or partners possess special qualifications for which they are paid a salary irrespective of the existence of profits and over and above their share of the profits, the salaries could be allowed as a deduction. The dual

(1) 1 I. T. C. 176.

capacity of a partner *cum* employee, though suspect, is possible, and to the extent that the person is in truth an employee the salary is deductible from the profits of the partnership.

Partners—Advances by—Interest on—

A sum was shown in the accounts of the assessees—a firm —as interest paid on account of money advanced during the year by partners in the firm for the purpose of carrying on the business. The assessees claimed that this interest should be treated as an allowance admissible under section 10 (2) (*iii*) of the Indian Income-tax Act, and should therefore be deducted from the net profits of the year before these were assessed to income-tax. The Assistant Commissioner who examined the books of the firm reported that the money in respect of which this interest was charged in the accounts was not really "capital borrowed for the purposes of the business," but represented "only an advance of capital by the partners."

Held that such interest represents merely an assignment of a part of the net profits for the year in favour of partners who are regarded as entitled to such assignment by reason of special advances of capital made by them in the course of the year and that the question whether there has been an advance of capital by particular partners, or a *bona fide* borrowing of money by the firm, in which the lender happens to be a partner in the firm, must be treated as one of fact in each case.—*In re Lallamal Hardeo Das.*[1]

Mudibhagidars—Advances by—Interest on—

The assessees were three brothers doing business as a firm. They attracted capital by means of borrowings from persons known as Mudibhagidars who received certain specified shares in the profits of the business, but were not responsible for the losses, if any. They were not partners in the business. The question was whether the firm was entitled to an allowance under section 10 (2) (*ix*). *Held* that no allowance was permissible.

Per Shah and Kincaid, JJ.—The advances made by "Mudibhagidars" are clearly in the nature of capital borrowed for the purposes of business. With reference to the allowance to be made in respect of the capital borrowed for the purpose of the business, there is an express clause, *viz.*, clause (*iii*) of that sub-section. Under that clause, the allowance can be made for the amount of the interest paid where the amount of interest in respect of capital borrowed is not in any way dependent on the earning of profits. In the present case, admittedly, the

(1) 1 I.T.C. 266.

amount payable to the "Mudibhagidars" is dependent upon the earning of profits. So, even if the payments of certain portion of the profits to the "Mudibhagidars" are to be treated as being in lieu of interest within the meaning of clause (*iii*), as they are dependent on the earning of profits, the profits would not be liable to any deduction or allowance in respect thereof. It would be rather an anomalous result if under clause (*iii*) which is directly applicable to capital borrowed for the purposes of the business, an allowance cannot be made, still, it should be capable of being made under clause (*ix*). There is considerable force in the argument urged on behalf of the Crown that in this case if an allowance cannot be made under clause (*iii*), it cannot be made at all. Still we have to consider the argument urged on behalf of the assessees whether this can be treated as expenditure incurred solely for the purpose of earning such profits or gains. Without attempting to define the exact scope of this clause, it seems to us to be sufficient to say that payments to be made in certain proportion out of the profits on the capital advanced for the purposes of business cannot be treated as expenditure incurred solely for the purposes of earning such profits or gains within the meaning of clause (*ix*) of sub-section (2) of section 10.[1]

Interest paid—Question of fact —

In *Nopechand Magniram* v. *Secretary of State*[2] interest was paid to an unsecured creditor whom the Income-tax Officer found as a fact to be a partner. Interest was also paid to relatives of partners, mostly women; and the Income-tax Officer found that these were also fictitious payments. *Held*, that the Income-tax Officer was justified in his findings of fact, as no evidence to the contrary was adduced even though the assessee was given an opportunity.

Borrowed Capital—Interest on—Company Working State Railway—

The Bengal Nagpur Railway Company was called upon to pay tax on the following items: (*a*) sum of Rs. 1,07,59,381 being the interest, debitable to the undertaking, on the Secretary of States's Open line capital. This sum was the interest due to the Secretary of State on 15½ Million Pounds capital found by him.

(*b*) A sum of Rs. 13,07,440 being the payment to the Secretary of State in rupee currency of the amount of the guaranteed interest payable by him on the share of the capital of the Company. This interest was paid on 3 million Pounds share Capital found by the Bengal Nagpur Railway Company

(1) *Commissioners of Income-tax* v. *Haji Jamal Nurmahomad & Co.*, 1 I. T. C. 396.

(2) 2 I. T. C. 146.

and made over to the Secretry of State to be held by the latter absolutely as his property and repayable only in the event mentioned in the agreement between the Secretary of State and the Bengal Nagpur Railway Company.

The contention of the Crown was that the Company should be taxed on its own earnings save such sums as may be deducted under section 9 (2) of the Income-tax Act (now section 10 (2)). *Held* that the liability to tax must be determined with reference to the special agreement between the two parties and the nature of their relation to one another.

Per Woodroffe, J.—" The Secretary of State is the owner of the Bengal Nagpur Railway which has been constructed and is managed for him by the Company. This is their business on the income of which tax is leviable. In my opinion the principle applicable is that the Company should pay tax on what they get. . . . .

In my opinion they are not liable in respect of sum (*a*). This is interest due to the Secretary of State on 15½ Million capital found by him. It is true that this capital has been the means whereby profits have been earned in which the Company share. But this is not the Company's property. It, as also three Million Pounds supplied by the Company, are the property of the Secretary of State, and all receipts earned by the use of these two sums are paid to Government Account. Thereout the Government supply what sums are necessary to defray expenditure under the Contract. Out of such receipts the Government repays itself the interest on the capital sum supplied by it. And this interest is deducted before the profits in which the Company are entitled to share can be ascertained. It is this share of surplus profits which is income earned by the Company and so liable to tax. Sum (*b*) represents interest which the Company get for their three Million capital money and which has to be deducted before surplus profits can be ascertained. This is deducted in order that the Secretary of State may meet his obligations to the Company in respect of the three Million Pounds they have made over to him. It is stated that that money was borrowed in England and the liability is to pay interest in England. It is stated in the case of the Company that the sum of Rs. 13,07,440 is payment to the Secretary of State in rupee currency of the amount of the guaranteed interest payable by him on the share capital of the Company. The guaranteed interest on the Company's share capital is payable and paid in London as in the case of a debenture obligation by the Secretary of State and is independent of the earnings of the Railway. The payment, it is contended, of the sum of Rs. 13,07,440 constitutes the payment of a debt due from the Company to the Secretary of State. In effect the transaction is one in which the Secretary of State pays in London certain monies to the Company which he recoups himself in this country out of the earnings of the Railway. In that view of the case I am of opinion that the Company is not liable for tax in respect of this sum. . . ."[1]

(1) *B. N. Ry. Co. v. Secretary of State* (1 I.T.C. 178.)

In *M. S. M. Railway* v. *Commissioners of Inland Revenue*,[1] a case relating to English Corporation Profits Tax, Rowlatt, J. held the contrary view, *viz.*, that the interest guaranteed by the Government of India is a distribution of the profits earned.

(iv) in respect of insurance against risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores, used for the purposes of the business, the amount of any premium paid ;

Business—Allowances in respect of insurance premia—

Section 10 (2) (*iv*).—The allowances under this clause are restricted to insurance policies taken out against the risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores, used for the purposes of the particular business of which the profits or gains are being calculated and no allowance can be made on account of premia in regard to other insurances. Further, any sums not actually expended on *premia* but merely set aside by a company or firm as an insurance fund are simply a particular description of reserve and no allowance or deduction can be given in respect of such reserves.

The Act does not contemplate the deduction of premia on account of insurance against a loss of profit. If, however, the owner of a business elects to claim any such allowance, he should signify his intention to the Income-tax Officer—and if he makes a declaration in writing, undertaking generally to pay the tax on any amounts recovered from an Insurance Company under any such policy or policies, the allowance will be granted in respect of the premia for any such policies that he may have taken out not more than a month before the date of such declaration or that he may take out subsequent thereto. Where no allowance is asked or allowed in respect of such policy, any sums received from the Insurance Company on account of the policy will not be liable to tax. (*Income-tax Manual*, para. 42.)

As regards the genesis of the above instruction, see Mr. Sim's speech when the Act was passed :—

"Sir, I can assure the Honourable Member that departmental instructions will be issued in the exact words used by the Joint Select Committee."

"I might explain that the reason why the Joint Committee decided not to put in a special provision in the Bill was that the commercial

(1) 5 A. T. C. 739.

representatives explained that it would not always be convenient to take advantage of the concession and that certain businesses might prefer not to have the allowance and not to be taxed on any amount received from the insurance company. It was, therefore, decided to leave it entirely to the option of the owners of each particular business.

