COMMISSIONER OF INCOME-TAX, BOMBAY

v.

AHMEDBHAI UMARBHAI & CO., BOMBAY.

1959

May 4

[SHRI HARILAL KANIA C.J., SAIYID FAZL ALI, PATANJALI SASTRI, MEHR CHAND MAHAJAN, MUKHERJEA and DAS JJ.]

Excess Profits Tax Act (XV of 1940), s. 5, Third Proviso—Indian Income-tax Act (XI of 1922), s. 42 (3)—Article manufactured outside British India—Sale in British India—Whether whole profits accrue or arise in British India—Liability to excess profits tax—Manufacturing operations, whether "part of business"—Apportionment of profits between place of manufacture and place of sale—Permissibility—Applicability of s. 42 (3).

Section 5 of the Excess Profits Tax Act, 1940, provided that "the Act shall apply to every business of which any part of the profits made during the chargeable accounting period was chargeable to income-tax." There was also a proviso to the effect that "the Act shall not apply to any business, the whole of the profits of which accrued or arose in an Indian State and that where the profits of a part of a business accrued or arose in an Indian State, such part shall for the purpose of this provision be deemed to be a separate business, the whole of the profits of which accrued or arose in an Indian State, and the other part of the business shall be deemed to be a separate business."

A firm which was resident in British India and carried on the business of manufacturing and selling groundnut oil, owned some oil mills within British India and a mill in Raichur in the Hyderabad State where oil was manufactured. The oil manufactured in Raichur was sold partly within the State of Hyderabad and partly in Bombay:

Held, *by the Full Court* (KANIA C. J., PATANJALI SASTRI, FAZL ALI, MEHR CHAND MAHAJAN, MUKHERJEA and DAS JJ.)—The expression "part of a business" in the proviso to section 5 does not necessarily mean a separate composite unit of all the constituent activities of the business or a complete cross-section of the entire business operations but is wide enough to mean one or more of the operations of the business, and that the manufacturing operations which the firm carried on at Raichur were "a part of the business" of the assessees within the meaning of the proviso to section 5 of the Act.

Held *also per* KANIA C.J., FAZL ALI, MEHR CHAND MAHAJAN, MUKHERJEA and DAS JJ.—that the profits of that part of the business, namely, the manufacture of oil at the mill in Raichur accrued or arose in Raichur within the meaning of the said proviso, even though the manufactured oil was sold in Bombay and the price was received there, and accordingly, that part of the profits derived from sales in Bombay which was attributable to the manufacture of the oil in Raichur was exempt from excess profits tax under the proviso to section 5 of the Act.

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Per PATANJALI SASTRI J.—The first part of sub-section (1) of section 42 of the Income-tax Act was applicable to the assessees, the expressions " business connection in British India " and " asset or source of income in British India " being wide enough to cover their selling organisation at Bombay ; and as a result, the profits received in Bombay from the sale of the oil manufactured in Raichur had to be apportioned under sub-section (3) of section 42 between the two operations of manufacture and sale, and only such portion of the profits as was attributable to the sale in Bombay should be deemed to have accrued or arisen in British India. It followed as a corollary that the rest of the profits attributable to the manufacture at Raichur must be regarded as accruing or arising in the Hyderabad State and was therefore exempt under the proviso to s. 5 of the Act.

Quaere: Whether it is in consonance with business principles or practice in the absence of any statutory requirement to that effect to cut business operations arbitrarily into two or more portions and to apportion as between them the profits resulting from one continuous process ending in a sale and whether *Kirk's case* is applicable to assessments under the Indian Acts as laying down any general principle of apportionment.

Per MAHAJAN J.—Though profits may not be realised until a manufactured article is sold, profits are not wholly made by the act of sale and do not necessarity accrue at the place of sale and to the extent profits are attributable to the manufacturing operations, profits accrue at the place where the operations are carried on.

Per MUKHERJEA J.—Where raw material is worked up into a new product by process of manufacture, it obviously increases in value and this increase in value represents the income or profit which is the result of the manufacture, and as this profit accrues by reason of the manufacture it cannot but be located at the place where the manufacturing process is gone through. It is immaterial that the manufactured goods are sold later on at various places. If the manufacturer is himself the seller, it might be that he receives the entire profits including that of the manufacture only at the time of sale; but in an inchoate shape a portion of the profits does accrue at the place of manufacture, the exact amount of which is only ascertained after the sale takes place. For purposes of computation the two parts of the business may be conceived of as being carried on by two different sets of persons.

APPEAL [Civil Appeal No. LXVIII of 1949] from a Judgment of the High Court of Bombay dated 18th March 1948 (Chagla C.J. and Tendolkar J.) in a Reference under the Excess Profits Tax Act, 1940.

M. C. Setalvad, Attorney-General for India, (*B. Sen* with him) for the appellant.

K. M. Munshi (*S. K. Aiyar and N. K. Gamadia* with him) for the respondents.

1950. May 4. The Court delivered the following Judgments :—

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KANIA C.J.—This is an appeal from a decision of the High Court of Judicature at Bombay upon a reference made by the Income-tax Appellate Tribunal, Bombay, under section 66 (1) of the Indian Income-tax Act. The respondent firm, the assessees, carried on business of manufacturing and dealing in oil during the relevant accounting periods. They are a registered firm under the Income-tax Act and are residents in Bombay. They own three mills at Bombay and one at Raichur for manufacturing oil from groundnuts. The oil produced at Raichur is sold partly at Raichur and partly in Bombay. Their liability to pay income-tax in respect of their whole profits is not disputed under the Income-tax Act. The question is in respect of their liability under the Excess Profits Tax Act for the oil manufactured at Raichur, but sold in Bombay.

The assessees contend that in respect of such oil a portion of the profits earned by them is attributable to their business of manufacturing oil at Raichur and that portion of the profits should not be assessed to tax under the Excess Profits Tax Act. The taxing authorities rejected the contention of the assessees. The Income-tax Tribunal agreed with them. On a reference the High Court disagreed with the view of the Tribunal and held that the assessees' contention was correct. The Commissioner of Income-tax has come in appeal from that decision. In the Excess Profits Tax Act, section 2 (5) defines "business" as follows:—

"'Business' includes any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture.....

Provided further that all businesses to which this Act applies carried on by the same person shall be treated as one business for the purposes of this Act."

Section 5 of the Act runs as follows:—

"5. This Act shall apply to every business of which any part of the profits made during the chargeable accounting period is chargeable to income-tax by virtue of the provisions of sub-clause (i) or sub-clause (ii) of clause (b) of sub-section (1) of section 4 of the Indian Income-tax Act, 1922, or of clause (c) of that sub-section:

Provided that this Act shall not apply to any business the whole of the profits of which accrue or

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arise without British India where such business is carried on by or on behalf of a person who is resident but not ordinarily resident in British India unless the business is controlled in India :

Provided further that where the profits of a part only of a business carried on by a person who is not resident in British India or not ordinarily so resident accrue or arise in British India or are deemed under the Indian Income-tax Act, 1922, so to accrue or arise, then except where the business being the business of a person who is resident but not ordinarily resident in British India is controlled in India, this Act shall apply only to such part of the business, and such part shall for all the purposes of this Act be deemed to be a separate business :

Provided further that this Act shall not apply to any business the whole of the profits of which accrue or arise in an Indian State ; and where the profits of a part of a business accrue or arise in an Indian State, such part shall, for the purposes of this provision, be deemed to be a separate business the whole of the profits of which accrue or arise in an Indian State, and the other part of the business shall for all the purposes of this Act, be deemed to be a separate business."

Section 21 of the Act, which was not referred to in the course of the arguments before us, runs as follows :—

" 21. The provisions of sections 4-A, 4-B, 10, 13, 24-B, 29, 36 to 44-C (inclusive), 45 to 48 (inclusive), 49-E, 49-F, 50, 54, 61 to 63 (inclusive), 65 to 67-A (inclusive) of the Indian Income-tax Act, 1922, shall apply with such modifications, if any, as may be prescribed as if the said provisions were provisions of this Act and referred to excess profits tax instead of to income-tax, and every officer exercising powers under the said provisions in regard to income-tax may exercise the like powers under this Act in regard to excess profits tax in respect of cases assigned to him under sub-section (3) of section 3 as he exercises in relation to income-tax under the said Act :

Provided that references in the said provisions to the assessee shall be construed as references to a person to whose business this Act applies."

The relevant portion of section 42 of the Indian Income-tax Act is in these terms :—

"42. (1) All income, profits or gains accruing or arising, whether directly or indirectly, through or from any business connection in British India, or through or from any property in British India, or through or from any asset or source of income in British India, or through or from any money lent at interest and brought into British India in cash or in kind, shall be deemed to be income accruing or arising within British India, and where the person entitled to the income, profits or gains is not resident in British India, shall be chargeable to income-tax either in his name or in the name of his agent....

(2) Where a person not resident or not ordinarily resident in British India, carries on business with a person resident in British India, and it appears to the Income-tax Officer that owing to the close connection between such persons the course of business is so arranged that the business done by the resident person with the person not resident or not ordinarily 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) In the case of a business of which all the operations are not carried out in British India, the profits and gains of the business deemed under this section to accrue or arise in British India shall be only such profits and gains as are reasonably attributable to that part of the operations carried out in British India."

On behalf of the appellant it was contended that in order to get exemption from the Excess Profits Tax Act the assessee has to show that his case is covered by section 5 proviso 3. It was argued on behalf of the appellant that in the

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present case the business of the assessee consisted of manufacturing and selling oil and unless each of those operations took place at Raichur, "a part of the business" of the assessee was not at Raichur in the Hyderabad State and therefore he was not entitled to the exemption claimed by him. It was secondly contended that even assuming that this was not correct the profits of that part of the business, which was carried on at Raichur, did not accrue or arise in the Hyderabad State because the profits arose on the sale of the oil in Bombay and therefore the assessee's contention was incorrect. Proviso 3 to section 5 of the Excess Profits Tax Act requires the assessee to fulfil three conditions to secure the exemption. They are (1) there should be a part of a business; (2) that must be in an Indian State; and (3) profits in respect of which exemption is claimed must accrue or arise from that part of the business. The appellant's contention is that the part of the business must be a complete unit or as described on his behalf a complete cross-section of the business. It is argued that inasmuch as the sale of the oil in question took place in Bombay the cross-section composed of manufacture and sale did not take place at Raichur in the Hyderabad State and therefore the assessee's contention must fail. In my opinion this contention is unsound. The definition of business in the Excess Profits Tax Act clearly envisages manufacture as a business by itself. It is not necessary that a manufacturer must be a trader in the commodity he manufactures. Similarly because he is a manufacturer and a trader it does not follow that the two activities necessarily become one indissoluble business of which the profits cannot be separately ascertained. Because a man is a manufacturer, a trader and even an exporter it is not correct to say that unless all the three activities take place in an Indian State he is not entitled to the benefit of the proviso because a part of his business is not in the Indian State. The argument of the appellant is that there should not be only a separate composite unit of the assessee's business in an Indian State but that each operation making up the assessee's business must take place in an Indian State. I find no

justification for putting such construction on proviso 3 to section 5. No authority is cited to support such interpretation of the proviso. It is not contended in the present case that the activities of the assessee as a manufacturer are so spread out as to be incapable of being ascertained as one unit of business in an Indian State. For instance, difficulties may arise if a manufacturer buys groundnuts in one place, has a crushing mill in another place, has a refinery in the third place and packing etc. in a fourth place. It is not disputed here that the assessee's activities as a manufacturer are all in Raichur and if so, that set of activities under the definition of "business" in the Excess Profits Tax Act is a complete unit. I have no doubt that on the facts of the present case the manufacturing operations of the assessee are "a part of his business in an Indian State." Those conditions of the proviso are therefore fulfilled.

