

(1977) 09 CAL CK 0023

In the Calcutta High Court

Case No : Income-tax Reference No. 384 of 1971

Stya Paul

APPELLANT

Vs

Commissioner of Income Tax (Central)

RESPONDENT

Date of Decision : 30-09-1977

Acts Referred:

Income Tax Act, 1922 — Section 7

Citation : (1979) 116 ITR 335

Hon'ble Judges : S.C. Deb, J;C.K. Banerji, J

Bench : Division Bench

Advocate : D. Pal and A.K. Roychoudhury, for the Appellant; Suhas Sen and Ajit Sengupta, for the Respondent

Judgement

Deb, J.—This is a reference u/s 66(2) of the Indian I.T. Act, 1922, for the assessment year 1954-55, the previous year ending on 31st March, 1954.

2. The assessee is the managing director of Surrendra (Overseas) Pvt. Ltd. for life and of Amin Chand Pyarelal (Calcutta) Ltd. for 20 years. Since his remuneration as the managing director of these two companies has been taxed under the head "Salary" and as the appellate authorities have sustained it, we are now concerned with the following questions of law :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 31,142 being the managing director's remuneration is taxable u/s 7 of the Indian I.T. Act, 1922?

2. Whether, on the facts and in the circumstances of the case, the managing director's remuneration was properly included in the income of the assessee during the relevant year ? "

3. It may be noted here that the learned counsel appearing for both the parties ultimately agreed that our answer to question No. 2 should abide by our answer to question No. 1 and accordingly we have dealt with their arguments only on question No. 1 and have allowed the articles of association of both the companies

to be kept on the record at their request.

4. There is no separate contract between the assessee and the companies regarding his appointment as the managing director. Their agreements in this behalf are enshrined in the articles of association of the respective companies.

5. The articles of association of these companies do not provide for dismissal of the assessee from the office of the managing director. Dr. Debi Pal, learned counsel for the assessee, therefore, argues that the assessee is an agent and not a servant of the companies. Whereas Mr. Suhas Sen, learned counsel for the revenue, argues that as the assessee has been appointed under the articles of association as the managing director and the companies have inherent right to alter the articles, the companies can always dismiss him from that office by altering their articles and, accordingly, it should be held that he is an employee of the companies.

6. In support of his aforesaid contentions Mr. Sen cited the cases of *Shuttleworth v. Cox Brothers & Co. (Maidenhead) Ltd.* [1927] 2 KB 9 ; *Fowler v. Commercial Timber Co. Ltd.* [1930] 2 KB 1; *Southern Foundries (1926) Ltd. v. Shirlaw* [1940] AC 701 ; 10 Comp Cas 255 , *Shindler v. Northern Raincoat Co. Ltd.* [1960] 2 All ER 239 ; [1961] 31 Comp Cas 22 ; *Alien, v. Gold Reefs of West Africa Ltd.* [1900] 1 Ch 656 ; *Yeo v. Stewart* [1947] 2 All ER 28 and *In re T.N. Farrer Ltd.* [1937] Ch 352 . In some of the aforesaid cases the agreements between the parties were not enshrined in the articles of association and, therefore, Mr. Sen also distinguished those cases from the instant case before us in which the agreements between the assessee and these companies, as already stated, are enshrined in their respective articles.

7. Though the arguments of Mr. Sen are attractive, the relationship between the assessee and the companies, in our opinion, should be determined on the basis of the existing articles of the companies in the accounting year and the true nature of contracts between them at the relevant time. Appointment of an agent or a servant for a fixed term can lawfully be terminated before the expiry of the term for fraud, dishonesty, gross negligence, wilful default, misfeasance and the like causes even in the absence of a specific term to that effect in the contract. Therefore, though the power or right to terminate an appointment is a relevant consideration, it does not necessarily lead to an irresistible conclusion that every contract is a contract for and not of service.

8. It may now be noted here that articles of both the companies provide that no director shall without the consent of the company in general meeting hold "any office of profit" under the company except that of a managing director, etc. Mr. Sen, accordingly, contends that it should be held that the assessee is a servant of these companies. But the expression "office of profit" is a term of wide import and it includes within its ambit an employee, an agent and also a contract and hence this expression by itself does not take us anywhere.

9. Mr. Sen also cited the case of *Catherine Lee v. Lee's Air Farming Ltd.* [1961]

AC 12 ; 31 Comp Cas 233 in support of his contention that the assessee has two different capacities, namely, the capacity of a director and the capacity of a manager. And as a director he gave direction to himself to do his duties as the manager of the companies and, therefore, it should be held that he is a servant of the companies. But we are not impressed by this contention, for it cannot be said that all managing directors are the servants of the companies and as already stated the true nature of the contracts between the assessee and the companies should determine their relationship.