Previous law—

The words "furniture, stocks or stores" were added in 1922.

Meaning of words—

As to what is meant by 'insurance', see notes under S. 4 (3) (*v*).

As regards the meaning of 'damage' and 'destruction', see notes under section 9 (1) (*iii*).

As to 'buildings', see notes under section 9 (1).

Machinery—

'Machinery' implies the application of mechanical means to the attainment of some particular end by the help of natural forces (Stroud).

" It is not an easy task to define its meaning. . . . The word . . . . . must mean something more than a collection of ordinary tools. It must mean something more than a solid structure built upon the ground, whose parts either do not move at all or, if they do move, do not move the one with or upon the other in interdependent action with the object of producing a specific and definite result.

Their Lordships concur with Lord Davey in thinking that there is great danger in attempting to give a definition of the word ' machinery ' which will be applicable in all cases. It may be impossible to succeed in such an attempt. If their Lordships were obliged to run the hazard of the attempt they would be inclined to say that the word ' machinery ' when used in ordinary language *prima facie* means some mechanical contrivances which by themselves or in combination with one or more other mechanical contrivances by the combined movement and interdependent operation of their respective parts generate power or evoke, modify, apply or direct natural forces with the object in each case of effecting so definite and specific a result. But the determination must depend on the special facts of (the) case."[1]

" A bequest of " Plant and Goodwill " passes the house of business held at rack-rent, also trade fixtures, benches, presses, and implements of trade; but not stock-in-trade or household furniture and effects of the ordinary kind.[2]

(1) *Corporation of Calcutta* v. *Cossipur Municipality*, I. L. R. 49 Cal. 190 (P. C.).

(2) *Blake* v. *Shaw*, 8 W. R. 410; Johns. 732.

The Employers' Liability Act, 1880, contains no definition of "Plant", as therein used, "but, in its ordinary sense, it includes whatever apparatus is used by a business man for carrying on his business,—not his stock-in-trade which he buys or makes for sale, but all goods and chattels, fixed or moveable, alive or dead, which he keeps for permanent employment in his business.[1] In that case Esher, M. R., and Lindley, L. J., held that, a Wharfinger's horse was part of his 'Plant"; so, of a Coal Merchant's ship.[2] The carcase of a house is not part of a Builder's "Plant"[3] but scaffolding and ladders are. *Cripps* v. *Judge*.

But (whilst recognizing *Yarmouth* v. *France*) a Cab Proprietor's horses were held not part of his "Plant" within section (2), Bills of Sale Act, 1882, because there the context,—*e.g.*, "Trade Machinery" and "Fixtures",—indicates that "Plant", as there used, refers to something connected with the premises.[4]

Qua, and by, section 104, Factory and Workshop Act, 1901, "'Plant' includes any gangway or ladder used by any person employed to load or unload or coal a ship."

"'Plant' and 'Machinery' are two quote different things."[5] O a contract for the sale of a Freehold Brewery which provided that 'Fixed Plant and Machinery' should be paid for by valuation, I wich, J., held that, "speaking generally, 'Machinery' includes thing which by its action produces or assists in production; 'Plant' might be regarded as that without which production go on . . . . and included such things as, brewer's pip the like"; and that therefore a Chimney Shaft, which v outside the boiler-house but formed no part of it, a doubl tion, forming a malt and grain store, and Staging, erected on the stout bearers built into the walls, were not to valuation. (Stroud).[6]

Plant—

A set of machinery, tools, etc., nece chanical business often including the bu in the case of a railroad the rolling stoc rial or produce; hence the permanent institution as a Post office. (Stand

The following have been he hulk which had formerly been a

(1) *Per Lindley, L. J. in Yarmouth* 36 W. R. 281.

(2) *Carter* v. *Clarke*, 78 L. T.

(3) *Conway* v. *Clemence*, 80

(4) *London and Eastern Co* L. J. Q. B. 503; 76 L. T. 612; 45

(5) *Per Kekewich, J.*, in

(6) (*Re Nutley and Fi*

(7) *Burnley Steamshi*

floating warehouse for coal,[1] railway engines, etc., and tools[2] and tramway rails[3] but a stallion is not 'plant'[4] nor the bed of a harbour.[5]

In construing the word 'plant' for income-tax purposes especially under the Indian Act, regard must be paid to the grouping in which the word occurs. In clause (iv) of this sub-section the grouping is 'buildings, machinery, plant, furniture, stocks or stores'; in clauses (v) and (vi) it is 'buildings, machinery, plant or furniture.' Considering this grouping it is doubtful whether the decisions under other Acts—*e.g.*, Employer's Liability Act—declaring horses, etc., to be a 'plant' will apply to income-tax cases. In *Derby* v. *Aylmer* cited *infra,* though it was decided that a stallion is not plant, the question whether a traction horse was 'plant' was left open, but it is doubtful whether it is 'plant'. It is similarly doubtful whether elephants, bullocks and other animals used in a business are 'plant' for income-tax purposes. See clause (vii-a) *nfra* inserte by Act III of 1928.

rniture—

" It has not yet been declared what is meant by furniture "—per M. R. in *In re Parker ex parte Turquand*, 14 Q. B. D. 636.

A bequest of furniture may pass pictures (*Cremarne* v. *Antro-'d* 312) or fixtures; but not a library of books[6] nor stock-in-trade.[7]

t there is nothing under the Indian Income-tax Act to cost of insurance of a library of books being claimed under section 9 (2) (*ix*) if the library is necessary

l practice it is usual to refer to 'stocks' of the ıls and of the finished goods and to 'stores' hich are consumed in the course of manu- l the semi-finished and finished yarn and of a cotton mill, the parts of machines, ing referred to as 'stores'. The In- the distinction nor is the distinction either case the cost of insurance

1 K. B. 311.
Cases 487.

35.
Cases 147.

'Stocks' exclude goodwill.[1]

"The phrase comprises all such chattels as are acquired for the purpose of being sold or let to hire in a person's trade; and it probably includes utensils in trade (*Seymour* v. *Rapier Bunb* 28)." (Stroud).

Utensils in trade, *i.e.*, implements and tools would, however, in commercial practice be more often classed as 'stores' than as 'stocks'.

Used for the purpose of the business—

This qualifies all the words from "buildings" to "stores". This of course is only a reiteration of the general principle that no expenditure can be deducted which is not necessary for earning the profits; but the words "used for the purpose of the business" are a little wider than "necessary for earning the profits" which is what "solely incurred for the purpose of earning profits" in Section 10 (2) (*ix*) means.

When used—

Section 3 governs the whole Act, and in section 10, where an allowance has to be made covering a longer period than a year or ascertainable only at a later period, a definite proviso is inserted to meet the case [see clauses (vi) and (vii)]. It is therefore obvious that the buildings, etc., should have been used for the purpose of the business during the previous year,[2] but they need not have been *actually* so used, since in every business there must be periods of relative inactivity when a part of the equipment may not be in use. Moreover, it is not always possible to separate different items of plant and machinery and say which are in use and which are not. In the Punjab case referred to above, however, it was so possible, since the case related to a lorry which was not used at all during the accounting year.

The above ruling and remarks apply equally to clauses (iv), (v) and (vi).

Livestock—

Insurance of livestock used in business is evidently admissible, either as insurance of plant (which is doubtful) or as stocks —which presumably includes not only stocks of goods but both live and dead stock. On the other hand in view of the express reference to furniture which is the same as dead stock it is possible to contend that the stocks contemplated are stocks of goods and do not include livestock. In that case the insurance would be admissible under clause (ix).

(1) *Chapman* v. *Haym*. 1 Times Rep. 397.
(2) *Radhakishen & Sons* v. *Commissioner of Income-tax*, unreported.