On behalf of the appellant it was pointed out that under section 42 (3) of the Indian Income-tax Act the legislature had made a provision for allocation of profits in respect of different operations of a business, but there was no such corresponding provision in the Excess Profits Tax Act. This contention overlooks section 21 of the Excess Profits Tax Act which expressly makes, amongst others, section 42 (3) a part of the Excess Profits Tax Act for assessing the profits of an assessee. If, therefore, profits can be allocated to the manufacture of oil in Raichur it seems to me clear that the manufacturing activity will be a part of the assessee's business in an Indian State.

The next contention of the appellant was that even if a part of the business was in an Indian State the profits accrued or arose only on the sale of the oil in Bombay and no part of the profits of manufacture therefore arose in an Indian State. In my opinion this argument is also unsound. On the sale of goods the assessee receives money. While the *receipt* of the price is thus in Bombay it is an entirely different thing to say that therefore the whole profits of the manufacture and sale *arose* in Bombay. This argument overlooks the distinction between accruing or arising on the one

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hand and receipt on the other. Again, the question of profits has to be determined not on receipt of the price of each lot sold by the assessee but the result of all the operations in connection with the manufacture and sale of oil during the accounting year. An individual transaction may result in profit but that will not make the assessee liable if the result of his accounting year's activities is a loss. It is therefore improper in a case of this kind to consider the sale of oil as the deciding factor either to ascertain profits or to determine the place of the accrual of profits. Several cases were cited at the Bar dealing with a trader's business where he bought and sold goods. In my opinion those are not relevant to determine the question before us because in the present case the business is of a different nature. In *The Commissioner of Taxation* v. *Kirk* (1), Lord Davey distinguished *Sulley* v. *Attorney-General* (2) and *Grainger & Son* v. *Gough* (3) on this ground. The place of sale was not considered the test when the business was of manufacturing and sale. Similarly cases which deal with the liability of the assessee under the Indian Income-tax Act because the profits were *received* (and not only accrued or arose) in India are also unhelpful. The Judges of the High Court strongly relied on *The Commissioner of Taxation* v. *Kirk* (1) for their conclusion in favour of the assessee. It was a case of mining operations where the mines were in one colony and the sale of the ore in another. Under the Taxing Act in that case, it was observed that it was wholly immaterial whether the person to be taxed resided in the colony or not. Nor was it material whether the income was received in the colony or not, if it was earned outside the colony. The Board attached no importance to the word "derived" which was treated as synonymous with *arising* or *accruing*. The real question was what income was arising or accruing to the assessee from the business operations carried on by him in the colony. This was considered a question of fact. Under the New South Wales Act the liability to tax has to be decided on the existence of the source of the income in the particular colony and

(1) [1900] A.C. 588. (2) [1860] 5 H. & N. 711. (3) [1896] A.C. 325.

to that extent the liability to tax is based on a different basis. While accepting this distinction, I am however unable to accept the contention that the source of income can never be the place where the income accrues or arises. In my opinion there is nothing to prevent income accruing or arising at the place of the source. The question where the income accrued has to be determined on the facts of each case. The income may accrue or arise at the place of the source or may accrue or arise elsewhere, but it does not follow that the income cannot accrue or arise at the place where the source exists. Therefore it is necessary to ascertain whether that part of the business which is capable of being treated as one separate unit in the Hyderabad State has given rise to the income or profit sought by the assessee to be exempted from taxation in the present case. On behalf of the respondents our attention was drawn to the *International Harvester Company of Canada* v. *The Provincial Tax Commissioner* (1). In that case the question was of the liability to tax of a resident outside the province of *S*, under the Income-tax Act of *S*, in respect of profits arising from the sale in that province of agricultural implements which were manufactured outside the province. Under the relevant Act the tax was leviable on a person residing outside *S* who was carrying on business in *S* on the net profit or gain arising from the business of such person in *S*. The Board held that although the profits were all received in *S*, where the goods were sold, the profits liable to taxation were only the net profits arising from the business in *S* and therefore the manufacturing profits should be excluded from the assessment. They referred to sections 23 and 24 of the Taxing Act, under which a non-resident person was charged to tax on an apportioned part of profit, which although it might be received outside the province of *S* could fairly be regarded as having been partially earned inside that province. In my opinion that case substantially helps the contention of the respondents and negatives the appellant's contention. It shows that when the manufacturing portion of the activity of the assessee is in

(1) [1949] A.C. 36.

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one province and the sale is in another province, the whole profits are not necessarily considered as arising from the sale or at the place of sale although they may be treated as received on sale of the products. Secondly, it shows that profits could be apportioned between the manufacturing and trading activities, particularly when the assessee carried on the business of a manufacturer and trader together. This decision was sought to be distinguished by the Attorney-General on the ground that sections 23 and 24 of the Taxing Act of that colony made it a completely different scheme of taxation. I do not think that is a good point of distinction, because proviso 2 to section 5 of the Indian Excess Profits Tax Act, read with section 21, prescribes also a scheme in respect of a non-resident although not in the same details or with the same results under the Indian Act. The expression "part of a business" must in my opinion be read with the same meaning and implication in provisos (2) and (3) to section 5 of the Excess Profits Tax Act. I am also unable to accept the contention of the Attorney-General that under our Act there is no scheme of apportionment. That overlooks, as pointed out above, the provisions of section 21 of the Act, which incorporates by reference amongst others section 42 (3) of the Indian Income-tax Act. In my opinion, therefore, proceeding on the footing that there can arise or accrue profits of the manufacturing activity of the assessee, profits have accrued to the assessee of a part of the business in an Indian State and they having accrued out of such business carried on in such State are exempted under the third proviso to section 5 of the Excess Profits Tax Act. For these reasons, in my opinion, the conclusion of the High Court is correct and the appeal is dismissed with costs.

Fazl Ali J.

FAZL ALI J.—I agree fully with the judgment of Mahajan J.

Patanjali Sastri J.

PATANJALI SASTRI J.—This is an appeal from a judgment of the High Court of Judicature at Bombay upon a reference made by the Income-tax Appellate

Tribunal, Bombay, under section 66 (1) of the Indian Income-tax Act, 1922, read with section 21 of the Excess Profits Tax Act, 1940.

The respondent firm (hereinafter referred to as the "assessees") are carrying on the business of manufacturing and dealing in oil at Raichur in the Hyderabad State and at Bombay which, during the relevant period, was part of what was then known as British India. The assessees are resident in Bombay and are registered for income-tax purposes, under section 26-A of the Income-tax Act, under the name of Ahmedbhai Umarbhai & Co., while their branch at Raichur is run under the name of Ahmed & Sons. They own three mills at Bombay and one at Raichur for manufacturing oil from groundnuts, and they sell the oil partly at Raichur and partly at Bombay. For the chargeable accounting period commencing from 31st October, 1940, and ending on 20th October, 1941, the assessees were assessed to excess profits tax in a sum of Rs. 1,61,807 on their business income of Rs. 6,08,761, including a sum of Rs. 2,49,615 which was said to have accrued or arisen from sales in Bombay of oil manufactured at Raichur. Part of such oil was also sold at Raichur, but the profits derived from such sales were not included in the assessment, and no question now arises in regard to such profits. For the succeeding period commencing from 21st October, 1941, and ending on 8th November, 1942, a tax of Rs. 2,55,485-1-0 computed on the same basis, was also imposed on the assessees. The assessees contended that a part of the profits derived from sales in British India of the oil manufactured at Raichur was attributable to the manufacturing operations at Raichur which are an essential part of their business, and that such profits must be excluded from the assessment, under the third proviso to section 5 of the Excess Profits Tax Act, as having accrued or arisen in the Hyderabad State. The contention was rejected and the whole of the profits arising out of the sales in British India of the oil produced in Raichur were included in the assessments.

After unsuccessful appeals to the Appellate

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Assistant Commissioner, Bombay, the assessees carried the matter to the Income-tax Appellate Tribunal, Bombay, but with no better result. The assessees thereupon applied to the Tribunal requiring them to draw up a statement of the case and refer it to the High Court at Bombay for decision of the question of law involved, and the Tribunal accordingly stated the case and referred the following question: "Whether on the facts stated above income accruing or arising to the assessees on sales made in British India of goods manufactured in Raichur situated outside British India has been rightly held by the Tribunal as income accruing or arising in British India and was liable to excess profits tax." In the letter of reference they indicated their view on the question referred by stating that the manufactured article received or brought into British India did not include any income, profits or gains, and that such profits and gains, having accrued only after the sale had taken place, accrued or arose in British India.

The reference was heard by Chagla C.J. and Tendolkar J. and they were of opinion that the question as framed by the Tribunal "did not really bring out the controversy between the parties." The learned Judges, after stating the facts of the case, framed the question thus: "Whether on the facts stated above the profits of a part of the business of the assessees accrued or arose in an Indian State." The question as reframed is also open to similar criticism, for, it assumes that the manufacture of oil at Raichur is "a part of the business" of the assessees, whereas the Commissioner of Income-tax has been seriously contesting that position as the judgment under appeal itself shows.

Excess profits tax is a charge on the profits arising out of a business in excess of its normal or standard profits, a business being regarded as the unit of assessment. "Business" is defined in section 2 (5) of the Excess Profits Tax Act as including, among other things, "manufacture," and a proviso to the clause says that "all businesses to which this Act applies

carried out by the same person shall be treated as one business for the purposes of this Act." Section 4 provides for the charge of tax in respect of any business to which the Act applies on the amount by which the profits during any chargeable accounting period exceed the standard profits. Section 5, on the true interpretation of which the question for determination in this appeal turns, runs thus :

"5. This Act shall apply to every business of which any part of the profits made during the chargeable accounting period is chargeable to income-tax by virtue of the provisions of sub-clause (i) or sub-clause (ii) of clause (b) of sub-section (1) of section 4 of the Indian Income-tax Act, 1922, or of clause (c) of that sub-section :

Provided that this Act shall not apply to any business the whole of the profits of which accrue or arise without British India where such business is carried on by or on behalf of a person who is resident but not ordinarily resident in British India unless the business is controlled in British India :

Provided further that where the profits of a part only of a business carried on by a person who is not resident in British India or not ordinarily so resident accrue or arise in British India or are deemed under the Indian Income-tax Act, 1922, so to accrue or arise, then, except where the business, being the business of a person who is resident but not ordinarily resident in British India is controlled in India, this Act shall apply only to such part of the business, and such part shall, for all the purposes of this Act, be deemed to be a separate business :

Provided further that this Act shall not apply to any business the whole of the profits of which accrue or arise in an Indian State, and where the profits of a part of business accrue or arise in an Indian State, such part shall, for the purposes of this provision, be deemed to be a separate business the whole of the profits of which accrue or arise in an Indian State, and the other part of the business shall, for all the purposes of this Act, be deemed to be a separate business."

