Privy Council Appeal No. 85 of 1939

The Bank of Chettinad Limited - - - - *Appellant*

v.

The Commissioner of Income-tax, Madras - - *Respondent*

FROM

THE HIGH COURT OF JUDICATURE AT MADRAS

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 2ND ~~JUNE,~~ 1940.

July.

Present at the Hearing:
LORD RUSSELL OF KILLOWEN
SIR LANCELOT SANDERSON
MR. M. R. JAYAKAR

[*Delivered by* SIR LANCELOT SANDERSON]

This is an appeal from a judgment of the High Court of Madras dated the 17th November, 1938, which was given upon a reference of a question of law made to the High Court by the Commissioner of Income-tax under section 66 (2) of the Indian Income-tax Act XI of 1922.

The question was as follows:—

> "Whether on the facts of this case the Income-tax authorities were entitled to hold that the income from the first six items of loans referred to in paragraph 21 of the Income-tax Officer's assessment order accrued and arose to the Pudukottai Bank directly or indirectly through or from a business connection in British India within the meaning of section 42 (1) of the Indian Income-tax Act between the Kanadukathan Bank and the Pudukottai Bank."

The Commissioner of Income-tax submitted that this question should be answered in the affirmative. The High Court (consisting of Sir Lionel Leach C.J., Madhavan Nair and Varadachariar JJ.), decided that the submission of the Commissioner was right and answered the question in the affirmative.

From this decision the appellant, the Bank of Chettinad, Ltd., has appealed to His Majesty in Council.

The reference arose out of the assessment of the Bank of Chettinad, Ltd., Kanadukathan (hereinafter for the sake of brevity referred to as the "Kanadukathan Bank") as agent of the Chettinad Bank, Ltd., Pudukottai (hereinafter referred to as the "Pudukottai Bank"), for the assessment year 1933-34.

The assessment proceeded on the basis that certain profits or gains accrued to the Pudukottai Bank, resident out of British India, directly or indirectly through or from

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a business connection in British India and that under section 42 (1) of the Indian Income-tax Act of 1922 such profits or gains were chargeable to income-tax in the name of the Kanadukathan Bank, resident in British India, which was treated as the agent of the Pudukottai Bank under section 43 for all the purposes of the Act.

The material facts may be stated as follows: —

Raja Sir Annamalai Chettiar of Chettinad with his three sons had a large money lending business with many branches in Burma, Ceylon, the Federated Malay States and French Cochin China. In 1929 they formed the Kanadukathan Bank which has its headquarters at Kanadukathan in British India. Kanadukathan lies about two miles from the border of the State of Pudukottai and 18 miles from the town of Pudukottai, the capital of the State. In 1930 they formed the Pudukottai Bank and also registered in Pudukottai a company called the Chettinad Corporation, Limited, both of which have their registered offices at Pudukottai. The businesses carried on by the Raja and his sons were wound up and all the assets and liabilities transferred to the three companies. The assets and liabilities of the branches in Burma (which until the 1st April, 1937, was a part of British India), were transferred entirely to the Kanadukathan Bank. The assets and liabilities of the branches in the Federated Malay States were mostly transferred to the Pudukottai Bank. The assets and liabilities of the branches in Ceylon were transferred partly to the Colombo branch of the Kanadukathan Bank and partly to the branches of the Pudukottai Corporation, Limited, in Ceylon. Part of the value of the excess over liabilities was adjusted against the paid-up capital of the three companies. The balance was apportioned and the sums treated as being deposits of the Raja and other members of his family with these companies.

The nominal capital of the Kanadukathan Bank is Rs.3,00,00,000 and the paid-up capital Rs. 1,00,00,000, divided into 20,000 shares of Rs.500 each. All the shares of the company are held by the Raja and members of his family. The directors are the Raja, his wife and two outsiders, neither of whom holds any shares: one is an employee and the other the agent of the Raja.

The nominal capital of the Pudukottai Bank is Rs.2,00,00,000, and its paid up capital is Rs.1,70,00,000, divided into 20,000 shares, of which 10,000 are Rs.700 each paid up and 10,000 of Rs.1,000 each fully paid up.

All these shares, except three, are held by the Raja and the members of his family. The directors are the Raja, his wife and his son, and two outsiders, each of whom holds one share. There is no doubt that the two companies are controlled by the same people.

The Kanadukathan Bank has 22 branches, 20 in Burma, of which one is at Rangoon, and one at Bentong, in the Federated Malay States and one at Colombo.

The Pudukottai Bank carries on no money lending business at Pudukottai, but it has a branch at Kualalumpur, situated about 30 miles from Bentong in the Federated Malay States.

It appears that between September, 1930, and February, 1933, loans amounting to Rs.1,32,86,888 were made by the Pudukottai Bank to the Kanadukathan Bank. The loans were carried out through the Kualalumpur branch of the Pudukottai Bank and the Bentong branch of the Kanadukathan Bank.

They fall under the following nine heads, as stated in the reference made by the Commissioner of Income-tax:—

	" Rs.
(1)	45,00,000
(2)	9,74,100
	($6,34,327)
(3)	5,24,191
(4)	2,35,000
(5)	19,38,505
(6)	4,40,000
(7)	5,15,092
(8)	34,60,000
(9)	7,00,000
Total	1,32,86,888 "

The Bentong branch of the Kanadukathan Bank did no money-lending business and the only duties of the officer in charge of that branch appear to have been to receive hundis from the Kualalumpur branch of the Pudukottai Bank and to pass them on to the Rangoon branch after making the relevant entries in the books.