Sums recovered for insurance policies—

There is no doubt that sums recovered on insurance policies on account of loss of circulating capital, *e.g.*, trading stock, should be treated as revenue items and taxed, but recoveries on account of loss of fixed capital would be capital receipts just as the loss of such capital would be capital loss. The point is that it is part of the business to insure stocks; and money received from insurance companies on account of loss of stocks stands on the same footing as the sale proceeds of such stocks.[1]

Insurance of profits—

As regards insurance against loss of profits, there is no difference between the provisions in the United Kingdom law and those in the Indian law. In either country if the cost of such insurance can be allowed at all it is only as expenditure incurred for the purpose of earning the profits. Under the Indian law it cannot be allowed under section 10 (2) (*iv*) but, if at all only under section 10 (2) (*ix*). In *Usher's Wiltshire Brewery* v. *Bruce*[2] it was held that premia paid by a Brewery in order to provide against the loss of trade occasioned by the taking away of a licence from the defaulting tenant of a Tied house was a permissible deduction from the profits of the Brewery. Presumably the same considerations will apply to premia paid to insure against loss of profits. That is to say insurance can be claimed against *specific* risks to profits. The line however which divides *specific* risks from *general* risks is difficult to define. The sum recovered under such an insurance policy is not a ' capital sum ' within the meaning of section 4 (3) (*v*) but a 'profit ' and therefore taxable as such in the year of receipt—*Cf. Green* v. *Gliksten & Son, Ltd., supra.* Paragraph 37 of the Income-tax Manual forbids deductions on account of losses recoverable under an insurance or a contract of indemnity. The strictly legal course would perhaps be to allow such losses—in so far as they are not capital losses—as deductions from profits, but at the same time to include in taxable profits the sums received from the insurance companies. Under the English Acts, there is a specific provision prohibiting such deductions on account of recoverable losses—Rule 3 (*k*), Cases I and II, Schedule D.

Insurance of Lives of Employees—

It is not clear how a premium paid to insure the life of an employee who personally influences the business and whose death

(1) *Green* v. *Glikston & Sons*, 6 A.T.C. 937 (C. of A.)

(2) 6 Tax Cases 399.

will cause a diminution of profits should be treated. On the same grounds as premia paid to insure against loss of profits such premium can presumably be claimed as a deduction under S. 10 (2) (*ix*). and the amount recovered under the insurance policy treated as profits in the year of receipt. Premia paid for the insurance of lives of employees for their benefit and not for that of the employer will stand on the same footing as a bonus or salary.

Insurance against accidents to employees—

Premia paid for such insurances as well as insurances against compensations under the Workmen's Compensation Act should all be dealt with evidently under section 10 (2) (*ix*), and not under this clause.

(v) in respect of current repairs to such buildings, machinery, plant, or furniture, the amount paid on account thereof ;

Previous Law—

The word 'furniture' was added in 1922.

Repairs—

This is a word with an indefinite connotation. It ordinarily means "to make good defects including renewal where that is necessary." It will include patching, where patching is reasonably practicable and "where it is not you must put in a new piece."[1] But 'repairs' do not connote a total reconstruction.[2]

"An agreement to keep 'in repair' a house out of repair means that the contracting party is first of all to put it in good repair having regard to its age and its class—a house in Spital-fields would not be repaired in the same style as one in Grosvenor Square—and (semble) you are to take into consideration the condition of the premises at the time of the contract."[3] (Stroud.)

Current—

The meaning of the word 'current' is not clear. It obviously means such repairs as can be fairly treated as current, *i.e.*, not being 'capital.' In that view it hardly adds to the connotation of the word 'repairs', as this word can never include total construction or reconstruction on such a large scale as to make it 'capital' expenditure. The construction of the word 'current' as equivalent to 'recurrent' would also lead to the same result.

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(1) Per Lord Blackburn, *Inglis* v. *Buttrey*, 3 A. C. 552.
(2) *R.* v. *Epsom.*
(3) *Stanley* v. *Towgood*, 6 L. J. P. 129.

The question whether expenditure in a shipowner's business is current as opposed to capital must essentially be one of degree and therefore one of fact. To elucidate the problem, a number of outside considerations have to be taken into account in addition to the materials provided by the assessee, *e.g.*, local conditions, the ordinary life of the type of boats used by the assessee and the normal cost of keeping them in serviceable condition. The assessee cannot neglect to provide the Income-tax Officer with the information that is necessary and then take advantage of his own negligence to plead that the Income-tax Officer's conclusions are based on insufficient evidence.[1]

Repairs—Question of fact—

Whether 'repairs' are really 'repairs' or constitute replacement of capital assets is a question of degree; and like all questions of degree, a question of fact.[2] It is also a matter depending to some extent on Accountancy and business usage and in this view also a question of fact.[3]

Such buildings, etc.,—

That is, buildings, etc., used for the purpose of the business. As to what is meant by this qualification, *see* notes under section 10 (2) (*iv*).

(vi) in respect of depreciation of such buildings, machinery, plant, or furniture being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed :

Provided that—

(*a*) the prescribed particulars have been duly furnished ;

(*b*) where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount

(1) *Ramanatha Reddi* v. *Commissioner of Income-tax*, 6 Rang. 175.

(2) *Stubbs* v. *Cooper*, 10 Tax Cases 29 (C.A.) 373; *Currie* v. *Inland Revenue Commissioners*, (1921) 2 K.B. 332 (C.A.).

(3) *Fassett and Johnston* v. *Commissioners of Inland Revenue*, 4 A.T.C. 89.

of the allowance for depreciation for the following year and deemed to be part of that allowance, or if there is no such allowance for that year, be deemed to be the allowance for that year, and so on for succeeding years ; and

(c) the aggregate of all such allowances made under this Act or any Act repealed hereby, or under the Indian Income-tax Act, 1886, shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant, or furniture, as the case may be;

Rule 8.

An allowance under section 10 (2) (*vi*) of the Act in respect of depreciation of buildings, machinery, plant or furniture shall be made in accordance with the following statement :—

Class of buildings, machinery, plant or furniture.	Rate.	REMARKS.
	Percentage on prime cost.	
1. *Buildings**—		*Double these rates may be allowed for buildings used in industries which cause special deterioration, such as chemical works, soap and candle works, paper mills, and tanneries.
(1) First class substantial buildings of selected materials.	2½	
(2) Buildings of less substantial construction .	5	
(3) Purely temporary erections such as wooden structures.	10	
2. *Machinery, Plant or Furniture** —		*The special rates for electrical machinery given below may be adopted, at firm's (assessee's?) option, for that portion of their machinery.
General rate	5	
Rates sanctioned for special industries—		
Flour Mills, Rice Mills, Bone Mills, Sugar Works, Distilleries, Ice Factories, Aerating Gas Factories, Match Factories.	6¼	
Paper Mills, Ship Building and Engineering Works, Iron and Brass Foundries, Aluminium Factories, Electrical Engineering Works, Motor Car Repairing Works, Galvanizing Works, Patent Stone Works, Oil Extraction Factories, Chemical Works Soap and Candle Works, Lime Works, Saw Mills, Dyeing and Bleaching Works, Furniture and Plant in hotels and boarding houses, Cement Works using rotary kilns.	7½	
Plant used in connection with Brick Manufacture, tile-making Machinery, optical Machinery, glass factories, Telephone Companies, Mines & Quarries.	10	

Class of buildings, machinery, plant or furniture.	Rate.	REMARKS.
	Percentage on prime cost.	
Sewing machines for canvas or leather . .	$12\frac{1}{2}$	
Motor cars used solely for the purpose of business, Indigenous sugarcane crushers (Kohlus or Belnas).	15	
Motor taxis, motor lorries and motor buses .	20	
3. *Electrical Machinery*—		
(*a*) Batteries	15	
(*b*) Other electrical machinery, including electrical generators, motors (other than tramway motors), switchgear and instruments, transformers and other stationary plant and wiring and fittings of electric light and fan installations.	$7\frac{1}{2}$	
(*c*) Underground cables and wires	6	
(*d*) Overhead cables and wires	$2\frac{1}{2}$	
4. *Hydro-Electric concerns*—		
Hydraulic works, pipe lines, sluices and all other items not otherwise provided for in this statement.	$2\frac{1}{2}$	
5. *Electric tramways*—		
Permanent way ..		
(*a*) Not exceeding 50,000 car miles per mile of track per annum	$6\frac{1}{4}$	
(*b*) Exceeding 50,000 and not exceeding 75,000 car miles per mile of track per annum.	$7\frac{1}{7}$	
(*c*) Exceeding 75,000 and not exceeding 125,000 car miles per mile of track per annum	$8\frac{1}{3}$	
Cars—car trucks, car bodies, electrical equipment and motors ..	7	
General plant, machinery and tools ..	5	
6. *Mineral Oil Companies*—		
A. Refineries—		
(1) Boilers ..	10	
(2) Prime movers	5	
(3) Process plant	10	
B. Field operations—		
(1) Boilers ..	10	
Prime movers (2) ..	5	