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As the assessees are resident in British India and the profits of their business in the Hyderabad State made during the relevant periods were charged to income-tax under section 4 (1) (b) (ii) of the Income-tax Act, that business was brought under charge to excess profits tax by section 5 of the Excess Profits Tax Act, and the duty would be leviable on the profits of the said business unless proviso (3) excluded the application of the Act to that business, in which case the proviso to section 2 (5) which operates to consolidate only those businesses to which the Act applies would also not take effect. It appears to have been conceded by the taxing authority that no excess profits tax was leviable on the profits derived from the sales in the Hyderabad State as they were profits of a part of the assessees' business accruing or arising in an Indian State and as such were exempted under proviso (3) to section 5, for these profits, as already stated, were not subjected to tax for the two chargeable accounting periods in question. But it was contended on their behalf by the Attorney-General that the proviso had no such operation in respect of the profits made by sales of the oil in British India, and that for two reasons: Firstly, because the manufacturing operations carried on in the Hyderabad State did not constitute a "part" of the assessees' business within the meaning of the proviso, and, secondly, because even if such operations could be regarded as a part of the business, the profits derived from the sales of the oil in Bombay could not be said to have accrued or arisen in that State. Both these propositions were held to be untenable by the learned Judges of the High Court and were contested before us by Mr. Munshi on behalf of the assessees.

On the first point, the Attorney-General insisted that a "part" of a business meant a fraction of the aggregate of all the constituent activities of the business or, as it has been put during the argument, a "cross-section" of the entire business operations, and not one or more of such operations, however essential for the production of the resulting profits. It is difficult to see how this construction will assist the

taxing authority in the present case, for, as already stated, the assessees were selling at Raichur, part of the oil manufactured there, and there was thus at that place a complete cross-section of their business which consists of manufacturing and selling oil. Apart from this consideration, I can find nothing in the context of section 5 to exclude the ordinary meaning of the words "part of a business" and to compel the somewhat strained and artificial interpretation sought to be put upon them which, it may be observed in passing, seems inconsistent with the view which left untaxed the profits derived from the sales at Raichur. Furthermore, section 5 is to be read with the provisions of section 42 of the Indian Income-tax Act which has been made applicable, with certain modifications not material here, to excess profits tax by section 21 of the Excess Profits Tax Act "as if the said provisions were provisions of this Act and refer to excess profits tax instead of to income-tax." That section has, in my opinion, an important bearing on the issues involved in this appeal and deserves careful consideration. So far as material here it reads thus :

"42. (1) All income, profits or gains accruing or arising, whether directly or indirectly, through or from any business connection in British India, or through or from any property in British India, or through or from any asset or source of income in British India, or through or from any money lent at interest and brought into British India in cash or in kind, shall be deemed to be income accruing or arising within British India, and where the person entitled to the income, profits or gains is not resident in British India, shall be chargeable to income-tax either in his name or in the name of his agent, and in the latter case such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax:

Provided that where the person entitled to the income, profits or gains is not resident in British India, the income-tax so chargeable may be recovered by deduction under any of the provisions of section 18.....

(3) In the case of a business of which all the operations are not carried out in British India, the

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profits and gains of the business deemed under this section to accrue or arise in British India shall be only such profits and gains as are reasonably attributable to that part of the operations carried out in British India."

It will be seen that these provisions, read together, lay down a rule of apportionment for ascertaining the profits of a business part only of whose "operations" are carried out in British India where such part could be regarded as either "a business connection in British India" or "a source of income in British India." They also provide machinery for facilitating collection of the tax from the resident agent where the person entitled to such income is a non-resident. Now, these provisions are obviously complementary to section 5 proviso (2) of the Excess Profits Tax Act, and unless we read "part of a business" in that proviso as meaning one or more "operations" of the business referred to in sub-section (3) of section 42, the machinery provided in the latter section for collection of the tax leviable on a non-resident person by virtue of proviso (2) will not be applicable, and the scheme of charge and collection in such cases will be rendered incoherent. A harmonious interpretation of the scheme requires that the words "part of a business" in proviso (2) must be taken to signify one or more of the operations of the business, and, if so, the same expression used in proviso (3), with which we are here concerned, must also have the same connotation. It follows that the manufacture of oil in the mill at Raichur is a part of the assessees' business.

The question next arises whether the profits derived from such manufacture, other than those arising from sales at Raichur which are not now in question, accrued or arose in Raichur, so as to bring the case within proviso (3). It is clear that the oil manufactured at Raichur cannot itself be regarded as income, profits or gains within the meaning of the Indian Income-tax Act or the Excess Profits Tax Act any more than the green coffee in *Mathias'* case (1) which the Privy Council held could not be so regarded.

(1) I.L.R. [1939] Mad. 178.

The oil is manufactured for purposes of sale in order that profits may be earned, and such profits are realised only when the commodity is sold and not before. But, as the test of non-liability under proviso (3) is the accruing or the arising of the profits in an Indian State, the question is whether the profits, when they do arise from the sales at Bombay of the product of the mill at Raichur, arose in whole or in part at Raichur? As pointed out by the Privy Council in *Chunilal Mehta's* case(1), the words "profits accruing or arising in" (a country) require a place to be assigned as that at which the trading operations come, whether gradually or suddenly, into existence, and they involve a notion difficult to apply to particular transactions. The words "accrue or arise," too, have been variously interpreted, and no conclusive or clear test of when or where income can be said to accrue has been formulated in the decided cases. The learned Judges in the Court below solved the problem by invoking what they conceived to be the general principle underlying the decision in *Kirk's* case (2), namely, the principle of apportioning profits as between the different processes employed in producing those profits and the different places where they are employed. The learned Judges disagreed with the view of the Calcutta High Court in *Re Mohanpura Tea Co.* (3) that the profits accrue or arise only when the goods are sold and at the place where they are sold, and that the decision in *Kirk's* case (2) laid down no principle of general application but proceeded on the language of an Australian statute. The question in *Kirk's* case (2) related to the assessment of the profits of a mining company which extracted ore and converted it into a merchantable product in one colony and sold it in another. Under the relevant statute, tax was leviable in respect of income "arising or accruing from any.....trade.....carried on" in the colony or "derived from lands," or "arising or accruing from any kind of property.... .....or from any other source whatsoever," in the colony, but no tax was payable in respect of income "earned" outside the

(1) I.L.R. [1938] Bom. 752. (2) [1900] A.C. 588.
(3) [1937] I.L.R. 2 Cal. 201.

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colony. The Board held that the profits, having been produced by the combined operations of extraction, manufacture and sale, were assessable to tax in the colony either as derived from land by reason of the extraction or as "arising or accruing," if not from a "trade," certainly from a "source," by reason of the manufacture in the colony, and were therefore "earned" in the colony, though the profits were received outside the colony. While it may well be a "fallacy," while in applying a taxing statute which directs attention to the situation of the source of income as the test of chargeability, to ignore the initial stages in the production of the income and fasten attention on the last stage when it is realised in money, it may be open to question whether it is in consonance with business principles or practice, in the absence of any statutory requirement to that effect, to cut business operations arbitrarily into two or more portions and to apportion, as between them, the profits resulting from one continuous process ending in a sale. It appears, however, unnecessary, in the present case, to consider the applicability of the decision in *Kirk's* case (1) to assessments arising under the Indian Act which makes the place at which the profits accrue or arise the test of liability or non-liability, as the case may be, as I am of opinion that section 42 of the Income-tax Act which, as already stated, has been incorporated in the Excess Profits Tax Act, is applicable here and sanctions such apportionment.

It is noteworthy that the first part of sub-section (1) of section 42 providing that certain classes of income are to be deemed to accrue or arise in British India is not confined in its application to non-residents, but is in general terms so as to be applicable to both residents and non-residents. Before its amendment in 1939 the sub-section began with the words "in the case of any person residing out of British India" which obviously restricted the application of the provision to non-resident persons, but in its amended form the sub-section has been recast into two distinct parts, the first of which is not so restricted, and the second part

(1) [1900] A.C. 588.

alone, which begins with the words "and where the person entitled to the income, profits and gains is not resident in British India," is made applicable to non-resident persons, thereby showing that the former part applies to both residents and non-residents. The opening words of the first proviso also point to the same conclusion, for these words would be surplusage if the sub-section as a whole applied only to non-residents. A contrary view has, no doubt, been expressed by a Division Bench of the Bombay High Court in *Commissioner of Income-tax* v. *Western India Life Insurance Co. Ltd.* (1). Though reference was made in that case to the alteration in the structure of sub-section (1) its significance, as it seems to me, was not properly appreciated. The facts that the marginal note to the whole section refers to "non-residents" and that the section itself finds a place in Chapter V headed "Liability in Special Cases" were relied upon as supporting the view that sub-section (1) as a whole applies only to non-residents. As pointed out by the Privy Council in *Balraj Kunwar* v. *Jagatpal Singh*(2), marginal notes in an Indian statute, as in an Act of Parliament, cannot be referred to for the purpose of construing the statute, and it may be mentioned in this connection that the marginal note relied on has since been replaced by the words "Income deemed to accrue or arise within British India," which makes it clear that the main object of sub-section (1) was to define that expression [see section 12 (a) of Act XXII of 1947]. Nor can the title of a chapter be legitimately used to restrict the plain terms of an enactment. I am therefore of opinion that the first part of sub-section (1) is applicable to the assessees, the expressions "business connection in British India" and "asset or source of income in British India" being wide enough to cover their selling organisation at Bombay. The result is that the profits received at Bombay from the sale of the oil manufactured at Raichur have to be apportioned under sub-section (3) between the two operations of manufacture and sale, and *only* such portion of the profits as is reasonably attributable to the sale should

(1) [1945] 13 I.T.R. 405. (2) I.L.R. 26 All. 393 at 406.

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be deemed to accrue or arise in British India. It must follow, as a corollary, that the rest of the profits, attributable to the manufacture at Raichur, must be regarded as accruing or arising in the Hyderabad State. Therefore proviso (3) to section 5 of the Excess Profits Tax Act becomes applicable to the case and exempts the manufacturing part of the assessees' business from the operation of the Act.

On behalf of the respondent, Mr. Munshi called attention to certain observations of the Privy Council in *Chunilal Mehta's* case (1) as supporting his contention that, although all the operations of a business must be completed before profit is received, the accrual of the profits begins with the first operation and continues cumulatively till the goods are finally sold, and that, therefore, the expression "accruing or arising in" a place must be applied distributively to the different operations and the places where such operations are carried out. The observations relied on are as follows: "But the legislature has chosen a different test and applied it to all kinds of profits accruing or arising in British India. It may even have chosen it as fairer because it can be applied distributively to the profits of a single source" (p. 765), and again, "no doubt if it can be held that under the Indian Act profit in the case of a business must be taken so strictly that it is not to be understood distributively at all the profit of the assessee's business would become an ultimate and single figure irreducible and referable only to Bombay, but such a high doctrine cannot be read into the Indian statute without violence not only to its language but to its scheme:" (p. 767). These passages may, at first sight, appear to lend some support to Mr. Munshi's thesis. But on closer examination in their context they do not, in my opinion, warrant any such general theory. Their Lordships were dealing with a case where the assessee, resident in Bombay, derived profits from speculative contracts for purchase and sale of commodities carried out through brokers in various foreign markets such as Liverpool, London and New York. The assessee

(1) I.L.R. [1938] Bom. 752.

contended that he was not liable to pay Indian income-tax in respect of such profits, which were not received in British India, on the ground that they were not profits accruing or arising in British India, and their Lordships upheld that contention. It is with reference to such transactions which individually contributed to the surplus arising in the various places abroad, that their Lordships spoke of the profits accruing or arising distributively and not in a single place. That they were not thinking of the profits resulting from a single composite process such as manufacture and sale, and their disintegration and apportionment as between the different operations is shown by their further observation that "profits are frequently, if not ordinarily, regarded as arising from many transactions each of which has a result not as if the profits need to be disintegrated with difficulty but as if they were an aggregate of the particular results:" (p. 767).

