PETITIONER:
THE WAR PROFITS TAX COMMISSIONER

Vs.

RESPONDENT:
M/s. BINODIRAM BALCHAND

DATE OF JUDGMENT:
20/12/1961

BENCH:
AYYANGAR, N. RAJAGOPALA
BENCH:
AYYANGAR, N. RAJAGOPALA
GAJENDRAGADKAR, P.B.
SARKAR, A.K.
WANCHOO, K.N.
GUPTA, K.C. DAS

CITATION:
1966 AIR 1768 1962 SCR Supl. (2) 243

ACT:
War Profits Tax-Tax on excess-Profits Managing agent of company-holding majority of its shares-Dividend income-Taxability as business profits-War Profits Tax ordinance-Schedule, if part of statute-"No connection whatever with the business"-Construction of rule-Gwalior War Profits Tax ordinance, Samvat 2001, ss. 2(5). 2 (14). 2(16).4 (I). 50, Sch. I r. 3 (1).

HEADNOTE:
Rule 3 (1) of such. I of the Gwalior War Profits Tax ordinance, Samvat 2001 provided: "Income received from investments shall be included in the profits of a business liable to the war Profits Tax, unless it is proved to satisfaction of the War Profits Tax officer that the investments have no connection whatever with the business."

The respondent, a Hindu undivided family, was carrying on various businesses in the erstwhile State of Gwalior, and one of them was its employment as the Secretary, Treasurer and Managing Agent of, a limited company. The respondent held a majority of the issued shares in the company. For the accounting period July 1, 1944, to October 16, 1944, the War Profits Tax officer by his assessment order dated July 9, 1951, included in its assessable profits the sum received by the respondent on July s, 1944, as the dividend declare and paid by the company on its shares. The respondent claimed that the said sum could not be included in its taxable profits on the ground that it did not deal in shares and that its holdings in the company were purely in the nature of investments having no connection with its business as defined s. 2(5) of the ordinance Gwalior War Profits ordinance and that the business of the Secretaries, Treasurers and

Managing Agent of the company which was carried on by it did not require any holding of the shares of the company and was not dependent on its investment in the said company. The High Court of Madhya Pradesh took the view (1) that on a proper construction of the provisions of the ordinance, unless the acquisition of the shares was an adventure in the nature of trade or the respondent was a dealer in shares such that the shares held by it were part of its stock in trade, the income derived therefrom by way of dividends could not be characterised as profits from business, and (2) that Sch. I of the Ordinance which
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was headed "Rules for the computation of business", though it purported to be part of the Ordinance, in reality comprised rules made by Government under the rule making power conferred on it by s. 50 of the ordinance and that r. 3 (I) of the Schedule, being subordinate legislation could not validly bring to charge an item of income which was not within the scope of the ordinance itself.
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Held that : Schedule I of the Gwalior War Profits Tax Ordinance was part and parcel of the ordinance itself and, therefore, could not be considered to be subordinate legislation as rules framed under s. 50 of the ordinance

(2) the word "connection" in r. 3 (1) of Sch. I of the Ordinance was not restricted to cases of "direct connection", in view of the expression "no connection whatever" in that rule; and

(3) the respondent as the holder of the majority of the shares in the company, was enabled by reason of this investment to control the action of the company which was true other party under the Managing Agency Agreement, and therefore, the investment was connected with the business carried on by it within the meaning of r. 3(1) of Sch. I of the ordinance. Accordingly, the dividend received by the respondent from the company was properly included by the assessing authorities in the computation of its taxable profits under the ordinance.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 225 of 1960.

Appeal from the judgment and decree dated April 19, 1957, of the Madhya Pradesh High court (Indore Bench) at Indore in Civil Reference No. 1 of 1952.

B. Sen, B.K.B. Naidu and I.N. Shroff, for the appellant.

A. V. Viswanatha Sastri, K. A. Chitale, J. B. Dadachanji, S. N. Andley, Rameshwar Nath and P. L. Vohra, for the respondents.