Class of buildings, machinery, plant or furniture.	Rate.	REMARKS.
	Percentage on prime cost.	
(3) Process plant ..	7½	
Except for the following items—		
(1) Below ground—All to be charged to revenue.	..	
(2) Above ground—(*a*) Portable boilers, drilling tools, well head tank, rigs, etc. ..	25	
(*b*) Storage tanks ..	10	
(*c*) Pipe lines—		
(*i*) Fixed boilers ..	10	
(*ii*) Prime movers ..	7½	
(*iii*) Pipe line ..	10	
7. *Ships*—		
(1) Ocean—		
(*a*) Steam ..	5	
(*b*) Sail or tug ..	4	
(2) Inland—		
(*a*) Steamers (over 120 ft. in length) ..	5	
(*b*) Steamers including cargo launches (120 ft. in length and under) ..	6	
(*c*) Tug boats ..	7½	
(*d*) Iron or Steel flats for cargo, etc. ..	5	
(*e*) Wooden cargo boats up to 50 tons capacity ..	10	
(*f*) Wooden cargo boats over 50 tons capacity ..	7½	
8. *Mines and Quarries*—		
(1) Railway siding* (excluding rails) ..	5	*Depreciation on rails used for tramways and sidings, and in inclines where the rails are the property of the assessee, is allowed at 10 per cent. under item 2 above (plant used in connection with Mines and Quarries) in addition to any depreciation allowance on the cost of constructing the tramways sidings or inclines.
(2) Shafts ..	5	
(3) Inclines* ..	5	
(4) Tramways on the surface* (excluding rails) ..	10	

Rule 9.—For the purpose of obtaining an allowance for depreciation under proviso (*a*) to section 10 (2) (*vi*) of the Act, the assessee shall furnish particulars to the Income-tax Officer in the following form :—

Description of buildings, machinery, plant, or furniture.	Original cost.	Capital expenditure during the year for additions, alterations, improvements and extensions.	Date from which used for the purposes of the business.	Particulars (including original cost, depreciation allowed and value realised by sale or scrap value) of obsolete machinery, plant or furniture sold or discarded during the year, with dates on which first brought into use and sold or discarded.	REMARKS.
1	1·A	2	3	4	5

I————declare that to the best of my information and belief the buildings, machinery, plant and furniture described in column 1 of the above statement were the property of—— during the year ended—————and that the particulars entered in the statement are correct and complete.

Place *Signature*

Date *Designation*

Allowances in respect of Depreciation—

[*Section* 10 (2) (*vi*).]—The allowances permissible under this clause are prescribed in rule 8 and the information that must be furnished in order to obtain an allowance is set out in rule 9. It is only the particular classes of buildings, machinery, plant or furniture mentioned in rule 8 in respect of which the depreciation allowance can be claimed, and the buildings, machinery, plant or furniture for which depreciation allowance is claimed must be used for the purposes of the particular business of which the profits or gains are being computed. No allowance can be claimed on account of depreciation, for example, of any portion of a building which is used as a residence by the assessee. Further, the buildings, etc., must be the property of the assessee. No allowance can be claimed if they are leased from others.

Buildings belonging to the owner of a business and used by him in order to house his employees are buildings used for the purpose of business if the owner charges no rent. If, however, rent is charged, Section 9 would apply.

The percentage allowance is on the original cost of the machinery, etc., *to the assessee* and not the original cost to a previous owner if it had been purchased from a previous owner. The rates of depreciation allowance fixed in rule 8 are fixed rates for the whole of India. Depreciation at those rates must be allowed each year when there are sufficient profits, and only the excess of the depreciation allowance over profits can be carried forward from year to year until absorbed, and this practice must be followed whether the depreciation allowance is adjusted in the accounts of the assessee or not and irrespective of the amount shown in the accounts. It is for this reason that in the form of returns of income prescribed in rules 18 and 19 any amounts entered in the accounts of an assessee for the depreciation of any of the assets of the business must be written back as the amount allowed for income-tax purposes is the amount prescribed in the rules and not the amount entered in the books of the assessee. The words "No profits or gains" in *proviso* (*b*) to Sub-section 2 (*vi*) mean "No profits or gains of the particular business of which the financial results are being computed." That is to say, if an assessee owns two businesses A and B, and the profits or gains of business A are insufficient to cover the full depreciation admissible on the machinery, etc., used for the purposes of business A, excess depreciation cannot be set off against the profits of business B, still less against income, profits or gains falling under any other 'head'. The effect of the express provision in proviso (*b*) in clause (*vi*) of Sub-section (2) of Section 10 is that an excess of the depreciation allowance over the profits or gains, etc., does not involve a "loss of profits or gains" within the meaning of Sub-section (*i*) of Section 24, but merely the non-payment of an admissible allowance—for which non-payment a specific remedy is afforded by the proviso just mentioned.

This clause provides for the depreciation of furniture, but it may not suit the convenience of particular traders to ask that a depreciation account should be kept up for petty items of furniture and a depreciation allowance on account of furniture should, therefore, be granted only in cases in which it is asked for, in which event the cost of replacement should not be allowed; where such depreciation allowance is not asked for, the cost of replacement should be allowed in the year in which the furniture is replaced.

Whatever depreciation allowances are granted, it will be necessary to maintain an account showing the original cost to the assessee of the plant, the amount of the annual allowance, the amount of the allowances already granted and the balance still to be allowed.

The percentage allowance fixed in the rule for the permanent way of electric tramways only covers cases where the number of car miles per mile of track does not exceed 125,000 car miles per annum. Where the number of car miles per mile of track per annum exceeds 125,000, special terms will have to be made in each case. Similarly special consideration should be given to each case where there are special circumstances such as exceptional gradients, the compulsory use of wood paving, etc., tending to show that the car mileage does not fairly represent the wear and tear of the track. The cost of renewing concrete foundations should be allowed as a trading expense as and when incurred, provided that, if the renewed foundations are an improvement on the old ones, so much of the cost of the renewed foundations as represents such improvement should not be admitted as a trading expense. Amounts received for the old materials, whenever renewals are effected, should be credited against the cost of the renewals, and if the old materials are not disposed of at the time or are used for other purposes, their estimated value should be deducted, subject to adjustment if necessary, as and when the old materials are disposed of. The percentages fixed for the depreciation of the permanent way are based upon the estimated life of a track from a consideration of the number of car miles per mile of track, and consequently these percentages may vary in connection with the same undertaking. It must be clearly understood that the revision of the life of a track need not necessarily be deferred till the whole track is renewed, because it may become clear before that date that revision is necessary either in the direction of increasing or decreasing the average life. As regards the rate for general plant, machinery and tools, all other plant and machinery including workshop tools but excluding loose implements, office furniture and small articles which require frequent renewals (expenditure on which is allowed as a business expense against revenue), should be lumped together and the rate of 5 per cent. depreciation should be allowed thereon in addition to the cost of repairs. No depreciation should be allowed on overhead equipment, *i.e.*, trolley wires and connections : all expenditure on maintenance and renewals should be charged as working expenses, as and when incurred.

The item "Below ground—All to be charged to revenue" in exception (1) under item 6 (Mineral oil companies)—B. (Field operations), in Rule 8 means that on the plant in question (pipes, etc.) below ground, depreciation is to be allowed at 100 per cent., so that if the profits are insufficient in any year to allow of the full 100 per cent., being written off against them, the balance can be carried forward, under proviso (*b*) to section 10 (2) (*vi*) of the Act to subsequent years.

No depreciation allowances are granted to railways on account of depreciation of their rolling stock as renewal charges are allowed as a business deduction.

As stated in paragraph 37 no allowance can be made on account of the depreciation of the assets of a business other than the particular items mentioned in this sub-clause and in rule 8. No depreciation allowance, for example, is permissible to provide for the amortization of capital sums paid on account of the purchase of the lease of a mine or for the depreciation of wasting assets such as coal. Depreciation allowances should, however, be allowed for sinking shafts, tramways and sidings in coal mines, which are included in the term "plant".

Shares and securities held as part of the capital of a business should be similarly dealt with. So long as shares or securities continue to be held by a company, firm or individual as part of his or its capital, any depreciation or appreciation in their market value is outside the scope of the Income-tax Act; and similarly, when the value of shares and securities so held (for example, the securities constituting the reserve fund of a bank or other company) is realised, the transaction is a capital transaction, and no account should be taken for income-tax purposes of any profit or loss resulting from the sale. On the other hand, where an individual, company or firm habitually uses part of his or its resources in the purchase of securities or shares with a view to obtaining profit on their sale and the subsequent reinvestment of the proceeds, the individual, company or firm is, in altering his or its investments, carrying on a trade for the sake of obtaining profit therefrom, and the profits secured or losses incurred are trade profits or losses which must be taken into account in determining the assessment to income-tax. It will, therefore, always be a question of fact to be decided on the merits of each case whether the changes in investment are of sufficiently systematic a character to constitute the exercise of a trade, but if they are, the profits therefrom are liable to assessment, and an allowance must be made for any losses in calculating the amount of tax payable. (*Income-tax Manual,* para. 43.)