Reference was also made to a recent decision of the same Tribunal in *International Harvester Co. of Canada* v. *The Provincial Tax Commission*(1). The case arose out of the assessment of the profits of a non-resident to income-tax, under a provincial Income-tax Act in respect of the profits arising from the sale within the province of goods manufactured outside the province. The tax was leviable, in the case of a non-resident person, on the "net profit or gain arising from the business of such person in" the province. Their Lordships held that, although the profits sought to be assessed were all received in the province where the goods were sold, as the profits brought under charge under the Act was only the net profit *arising from the business in the province*, the manufacturing profits should be excluded from the assessment. Their Lordships referred to other provisions of the Act which, in the converse case, sought to charge a proportionate part of any profit derived from sale outside the province of goods produced in the province as being "earned" within the province, and inferred from those provisions that the intention of the legislature in the

(1) [1949] A.C. 36.

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charging section was to bring within the ambit of taxation only an apportioned part of the profit. Such a construction, they thought, would "result in a fair and reasonable scheme of taxation in accordance with that comity which naturally prevails between one province and another." Referring to *Kirk's* case(1) their Lordships remarked "that although the sections under consideration in *Kirk's* case (1) differed in their language from the provisions which their Lordships were considering, the reasoning which appears in the judgment in that case was helpful to the appellants' contention in the present case." This was, presumably, because chargeability in both cases depended not on the income accruing or arising in the country, but, on the source of the income being in the country. The decision was based on the language of the statute and the scheme of taxation disclosed thereby, and what I have said about *Kirk's* case(1) equally applies to it. The other cases cited by Mr. Munshi do not call for any special notice.

I agree with the conclusion reached by the High Court, though on different grounds, and dismiss the appeal with costs.

Mahajan J.

MAHAJAN J.—This is an appeal by the Commissioner of Income-tax, Bombay City, from the judgment of the High Court of Judicature at Bombay upon a case stated by the Income-tax Appellate Tribunal under the provisions of section 66 (1) of the Indian Income-tax Act, 1922, and it raises a question as to the liability of the respondent, Messrs. Ahmedbhai Umarbhai & Co., for excess profits tax.

Excess profits tax is levied under section 4 of the Excess Profits Tax Act, XV of 1940, "in respect of any business to which the Act applies on the amount by which the profit during any chargeable accounting period exceeds the standard profits....." The respondent is a registered firm resident in British India and owns three oil mills in Bombay and one oil mill in Raichur in Hyderabad State and the question to be decided in the appeal is whether the profits which were received or realized by the respondent on the sale of

(1) [1900] A.C. 588.

oil manufactured in Raichur and sold in British India are liable to excess profits tax.

By an order dated 27th March, 1944, the Excess Profits Tax Officer, Circle III, Bombay, assessed the respondent to excess profits tax in the sum of Rs. 1,61,807 for the chargeable accounting period commencing from 31st October, 1940 and ending on 20th October, 1941 on the business income of Rs. 6,08,761, which included a sum of Rs. 2,49,615, being profits accruing or arising in British India in respect of the respondent's branch at Raichur in Hyderabad State and run in the name of Messrs. Ahmed & Sons. By another order dated 28th March, 1944 the same officer assessed the firm to excess profits tax in a sum of Rs. 2,55,485-1-0 for the chargeable accounting period commencing from 21st October, 1941 and ending on 8th November, 1942 on the business income of Rs. 7,46,561, which included a sum of Rs. 2,34,785, being the profits accruing or arising in British India in respect of the Raichur branch. Both the assessment orders were appealed against to the Appellate Assistant Commissioner but without any success. The Income-tax Appellate Tribunal on appeal drew up a statement of case and referred the following question of law to the High Court :—

" Whether on the facts as stated above income accruing or arising to the assessee on sales made in British India of goods manufactured in Raichur situated outside British India has been rightly held by the Tribunal as income accruing and arising in British India and was liable to excess profits tax ? "

The High Court re-framed the question as follows :—

" Whether on the facts as stated above profits of a part of the business of the assessee accrued or arose in an Indian State "

and answered it in the affirmative. It held that the activity which the respondent carried on at Raichur was a part of its business within the meaning of the third proviso to section 5 of the Excess Profits Tax Act and that the profits of a part of the business accrued or arose in an Indian State and that

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the said profits were not assessable to excess profits tax. This order of the High Court is being contested in the present appeal and it has been urged that as regards the oil manufactured in Raichur but sold in British India, no profits accrued or arose in the Indian State, but the profits accrued or arose in British India and are subject to excess profits tax. It was further contended that the construction put by the High Court on the third proviso to section 5 and on the phrase " part of a business " is erroneous and is not justified on the language of the proviso and the context. It was suggested that in order to constitute " a part of the business " within the meaning of that proviso it must be a complete cross-section of the whole business and not merely one or more of the operations of that business.

Section 5 of the Act on the true construction of which depends the decision of the appeal is in these terms :—

" This Act shall apply to every business of which any part of the profits made during the chargeable accounting period is chargeable to income-tax by virtue of the provisions of sub-clause (i) or sub-clause (ii) of clause (b) of sub-section (1) of section 4 of the Indian Income-tax Act, 1922, or of clause (c) of that sub-section."

In other words, the Act brings within its ambit all income in the case of a person resident in British India which accrues or arises or which is deemed to accrue or arise to him in British India during the accounting year, as also all income which accrues or arises to him without British India during such year ; and if such person is not resident in British India during that year, then all income which accrues or arises or is deemed to accrue or arise in British India during such year. If section 5 of the Act stopped short at that stage, it is undoubted that in the case of the respondent who is a resident in British India all his income, no matter where it arose, within British India or without British India, would be chargeable to excess profits tax just in the same way as it is chargeable to income-tax under the Indian Income-tax Act. The whole of his income arising

in Raichur has legitimately been taxed under that Act.

Section 5 however has three provisos which limit its scope and take certain incomes outside its ambit. The first proviso is to the following effect :

"Provided that this Act shall not apply to any business the whole of the profits of which accrue or arise without British India where such business is carried on by or on behalf of a person who is resident but not ordinarily resident in British India unless the business is controlled in British India."

This exception has no bearing to the facts of the present case. The second proviso is in these terms :—

"Provided further that where the profits of a part only of a business carried on by a person who is not resident in British India or not ordinarily so resident accrue or arise in British India or are deemed under the Indian Income-tax Act, 1922, so to accrue or arise, then, except where the business being the business of a person who is resident but not ordinarily resident in British India is controlled in India, this Act shall apply only to such part of the business, and such part shall for all the purposes of this Act be deemed to be a separate business."

This proviso also concerns a person not resident in British India and does not touch the present case. It however furnishes a clue to the meaning of the following proviso inasmuch as it attracts the application of section 42 of the Indian Income-tax Act to the case of a non-resident and contemplates the apportionment of income between part of a business controlled in British India and a part not so controlled. Sub-section (3) of section 42 of the Income-tax Act enacts thus :

" In the case of a business of which all the operations are not carried out in British India, the profits and gains of the business deemed under this section to accrue or arise in British India shall be only such profits and gains as are reasonably attributable to that part of the operations carried out in British India."

Under the second proviso by reason of the application of section 42 (3) of the Income-tax Act, if the manufacturing business of the assessee was in British

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India and all his sales took place in Raichur, then excess profits tax could only be chargeable on such profits as would really be attributable to his manufacturing operations in British India and the manufacturing operations would be treated as part of the business of the assessee under the proviso. It is the third proviso to which the controversy in the case is limited and this proviso is in these terms :—

" Provided further that this Act shall not apply to any business the whole of the profits of which accrue or arise in an Indian State, and where the profits of a part of business accrue or arise in an Indian State, such part shall, for the purposes of this provision, be deemed to be a separate business the whole of the profits of which accrue or arise in an Indian State, and the other part of the business shall, for all the purposes of this Act, be deemed to be a separate business."

We have firstly to determine the meaning of the words "part of a business "in this proviso ; does it mean, as argued on behalf of the Commissioner, that the business must be a complete cross-section of the whole business and not merely one or more of the operations of that business, or, does it mean, as contended by the learned counsel for the respondent, *a continued and severable business activity of which the profits could be apportioned or ascertained separately*. Secondly, we are called upon to determine at what place do the profits accrue or arise in respect of the part of such business. Do they arise at the place where in the case of a manufacturer his goods are sold, or can they be said to accrue or arise at the place of manufacture ?

The word "business" has been defined by the Act in section 2 (5) as follows :—

" 'Business' includes any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture or any profession or vocation...."

It means any continued activity of a person which yields profits and which is in the nature of trade, commerce or manufacture. It may even be any adventure in the nature of trade, commerce or

manufacture. A proviso was added to this definition in the year 1940 in these terms :—

"Provided further that all businesses to which this Act applies carried on by the same person shall be treated as one business for the purposes of this Act."

The effect of the proviso is that if a man is carrying on a number of activities, whether of the same or of different natures, all these various businesses are treated as one. The same person, if engaged in the manufacture of hardware, oils, textiles, motor tyres, bicycles and owning mills for his diverse activities in different places and also trading in merchandise and doing contract business, is deemed to carry on a single business. All the businesses that he carries on are lumped together and treated as one business for the purpose of levying the tax and calculating the profits. The proviso has made an amalgam of all the businesses of one individual and it is in view of this amalgam that proviso 3 of section 5 has to be considered. It seems to me that what has been amalgamated by the definition has again been made separate by the proviso to section 5. If a number of businesses carried on by a person are situate in different places, then the effect of the proviso is to again treat them as separate business under the description of the phrase "part of a business." In other words, if a man is carrying on manufacture in textiles in Bombay, a shop at Mysore, has a distillery in Allahabad and has an oil mill in Gwalior, then for the purpose of section 5 all these four trades are part of the business within the meaning of proviso 3 to section 5, one part situate in one place and another part situate at another place and if any of these parts produce profits at the place of the business, that place being in an Indian State, then proviso (3) would have application. I think that the effect of the language of proviso (2) of section 5 is to give colour to proviso (3) as being complementary to it and providing for converse cases to those arising under this proviso concerning non-residents. Illustratively it may be said that proviso (2) would cover the case if the manufacturing business of the

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respondent was situate in Bombay and his sales exclusively were made at Raichur provided he was a non-resident. In that event excess profits duty would be chargeable on a part of the profits attributable to the part of the business in Bombay, or in other words, to those business operations that were being carried on in Bombay. The converse case where the manufacturing operations are being carried on in Raichur by a resident in India and the sales are made exclusively in Bombay is apparently covered by proviso (3) because a part of the business being situate in Raichur profits attributable to that part of the business out of the total sale proceeds could only be said to accrue at the place of manufacture.

