

PETITIONER:
THE COMMISSIONER OF INCOME-TAX, TAMIL NADU

Vs.

RESPONDENT:
CITY MILLS DISTRIBUTORS (P) LTD.

DATE OF JUDGMENT: 05/02/1996

BENCH:
BHARUCHA S.P. (J)
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BHARUCHA S.P. (J)
VERMA, JAGDISH SARAN (J)
MANOHAR SUJATA V. (J)

CITATION:
1996 SCC (2) 375 JT 1996 (3) 15
1996 SCALE (1) 674

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T

BHARUCHA.J.

This is a reference under Section 257 of the Income Tax Act, 1961, made by the Income-Tax Appellate Tribunal directly to this Court in view of the difference in the views taken by the Allahabad and Calcutta High Courts upon the same issue. The question to be answered reads thus :

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the pre-incorporation profits of Rs.24,862/- cannot be included in the assessment of the assessee-company for the Assessment Year 1974-75?"

The assessment year is the assessment year 1974-75. The relevant accounting year ended on 30th September, 1973. The assessee company was incorporated on 30th October, 1972. It filed a return for AY 1974-75 disclosing an income of Rs.1,79,690/-. The Income Tax Officer assessed the assessee company's total income at Rs.2,04,530/-. In so doing, he included, inter alia, the sum of Rs.24,862/- as the assessee company's pre-incorporation profit. He found that the promoters of the assessee company had carried on business on its behalf and had received the sum of Rs.80,534/- for the period 1st October to 29th October, 1972. After deducting expenses, the income in this behalf was Rs.24,862/-. According to the ITO, this was the income of the assessee company because its promoters had acted and carried on business on its behalf and the assessee company had accepted the act of the promoters after its incorporation.

The assessee company's appeal to the Commissioner of Income Tax (Appeals) was dismissed. The assessee company then appealed to the Tribunal. The Tribunal observed that

the real questions were : When did the pre-incorporation profit accrue ? Did it accrue before incorporation ? If so, who was the legal entity which carried on the business and earned the income at the time of accrual ? The Tribunal held that, in law, the promoters and the assessee company were different legal persons and that the income which had accrued on 29th October, 1972, was income that was earned by the promoters. Accordingly, the appeal of the assessee company was allowed.

The reference was made because of the decisions we now cite.

In Commissioner of Income-Tax, U.P. and Ajmer-Merwara vs. The Bijli Cotton Mills Ltd., Agra, 23 ITR 278, the respondent company was incorporated on 11th December, 1943. Prior to that date the firm that promoted it had entered into an agreement to purchase a mill for it and, on 10th December, 1942, had obtained its possession. The sale deed of the mill was executed in favour of the respondent company after it had been incorporated. The respondent company chose to accept the profits of the mill made before its incorporation, but treated the promoters as accountable therefor. The Allahabad High Court observed that it was true that under the law the respondent company had come into existence only upon its incorporation and it was not possible to hold that the legal title in the business or its profits had vested in it before its incorporation. It was, however, well settled that if the promoters of a company carried on business on behalf of a company which they intended to float, the company, on its incorporation, had a right to either accept what had been done on its behalf by the promoters or repudiate the same. If the company accepted what the promoters had done on its behalf it had a right to claim from them the entire income for the period during which the business was carried on for its benefit. Reliance was placed upon the judgments of the Bombay High Court in Commissioner of Income-tax, Bombay vs. Abubaker Abdul Rehman, 7 I.T.R. 139, and Commissioner of Income-tax, Bombay vs. Trustees of Sir Currimbhoy Ebrahim Baronetcy Trust, A.I.R. 1932 Bom. 106, where it had been held that if the income of trust property as it accrued was earmarked and had to be handed over by the trustee to the beneficiary, the beneficiary could be said to be in receipt of that income and could be taxed directly. If, on the other hand, the income came into the hands of the trustee and he had the right to dispose of it and it was only the balance left over that was payable to the beneficiary, then the income was taxable in the hands of the trustee. The latter decision had been upheld by the Privy Council. These decisions showed that under not only legal ownership that had to be looked into, but the court could also go into the question of beneficial ownership and decide who should be held liable for tax after taking into account the question as to who, as a matter of fact, was in receipt of the income which was to be taxed. The assessment proceedings in respect of the respondent company had been started at a time when it had already decided to accept what had been done on its behalf by the promoters and take over the business and income therefrom. It was, therefore, in the same position as a beneficiary for whom the income was earmarked as payable to it and the same could be legally assessed in its hands.