Previous law—

The word 'furniture' was added in 1922. Under the 1918 Act the rates of depreciation were maxima; now they are fixed rates. Also under the 1918 Act no depreciation could be claimed unless it had been debited in the accounts. Also the 1918 Act only provided that the balance of unadjusted depreciation could be added to the allowance for the next year or years but did not clearly permit its being carried forward indefinitely until adjusted.

Depreciation—Meaning of

There is no definition of 'depreciation'. The word is actually used in practice by Accountants in varying senses, often including even obsolescence. Recent usage, however, confines the word to the sense of wear and tear, and of this only that portion which cannot be made good by repairs. That is to say, depreciation represents the insidious and irreparable decay of the plant or machinery, obsolescence being used to signify the unsuitability of a machine or plant on account of its being out of date.

'Such' buildings—

That is, those used for the purpose of the business. See notes under section 10 (2) (*iv*).

Law in the United Kingdom—

In the United Kingdom law an allowance is made representing "the diminished value by reason of wear and tear during the year". This expression may mean on the one hand that no loss by depreciation may be allowed unless expenditure has been incurred in making it good by repairs. On the other hand it may mean that after all damage by wear and tear has been made good by repairs, short of renewal, a further allowance may be made in respect of the imperceptible and irremediable deterioration due to age. That is to say, besides allowing for cost of repairs, allowance should also be made to an extent that should permit of the setting aside out of profits, of sums sufficient to provide funds to replace the instrument when by reason of physical deterioration through age it should cease to be worth repairing.

In the *Caledonian Railway Company* v. *Banks*[1] the Scottish Court held that the depreciation allowance was "for diminished

(1) 1 Tax Cases 487.

value as a means of earning income and not as a saleable subject" and held that no allowance could be claimed on newly added rolling stock which had not required any repair. As the law stands in the United Kingdom, the allowance for depreciation is determined entirely at the discretion of the Commissioners. In practice, however, standard rates of depreciation have been fixed in most cases by the Board of Inland Revenue for the guidance of the General and Special Commissioners. Though the courts cannot interfere with the adequacy or otherwise of the rates, there is provision for the question to be referred to a Board of Referees if the representatives of a particular trade desire it [Rule 6 (7) of Cases I and II of Schedule D].

Even in the United Kingdom where the allowance for depreciation is in the discretion of the Commissioners, the system of allowing the actual cost of Repairs and Renewals instead of a provision for wear and tear is of doubtful legal validity, and rests on the mutual consent of the Crown and the assessee and the convenience that it affords both. In India also, to the extent that such practice is followed, it is outside the law. Under the law, a *fixed* allowance prescribed by the Rules has to be given, which has nothing to do with the actual expenditure on Renewals. See however notification under section 60 permitting Railways and Tramways to claim at their option the actual cost of Renewals and Replacements.

Depreciation—Computation of—

The original block of machinery, and each block constituted by a year's additions, should be treated as separate units on each of which depreciation should run independently so that block after block in chronological order is eliminated, each after its full value is written off, from the original cost on which depreciation is based.

Onus of proof—

Unless the prescribed particulars (See Rule 9) have been furnished to the Income-tax Officer no depreciation can be claimed. The onus of proof as to the correctness of the particulars furnished will, as in almost everything else, rest upon the assessee. Depreciation allowances being on a percentage basis, the assessee should furnish the prime cost of each item.[1]

Concerns newly assessed—Accumulated depreciation—

When a concern that has been in existence for some years becomes liable to income-tax for the first time, depreciation

(1) *Ramanatha Reddiar* v. *Commissioner of Income-tax*, 6 Rang. 175.

should apparently be allowed not with reference to the value of the plant, etc., on the date on which it so becomes liable, but with reference to the original cost of the plant, etc., to the assessee. The latter cost would ordinarily be higher than the value at the time the concern became liable to income-tax. Such concerns could not, however, claim the benefit of accumulated depreciation under the proviso to section 10 (*vi*), since the proviso clearly contemplates that the income was taxed in previous years. Cases of this kind can, however, seldom arise.

Additions to plant during the year—

The law is silent as to the extent to which depreciation is to be allowed in respect of additions during the previous year. In the absence of any express provision to the contrary, the assessee is probably entitled to depreciation for the whole year.

Buildings let to employees—

Depreciation should be allowed on buildings used for the purpose of the business. Whether they are so used or not is a question of fact. It is a reasonable presumption that they are, if they are let out without rent to employees. If rent is paid, it will depend on the facts of the case how far the buildings are used for the purpose of the business. If they are not so used, section 9 applies.

Unabsorbed depreciation—Set-off between different businesses—

Not only is a set-off of unabsorbed depreciation inadmissible against other sources of income under section 24, but it is also inadmissible as between different businesses. Though "any business" as used in section 10 (1) comprehends each and every business carried on by the assessee, it evidently refers to each business separately. The computation of the profits of each business has to be made separately. The unabsorbed depreciation of each business should be carried forward to the next year.

Profits earned partly outside British India—Depreciation—How computed—

In respect of assessees with profits accruing partly in British India and partly outside, the problem of depreciation is somewhat complicated. If the assessee furnishes annual accounts for the whole business, the second method of rule 33 could be applied. The 'world-profits' should evidently be calculated for the business under the Indian law, *i.e.*, deductions not permitted in India but permitted in other countries should be added back and deductions admissible in India allowed. On this 'world profits' depreciation should be allowed according to the Indian law, *e.g.*, allowance being made for unabsorbed depreciation of previous years, etc., and of the net income, the fraction $\frac{\text{British India receipts}}{\text{Total receipts.}}$ should be taken as the net taxable income in British India (without, of course, a further allowance for depreciation).

The same arrangement also applies to obsolescence.

This problem of depreciation and obsolescence is complicated in respect of businesses like those of shipping companies. If the companies keep accounts not by the year but by 'trips', and the trade is entirely in Indian waters, the problem is simple. Otherwise some equitable method of computation has to be followed, the law not making any explicit provisions as to the computation. *See* also paragraphs 84-A and 85 of the *Income-tax Maunal.*

Bank—Securities held by—Depreciation of—

A banking concern claimed, in computing its profits, to deduct the amount of depreciation of war bonds and securities belonging to it arrived at by comparing the market rates at the time of closing the accounts with the original price paid for the bonds. *Held,* that the deduction was inadmissible.

Per Macleod, C. J.—" From the gross income only certain debits for depreciation are to be allowed, and this debit asked for by the Bank not being mentioned therein cannot be allowed. I think this was the obvious intention of the Legislature, since, while depreciation of machinery, plant and buildings can easily be calculated as provided in the Act, it would be a very different matter to have to enter into such calculations with regard to assets other than these. But this much is clear that if the profits of a business are to be calculated according to the legal definition of profits, that method of calculation must be continued from year to year, and an assessee would not be allowed to write down his assets in a year when market values had declined without writing them up when values had increased."[1]

A bank claimed to deduct the depreciation in certain securities held by it on the ground that the securities represented money lent to Government just like money lent to the bank's customers. As the bank held these securities not with the object of dealing with them as stock-in-trade from day to day in the ordinary course of business but as an emergency reserve in lieu of cash, it was held that the investments were part of the fixed Capital as distinguished from the floating Capital of the bank, and

(1) *In re Tata Industrial Bank,* 1 I. T. C. 152.

that therefore the deduction on account of depreciation was inadmissible.[1]

In *Scottish Investment Trust Co.* v. *Forbes*[2] it was held that the net profit made by an investment trust company during the year by realising investments at higher prices than they were bought for, should be taxed even though in the books this profit had been set off against the depreciation of other securities which the company possessed.

In all such cases, if the business of the Bank or Company was to trade or deal in shares or securities, such depreciation would be automatically allowed, inasmuch as the shares or securities would be treated as stock-in-trade and valued at cost price or market price, whichever was lower.