The present assessee has three mills in British India and a mill at Raichur. He has also a sales depot at Bombay. In his case but for the proviso to the definition of "business" it could be said that he was carrying on five businesses, three of manufacture of oil in India and one of manufacture of oil in Hyderabad and a fifth business as trader at Bombay. By reason of the proviso to the definition, all these businesses become a single business. But for the purposes of provisos (2) and (3) of section 5 all these are part of a business and have to be treated as separate businesses. The theory of cross-section of a business contended by the appellant is not very intelligible. It was contended that if a man is a manufacturer as well as a seller of goods and also an importer of goods, then in his case the term "part of a business" means the carrying on of all the three activities together and that unless he carries on all the three activities, it cannot constitute "part of business" under the proviso. This contention to my mind is untenable. The only construction which in the context of the Act can be reasonably placed on the proviso to section 5 and on the words "part of a business" is the one suggested above. I am therefore of the opinion that the learned Chief Justice was right when he held that the activities which the assessee carried on at Raichur are certainly a part of the business of the assessee. Mr. Justice Tendolkar on this part of the case observed as follows :—

"The normal meaning of the word is a 'portion' in whatever way carved out and I have no doubt in my mind that any of the operations that go towards a complete business are a part of that business.

The contention of the Advocate-General becomes the more untenable when one looks at the second proviso to section 2 (5) of the Excess Profits Tax Act.....

Now, under this proviso you may have several businesses of a totally different character carried on by the same person and they all together constitute one business for the purposes of the Excess Profits Tax Act, if the contention of the Advocate-General is right, even if one of these different businesses in the ordinary sense of the term was wholly carried out in a Native State, it would still not be a part of the whole business in the sense of being a cross-section of all the businesses which together constitute one business under the Excess Profits Tax Act. I am, therefore, of opinion that the manufacture of oil was part of the business of the assessee firm."

I am in complete agreement with the observations cited above.

The next question for consideration is whether that part of the business situate in Hyderabad gives any profits, in other words, whether any profits of the manufacturing business of the assessee at Hyderabad accrue or arise in that State.

On behalf of the Commissioner it was contended that the place where the profits accrue or arise is not ordinarily the place where the source that produces the profits is situate and that the High Court had erred in taking the view that in respect of sales of oil in British India produced by the mill at Raichur any profits accrued at the place of manufacture. It was said that profits in such a case only accrue at the place of sale and not at the place of manufacture. I am unable to accede to this contention. It is true that no profits are realized until the oil is sold but the act of sale merely fixes the time and place of receipt of profits, profits are not wholly made by the act of sale and do not necessarily accrue at the place of sale.

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Act of sale is the culminating process in the earning of profits but it goes without saying that the act of sale could not be performed unless the goods were produced at Raichur and it would be wrong from a business point to say that all the profits resulted from that operation. It was the operation of manufacture at Raichur that enabled the assessee to sell oil and some portion of the profits must necessarily be attributable to the manufacturing process. To the extent that the profits are attributable to the manufacture of oil it is not possible to say that they accrue or arise at any place different from the place where the manufactured article came into existence.

It was not denied that the business of manufacture at Raichur may produce profits or it may even earn profits and it was conceded that it may also be said that profits are derived from that process of manufacture but it was strenuously argued that earning of profits is not the same thing as the accrual of profits and no profits could be said to accrue or arise at a place where the profits may well have been earned or produced and that the place of accrual of profits must necessarily be the place where the sale proceeds are received or realized. On behalf of the assessee it was urged that the words "derived," "earn," "accrue" or "arise" are synonymous and it is immaterial which word is used indicating the result of the activities of various business operations. The totality of profits that accrues to a business or is earned by it may be ascribed to a number of operations; though it is ascertained at the place where the produce is sold, it accrues where it is earned. Whether the words "derive" and "produce" are or are not synonymous with the words "accrue" or "arise," it can be said without hesitation that the words "accrue" or "arise" though not defined in the Act are certainly synonymous and are used in the sense of "bringing in as a natural result." Strictly speaking, the word "accrue" is not synonymous with "arise," the former connoting idea of growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable. There is a distinction in the dictionary

meaning of these words, but throughout the Act they seem to denote the same idea or ideas very similar and the difference only lies in this that one is more appropriate when applied to a particular case. In the case of a composite business, *i.e.*, in the case of a person who is carrying on a number of businesses, it is always difficult to decide as to the place of the accrual of profits and their apportionment *inter se*. For instance, where a person carries on manufacture, sale, export and import, it is not possible to say that the place where the profits accrue to him is the place of sale. The profits received relate firstly to his business as a manufacturer, secondly to his trading operations, and thirdly to his business of import and export. Profit or loss has to be apportioned between these businesses in a businesslike manner and according to well-established principles of accountancy. In such cases it will be doing no violence to the meaning of the words "accrue" or "arise" if the profits attributable to the manufacturing business are said to arise or accrue at the place where the manufacture is being done and the profits which arise by reason of the sale are said to arise at the place where the sales are made and the profits in respect of the import and export business are said to arise at the place where the business is conducted. This apportionment of profits between a number of businesses which are carried on by the same person at different places determines also the place of the accrual of profits. To hold that though a businessman has invested millions in establishing a business of manufacture, whether in the nature of a textile mill or in the nature of steel works, yet no profits are attributable to this business or can accrue or arise to the business of manufacture because the produce of his mills is sold at a different place and that it is only the act of sale by which profits accrue and they arise only at that place is to confuse the idea of receipt of income and realization of profits with the idea of the accrual of profits. The act of sale is the mode of realizing the profits. If the goods are sold to a third person at the mill premises no one could have said that these profits arose merely by reason of

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the sale. Profits would only be ascribed to the business of manufacture and would arise at the mill premises. Merely because the mill owner has started another business organization in the nature of a sales depot or a shop, that cannot wholly deprive the business of manufacture of its profits, though there may have to be apportionment in such a case between the business of manufacture and business of shopkeeping. In a number of cases such apportionment is made and is also suggested by the provisions of section 42 of the Indian Income-tax Act, reference to which has also been made in proviso (2) of section 5 of the Excess Profits Tax Act.

In *Commissioners of Inland Revenue* v. *Maxse* (1), Maxse purchased a monthly magazine for £ 1,500 and was the sole proprietor, editor and publisher thereof. The earnings were derived from sales of the magazine, from advertisements and from reprints of articles mostly written by him. Before the war Maxse wrote a large part of each number, and, though some of the matter was contributed by others, the sales were largely due to the popularity of his own writings. When war broke out, he increased his personal contributions and did most of the writing. At that time he required practically no capital. Having been assessed to excess profits duty for the year ending May 31, 1915, he appealed to the General Income Tax Commissioners and contended that the profits were earned by reason of his personal qualifications, that the capital expenditure was small in comparison with the personal qualifications required to earn the profits, and that he was exempt from duty by virtue of para. (c) of section 39 of the Finance (No. 2) Act, 1915. The General Commissioners having discharged the assessment, their decision was reversed by Sankey J. who held that Maxse was carrying on a commercial business and not a profession within para. (c) and therefore he was liable to duty. The Court of appeal held that Maxse was carrying on the profession of a journalist, author or man of letters, and also the business of publishing his own periodical. The publishing

(1) [1919] 1 K.B. 647.

business should be debited with a fair and reasonable allowance in respect of Maxse's contributions, and a proper sum for his remuneration as editor, and on that footing he would be liable to duty in respect of his business but exempt therefrom in respect of his profession. This is a case of a combination of a profession with a business. Under the law no excess profits duty could be levied on his professional income but his business income was liable to such duty and the duty was so levied by making the apportionment. The rule laid down in this case, though it has special reference to the scheme of the English statute, can appositely be laid down for the apportionment of profits qua parts of a business of an assessee. A similar view was expressed by a Bench of the Calcutta High Court in *Killing Valley Tea Company* v. *The Secretary of State for India*(1). There the question arose whether the income from a tea garden where tea was grown and made ready for the market by mechanical process, was assessable. It was held that the income was to be apportioned and so much of it as was obtained by the manufacturing process was assessable. The principle of *Maxse's* case and of other English cases was applied to the facts of that particular case. In cases where a person is carrying on composite businesses which for purposes of section 5 are regarded as one business and for purposes of the proviso as several parts of a business, it may be said that there are two stages in the production of the net profit, (1) the manufacture of the article, and (2) the sale of the article and that part of the net profit should be attributed to each stage, the part attributed to the earlier stage being described as a manufacturing profit. Reference in this connection may be made to the case of *International Harvester Co. of Canada Ltd.* v. *Provincial Tax Commission* (2). In that case it was argued that when money was received by the appellant in Saskatchewan as a result of a sale in Saskatchewan the whole of the net profit on the sale arose from the business of the appellant in Saskatchewan, and no apportionment was necessary. This contention

(1) I.L.R. 48 Cal. 161. (2) A.I.R. 1949 P.C. 72.

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was described by their Lordships as fallacious and untenable. Their Lordships quoted with approval the following observations from the minority judgment of Sir Lyman Duff C. J. The quotation is in these terms :—

" Nowhere does the statute authorise the Province of Saskatchewan to tax a manufacturing company, situated as the appellant company is, in respect of the whole of the profits received by the company in Saskatchewan. It is not the profits received in Saskatchewan that are taxable, it is the profits arising from its business in Saskatchewan not the profits arising from the company's manufacturing business in Ontario and from the company's operations in Saskatchewan taken together, but the profits arising from the company's operations in Saskatchewan."

The question in the present case in whether in respect of the manufacturing business of the assessee in Raichur profits accure or arise and if so, at what place. My answer unhesitatingly is that the manufacturing profits arise at the place of manufacture. They could arise nowhere else. The sale profits arise at the place of sale and apportionment has to be made between the two, though the place of receipts and realization of the profits is the place where the sales are made. The manufacturing profits could not be said to have accrued or arisen at that place because there was nothing done from which they could accrue or arise as natural accrual or as an increase. The increase only took place at the place of manufacture and if there was any accrual over the production cost, that accrual was at the place of the production itself.