1961, December, 20-The Judgment of the Court was delivered by

AYYANGAR, J.-This appeal comes before us by virtue of a certificate of fitness granted by the High Court of Madhya Pradesh under s. 47(2) of the

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Gwalior War Profits ordinance, Samvat 2001 (hereafter called the Ordinance) on the ground that the appeal involves a substantial question of law.

The question of law which arises in the appeal relates to the proper construction of r. 3(1) of the Schedule of the ordinance. The respondent-M/s. Binodiram Balchand is the name under which a Hindu undivided family which wag resident in the State of Gwalior carried on various businesses in that State. Profits derived from business carried in the State were charged to War Profits Tax under the ordinance. Among the businesses carried on by the respondent was its employment as the Secretary Treasurer and Managing-agent of a textile mill which was a limited company bearing the name of Binod Mills Company Limited, Ujjain. The appeal is concerned with the computation of the profits of the respondent to War Profits Tax under the ordinance, which it might be stated at the outset, was on lines very similar to the Indian Excess Profits Tax Act, 1940.

The chargeable accounting period with which the appeal is concerned, is the period commencing from July 1, 1944, to. October 16, 1944. The respondent-assessee submitted its return and thereafter the War Profits Tax officer by his assessment order dated July 9, 1951, determined the taxable income of the assessee for this chargeable accounting period at Rs. 12,16,145/- and assessed it to tax in the sum of Rs. 2,02,691/-. Several points were raised in relation to this assessment order by the respondent, and one of them related to the inclusion in its assessable profits of a sum of Rs. 11,09,332/- which was received by the respondent on July 5, 1944, being the dividend declared and paid by the Binod Mills Ltd" for 1943 on the shares held by the respondent. It was the contention of the respondent that this sum was its income from an investment pure and simple and was not
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"profits" from business, and so could not be included in its taxable profits on a proper construction of the relevant provisions of the ordinance. From the assessment order the respondent filed an appeal to the appellate authority which however was unsuccessful. A revision to the Commissioner of War Profits Tax met with the same fate and thereafter the respondent prayed for a reference to the High Court under s. 46(1) of the ordinance which ran thus:

> '46(1) If, in the course of any assessment under this ordinance or any proceeding in connection therewith, a question of law arises, The Commissioner, may; either on his own motion or on reference from any War Profits Tax authority subordinate to him, draw up statement of the case and refer it with his own opinion thereon to the High Court."

The Commissioner acceded to this request and

referred for the opinion of the High Court three questions:,

"(1) Whether the dividend income of Rs. 11,09,332/- received from the Binod Mills was chargeable under the War Profits Tax ordinance ?

(2) Whether certain bad debts written off by the assessees could be allowed as deductions in computing profits for war tax purpose?

(3) Whether the expenses of assessees' branch at Gwalior which was defunct, could be allowed as admissible expenses ?"

The High Court answered questions 2 and 3 in favour of the department, but the first question was answered in the negative and in favour of the assessee. There is now no dispute as regards questions 2 & 3 and the appeal is confined to the correctness of the answer to the first question.

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Before setting out the grounds upon which the High court decided the reference in favour of the respondent it is necessary to read a few of the provisions of the relevant law which bear upon the point arising for consideration. The preamble to the ordinance recites that it was enacted to impose a tax on "excess profits arising out of certain businesses" and this intention is carried out by s. 4(1) which is the charging section which enacts:

"4(1) Subject to the provisions of this ordinance, there shall, in respect of any business to which this ordinance applies, be charged, levied and paid on the amount by which the profits during any chargeable period exceed the standard profits, an excess profit tax (in this ordinance referred to as the War Profits Tax') which shall be equal to 60 per cent. of the aforesaid amount."