Machinery let—Depreciation on—

It is a condition under this clause that the machinery, etc., should be the property of the assessee. It follows therefore that if the machinery, etc., are leased, the allowance cannot be claimed by the lessor because he does not carry on the business. Nor can the lessee who carries on the business, claim any allowance because the machinery, etc., are not his property—see, however, the case of *Mangalagiri Factory* cited *infra*. Under clause (5) of rule 6 under Cases I and II of Schedule D to the English Income-tax Act, the lessor, in a case of this kind, would be entitled to an allowance on account of depreciation, if under the terms of the lease he was to maintain and restore the machinery, etc. Similarly, the lessee would be entitled to treat the machinery, etc., as his own if under the lease he was to maintain and restore the machinery, etc. But it should be remembered that the allowance for 'wear and tear' in the United Kingdom covers both depreciation and repairs, for which separate allowances are given in India.

The allowance of obsolescence, however, stands on a different footing and should obviously go to the owner or lessor in all cases, because a claim for obsolescence can occur only once in the lifetime of the machinery, etc., and is not of a recurring nature; nor can one ordinarily conceive of the burden of obsolescence falling upon the lessee.

Machinery, etc.—Leased— Depreciation allowance—

An English company had some foreign cold storage business which it carried on either directly or through subsidiary

(1) *Punjab National Bank* v. *Commissioner of Income-tax*, 2 I.T.C. 184.
(2) 3 Tax Cases 231.

companies. The foreign business was transferred to an American company for a term of years in consideration of certain annual payments to the subsidiary companies, whose shares the parent English company continued to own, receiving dividends therefrom. The American company also guaranteed sums necessary to meet the fixed charges of the English company and maintain its dividends. The premises, machinery and plant of the foreign business remained the property of the English company, but they were placed under the sole control of, and were used by, the American company for the purpose of carrying on the businesses as it thought fit. They were not demised or leased to the American company, and no rent was payable for their use, but the American company was to keep them in proper repair and working order, save as regards all ordinary wear and tear and damage by fire. The English company claimed that, in taxing its profits, deductions should be allowed for the fire insurance premiums paid by it in respect of the premises, and for wear and tear of the machinery and plant, of the transferred business. *Held*, that the fire insurance premiums did not represent money wholly and exclusively laid out or expended for the purposes of the trade of the English company, that the machinery and plant in question was not used for those purposes, and that the deductions claimed were accordingly inadmissible.

Per Pollock, M. R.—". . . . it is not all money that is laid out by the subject but only money which is laid out, first of all, for the purposes of the trade, and, secondly, laid out wholly and exclusively for the purposes of the trade, and unless the expense incurred can be brought within these words which are narrow words, the deductions cannot be allowed. It is quite plain that the intention of the Legislature was not to make a broad general rule that whatever a subject likes to expend in his business could be deducted but only such sums were to be allowed to which the character could be assigned that they had been wholly and exclusively laid out for the purposes of the subject's business. . . . . The principle which is invoked is the principle, as I say, of the *Usher's Wiltshire Brewery Company, Limited*,[1] and I think it is important that one should just see what rule was intended to be laid down in that case. Up to that time the ruling decision was the one in *Brickwood & Co., Limited* v. *Reynolds*.[2] The decision there was that the repairs which were executed by brewers to their tied houses in which their beer was sold could not be allowed as a deduction from the profits and gains of their trade in arriving at the true figure to be returned for the purposes of Income-tax, and what Lord Justice Smith said there was this: It is true they incurred the expense upon these tied houses and it is true in one sense they are useful

(1) 6 Tax Cases 399.
(2) (1898) 1 Q. B. at page 95 (3 Tax Cases 600).

to the trade in respect of which the return to Income-tax is made, but, he said, by doing the repairs to the tied houses they keep up and foster the trade of the publican which is a wholly independent trade, wholly independent of the brewers' trade, and he adds at the end of his judgment: the expense was incurred for many other things, one being the purposes of the trade of the publicans who occupy these houses. *Brickwood* v. *Reynolds* therefore took the view that this sort of expenditure, inasmuch as it was expenditure which inured or might be considered to inure to the benefit of somebody else's trade and not the trade of the subject making the return, inasmuch as that was the case, no deduction could be claimed successfully in respect of money expenditure for that sort of trade, a trade which did not immediately concern the subject making the return.

The House of Lords in *Usher's Wiltshire Brewery Company, Limited,* overruled the case of *Brickwood* v. *Reynolds*, and they said that the deduction may be allowed in cases where the payment or expenditure is incurred for the purposes of the trade of the subject that has made the return, and it does not matter that this payment may inure to the benefit of somebody else, to the benefit of a third party; if it primarily inures and was incurred and laid out for the purposes of the trade of the subject making the return, then it is within the clause relating to deduction.

I think that it would be a very serious mistake and very misleading if the principle of the *Usher's Wiltshire Brewery case* was to be supposed to be this: if you can find that the expenditure has been made on commercial lines advantageously for the purpose of the business, if you are able to say that, then you are entitled to apply the rule in the *Usher's Wiltshire Brewery case* and to secure any deduction. I do not think that rule was intended to be laid down so widely; you would have to scrutinise the expenditure very narrowly to find out whether it was laid out for the purpose of the subject's trade, and then ask the second question—was it laid out wholly for the subject's trade and exclusively for his trade?"[1]

Plant—Leased by company—Depreciation on—

In *Commissioners of Income-tax* v. *Mangalagiri Sri Umamahesvara Gin and Rice Factory,*[2] the assessees, who were a limited company, elected not to work their mill but to let it out to other persons who worked it. *Held* by the Madras High Court that the assessees used the factory for the purpose of the business—not of working it but of leasing it—and that deduction for depreciation was admissible.

This decision is at first sight in conflict with that *In re Kaladan Suratee Bazar Co., etc.*[3] The *ratio decidendi* of the Madras case is not clear but it would seem that the High Court

(1) *Union Cold Storage Company, Ltd.* v. *Jones*, 8 Tax Cases 738.
(2) 2 I. T. C. 251.
(3) 1 I. T. C. 50.

based their decision on the fact that the assessees were a company and that the Articles of Association contemplated the mill being let out if the company did not want to work the mill—*see* particularly Krishnan, J.'s judgment. Perhaps also a distinction is sought to be made between the letting of buildings and the letting of machinery and plant. The Court evidently did not contemplate that any assessee who let houses could claim to carry on the *business* of letting houses.

The following portions in the judgment of Coutts Trotter, C. J., are however not clear :—

"It seems to me that this is not an infrequent case of the same building and its contents being taxable both in the case of the lessors and the lessees. Different deductions will be allowable in the case of the lessors and the lessees. The lessors as carrying on the business of letting a rice mill can justly deduct from their assessment any sum which is due to depreciation of the lettable value of the property by reason of wear and tear of machinery which falls upon them under the contract of lease. Similarly the lessees being taxable as carrying on the business of rice-milling will be entitled to a deduction of such repairs as fall upon them under the lease. The Crown does not suffer from the fact that the parties can distribute the incidence of the liability for repairs as they choose, because only one total sum can be allowed as deduction; if that principle be right, it answers the question raised by the case and it is not our function to apportion which deduction can be rightly claimed by the lessors and which by the lessees, which is a matter for the Commissioner to work out as a question of fact."

In the first place, it is not clear how the same building or its contents can come to be taxed in the hands of both the lessor and the lessee. The rent paid by the lessee is deducted from his taxable profits, and the lessee is *not* taxed on the rent. In the second place, 'depreciation' is a special allowance which permits capital losses to be spread over the revenue accounts; and it is not clear how the 'depreciation' allowance can be divided between two persons one of whom is not the owner, nor how a portion of it can be set off against the cost of 'repairs'. In the third place, it is not one sum that the law allows as a deduction. Unlike the United Kingdom law which allows a single sum for both repairs and depreciation the Indian law allows both 'repairs' and 'depreciation' as deductions—for different objects altogether—the former for keeping up the machinery, etc., in working order and the latter to enable the owner to replace the machinery, etc., when they are eventually worn out. 'Repairs' will be allowed under clause (v), irrespective of the ownership, if the machinery, etc., are used for the business taxed; and depreciation will be allowed if (1) the machinery, etc., are used for the business of the assessee, and (2) the assessee owns them.

Harbour—Silting up—Clearance of—

A Harbour Board charged by statute with the duty of maintaining a harbour, which included a part of a river bed deepened to give access to ships, claimed to deduct as "wear and tear of machinery and plant" or 'repairs to premises', expenses incurred in dredging out accumulated silt. *Held,* that (*a*) the harbour was not 'plant or machinery' nor was the silting "wear and tear"; (*b*) if the expenditure incurred on removing the silt was admissible at all as expenditure "on repairs of premises", it should be deducted from profits in the year actually incurred, and no part of it could be set off against earnings in other years.