10. We will now take up the articles of association of Surrendra (Overseas) Pvt. Ltd. which was incorporated as a private limited company under the provisions of the Indian Companies Act, 1913. Retirement by rotation under Article 68 does not apply to the assessee. Article 69, inter alia, provides that the directors may meet together to despatch the businesses and the questions arising at any such meeting shall be decided by a majority vote. Article 76 deals with the disqualification of the directors and it provides that the office of the director shall be vacated in case of happening of any of the events specified therein. Article 79 provides that the business of the company shall be managed by the directors. Other powers of the directors are specified in Article 80. Article 94 relates to the remuneration of the managing directors and arts. 92 and 93 read as follows :

"92. Mr. Stya Paul, merchant, Bombay, shall be the first managing director of the company and he shall continue and be the managing director of the company throughout his life unless he voluntarily resigns from his office. It is specifically understood that Mr. Stya Paul is permitted to engage himself in other businesses as well besides holding his office as managing director.

93. As such managing director as aforesaid Mr. Stya Paul shall have power of acting alone to exercise all the powers exercisable under these presents by the directors except the power to make calls, forfeit shares or issue debentures. "

11. In view of the aforesaid articles of this company, Mr. Sen argues that this company and its directors exercise a supervisory control over the assessee and, therefore, it should be held that the assessee is an employee of this company. As Article 79 of this company provides that its business shall be managed by the directors, Mr. Ajit Sengupta, learned counsel appearing with Mr. Sen, argues that the business of this company cannot be managed alone by the assessee in view of Perrot and Perrot Ltd. v. Stephenson [1934] 50 TLR 44; [1934] 4 Comp Cas 358 . Mr. Sengupta also argues that Article 93 should be read subject to arts. 79 and 69 which, inter alia, provide that the directors may meet to despatch the business and any question arising in such meeting shall be decided by a majority vote. Accordingly, Mr. Sengupta argues that the assessee is bound to act in terms of the majority decision and, therefore, the other directors have a supervisory control over his activities as contended by Mr. Sen, and, hence, it should be held that the assessee is a servant of this company.

12. Dr. Pal, on the other hand, contends that the assessee is alone entitled to

exercise all the powers of the directors and, therefore, the other directors have no supervisory control over him.

13. Now, Article 62 of Surrendra (Overseas) Pvt. Ltd. reads as follows :

"62. The first and permanent director, chairman and managing director of the company shall be Mr. Stya Paul, merchant, Bombay, and he shall have the power from time to time and at any time to appoint any other person to be an additional director and may at any time remove such director so appointed by him. "

14. The assessee is the managing director of this company for life. He is also the first and the permanent director and chairman of this company. His powers under Article 62 are of pivotal importance. He can from time to time and at any time appoint any person as an additional director and can also remove him. No servant of any company can appoint a director, not to speak of dismissing him. These two powers, in our opinion, lead to an irresistible conclusion that the assessee is not a servant of Surrendra (Overseas) Pvt. Ltd., although this company and its directors exercise some amount of supervisory control over him and his appointment can lawfully be terminated by this company without amending its articles if he is found to be guilty of fraud, misfeasance, dishonesty, wilful default, gross negligence and the like causes.

15. In the premises, it must be held that the assessee's remuneration as the managing director of Surrendra (Overseas) Pvt. Ltd. is not assessable u/s 7 of the Act. In this behalf, we may also say here that the provision for payment of remuneration by itself is not a decisive factor as held by Chagla J. (as he then was) in COMMISSIONER OF Income Tax, BOMBAY CITY Vs. LADY NAVAJBAI R. J. TATA., and by the Supreme Court in Commissioner of Income Tax, Uttar Pradesh Vs. Manmohan Das (Deceased), and also in Ram Pershad Vs. The Commissioner of Income Tax, New Delhi, .

16. We will now deal with the remaining cases which were cited at the Bar in the context of the arguments made in connection with Aminchand Pyarelal (Calcutta) Ltd.

17. In DWIJENDRA CHANDRA CHOWDHURY Vs. COMMISSIONER OF Income Tax, ASSAM. SUBODH CHANDRA DUTTA v. COMMISSIONER OF Income Tax, ASSAM., , it was held by the High Court of Assam and Nagaland that the managing directors were not the servants of that company and their remuneration was assessable u/s 10 of the 1922 Act.

18. Mr. Sengupta, however, submits that this case should not be followed by us as the learned judges have failed to notice the distinction between an ordinary director who is an agent of the company and a managing director who is not only a director but also a manager and as a manager he is a servant of the company. Dr. Pal disputes the aforesaid contentions and cites the case of Re Newspaper Proprietary Syndicate [1900] 2 Ch 349 and argues that a managing director can

never be a servant of the company.