The expression 'business', the profits derived from which are thus brought to charge is defined by s. 2(5) in these terms:

"2(5) 'business' includes any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacturer or any profession or vocation, but does not include a profession carried on by an individual or by individuals in partnership, if the profits of the profession depend wholly or mainly on his or their personal qualifications, unless such profession consists wholly or mainly in the making of contracts on behalf of other persons or the giving to other persons of advice of a commercial nature in connection with the making of contracts:

Provided that where the functions of a company or of a society incorporated by or under any enactment consist wholly or mainly in the holding of investments or other property or both, the holding thereof shall be

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deemed for the purpose of this definition to be a business carried on by such company or society;

Provided further that all businesses to

which this ordinance applies carried on by the same person shall be treated as one business for the purposes of this ordinance;"

There are two further definitions which are of some relevance to the arguments addressed to us and might therefore be set out at this stage. Section 2(14) defines the expression 'prescribed' as meaning "prescribed by Rules made under the ordinance;" s. 50 being the provision empowering the Government make rules and this section ran:

"50(1) Subject to the provisions of this ordinance, Government may make rules for carrying out the purposes of this ordinance.

(2) Rules made under this section shall be published in the official Gazette and shall thereupon have effect as if enacted in this ordinance."

The other relevant definition is of the expression profits' which is defined in s. 2 (16) as:

"profits as determined in accordance with the provisions of this Ordinance and its first schedule;"

There is a First Schedule which follows the ordinance and which is headed 'Rules for the computation of profits for the purposes of War Profits Tax', and of these the one pertinent to the matter in controversy in the appeal is r. 3 of which sub-rs. (1) and (2) have been relied on in the course of arguments. They run:

"3(1)Income received from investments shall be included in the profits of a business liable to the War Profits Tax, unless it is proved to satisfaction of the War Profits

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Tax Officer that the investments have no connection whatever with the business.

(2) In the case of a business which consists wholly or mainly in the dealing in or holding of investments, income received from investments shall be deemed to be profits of that business, and in the case of a business, a specific part only of which consists in dealing in investments, the income received from investments held for the purpose of that part of the business shall be deemed to be profits of that part of the business.

Explanation:-'The income from investments to be included in the profits of the business under the provisions of this rule shall be computed exclusive of all income received by way of dividends or distribution of profits from a company carrying on a business, to the whole of which the Section of the Ordinance imposing the War Profits Tax applies".

Pausing here, it is necessary to mention that in relation to the first question regarding the inclusion of the dividend income in the taxable profits of the assessee three contentions were raised on behalf of the respondent which are thus set out in the judgment under appeal:

"(1) The assessees did not deal in shares and

their holdings in the Binod Mills Limited, were purely in the nature of investments, having no connections with their business as defined in Section 2(5) read with Rule 1 of Sch. I of the Gwalior War Profits Tax Ordinance. The business of the Secretaries, Treasurers and Agents of the Binod Mills Limited, which was carried on by them did not require any holding of the shares of the company and

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was not dependent on their investment in the said company.

(2) The dividend income accrued or arose from the profits of the Binod Mills Limited, and as the Ordinance applied to the business carried on by this company, the dividends were excluded under the explanation to Rule 3(1) of Schedule I.

(3) The dividend income should be considered as income of the full accounting period, i.e. from Diwali of 1943 to Diwali of 1944 and should be apportioned on that basis."

The learned Judges of the High Court dealt only with the first of the above contentions, and having accepted it, considered it unnecessary to express any opinion on the other two.

We may now proceed to state the grounds upon which the learned Judges of the High Court answered this contention in favour of the respondent. It was urged before them by the respondent that though the provisions headed 'Rules for the computation of business' purported to be part of the Ordinance itself as forming the Schedule to the Ordinance, they were in reality rules made by government under the rule-making power conferred on it by s. 50 of the Ordinance, This argument was accepted apparently being aided by the fact that immediately after the title "Schedule I" occur the words "See Section 2(14)". Proceeding on this basis the reasoning of the learned Judges was on these lines. The charge under s. 4(1) was on the profits of a business and unless an activity which resulted in any income derived was one in the nature of trade, the mere fact that income was derived therefrom would not make it assessable to tax under the ordinance. This they deduced from an interpretation of the words used in the charging section read in conjunction with the definition of "profits" in s. 2(16). The next question was whether