Per the Lord President.—"A Harbour bed is neither plant nor machinery. Nor is silt "wear and tear" . . . . Next the deduction was sought to be justified as " Repairs on premises." For my part and speaking for myself alone I am equally unable to accept that view. According to the ordinary use of language, and we are not dealing here with technical phraseology, to dredge out silt from a harbour cannot be accurately or even intelligibly described as making ' repairs on premises.' The Revenue however considered that the outlay was "applicable to maintenance."[1]

In India, of course, an exact case of this kind could not arise, as harbour boards are 'local authorities' and therefore exempt under section 4 (3) (iii). But the principle underlying the decision can be applied to docking companies, etc. In this case of the *Dumbarton Board,* the Crown was prepared to concede that the expenditure in question could be charged to revenue, and the Court did not therefore give a decision, though the Lord President said,

"It was . . . . plainly capital expenditure just as much as the cost of originally making the harbour."

In India, a dock would not be assessed as 'property' but under 'Business', whereas in the United Kingdom the tax would be under Schedule A roughly corresponding to our 'property' in section 6.

Railway—Renewals allowed—No further depreciation admissible—

In the case cited below, the Commissioners refused to grant an allowance for depreciation, on the ground that there was no diminution of value on account of wear and tear, the sums allowed in respect of repairs and renewals having been

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(1) *Dumbarton Harbour Board* v. *Cox,* 7 Tax Cases 147.

sufficient to meet the loss by wear and tear. They also refused to grant any allowance under the section for depreciation of new plant which had not yet been in need of repair. The decision of the Commissioners was confirmed.

Per Lord Gifford.—"The Company cannot get deduction for deterioration twice over, first by deducting the actual expense of repair and renewal, and then by deducting an additional estimate for the same thing. Nor will it do, as the Railway Company urge, to make a distinction between old and new plant, and to deal with the old plant in one way and with the new in another. I think the same principle must be applied to both."[1]

In this case it was obviously open to the Crown to have disallowed the deduction on account of renewals and allowed a deduction for wear and tear, but the Revenue, evidently as a matter of convenience, both to the assessee and to the Revenue, allowed the cost of renewals as a deduction.

Tramways—Renewals allowed—No further depreciation admissible—

The London County Council acquired some horse tramways, and reconstructed them for electric traffic. At the time of reconstruction only a part of the track was completely worn out, the average unexhausted life of the horse rails replaced being eight years. Under an arrangement agreed to by the Crown and the Council it had been the practice to allow as a deduction from profits the cost of the actual renewals in each year. The Council claimed that the deduction, under the practice, should not be restricted to the cost of renewal of the rails wholly exhausted (as conceded by the Crown), but should include an allowance for the partial exhaustion of the remainder of the track which had been reconstructed. Failing this they asked that the assessment should be amended by allowing the depreciation during the year. *Held*, that no question of law was involved, that, accepting the practice, the Council were not entitled to more than an allowance for renewal of the lines which had been completely worn out, and that they were not entitled to have the case reheard on a differnt principle.[2]

Depreciation—Interest should be ignored—

A company owned a fleet of passenger and cargo steamers, and was assessed to income-tax on the profit earned less a deduction for depreciation. In fixing the deduction, the Commissioners

(1) *Caledonian Railway Company* v. *Banks*, 1 Tax Cases 487.
(2) *London County Council* v. *Edwards*, 5 Tax Cases 383.

took into account an assumption that the sum annually allowed might be so invested as to produce interest at 3 per cent. per annum. *Held*, that the Commissioners were not entitled to make any deduction from the sum representing the wear and tear on account of any interest that might be earned on the sums allowed.[1]

This question cannot arise in India, as the rates of depreciation are *fixed* by Rules.

Stallion—Depreciation—Inadmissible—

The assessee owned two stallions at stud and was assessed in respect of the profits from the stallion fees. He contended that in the computation of these profits for income-tax purposes he was entitled to a deduction by reason of the diminished value of the stallions year by year. *Held*, that the claim could not be allowed.

Per Rowlatt, J.—"Now those words authorise such deduction as the Commissioners may think just and reasonable as representing the diminished value by reason of wear and tear during the year of any machinery or plant. I do not know whether a horse used for traction comes within that or whether it does not, but I am clearly of opinion that the diminished value of a breeding animal, merely due to the fact that having lived a year it is a year nearer its end . . . . is not within this section. You need not take only the case of an animal, you may take the case of the value of a prolific tree. You have here an article which you are not wearing out by use. You have got an article whether it be an animal or a vegetable article the life of which is only a limited term of years. As the years go on you take the produce and the reproduction of the animal, or the tree or whatever it is, dies or is killed because it is no longer worth keeping. That diminished value, by the efflux of time . . . . does not seem to be diminished value by reason of wear and tear; it is simply diminished value because you have invested your money in a source of production which is a wasting source of production."[2]

(vii) in respect of any machinery or plant which, in consequence of its having become obsolete, has been sold or discarded, the difference between the original cost to the assessee of the machinery or plant as reduced by the aggregate of the allowances made in respect of depreciation under clause (vi) or any Act repealed hereby, or the

(1) *Leith, Hull, and Hamburg Steam Packet Company* v. *Musgrave*, 4 Tax Cases 80.

(2) *Earl of Derby* v. *Aylmer*, 6 Tax Cases 665.

Indian Income-tax Act, 1886, and the amount for which the machinery or plant is actually sold, or its scrap value ;

Business—Obsolescence allowances—

Section 10 (2) (*vii*).—It must be particularly noted that the allowances under this clause can only be given where the machinery or plant *becomes obsolete*. Where machinery or plant is sold for reasons other than that it has become obsolete, no allowance can be given. Where a machine is sold no allowance can be given if the facts present evidence that the machine is not obsolete.

The amount allowed for obsolescence is, again, calculated upon the original cost *to the owner*. The amount to be given is the amount of such original cost to the owner as reduced by the depreciation allowances under clause (*vi*) and the amount for which the machine is actually sold or its scrap value. For example, a machine costing Rs. 10,000 on which a depreciation allowance of ten per cent. of the original cost is admissible is sold after 5 years for Rs. 2,000. The original owner gets Rs. 5,000 for depreciation and nothing for obsolescence as the machine is not scrapped or sold on account of obsolescence. The second owner gets also an allowance at the rate of ten per cent., and as the cost of the machine to him was Rs. 2,000, his annual allowance is Rs. 200. If owing to its becoming out of date the machine is scrapped as useless after three years, then in the year in which it is so scrapped, the second owner can claim Rs. 1,400 for obsolescence. No allowance for obsolescence is obviously permissible if the machine lasts 10 years or more. (*Income-tax Manual*, para, 44.)

Note that the allowance applies only to machinery and plant.

Law in the United Kingdom—

For quite a long time there was no provision in the English law permitting a deduction for obsolescence; and the earlier English decisions disallowing claims for obsolescence are now obsolete. The law at present is practically the same as in this country except that obsolescence can be claimed in respect of plant and machinery used in a profession—*see* notes under Section 11.

History—

The words "in consequence of its having become obsolete" were inserted before "sold or discarded", in 1922. Formerly the expression was "has been sold or discarded as obsolete."

And in *Secretary, Board of Revenue, Madras* v. *S. R. M. A. R. Ramanathan Chettiar*,[1] it was contended on behalf of the assessee that the words " as obsolete " governed only ' discarded ' and not 'sold' and that a loss on account of sale otherwise than for obsolescence should be allowed as a deduction. The Court did not admit the contention. It held that, as the statute was punctuated, it was open to it to take punctuation marks into account, and that the absence of a comma after 'sold' made it clear that the words "as obsolete" governed both "sold" and "discarded." Besides, the provision for only one kind of capital loss would have been queer in a statute which ignores both capital profits and capital losses throughout. The present wording of the section, it will be seen, removes the ambiguity.

Saleable but not sold—When claim arises—

In respect of machinery and plant discarded but not sold, the claim for obsolescence can be allowed only in the accounting year in which the machinery or plant is discarded.[2] The claim will be allowed on the basis of scrap value. But if such a claim is not made in the accounting year in which the plant or machinery is discarded, the claim will nevertheless be admissible if and when the plant or machinery is sold. In that case also the claim can only be made in the accounting year in which the sale takes place. If an assessee has been given the allowance on the basis of scrap value and afterwards, *i.e.*, in a later year, gets a better price than the scrap value, he cannot, presumably, be taxed on the difference between such price and the scrap value on which obsolescence allowance was originally given by the Income-tax Officer.

Buildings—

No obsolescence allowance is admissible for buildings, nor indeed for anything except plant and machinery.