19. But in *Ram Pershad Vs. The Commissioner of Income Tax, New Delhi*, the Supreme Court says thus :

"It is again true that a director of a company is not a servant but an agent inasmuch as the company cannot act in its own person.....A managing director may have a dual capacity. He may both be a director as well as an employee. It is, therefore, evident that in the capacity of a managing director he may be regarded as having not only the capacity as persona of a director but also has the persona of an employee, or an agent depending upon the nature of his work and the terms of his employment.....In other words, whether or not a managing director is a servant of the company apart from his being a director can only be determined by the articles of association and the terms of his employment. "

20. We are, therefore, unable to accept the aforesaid extreme contentions made on behalf of both the parties, although Mr. Sengupta was right in pointing out that the aforesaid distinction was lost sight of in *DWIJENDRA CHANDRA CHOWDHURY Vs. COMMISSIONER OF Income Tax, ASSAM. SUBODH CHANDRA DUTTA v. COMMISSIONER OF Income Tax, ASSAM,* .

21. In *COMMISSIONER OF Income Tax BOMBAY Vs. L. ARMSTRONG SMITH.,* , the assessee was the managing director and chairman for life under the articles of a company in which he held almost all the shares. The articles provided that he was to hold those offices until resignation or ceasing to be a shareholder of the company. His two nominees were the other shareholders and directors. Under the articles, the management of the company vested in the directors who were to act under the supervisory control and direction of the assessee whose remuneration for acting as the managing director was. to be voted in the annual general meeting of the company. His remuneration as the managing director was held to be assessable u/s 7 of the Indian I. T. Act, 1922, in the following terms at pages 610, 611 of the report:

"It is to be observed that Mr. Smith is under article 58 appointed for life and that there is vested in him the power to control and manage the whole of the company's business and that so long as he retains the said office no one else has any right to intervene in the management. In my opinion these articles fall under the head of creating a contractual relationship between the company and Mr. Smith by which Mr. Smith is to be in the service of the company.....In these circumstances his remuneration falls to be taxed u/s 7 and not Section 12..... "

22. The case of *L. N. GADODIA AND CO. Vs. COMMISSIONER OF Income Tax, UNITED AND CENTRAL PROVINCES AND BERAR.,* was decided on different facts and it does not throw any light on the points involved before us.

23. In *Lakshminarayan Ram Gopal and Son Ltd. Vs. The Government of Hyderabad*, it was held by the Supreme Court that the appellants were the agents and not the servants of the company and that the commission earned by

them was liable to excess profits tax as their activities constituted a business from which the commission was earned by them under the terms of the agency agreement under which they were to act for 30 years as agents of the company and inasmuch as they were entitled to assign the agency agreement including their rights thereunder and were also entitled to sub-delegate their functions under that agreement.

24. In *Piyare Lal Adishwar Lal Vs. The Commissioner of Income Tax, Delhi*, , the assessee was a HUF and its karta was Sheel Chandra, who was a treasurer of a bank under an agreement which could be terminated by three calendar months' notice by either side. After considering the nature of his work and the supervisory control over him by the bank, it was held by the Supreme Court that he was a servant of the bank and the remuneration received by him was assessable under the head "Salary".

25. In *Commissioner of Income Tax, Madras Vs. B. Nagi Reddy*, , the Madras High Court was concerned with the question as to whether the additional remuneration received by the managing director of two companies was assessable u/s 10 of the Indian I. T. Act, 1922, and it was answered in the negative by following the decision of the Supreme Court in the case of *Lakshminarayan Ram Gopal and Son Ltd. Vs. The Government of Hyderabad*, . Their Lordships of the Madras High Court, however, did not deal with Section 7 of the Act as stated by them at page 186 of the report.

26. In terms of a separate agreement as provided in the articles of association of a company in the case of *K.R. Kothandaraman Vs. Commissioner of Income Tax, Madras*, , the assessee became the managing director for 5 years and was to act under the supervisory control of the board of directors. It was held by the Madras High Court that the assessee was an employee of the company and his monthly remuneration was assessable u/s 7 of the Indian I.T. Act, 1922.

27. In *COMMISSIONER OF Income Tax Vs. LAKSHMIPATI SINGHANIA*, , the assessee was appointed as an adviser of a company by a board resolution which did not contain any terms and conditions under which he was to work. He was allowed a rent-free accommodation and the question was whether the value of the rent-free accommodation was assessable as salary or perquisite. The Allahabad High Court answered the question in the negative by holding that he was not a servant of the company.