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the dividend which the respondent obtained from the shares held by it in the Binod Mills Ltd., of which it was the Secretary, Treasurer and Managing-agent were profits derived by any business activity. Unless the acquisition of the shares was an adventure in the nature of trade or the respondent was a dealer in shares, such that the shares held by it were part of its stock in trade, the income derived therefrom by way of dividends could not be characterised as profits from business. If this was the result on a proper

construction of the Act the question the learned Judges addressed themselves to next was, whether r. 3(1), which according to them was a piece of subordinate legislation, could validly bring to charge an item of income which was not within the scope of the Ordinance itself, and this had necessarily to be answered in the negative. They consequently held that r. 3(1) of the 1st Schedule was beyond the power of the rule-making authority under s. 50 of the Ordinance and answered the first question referred to them in favour of the assesssee.

Mr. Sen, learned Counsel for the appellant has however placed before us material to show that Sch. I containing the rules for the computation of profits were not rules made by the Government under s. 50 of the Ordinance but was really part of the Ordinance itself. In the first place, it has to be noted that s. 2(16) speaks of Sch. I to the Ordinance, and admittedly besides the one now produced before us there was no other Schedule attached to the Ordinance. It is impossible to hold that with s. 2(16) in the form in which we now find it, the rules for the computation of the business did not form part of the Ordinance having been enacted simultaneously as part and parcel thereof. In this connection it might be pointed out that the Excess Profits Tax Act, 1940, which formed the basis or model upon which the Ordinance was fashioned has

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a similar Schedule headed "Rules" for the computation of profits" and the Schedule formed part of that Act. The only ground for even a suspicion that Sch. I was not a part of the Ordinance itself is the reference to s. 2 (14) in the heading of these rules just below the words Schedule I, but very little assistance can be sought from this reference, because s. 2(14) in not itself the source of power for making rules which is s. 50 of the Ordinance and, in fact, rules have been made under the power conferred by s. 50 of the Ordinance; vide War Profits Tax Rules Samvat 2001, No. 65 dated December 26, 1944, which carries the recital in the following terms:

> "In exercise of the powers conferred by s. 50 of the War Profits Tax Ordinance the Government of Gwalior are pleased to make the following rules....."

It is obvious therefore "s. 2(14) in Sch. I is a mistake or a misprint for "s. 2(16)" and it might be noted that in the corresponding Schedule to the Indian Excess Profits Tax Act, 1940, immediately after the title "Schedule I" occur the words "See s. 2(19)" which in that enactment corresponds to s. 2(16) of the Ordinance.

There are other circumstances to which Mr. Sen has drawn our attention which also point to the Schedule being part of the Ordinance and not rules made under s. 50. The Schedule was the subject of amendments more than once and each time this was done it is significant that this was done not by virtue of the exercise of the rule-making power under s. 50 of the Ordinance but by further ordinances showing clearly that the Schedule was

part of the Ordinance itself. To give just a few example, the Explanation to r. 3(2) which we have extracted earlier was not in the Schedule as originally enacted but was introduced as
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an amendment by Ordinance No. 42 dated February 28, 1946. The short title of this Ordinance runs:

> "This Ordinance might be called the Gwalior War Profits Tax (Amendment) Act, Samvat 2002".

Further it would be noticed that in the Explanation there is a comma after the words "carrying on a business". That comma was not there when the schedule was amended by the Amending ordinance of February 28. 1946, but was introduced by Ordinance 5 of Samvat 2004 and the short title of this second Ordinance reads:

> "This Ordinance might be called the Gwalior War Profits Tax (Amendment) Ordinance Samvat 2004".

We do not consider it necessary to dilate on the point as we are clearly of the opinion that the Schedule was part of the Ordinance and has therefore to be read not as subordinate legislation under r. 50 but as part and parcel of the Ordinance itself.