Law Books—Obsolescence claim—

In *Daphne* v. *Shaw*,[3] Mr. Justice Rowlatt held that law books were not 'plant' and disallowed a claim for deduction in respect of their becoming decayed or obsolete.

" I cannot bring myself to say that such books as these people use to consult are ' plant.' It is impossible to define what is meant by ' plant and machinery.' It conjures up before the mind something clear in outline at any rate; it means apparatus, alive or dead, stationary or movable, to achieve the operations which a person wants to achieve in his vocation."

(1) 1 I. T. C. 244.
(2) *Radha Kishen & Sons* v. *Commissioner of Income-tax*, unreported.
(3) 62 L. J. N. S. (jour.) 321.

Obsolescence—Question of fact—

Obsolescence is a question of fact to be determined entirely by the income-tax authorities. Whether the machinery has in fact become obsolete on account of subsequent improvements in the business and whether it was really sold or discarded for this reason are obviously questions of fact. See *Secretary, Board of Revenue, Madras* v. *S.R.M.A.R. Ramanathan Chettiar*.[1]

Destruction—Not obsolescence—

Loss due to destruction, whether accidental or otherwise, is not obsolescence.[2] Obsolete machinery means machinery which, though it is able to perform its function, has become in common parlance out of date and performs its function so indifferently or at such a cost that a prudent man, instead of continuing to use such machinery, would discard it and instal more modern and more labour-saving machinery.

For a thing to become obsolete it is not necessary that it should be worn out; nor that it should not be useful to other people in the same business who are less progressive in their methods. On the other hand, merely because a person wants better plant and machinery, not because his old plant, etc., had been superseded by improvements, but because he wants something better than his competitors have, it cannot be said that the plant is obsolete. The question of obsolescence is therefore one of degree and consequently a question of fact.[3]

Obsolescence—Change of business—Inadmissible—

A claim for 'obsolescence' can arise only if the machinery becomes unsuitable or out of date for the purpose for which it was originally intended. It cannot be allowed if machinery is discarded owing to a change in the character of the business, *e.g.*, a munition factory adapting itself to ordinary engineering work. Malony, C. J., said that the word 'obsolete' meant—

> "out of use, of a discarded type or fashion for the particular purpose for which it was intended, and cannot apply to a case where the machinery remains suitable but there is no occasion for its use."

Samuel, J., said that the word means :

> "worn out, degenerated or out of date as machinery for the purposes for which it was originally installed."[4]

(1) 1 I. T. C. 244.
(2) *Commissioner of Income-tax, Madras* v. *Rattan Singh*, 2 I. T. C. 107 & 294.
(3) *South Metropolitan Gas Co.* v. *Dadd*, 6 A. T. C. 983.
(4) *Evans & Co.* v. *Philips*, 4 A. T. C. 520.

(vii-a) in respect of animals which have been used for the purposes of the business otherwise than as stock in trade and have died or become permanently useless for such purposes, the difference between the original cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals.

History—

The clause was inserted by Act III of 1928. It is doubtful if draught animals and other livestock are 'plant'—see *Earl of Derby* v. *Aylmer*[1] set out under section 10 (2) (*vi*); but they are analogous to 'plant' and it was therefore thought desirable to give some concession in respect of them. In the Bill as published, the allowance was proposed only in respect of animals replaced because of death or disablement and to the extent of the difference between the original cost to the assessee and the value of the carcasses or the discarded animals. But the clause as passed by the Legislature makes the allowance independent of replacement. Also the word 'realised' was substituted for "realised or realisable" in the original Bill.

(viii) any sums paid on account of land-revenue, local rates or municipal taxes in respect of such part of the premises as is used for the purposes of the business ;

Allowance on account of rates or taxes—

Section 10 (2) (*viii*).—The allowance under this clause covers only the land revenue and local rates or municipal taxes paid in respect of the portion of the *premises* used for the purposes of the business. In assessing income from business, a local rate or tax which is payable irrespective of whether profits are made or not, should be treated as expenditure incurred *solely* for the purpose of earning profits or gains within the meaning of section 10 (2) (*ix*) if the rate or tax is not an admissible deduction under section 10 (2) (*viii*). No allowance can be given on account of any other rates or taxes whatsoever. All rates and taxes, therefore, whether levied on the profits of a business or charged on the proprietor of a business in respect of anything other than the actual portion of the premises used for the purposes of the business, must be disallowed. (*Income-tax Manual*, para. 45.)

(1) 6 Tax Cases 665.

(See also notes under section 12.)

Sir George Lowndes pointed out in 1918 (when the then Act was discussed in the Legislative Council) :—

"Municipal taxes are a purely personal expense. You may have a house with water laid on, municipal water, and if you pay rates for it, that is paying for something in addition to the house. Supposing you have no water laid on, you have to provide it otherwise. The man who gets water from a Municipality will be allowed the municipal tax; the other, who does not get it, will receive no allowance. As far as I can understand it, that is what my honourable friend means. It is almost an absurdity. These local rates are just like personal expenses, for which we do not allow abatement of income-tax. They are like the expenses for servants, motor cars, clothes, or anything of that sort. Expenditure on such things as municipal scavenging, etc., are treated as purely personal expenses and are not allowed in England. We do not propose to allow it out here."

There is a distinct rule under Schedule D in the English Act prohibiting the deduction of personal expenses.

Deductions on account of taxes paid—

No deduction is permissible in computing the income, profits or gains on account of any taxes or rates paid in respect of such income, profits or gains except that a local rate or tax which is payable irrespective of whether profits are made or not (see para. 45) is to be allowed as deduction from income from business. Section 10 (2) (*viii*) of the Act allows as a deduction from business profits sums paid on account of land revenue, local rates or municipal taxes in respect of premises used for the purposes of a business. This specific provision has been inserted because the local rates paid on account of such premises are usually in the nature of a payment for services rendered (*e.g.*, by supply of water, conservancy arrangements, etc.), but that allowance is closely restricted to a local tax or rate levied *in respect of the premises* used for the purposes of the business. No deduction is allowed for any other local rate or tax such as, for example, local taxes varying according to the income or profits of a business. Nor is any deduction on account of a local rate or tax on property allowed from the annual value of property which is taxable under section 9. Similarly, no allowance is permissible on account of income-tax or super-tax paid by an assessee. Where property, profits or gains are liable to taxation in other countries or by other authorities in British India, all these authorities are taxing the same property or profits for different purposes. Attention is invited to the ruling of the High Court at Patna (Jyoti

Prasad Singh's case *infra*), in which it was held that the amounts paid for cesses by a person deriving an income from rents of collieries and from royalties on the amount of coal raised from the collieries are not to be deducted in computing the amount of his assessable income, and in which it was clearly stated that "the payment of a tax which is conditional on the making of an income and which has to be calculated on the amount of such income after it has come into existence, cannot be said to be expenditure for the making of such income." (*Income-tax Manual, para.* 50.)

Previous law—

Under the 1918 Act, the whole tax was deductible even if only a part of the premises was used for the business. The proviso to clause (*ix*) of this sub-section inserted by Act III of 1928, prohibits the allowance of local rates based on profits.

Cesses based on Income—

Road, public works and other cesses—which are paid on income from royalties—are not admissible deductions under S. 12 —*Per Dawson Miller, C. J.*, in *In re Raja Jyoti Prasad Singh Deo.*[1]

"The liability to pay cesses results from the income having been made and the payment of the cess can hardly be said to form a necessary part in the making of the income, which must come into existence before the liability to cess arises. The payment of cess is a necessary expense arising in connection with the ownership of royalties, but it is in no sense an expenditure incurred for any purpose incidental to the making of income."

Per Bucknill, J.—"It is most difficult to see how it can be argued that road or public works cesses are *expenditure* incurred *at all* for the *purpose* of making income or earning profits." (*Ibid.*)

Per Mullick, J.—"Clause 2 of section 11 (now section 12) is exhaustive. The expenditure must be incurred as a condition precedent to the production of the income. The payment of a tax which is conditioned on the making of an income and which is calculated on the amount of such income after it has come into existence, cannot be said to be expenditure for the making of such income. A tax levied as a condition precedent to the creation of the source of income, such as a licence fee, would stand on a different footing."

Income from royalties is taxable under section 12 and not under section 10; but the principle of the above decision applies as much to cases under section 10 as to those under section 12.

Also, see *Commissioner of Income-tax, Bihar and Orissa* v. *Shiva Prashad Singh*, in which a royalty owner claimed without

(1) 1 I. T. C. 103.