28. Reliance was also placed before us on Halsbury's Laws of England and the recognised text books on company law. As the Supreme Court has already considered them in *Ram Pershad Vs. The Commissioner of Income Tax, New Delhi*, , it is unnecessary for us to discuss them or to enumerate the principles discussed in the aforesaid cases. We will, however, refer to *Ram Pershad Vs. The Commissioner of Income Tax, New Delhi*, while dealing with the arguments of Dr. Pal.

29. Dr. Pal argues that the directors of Aminchand Pyarelal (Cal) Ltd. have no

supervisory control over the assessee and, therefore, the assessee is not a servant of this company. But we are not impressed by it.

30. This company was incorporated as a public limited company under the Indian Companies Act, 1913. The control of this company is vested in the directors under Article 133. The management of the business of the company is also vested in the directors under the provisions of the Indian Companies Act, 1913. The assessee is to manage the business of the company with the help of the directors under Article 134, and he is also bound to act in terms of the resolutions of the board of directors of this company under Articles 125, 127, 128 and 131. Moreover, Articles 140 and 141 show that the powers enumerated therein cannot be exercised by the assessee as the managing director of this company. They also show that the company has a final say over those matters. The assessee has also no power to use the seal of the company without the authority of the board of directors as provided in Article 142.

31. In the premises, it must be held that this company and its directors exercise a supervisory control over the assessee in view of the following observations of the Supreme Court in *Ram Pershad Vs. The Commissioner of Income Tax, New Delhi*, :

"The control which the company exercises over the assessee need not necessarily be one which tells him what to do from day to day.....Nor does supervision imply that it should be a continuous exercise of the power to oversee or superintend the work to be done. The control and supervision is exercised and is exercisable in terms of the articles of association by the board of directors and the company in its general meeting. As a managing director he functions also as a member of the board of directors whose collective decisions he has to carry out in terms of the articles of association and he can do nothing which he is not permitted to do. u/s 17(2) of the Indian Companies Act, 1913, Regulation No. 71 of Table A, which enjoins that the business of the company shall be managed by the directors, is deemed to be contained in the articles of association of the company in identical terms or to the same effect. Since the board of directors are to manage the business of the company they have every right to control and supervise the assessee's work whenever they deem it necessary. Every power which is given to the managing director, therefore, emanates from the articles of association which prescribes the limits of the exercise of that power. The powers of the assessee have to be exercised within the terms and limitations prescribed thereunder and subject to the control and supervision of the directors which, in our view, is indicative of his being employed as a servant of the company."

32. It may now be noted here that as the assessee has been appointed as the managing director for 20 years under Article 135 of *Aminchand Pyarelal (Calcutta) Ltd.*, Dr. Pal argued that the assessee cannot be removed before 20 years from the office of the director under Article 116, the relevant portion whereof reads as follows:

"Subject to the provisions of any agreement for the time being in force the company may by extraordinary resolution remove any director before the expiration of his period of office....."

33. Dr. Pal made the aforesaid contention in support of his earlier submission, namely, that this company has no power to dismiss the assessee from the office of the managing director and, therefore, he is not a servant of this company. But Article 135 is solely confined to the assessee's appointment as the first managing director of this company and apart from it there is no agreement on the record relating to his directorship.

34. Therefore, the words "subject to the provisions of any agreement for the time being in force" in Article 116 do not apply to him in his capacity of a director. He can accordingly be removed from the office of the director under Article 116 which is an overriding article giving a specific right to the company to remove any director "before the expiration of his period of office by an extraordinary resolution". And if he is so removed, he will automatically be dismissed from the office of the managing director, because it is elementary that no one can be a managing director of a company unless he is director of that company. Further, he can be dismissed by the company without amending its articles if he is found to be guilty of fraud, misfeasance, gross negligence, dishonesty, wilful default and the like causes.

35. In the premises, the contentions of Dr. Pal must fail and we hold that the assessee is an employee of Aminchand Pyarelal (Calcutta) Ltd. and his remuneration is taxable u/s 7 of the Indian I.T. Act, 1922.

36. Our above conclusion also disposes of question No. 2 and we accordingly answer the questions as follows:

Question No. 1.--With regard to Surrendra (Overseas) Pvt. Ltd., it is in the negative and in favour of the assessee and with regard to Aminchand Pyarelal (Calcutta) Ltd., it is in the affirmative and against the assessee.

Question No. 2.--With regard to Surrendra (Overseas) Pvt. Ltd., it is in the negative and in favour of the assessee and with regard to Aminchand Pyarelal (Calcutta) Ltd., it is in the affirmative and against the assessee.

37. This case has been well argued by the learned counsel for the parties and in view of their divided success we make no order as to costs.

C.K. Banerji, J.

38. I agree.