

(1942) 04 BOM CK 0001
In the Bombay High Court
Case No : O.C.J. Suit No. 411 of 1942

James Finlay and Co. Ltd.

APPELLANT

Vs

Finlay Mills, Ltd.

RESPONDENT

Date of Decision : 02-04-1942

Acts Referred:

Excess Profits Tax Act, 1940 — Section 4

Citation : (1945) 47 BOMLR 774

Hon'ble Judges : Kania, J; John Beaumont, J

Bench : Division Bench

Judgement

John Beaumont, Kt., C.J.—This is a special case stated u/s 90 and Order XXXVI, Civil Procedure Code, 1908, raising the following question:

Whether under Clause 2(b) of the Managing Agency Agreement between the plaintiff company and the defendant company dated December 19, 1923, the plaintiff company is entitled to be paid ten per cent. commission on the net annual income of the defendant company before setting aside any sums for payment of excess profits tax payable by the defendant company under the Indian Excess Profits Tax Act, 1940.

2. The question turns entirely on the construction of Clause 2(b) of the managing agency agreement, which provides for payment of commission to the managing agents of the following amount:

A commission of ten per cent. on the net annual income of the company before setting aside any sum to reserve or depreciation funds or for payment of Income Tax or super-tax or any other tax on income.

That is the only portion of the clause which is relevant.

3. Now, if excess profits tax falls within the words "any other tax on income," it seems to me that there is nothing to be said on the subject. The question has been answered by the parties themselves, because they have said that the

commission of ten per cent. is to be based on the net annual income of the company before setting aside any sum for excess profits tax. If, on the other hand, the excess profits tax does not fall within the description of "any other tax on income," then a further question arises whether or not in ascertaining the net annual income of the company sums payable for excess profits tax should be deducted. But that question only arises if the excess profits tax does not fall within the description of "any other tax on income."

4. Excess profits tax was originally invented by the revenue authorities in England in the course of the War of 1914 and in order to impose a tax on what were considered to be war profits. Putting it colloquially the scheme of the tax was to take the standard profits of a business before the war started, and then to impose a tax on any excess profits beyond the amount of the standard profits in the year of assessment. The only relevance for the present purpose of the origin of the tax is that the tax had existed long before this managing agency agreement was entered into, and one must assume that, when the parties used the expression "any other tax on income," they had in mind the possibility of excess profits tax.

5. The tax is chargeable in India under the Excess Profits Tax Act of 1940, and the charging section is Section 4, which provides:

Subject to the provisions of this Act, there Shall, in respect of any business to which this Act applies, be charged, levied and paid on the amount by which the profits during any chargeable accounting period exceed the standard profits a tax (in this Act referred to as "excess profits tax") which shall, in respect of any chargeable accounting period ending on or before the 31st day of March, 1941, be equal to; fifty per cent. of that excess and shall, in respect of any chargeable accounting period beginning after that date, be equal to such percentage of that excess as may be fixed by the annual Finance Act.

It is, therefore, clear that the tax is imposed in respect of any business upon certain profits of the business, and I find it very difficult to see why it should not be described as a tax on income. It is a tax on certain income derived from a business; it is not a charge on the capital, and has no direct concern with capital. The capital employed in a business may be relevant for the purpose of determining the amount of tax, because, if a larger or smaller capital be employed during the period by reference to which the standard profits were ascertained than during the accounting period, some allowance would have to be made, and that matter is dealt with in Section 6 of the Act. But the tax itself is undoubtedly a tax on the profits of the business, and is collected under the provisions of the later sections of the Act by reference to powers contained in the Income Tax Act for the collection of Income Tax. If default in payment is made, the assessee is liable, and not merely the assets of the business. In my opinion there, can be no question that excess profits tax is a tax on income, and if that is so, there is an end of the matter.