The aforesaid decision, it may be mentioned, was followed in a subsequent decision of the Allahabad High Court, Security Printers of India (P) Ltd. vs. Commissioner Income Tax, U.P. 78 I.T.R. 766.

The Calcutta High Court has taken a different view in

Commissioner of Income-tax, West Bengal vs. Tea Producing Co. of India Ltd., 48 I.T.R. 200. The respondent company was incorporated on 29th May, 1951 with, inter alia, the object of taking over a tea estate as a going concern. It commenced business on 23rd June, 1951. In November, 1951 it purchased the tea estate with effect from 1st January, 1951 and the terms of the sale deed stated that all income and profits from 1st January, 1951 would belong to the respondent company and it would be liable for all tax dues from that date. For

the accounting year ending 31st December, 1951, the respondent company showed a loss. The Income-tax Officer held that the assessee was not entitled to claim the whole of 40 per cent of the loss but only the portion of the 40 per cent proportionate to the period from which it commenced business, i.e., from 23rd June, 1951 to 31st December, 1951. The Tribunal allowed the loss for the entire year. The High Court considered the judgment in the case of Bijli Cotton Mills Ltd. and disagreed therewith. It said that under the Income Tax Act an assessee meant a person by whom income tax or any other sum of money was payable thereunder. Tax had to be paid by an assessee under the head "profits and, loss of business, profession or vocation" in respect of the profits or gains of any business, profession or vocation carried on by him. Therefore, before a person could be assessed, it had to be shown that it was he who had carried on the business, profession or vocation. The Calcutta High Court could not see how a person could be said to have carried on business during a period when he was not born or how he could be assessable to tax in respect thereof. As in the case of a natural born person so in the case of a legal entity like a company, the liability to pay tax could only arise after the date of birth or incorporation. The liability of a company to pay income-tax for business carried on by its promoter could only be in respect of a period subsequent to its incorporation. In the case of Bijli Cotton Mills Ltd., the Allahabad High Court had placed reliance upon the judgment of the Bombay High Court in the case of Abubaker Abdul Rehman and has taken the view that under the Income Tax Act it was not only legal ownership that had to be looked into but the court could go into the question of beneficial ownership and decide who should be held liable for tax after taking into account the question as to who was, as a matter of fact, in receipt of the income which was to be taxed. The Calcutta High Court pointed out that the observations of the Bombay High Court in this regard had been disapproved by the Privy Council in Commissioner of Income-tax vs. Dewan Bahadur Dewan Krishna Kishore, 9 I.T.R. 695.

In our view, the Tribunal was right in saying that the relevant question was : what was the legal entity that had carried on the business before the assessee company was incorporated and earned the income at the time of its accrual. A company becomes a legal entity in the eye of the law only when it is incorporated. Prior to its incorporation, it simply does not exist. The assessee company did not exist when the income with which we are here concerned was earned. It is, therefore, not the assessee company which earned the income when it accrued and it is not liable to pay tax thereon.

The same result is reached by a somewhat different process of reasoning. A company can enter into an agreement only after its incorporation. It is only after incorporation that a company may decide to accept that it had to be looked into but the court could go into the question of beneficial ownership and decide who should be held liable

for tax after taking into account the question as to who was, as a matter of fact, in receipt of the income which was to be taxed. The Calcutta High Court pointed out that the observations of the Bombay High Court in this regard had been disapproved by the Privy Council in Commissioner of Income-tax vs. Dewan Bahadur Dewan Krishna Kishore, 9 I.T.R. 695.

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The same result is reached by a somewhat different process of reasoning. A company can enter into an agreement only after its incorporation. It is only after incorporation that a company may decide to accept that its promoters have carried on business on its behalf and appropriate the income thereof to itself. The question as to who is liable to pay tax on such income cannot depend upon whether or not the company after incorporation so decides. It is he who carried on the business and received the income when it accrued who is liable to bear the burden of tax thereon.

It may be that the transaction of appropriation by a company to itself of income earned by its promoters before its incorporation is also subject to tax; that is not in issue before us and we do not express any view in that behalf.

For the reasons aforesaid, we answer the question in the affirmative and in favour of the assessee.

There shall be no order as to costs.