The whole basis therefore of the reasoning upon which the learned Judges of the High Court proceeded falls to the ground and the only question is whether accepting the respondent's case that the shares held by it in the Binod Mills Ltd. were really part of its investments, these investments have "any connection" with its business. It is common ground that the respondent was the Secretary, Treasurer and Managing-agent of the Binod Mills and what we are now concerned with are the shares held by it in that company. In the case of every assessee who carries on a business activity and is in receipt of profits from that business, on the terms of r. 3(1) income from every investment held by him is liable to be included in the profits assessable to tax unless such person was able to satisfy the
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revenue authorities that the investments had "no connection whatever" with his business. Mr. Viswanatha Sastri, learned Counsel for the respondent sought to overcome this position by submitting that the "connection" contemplated by the rule was a direct "connection" and not a remote or fanciful one and that in the present case there was really no connection between the respondents ownership of these shares and the office of managing agent which it held. His contention was that except the fact that the recipient of the profits from the "business" of managing agency and of the dividend income was the same, there was no other connection between the one and the other. In further elaboration of his point, he invited us to hold that the "connections would be direct only where the investment was related to a business activity as cause and effect or as a sine qua non. Thus if it was a requirement either of the Articles of Association of the company or of the Managing Agency Agreement, that

the managing agent should be a shareholder, or the holder of specified number of shares, then alone, learned Counsel contended, the managing agent being dependent on the shareholding, there would be that connection which would bring the dividend income with in the expanded definition of profits from business under r. 3(1). In all other cases where shares were held, without the assessee being obliged to hold them for the purpose of his business activity, no distinction, Counsel submitted, could be drawn between the investment in the shares of a company with which he had nothing to do, and a company which he managed under an agreement. Learned Counsel further stressed that the case of the respondent was stronger because the Managing Agency Agreement with the respondent was to last so long as the respondent firm existed and carried on business in that name and could not be terminated by the company "save and except when the agent being
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found guilty of fraud in the Management or in the discharge of their duties." and having regard to this security of tenure which the respondent enjoyed, the holding of these shares had no connection whatever with the business of managing agency. We find ourselves unable to accept this interpretation of r. 3(1). The relevant words in the rule being "any connection whatever" it would not be giving proper effect to the meaning of the words "any" and "whatever" to restrict it to cases of "direct connection" in the sense suggested on behalf of the respondent. But this apart, by the number of shares which the respondent owned in the mills it is admitted that it obtained a controlling interest-it held the majority of the shares in the company. The respondent was therefore enabled by reason of this investment to control the action of the company which was the other party under the Managing agency Agreement. This control was capable of being used to further the interests of the Managing agent in its relations with the company and whether or not this was used for obtaining advantages, it would certainly be available for avoiding any disadvantages arising from misunderstandings with the company. It could not be denied that the control would certainly be useful to keep the relations between the company and the Managing agent smooth so as to enable the Managing agent to earn his commission etc. without differences or disputes. Even if therefore the word "connection" in r. 3(1) meant a "direct" connection a construction which we do not adopt-it appears to us that the present case satisfied even that test. In any event the "connection" is not anything remote, fanciful or imaginary, but on the other hand real and capable of being turned to good account. It certainly cannot be equated with the holding of shares by the respondent in a company with which he had no connection other than as a shareholder.
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We are therefore of the opinion that the dividend received by the respondent from the Binod

Mills Ltd., was properly included by the assessing authorities in the computation of the taxable profit of there respondent under the Ordinance and that the High Court erred in answering the reference in favour of the assessee. We have already pointed out that the High Court did not deal with or express any opinion on the two subsidiary contentions urged by the respondent with reference to the first question. Those points were also naturally not argued before us and we do not express any opinion on them. It is obvious that the reference cannot be disposed of without deciding these contentions and the case would have to be remanded to the High Court for dealing with these subsidiary points.

The appeal will accordingly be allowed, the judgment of the High Court set aside and the first contention in relation to question No. 1 answered against the assessee and in favour of the appellant and the case remanded to the High Court for the consideration of the other contentions with reference to that question. The appellant will be entitled to his costs here. The costs in the High Court will be provided in its final order.

Appeal allowed.

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