Mr. Setalvad for the Commissioner placed reliance on a number of cases, *inter alia*, *The Board of Revenue* v. *The Madras Export Company* (1), *Jiwan Das* v. *Income-tax Commissioner, Lahore* (2), *In re Port Said Salt Association Limited* (3), and *Sudalaimani Nadar* v. *Income-tax Commissioner* (4). All these cases fall in one category. These are cases where raw materials

(1) I.L.R. 46 Mad. 360.
(2) I.L.R. 10 Lah. 657.
(3) I.L.R. 59 Cal. 1296.
(4) A.I.R. 1941 Mad. 229.

were purchased at one place and sold at another and it was held that in such cases it was the act of sale from which the profits accrued or arose. In most of these cases the goods as purchased were sold without going through any manufacturing process. It was observed that mere act of purchase produces no profit. This proposition has been doubted in a later case. But it is unnecessary to go into this matter. In the case of a trading business, like purchase and sale, it may be said that the business of a person is one operation and the nature and character of the business is such that the profits arise at the place of sale and that in such a case it is not possible to ascribe any profits to the act of purchase and it is still more difficult to apportion them. These cases are no guide for the decision of cases of manufacturing business or business of a like nature. Observations made in these cases must be limited to the facts of each particular case. A number of cases were cited for the proposition that under the Indian Act it is not the place where a person carries on business (as it is under the English law) where necessarily profits can be said to arise, because the Indian Act takes notice only of the place of accrual of profits and not of the place where the business is carried on or where the source which produces profit is situate. The matter was discussed by their Lordships of the Privy Council in *Commissioner of Income-tax, Bombay* v. *Chunilal B. Mehta* (1). The assessee in that case was carrying on buying and selling operations in commodities in various foreign markets. No delivery was ever given or taken and the profits of such forward contracts were not received in fact in British India, and it was held that the contracts having been neither framed nor carried out in British India, the profits derived from the contracts did not accrue or arise in British India within the meaning of section 4, sub-section (1) of the Indian Income-tax Act, 1922. The contention raised in that case on behalf of the Commissioner was that these profits resulted from the exercise of skill and judgment in Bombay by the assessee and by the giving of directions

(1) 65 I.A. 336.

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from Bombay. This contention was negatived and it was observed that to determine the place at which such a profit arises not by reference to the transactions, or to any feature of the transactions, but by reference to a place in India at which the instructions therefor were determined on and cabled to New York is, in their Lordships' view, to proceed in a manner which cannot be supported if the transactions are to be looked at separately and the profits of each transaction considered by themselves. It was said that there is a distinct paradox in the contention that the profits resulting from an order placed in New York would have accrued or arisen in the same place (Bombay) had the order been sent to Liverpool with a like result, but that had the assessee decided on and directed the same New York transaction when in Hyderabad the same profits would have arisen in a different place (Hyderabad). It may be observed that the business of the forward contracts was not being conducted in Bombay at all in this case. The whole argument was based on the ground that the assessee, a big business magnate, was directing and controlling that business. Such direction and control could hardly be said to be the place of the accrual of profits on the transactions done elsewhere. It was next argued in that case that these foreign transactions were part of the profits of the Bombay business carried on by the assessee and all the profits of the business must be computed as a whole. Their Lordships negatived this contention and observed as follows :—

"But the legislature has chosen a different test, and applied it to all kinds of profits—'accruing or arising in British India.' It may even have chosen it as fairer because it could be applied distributively to the profits of a single source. However that may be, the profits of each particular business are to be computed wherever and by whomsoever the business is carried on, but only on condition that they are profits 'accruing or arising or received in British India,' etc. What connection exists, if any, between place of direction and place at which the profits arise is a matter not touched by sections 4, 6 or 10. Not only

do they lay no stress upon the place at which the business is carried on, they make no mention of it. In these circumstances it cannot be held that it is itself the test of chargeability by virtue of a rule, not mentioned either, that profits arise or accrue at the place where the business is carried on."

Later in the same judgment it was observed that there seemed to be no necessity arising out of the general conception of a business as an organization that profits should arise only at one place, that profits are frequently, if not ordinarily, regarded as arising from many transactions, each of which have a result—not as if the profits need to be disintegrated with difficulty, but as if they were an aggregate of the particular results. It was said that the assessment order had discriminated between the Bombay and the foreign business income and that to discriminate between all kinds of profits according to the place at which they accrue or arise was a plain dictate of the statute, other discrimination was involved in the exemptions, and in such sections as section 42. In the concluding part of the judgment their Lordships said as follows :—

" These considerations lead their Lordships to the conclusion that under the Indian Act a person resident in British India, carrying on business there and controlling transactions abroad in the course of such business, is not by these mere facts liable to tax on the profits of such transactions. If such profits have not been received in or brought into British India, it becomes, or may become necessary to consider on the facts of the case where they accrued or arose. Their Lordships are not laying down any rule of general application to all classes of foreign transactions, or even with respect to the sale of goods. To do so would be nearly impossible, and wholly unwise. They are not saying that the place of formation of the contract prevails against everything else. In some circumstances it may be so, but other matters—acts done under the contract, for example—cannot be ruled out *a priori*. In the case before the Board the contracts were

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neither framed nor carried out in British India, the High Court's conclusion that the profits accrued or arose outside British India is well founded."

In my view this decision does not make us any the wiser for the decision of the present case. It is true that the Indian Act does not lay down that profits necessarily arise or accrue at the place where the business is carried on or that they necessarily arise at the place where the source which produces the profit is situate but at the same time the Act does not lay down that the profits necessarily accrue or arise at the place where only one operation, namely of sale is performed. Place of accrual of profits cannot necessarily be determined on the test of receivability. In certain cases the place of origin of the profits may be the determining factor while in others the test of receivability may have application. Profits of a trade or business are what is gained by the business. The term implies a comparison between the state of business at two specific dates separated by an interval of an year and the fundamental meaning is the amount of gain made by the business during the year and can only be ascertained by a comparison of the assets of the business at the two dates, the increase shown at a later date compared to the earlier date represents the profits of the business. In this concept of the term the place of business or the source from which they originate would in the case of certain businesses be the place where they can be said to accrue or arise. In this situation the profits realized at sale have to be apportioned between the different business operations which have produced them and those apportioned to the part of business of manufacture at Raichur can only be said to arise at the place of manufacture as no other activity has produced those profits. No other place can be suggested where this increase can be said to have arisen. In the view that I have taken it is unnecessary to refer to all the cases that were cited at the Bar, for most of these cases concerned the interpretation of the various sections of the Indian Income-tax Act and none of them concerned the interpretation placed on the Act with which we are concerned.

The result therefore is that in my opinion the High Court was right in answering the question in favour of the assessee and no grounds exist for reversing that decision in appeal, which is therefore dismissed with costs.

Mukherjea J.

MUKHERJEA J.—I agree that this appeal should be dismissed and I would indicate briefly the reasons which have weighed with me in affirming the judgment of the High Court.

The question which was referred by the Income-tax Commissioner, Bombay, to the High Court under the provision of section 66 (1) of the Indian Income-tax Act, 1922 and which the latter reframed for the purpose of bringing out clearly the real controversy between the parties, turns upon the applicability of the third proviso to section 5 of the Excess Profits Tax Act (Act XV of 1940) to the facts of the present case. The facts are not in controversy and may be shortly stated as follows :

The respondents assessees are a firm, resident in British India and they are registered for income-tax purposes under section 26A of the Income-tax Act. Their business consists in manufacturing and selling groundnut oil and they have three mills in Bombay and one at Raichur in the Hyderabad State where oil is manufactured. During the chargeable accounting period, the oil that was manufactured at Raichur was sold partly in Raichur itself and partly in Bombay, and what the Income-tax Officer did was to ascertain the income arising to the assessees out of the Raichur business and apportion the same on the basis of sales made in Raichur and Bombay respectively. The profits arising out of sales made in Bombay were held by the Income-tax Officer to be assessable both to income-tax and excess profits tax. There is no doubt as to the propriety of his decision so far as income-tax is concerned. The only question that is raised relates to the liability of the firm to pay excess profits tax in respect of income arising out of the sales made in Bombay of the oil manufactured at Raichur. The contention put forward

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by the assessees is that although the oil was sold in Bombay, it was manufactured at Raichur and a portion of the profits ultimately made must be allotted to the manufacturing process that was carried on at Raichur. The manufacture of the oil, therefore, must be regarded as a part of the business and as the profits of this part accrued at Raichur, it has to be treated as a separate business for purposes of excess profits tax under the third proviso to section 5 of the Excess Profits Tax Act. The High Court answered this question in favour of the assessees and the Commissioner of Income-tax, Bombay, has come up on appeal to this Court.

With a view to appreciate the contentions that have been raised by the learned counsel on both sides, it will be convenient, first of all, to advert to the provisions of the Excess Profits Tax Act which have a bearing on the point. Section 2, sub-section (5), of the Act defines "business" as including any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture 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.....One of the provisos attached to this definition provides that all businesses to which this Act applies carried on by the same person shall be treated as one business for the purposes of this Act. Section 4 is the charging section and under it any business to which this Act applies is subject to payment of excess profits tax in the manner and to the extent indicated in the section. Section 5 lays down to what businesses the Act will apply.

"This Act shall apply" so runs the section, "to every business of which any part of the profits made during the chargeable accounting period is chargeable to income-tax by virtue of the provisions of sub-clause (i) or sub-clause (ii) of clause (b) of sub-section (1) of section 4 of the Indian Income-tax Act, 1922, or of clause (c) of that sub-section."

There are three provisos attached to this section;

we are concerned for our present purposes with the third proviso which is worded as follows:

"Provided further that this Act shall not apply to any business the whole of the profits of which accrue or arise in an Indian State, and where the profits of a part of a business accrue or arise in an Indian State, such part shall, for the purposes of this provision, be deemed to be a separate business the whole of the profits of which accrue or arise in an Indian State, and the other part of the business shall, for all the purposes of this Act, be deemed to be a separate business."

The point for consideration is whether on the facts of this case which have been stated above, this third proviso to section 5 can be invoked by the assessees and it is open to them to claim that the work of manufacture of groundnut oil carried on by them at Raichur should be treated as a separate business within the meaning of this proviso. To succeed in their claim, it is incumbent upon the assessees to show that there was in fact a part of a business in the present case and that profit accrued or arose to this part in an Indian State. If both these elements are found to exist then and then only the part of the business could be treated as a separate business for purposes of the Act.

It is contended by the assessees that though they carry on the business of manufacturing and selling oil, the process of manufacture apart from the sale is itself a business and can be treated as a separate part of the trade that the assessees are carrying on. As the profits of this part arose or accrued at Raichur, both the conditions of the proviso are fulfilled in the present case. The learned Attorney-General appearing for the Commissioner of Income-tax has, on the other hand, argued that the expression "part of a business" occurring in the proviso does not refer to or contemplate one of the many activities or processes that are comprised in a business. It can only mean a cross-section of the entire business, complete in itself and including parts of each of the processes that are comprised in the same. It is next said that even assuming that the manufacturing operation can be treated as a part of the business, the

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profits of the same could and did accrue only at the place of sale and hence the proviso could not be attracted to the facts of the present case.

As regards the first part of Mr. Setalvad's contention, I do not think that it can be accepted as sound. "Business" is defined in the Act to include any trade, commerce or manufacture. A man may carry on the trade of a seller or purchaser of goods; he may be a manufacturer of goods or an exporter or importer of the same. Each of these would be a business within the meaning of the Act. Suppose, for example, that he combines all these activities and carries on a business which includes manufacturing, selling and also exporting and importing of goods. Can it not be said that each one of these activities is a part of the business which he carries on? I agree with Mr. Munshi that if a particular process or activity of a continuous character can be distinguished from other processes and if a separate profit can be ascertained and allotted in respect to the same, there is no reason why it should not be regarded as a part of the business which yields income or profits.

The question has been raised in several cases in English Courts regarding liability to excess profits duty when a person carries on a trade or business liable to duty in connection with another business which is not so liable. It has been held that if separation is possible in such cases the proper course to follow is to sever the profits of the two businesses and assess accordingly.