6. Sir Jamshedji Kanga has referred us to some English cases, and his contention is that this tax is a tax on a business. He had to admit that it is a tax on the profits of the business, and not a tax on the capital of the business. But he says that the unit of taxation is the business, and not the assessee who owns the business, For that proposition he relies particularly on two decisions of Mr. Justice Peterson in *Collins v. Sedgwick* [1917] 1 Ch. 179 and *Condran, In re : Condran v. Stark* [1917] 1 Ch. 639 and a decision of the English Court of Appeal in *Patent Castings Syndicate, Ltd. v. Etherington* [1919] 2 Ch. 254 which was followed by the Court of Appeal, though with some doubt on the part of Scrutton L.J., in *Vulcan Motor and Engineering Co. v. Hampson* [1921] 3 K.B. 597. Those cases were, I think, founded on the general consideration, that where one is dealing with a profit sharing agreement, an agreement under which an employer is paying an employee a commission based on the profits of the business, it is reasonable to suppose that what the parties intended to share were the profits which otherwise would have belonged to the employer, and that a portion of the profits taken bodily by the revenue authorities, which the employer himself never gets the benefit of, was probably not intended to be shared with the employee. But in arriving at that conclusion the Judges were in the difficulty of having to distinguish excess profits tax from Income Tax, because it was very well settled at the dates when those cases were decided that one could not deduct Income Tax from divisible net profits in such a case. It had been held that Income Tax is something which is payable out of profits after they are ascertained, and not a liability to be deducted in ascertaining the profits. No doubt, it was rather difficult to explain why the same principle should not be applied to excess profits duty, but I think the Judges¹ felt that, if they did apply the same principle, they would be reaching a very inequitable result, and they did manage to distinguish the case of excess profits duty from the case of Income Tax. Whether all the grounds of distinction are sound in law, it is not necessary to consider, because those cases: are! really only relevant, if the excess profits tax is not expressly dealt with in this agreement as "another tax on income"; if, that is to say, we have to decide the second branch of the question and determine whether excess profits duty was properly deductible before arriving at the net annual income, which, I will assume, has the same meaning as net annual profits. But, in my view, that question does not really arise. The excess profits tax is, in my opinion, a tax on income, and there is nothing in any of the English cases to suggest the contrary. It is said that the unit of taxation is the business, and that the excess profits duty is a debt due to the Crown. That may be so, but the tax remains a tax on income. If that is so, in my view, the parties have really answered the question themselves, and have provided that in arriving at the net annual income, on which the commission is to be based, no deduction is to be made for excess profits tax.

7. We must, therefore, answer the question in that sense.

8. The parties are agreed that there should be no order as to costs.

Kania J.

9. I agree. The point for consideration, on the true construction of the agreement between the parties in this case, is, what is the meaning to be attached to the words:

A commission of ten per cent on the net annual income of the Company before setting aside any sum to reserve or depreciation funds or for payment of Income Tax or super-tax or any other tax on income.

It has been laid down by the highest authorities that in construing one document it is not useful to refer to decided cases which deal with the construction of documents where the wording is materially different. No case has been cited in which the agreement contained the words, "before setting aside any sum for payment of any other tax on income".

10. It was contended that the Excess Profits Tax Act (XV of 1940) did not impose a tax on income, because the Income Tax Act was exhaustive of all taxes on income. I do not think that argument is sound. There is nothing in law to prevent the Legislature from making an Act imposing a tax on income in certain contingencies and in certain circumstances, in addition to the Income Tax Act, which is an Act on the statute book for all times. The Excess Profits Tax Act is clearly made for a particular class of income derived under particular circumstances, and, as the different sections themselves show, is to remain in force only for a particular period. It seems to me that the Legislature, instead of amending very largely the Income Tax Act and embodying the provisions of the Excess Profits Tax Act therein, found it more convenient to enact a separate piece of legislation to deal with the particular set of circumstances under which it was considered desirable and necessary to impose an additional tax. The fact, that the Excess Profits Tax Act is a different Act from the Income Tax Act, does not by itself therefore make the tax any the less a tax on income.

11. I do not propose to deal with the question of what would be the meaning of the words "net annual income" in a profit sharing agreement, if the words stood by themselves without the additional words as found in the agreement in question. It may not be disputed that before arriving at the divisible profits amongst shareholders, in the normal course, amounts are set apart for reserve or depreciation funds. Those would be voluntary deductions from the profits, which otherwise might be divided between the shareholders. But in the present case the parties have expressly agreed that no such deduction should be permitted before the ten per cent. commission on the profits to be paid to the plaintiffs is ascertained. In the same way the parties have also provided that no deduction from the amount which is to be divided between them should be made on account of any payment of Income Tax or super-tax or any other tax on income. If the excess profits tax is a tax on income, there remains nothing more to be said on the construction of this agreement. None of the cases cited on behalf of the defendants show that any Judge has said that the excess profits tax

is not a tax on income. They have distinguished the characteristics of the excess profits tax from Income Tax, and have also stated that it is a tax on business. The liability to pay excess profits tax is not relieved by allowing a set-off as permitted under the Income Tax Act. But all those points of distinction between the two Acts do not in any way make the excess profits tax not a tax on income. In fact, even in those cases where the distinctions are pointed out, the learned Judges have stated that the excess profits tax is a tax on income.

12. I do not propose to deal with the different English cases cited, because, in my opinion, in none of them the construction of a document similarly worded as in this was in question.

13. I, therefore, agree that the answer to the question must be in the affirmative.