In the case of *Commissioners of Inland Revenue* v. *Ransom*(1) the respondents carried on the business as manufacturing chemists and growers of medicinal herbs; they owned a factory where the manufacture and distillation of herbs were carried on and they also occupied a farm on which they grew herbs for treatment in the factory. The respondents were assessed to excess profits duty and on appeal against the assessment, the General Commissioners held that although the respondents occupied the farm mainly for the purpose of the factory, which was excluded from excess

(1) [1918] 2 K.B. 709.

profits duty, as separation was possible, the profits of the farm were excluded and they were only assessed on the profits of the factory. This view of the General Commissioners was upheld by Sankey J. on appeal.

The same question arose in *Commissioners of Inland Revenue* v. *Maxse*(1), where the Court of appeal reversed the decision of Sankey J. In that case the appellant was the sole proprietor, editor and publisher of the "National Review" and was assessed on the profits of the publication. The General Commissioners held that the appellant was exempt from duty as he carried on the profession of a journalist, the profits of which depended mainly upon his personal qualifications within the meaning of the Finance Act. On appeal, Sankey J. reversed the decision of the General Commissioners and held that the assessee was not in the position of an ordinary journalist but derived his profits by the sale of a commodity, thereby carrying on an ordinary commercial business. The Court of appeal upset this decision of Sankey J. and held that the assessee was really carrying on two businesses, one that of a journalist, author and a man of letters and the other that of publishing his periodical. The result was that the profits of the two businesses were directed to be apportioned, though the process was by no means an easy one. The same principle was applied by the Calcutta High Court in a case where the growing of tea as an agricultural produce, which was not liable to income-tax was carried on along with the business of manufacturing tea [vide *Killing Valley Tea Co.* v. *Secretary of State* (2)]. It is true that these are cases where several businesses were amalgamated and carried on together, or more of which were not liable to tax or excess profits duty; but the principle of apportionment upon which these cases were decided could, in my opinion, be applied with equal propriety to cases where one part of the business is distinct and separate from the other parts and is capable of earning profits separately.

That profits could and should be allotted to and

(1) [1919] 1. K.B. 647. (2) I.L.R. 48 Cal. 161.

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apportioned between different parts of a business of a composite character is fully illustrated by the decision of the Privy Council in the *Commissioner of Taxation* v. *Kirk*(1). In that case the assessees were a mining company who had mines in the colony of New South Wales. The ore was extracted in New South Wales and was converted there into merchantable product. The product, however, was sold not in New South Wales but in Victoria. Under section 15 of the New South Wales Land and Income Tax Assessment Act, the following incomes were liable to be taxed :—

"Sub-section (1). Arising or accruing to any person wheresoever residing from any profession, trade, employment or vocation carried on in New South Wales, whether the same be carried on by such person or on his behalf wholly or in part by any other person ..... (3) Derived from lands of the Crown held under lease or licence issued by or on behalf of the Crown. (4) Arising or accruing to any person wheresoever residing from any kind of property except from land subject to land tax as hereinafter specifically excepted, or from any other source whatsoever in New South Wales not included in the preceding sub-sections."

It was held by the New South Wales Court that the assessee was not liable to tax under any of the above provisions. This decision was reversed by the Judicial Committee.

"It appears to their Lordships," so runs the judgment of the Judicial Committee, "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 fallacy of the judgment of the Supreme Court in this and in *Tindal's* case is in leaving out of sight the initial stages, and fastening their attention

(1) [1900] A.C. 588.

exclusively on the final stage in the production of the income."

Thus according to the Judicial Committee it was a fallacy to regard the profits as arising solely at the place of sale. It is to be noted that under the provisions of the New South Wales Act referred to above, the liability to tax depended not whether the income arose or accrued in New South Wales but whether it accrued from a *source* in New South Wales. This distinction is undoubtedly important and the learned Chief Justice of the Bombay High Court was not, it seems, right in laying no stress upon it and in observing in course of his judgment that income accrues or arises only at the place where its source is situated. This aspect of the case I will discuss later on in connection with the second point that arises for consideration in this case. It is enough to state at the present stage that on the authority of *Kirk's* case it would be quite legitimate to hold that a portion of the net profit that the assessees in the present case made out of their total business could and should be allotted to the manufacturing process that was carried on at Raichur. The view is strengthened by two recent pronouncements of the Judicial Committee, the earlier of which reported in *International Harvester Company of Canada* v. *Provincial Tax Commission* (1) discusses the point in great details and was followed in its entirety in the later decision in *Provincial Treasurer of Manitoba* v. *Wrigley Jr. Co. Ltd.* (2). In *International Harvester Co. of Canada* v. *Provincial Tax Commission* (1), the question for decision turned upon the construction of section 21 (a) of the Income Tax Act, 1932 of Saskatchewan which after amendment was in the same terms as section 23 of the later Act of 1936. The section provides that "the income liable to taxation under this Act of every person residing outside of Saskatchewan who is carrying on business in Saskatchewan either directly or through or in the name of any other person shall be the net profit or gain arising from the business of such person in Saskatchewan." The appellant company had its Head Office in Hamilton,

(1) [1949] A.C. 36. (2) (1950) A.I.R. 1950 P.C. 53.

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Ontario, and was for income-tax purposes resident outside of Saskatchewan. Its business was that of manufacturing and selling agricultural implements, the manufacturing operations being carried on entirely outside the province of Saskatchewan and the selling operations partly in that province and partly in other provinces and countries. The selling business in Saskatchewan was carried on at Branch Offices, all moneys received by the appellant in Saskatchewan being deposited in separate bank accounts and remitted in full to the Head Office which sent to the Saskatchewan branches such moneys as were required for operating and incidental expenses. It was held by the Judicial Committee that any part of the appellant's net profit which might fairly be attributed to its manufacturing operations outside the province of Saskatchewan was not profit arising from the business of the appellant in Saskatchewan within the meaning of section 21 (a) of the Income Tax Act, 1932, as amended, and must be excluded in ascertaining the income of the appellant liable to taxation under that section. The Judicial Committee in course of its judgment referred to the following passage occurring in the judgment of Duff C.J. in the Supreme Court of Canada.

"The profits of the company are derived from a series of operations, including the purchase of raw materials or partly manufactured articles, completely manufacturing its products and transporting and selling them, and receiving the proceeds of such sales. The essence of its profit-making business is a series of operations as a whole. That part of the proceeds of sales in Saskatchewan which is profits is received in Saskatchewan, but it does not follow, of course, that the whole of such profit 'arises from' that part of the company's business which is carried on there within contemplation of section 21 (a)."

Their Lordships agreed with the appellant that a portion of the money received in Saskatchewan which represents net profit should be sub-divided and part of it should be treated as a 'manufacturing profit'

arising from the manufacturing business of the appellant outside Saskatchewan. There was no insuperable difficulty according to their Lordships in making this apportionment.

This reasoning applies fully to the facts of the present case, though here again I should point out that the scheme of the Saskatchewan Act was to tax profits arising *from* a business in a particular place and to that extent the language of the Indian Act is undoubtedly different. Like the *Kirk's* case, it can, however, be taken as an authority for the proposition that in cases like the one we have before us, there could be apportionment of the net profits that accrue to the business of the assessee and one portion of it could be allotted to that part of the business which relates to the manufacture of commodities which are ultimately sold in the market. The later decision of the Judicial Committee referred to above simply follows the *International Harvester Company's* case without any further discussion.

Mr. Munshi in course of his arguments has referred to the provisions of section 42 (3) of the Indian Income-tax Act and he contends that the language of this sub-section clearly indicates that in the contemplation of the legislature certain operations of a business could be regarded as a part of the business and the principle of apportionment which this sub-section provides can very properly be made applicable to a case coming under the third proviso to section 5 of the Excess Profits Tax Act. Section 42, sub-section (1), provides *inter alia* that the whole of the income and profits accruing or arising whether directly or indirectly through business connection in British India would be deemed to be income accruing within British India so as to be liable to tax in this country. The scope of this provision is narrowed down by sub-rule (3) which provides that where all the operations of the business are not carried on in British India, the profits and gains of the business deemed to accrue or arise in this country are limited to such profits or gains as can reasonably be attributed to the part of the

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operations carried on in this country. The Raichur factory certainly has business connection in British India for a part of the oil manufactured by it is sold through the Bombay establishment of the assessees. It is clear also that all the operations of the Raichur business are not carried on in Bombay. Therefore, the profits that would be deemed under this section to accrue or arise in Bombay will only be the profits which may reasonably be attributed to that part of the operations carried on in Bombay, that is to say, to sale of part of its oil in Bombay. As section 42 applies to an assessee who is a resident in India, there is no reason why this principle of apportionment should not apply to a case falling within the third proviso to section 5 of the Excess Profits Tax Act. Mr. Setalvad points out that section 42 contemplates income or profits not actually arising or accruing in British India but only deemed to arise or accrue in this country under the circumstances specified in the section, and therefore no such question can arise under proviso (3) to section 5 of the Excess Profits Tax Act. It appears, however, that in enacting proviso (2) to section 5 of the Excess Profits Tax Act which relates to business carried on by a non-resident, the legislature had in mind the provision of section 42 of the Income-tax Act. The expression " part of a business " occurring in proviso (2) to section 5 can, therefore, be taken legitimately to mean such operations of the business to which separate profits are attributable as laid down in sub-section (3) of section 42. Although proviso (3) is applicable to a different set of circumstances, the words " part of a business " as used in that proviso must be taken to have been used in the same sense as in the earlier proviso and to this extent, at any rate, it favours the contention of the respondents that no cross-section of the entire business was meant by that expression.

Again it is quite true that there is no express direction as to apportionment in the third proviso to section 5 of the Excess Profits Tax Act as there is in sub-section (3) of section 42 of the Income-tax Act. However, profits can accrue in respect to a part of a business only when apportionment is possible and it is

on this assumption that this proviso is based. If no apportionment can be made in respect of the processes or activities of a particular business, they will not be considered to be a part of the business at all and the proviso will not apply. The principle of apportionment, therefore, is implied in the third proviso to section 5 of the Excess Profits Tax Act.

I now come to the other question as to whether the profits of the manufacturing part of the assessees' business did arise or accrue at Raichur within the Hyderabad State. The point is not altogether free from difficulty and although a large number of decided authorities have been placed before us in this connection by the learned counsel on both sides, none of them seems to be directly in point. The cases cited relate mostly to different provisions of the Income-tax Act which make income taxable if it arises, accrues or is received in British India or is deemed under the provisions of law to arise, accrue or to be received in British India. So far as the third proviso to section 5 of the Excess Profits Tax Act is concerned, it is to be noted that it uses the expression "accrue" and "arise" but not the word "received" and further there is no provision here under which income could be deemed to arise or accrue at a particular place even if it does not actually do so. Profits of a business are undoubtedly not "received" till the commodities are sold and they are ascertained only when the sale takes place, but the question is that if a part of the business which consists of manufacturing goods and is carried on prior to the sale, yields profits, do these profits accrue or arise only at the place where the manufactured goods are sold? We have been referred to a number of decided authorities, where the assessee carried on the business of buying and selling and the goods and raw materials were purchased in one place and sold in another and the question arose whether for purposes of taxation portion of the profits could be held to arise at the place of buying also.

The decision of the Madras High Court in *Secretary, Board of Revenue, Madras* v. *Madras Export*

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Company (1) is one of the leading pronouncements in this line of authorities. The question for decision in that case was whether the profits of a firm which had its headquarters in Paris and purchased raw skins through an Agent in Madras which were exported to and sold in Paris were taxable in British India under section 33 (1) of the Income-tax Act of 1918 which corresponded, though not identically, to section 42 of the present Act. The question was answered in the negative. The learned Judges held that section 33 was not a charging but a machinery section and relied on the decision of the English Court in *Greenwood* v. *Smidth and Company* (2), which laid down that a trade is exercised in the place where the business transactions are closed; and in the case of a selling business, that place would be where the sales are effected and the profits realised. The propriety of the Madras decision was questioned by the Calcutta High Court in *Rogers Pyatt Shellac and Company* v. *Secretary of State for India* (3), and it was pointed out that the Judges of the Madras Court wholly overlooked a vital distinction between Indian and English Income Tax Law in so far as the former lays down that certain profits, though not actually arising or accruing in British India, should be deemed to arise or accrue in this country. Under the English law, the essential thing for purposes of taxation was that profit should accrue from trade exercised within the United Kingdom and there was no provision there corresponding to that contained in section 42 of the Indian Income-tax Act. The decision in the *Secretary, Board of Revenue, Madras* v. *Madras Export Company* (1) was, however, followed by a Full Bench of the Lahore High Court in *Jiwandas* v. *Income-tax Commissioner, Lahore* (4). In that case, the question arose as to whether a person residing and carrying on business in British India and purchasing goods there which were sold in Kashmir was liable to assessment on the ground that a part of the profits accrued within British India. The Full Bench gave a negative answer to this question and the basis

(1) I.L.R. 46 Mad. 360.
(2) [1922] 1 A.C. 417.
(3) I.L.R. 52 Cal. 1.
(4) I.L.R. 10 Lah. 657.

of the decision was that mere purchase of goods in British India had too remote a connection to justify the conclusion that a part of the profits should be held to have "accrued" in this country. As the business was one of buying and selling, it was held that the profits accrued or arose actually at the place where the goods were sold and not at the place where they were merely purchased for export. It should be noted that this case was decided prior to 1939 and the changes that were introduced into section 42 of the Income-tax Act by the Amending Act of 1939 were not in existence at that time. The assessee was a resident of British India and the only question for decision in that case was whether the profits did actually arise or accrue in British India. It was held that they did not. Both these cases were followed with approval by a Madras Special Bench in the subsequent case of *S. V. P. Sudalaimani Nadar* v. *Commissioner of Income-tax, Madras*(1). That was also a case where the assessee was a resident of British India and having purchased animals in British India exported them to foreign countries for sale. It was held that he was not assessable to income-tax, as the profits were not received or brought into British India. All these cases were reviewed by a Division Bench of the Orissa High Court, consisting of Chief Justice Ray and Narasimham J. in *Rahim* v. *Commissioner of Income-tax* (2). Here the assessee used to buy hides, horns, etc. in the Orissa State and sell them in British India and the question was whether any part of the profits accrued or arose within an Indian State. The answer given by the Court was in the negative, though the Chief Justice in a separate judgment observed that he was not prepared to lay down as a proposition of law that in all businesses of buying and selling, the entire profits necessarily accrue at the place where the sales take place. Each case would depend upon its own circumstances and there may be cases where the place where the commodities are purchased has an importance of its own. On the facts of the case which they were actually deciding it was said that the act of buying

(1) A.I.R. [1941] Mad. 229. (2) A.I.R. [1949] Orissa 60.

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was so negligible a part of the operation of the business as not to make any appreciable difference in the apportionment of the amount that accrued or arose in British India.

It will be seen that none of these decisions are really of any assistance to the appellant in the present case. All of them proceeded on the footing that no appreciable profit resulted from the operation of buying when the goods were purchased at one place and exported in a raw state to another place for sale. In the Orissa case referred to above, Narasimham J. expressly observed in course of his judgment that the position might be different if the materials purchased underwent any manufacturing process before they were exported. If no profits really resulted from the purchasing part of the business, obviously the question of the place where such profits arise or accrue does not become material at all.

As against these cases, several authorities have been cited to us which have proceeded on the footing that even purchase of raw materials could be an operation in connection with a business and if it was carried on in British India, it might make the profits attributable to such operation taxable under section 42 of the Indian Income-tax Act. The case of *Rogers Pyatt Shellac and Company* v. *Secretary of State for India* (1) is one of the leading decisions on this point. In that case, a company incorporated in U. S. A. and having its Head Office in New York and Branch Offices, Agencies and factories in Calcutta, London, etc. purchased goods in India for sale in America. It had also a factory in the United Provinces where raw produce was bought locally and worked up into a form suitable for exports to America. It was held that the company was not exempt from assessment to income-tax or super-tax in India. This case was decided under section 33 of the Income-tax Act of 1918 and the judgment shows that the principle followed in the case was similar to that which was subsequently embodied in section 42 (3) of the Income-tax Act of 1922. The same line of reasoning was adopted by the Rangoon

(1) I.L.R. 52 Cal. 1.

High Court in *Commissioner of Income-tax, Burma* v. *Messrs. Steel Brothers and Company* (1). Among recent cases, on this point, which were decided under section 42 of the Income-tax Act of 1922, can be mentioned the case of *Motor Union Insurance Co. Ltd.* v. *Commissioner of Income-tax, Bombay* (2) and that of *Webb Sons and Company* v. *Commissioner of Income-tax, East Punjab* (3). In the last case, the assessee company which was incorporated in the United States of America, was carrying on in America the business of manufacturing carpets. Its only business in India was the purchase of wool as raw material for the carpets. It was held that the purchase was an operation within the meaning of section 42 (3) of the Income-tax Act and profits from such purchases could be deemed to arise in British India and was consequently assessable under section 42 (3) of the Income-tax Act.

These cases, it must be admitted, are not of much assistance to the respondents in this case, though they do not help the appellant either. They were decided on the express language of section 42 of the Income-tax Act, 1922, as it then stood or the section corresponding to it in the earlier Act. There remains for me to refer to the other line of authorities upon which the judgment of the High Court seems to be primarily based. In my opinion, they cannot also be regarded as direct authorities on the point requiring consideration in the present case. In *Commissioner of Income-Tax* v. *Kirk* (4), the profits derived from extraction of ore from the soil and also from the conversion of the crude ore into merchantable product were held to be taxable, as the *source* of these profits was situated in New South Wales and that was the basis of taxation under the New South Wales Act. The High Court was not right in holding that as a matter of law, profits must be held to arise at the place where the source of the profit is situated. The Privy Council clearly laid down in the case of the *Commissioner of Income-tax* v. *Chunilal* (5) that income from business does not

(1) I.L.R. 3 Rang. 614. (2) A.I.R. [1945] Bom. 285.
(3) [1950] 18 I.T R. 33. (4) [1900] A.C. 588. (5) 65 I.A. 332.

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necessarily arise or accrue at the place from which directions are given or skill and judgment exercised, although the operations may take place elsewhere; and it is not the scheme of the Income-tax Act that the profits in the case of a business cannot be taken distributably but must be taken as a single indivisible result accruing at one place.

The learned Chief Justice of Bombay in support of his judgment relied strongly upon the decision of the Madras High Court in *Commissioner of Income-tax* v. *Mathias*(1). In that case, the assessee, who was a resident of Mangalore in British India, owned coffee plantations in Mysore. The harvested crops were brought to Mangalore to be dried and cleansed there in the factory of the selling agents of the assessee and sold there by that company, the sale proceeds being received and retained at Mangalore by the assessee himself. The question was whether the assessee was entitled to claim the benefit of the second proviso to section 4 (2) of the Income-tax Act and if so, to what extent? It was held by the learned Judges that the assessee was entitled to exemption of the whole profits earned by the sale of the produce at Mangalore, and the ground upon which the decision rested was that the agricultural produce itself could be taken to be income in kind which accrued at Mysore outside British India. On appeal to the Privy Council, this decision was reversed and the Privy Council took the view that as the income was received in British India, the proviso to section 4 (2) had no application (2). The particular point upon which the Madras High Court based its decision was not considered by the Judicial Committee and was left open. Obviously in the case before us the manufactured oil that was produced at Raichur could not be taken to be income or profits in kind. The manufactured products themselves cannot be regarded as income though the process of manufacture yields profits which form a portion of the profits ultimately realised at the time of the sale. The question before

(1) I.L.R. [1938] Mad. 25.

(2) Vide *Commissioner of Income-tax* v. *Mathias*—66 I.A. 23.

us is, where do the profits resulting from the manufacturing process accrue or arise?

It was pointed out by Mukherji J. in *Re Rogers Pyatt Shellac and Co.* v. *Secretary of State for India* (1) that etymologically the word "accrues" connotes the idea of a growth, addition or increase by way of accession or advantage, while the word "arises" suggests the idea of growth or accumulation with a tangible shape so as to be receivable. The two expressions denote almost the same idea and the difference only lies in the fact that one is more appropriate than the other when applied to particular cases. It is clear, however, as the learned Judge pointed out that these words have been used in contradistinction to the word "received" and both of them represent a stage anterior to the point of time when the income becomes receivable; they connote a character of income which is more or less inchoate. As I have stated already, in proviso (3) to section 5 of the Excess Profits Tax Act, the legislature has deliberately left out the word "received" and has spoken only of "accruing" or "arising." This shows that the legislature had in mind cases where profits could accrue to parts of a business before they were actually received. When a raw material is worked up into a new product by process of manufacture, it obviously increases in value; in other words, there is an accretion of profit to it and the increased value represents this income or profit which is the result of manufacture. As these profits accrue by reason of manufacture, the accrual, in my opinion, cannot but be located at the place where the manufacturing process is gone through. It is immaterial that the manufactured goods are sold later on at various places. If the manufacturer is himself the seller, it might be that he receives the entire profits including that of the manufacture only at the time of the sale; but in an inchoate shape, a portion of the profits does accrue at the place of manufacture, the exact amount of which is only ascertained after the sale takes place. For purposes of computation, the two parts of the business may be conceived of as being carried on by two

(1) I.L.R. 52 Cal. 1 at p. 30.

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different sets of persons. As soon as the manufacture is complete, that part of the business is finished and the profits that accrue to that part certainly arises at the place where the manufacture is carried on and not where the sale ultimately takes place. As the principle of section 42 of the Income-tax Act applies to this case the profits to be deemed under that section to accrue or arise in British India would only be the profits that may reasonably be attributed to one part of the operations, namely, sales of part of the oil; and the profits accruing or arising out of the other part of the operation, namely, the manufacture of the oil which takes place outside India could not be deemed to accrue or arise in India. Where then these profits would arise or accrue or be deemed to arise or accrue except at the place of manufacture?

My conclusion, therefore, is that the profits of the manufacturing part of the assessees' business did accrue and arise at Raichur and the judgment of the High Court should be affirmed, though I do not concur in all the reasons given by the learned Judges.

Das J.

DAS J.—I substantially agree with the reasonings given in the judgment just delivered by my learned brother Mukherjea and concur in dismissing this appeal.

Appeal dismissed.

Agent for the Appellant: *P.A. Mehta.*
Agent for the Respondents: *Ranjit Singh Narula.*