The first six of the above-mentioned items represent monies used in the Rangoon business of the Kanadukathan Bank in accordance with the procedure hereinbefore indicated: They are the six items mentioned in the reference to the High Court, and the income arising from the said loans is the subject matter of the assessment, which is now in question.

The Commissioner of Income-tax in his reference stated that "*in substance* these loans represent money lent by the Pudukottai Bank to the Kanadukathan Bank, but the transactions have been unnecessarily complicated by resorting to a series of entries which are as superfluous as they are confusing."

Their Lordships think it necessary once more to protest against the suggestion that in revenue cases "the substance of the matter" may be regarded as distinguished from the strict legal position.

In the case of *Inland Revenue Commissioners* v. *The Duke of Westminster* [1936] A.C. 1, disapproval of this doctrine was expressed in the opinions of Lord Tomlin and Lord Russell of Killowen.

A passage from the opinion of Lord Russell of Killowen at page 24 may usefully be cited. It is as follows:—

"I confess that I view with disfavour the doctrine that in taxation cases the subject is to be taxed if, in accordance with a Court's

view of what it considers the substance of the transaction, the Court thinks that the case falls within the contemplation or spirit of the statute. The subject is not taxable by inference or by analogy, but only by the plain words of a statute applicable to the facts and circumstances of his case. As Lord Cairns said many years ago in *Partington* v. *Attorney-General* (1869) L.R 4, H.L. 100, 122: 'As I understand the principle of all fiscal legislation it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.' "

The question on this part of the case is not whether "in substance" the loans represented money lent by the Pudukottai Bank to the Kanadukathan Bank, but it is whether in fact the Pudukottai Bank lent the said money to the Kanadukathan Bank.

Their Lordships have no doubt that on the facts of the case the said six items did represent loans made by the Pudukottai Bank to the Kanadukathan Bank, and that the money was used in the branch of the Kanadukathan Bank at Rangoon, which was then in British India.

The fact that the transactions were negotiated through the branches of the banks does not affect this question: the branches were not separate entities, but were parts of the two respective banks, and it is obvious that the business so transacted by the two branches was the business of the two banks.

The questions to be considered are whether on the facts of this case the Pudukottai Bank had a business connection in British India and whether the profits in question accrued or arose to the Pudukottai Bank directly or indirectly through or from such business connection within the meaning of section 42 (1) of the Act.

It was argued on behalf of the appellant bank that in order to bring the case within the section it must be shown by the Income-tax authorities that the Pudukottai Bank, non-resident in British India, had a business connection in British India in relation to the actual transactions in question, that a business connection arises out of business transactions and that the transactions in this case, namely, the abovementioned loans, were made not in British India but in the Malay States and were to be repaid in the Malay States in the Malay States currency. Consequently it was argued that although the profits of such transactions did accrue to the Pudukottai Bank, they did not accrue through a business connection in British India.

Section 42 (1) is as follows:—

In the case of any person residing out of British India, all profits or gains accruing or arising to such person, whether directly or indirectly, through or from any business connection or property in British India, shall be deemed to be income accruing or arising within British India, and shall be chargeable to income-tax in the name of the agent of any such person, and such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax:

The terms of the section are very wide, and their Lordships are not prepared to place upon them the limitation for which the appellant contends. The words are wide enough to cover profits or gains which can be said to accrue or arise to the Pudukottai Bank directly or indirectly through or from *any* business connection which may exist between the Pudukottai Bank and the Kanadukathan Bank in British India.

That the Pudukottai Bank had a business connection with the Kanadukathan Bank in British India cannot on the facts be doubted, and the transactions in question could not have been carried out but for the existence of the Kanadukathan Bank which was in British India, and the business connection between that bank and the Pudukottai Bank.

It has already been shown that the two banks are controlled by the same people, viz., the Raja and his family. It further appears that the main function of the Pudukottai Bank was to finance the Kanadukathan Bank, that the loans advanced by the Pudukottai Bank to the Kanadukathan Bank represented a large part of the capital of the Pudukottai Bank, that the flow of business between the two banks was secured by the complete control exercised by the Raja and his family over the business of both banks, so that the loans could be safely made without security and for indefinite periods. In view of these facts their Lordships are of opinion that the High Court was right in holding that the Pudukottai Bank had a business connection with the Kanadukathan Bank in British India during the year of assessment, and they are further of opinion that the profits and gains, the subject matter of the assessment, accrued to the Pudukottai Bank directly or indirectly through such business connection in British India.

There remains the question whether the Income-tax Commissioner was correct in treating the Kanadukathan Bank as the agent of the Pudukottai Bank within the meaning of section 43 of the Act.

It is to be noted that the agent contemplated by the section is so to speak an artificial creation, for it is provided that any person having a business connection with a person residing out of British India, upon whom the Income-tax Officer has served a notice of his intention of treating him as agent of the non-resident person is to be deemed to be such agent.

In view of the above-mentioned conclusions it is clear that the Income-tax Officer was acting within the power conferred upon him by section 43 in treating the Kanadukathan Bank as the agent of the Pudukottai Bank for the purposes of the Act.

Several cases were cited to their Lordships, but, with one exception, they were not of much assistance, for the facts in the cited cases were different from those of the present

appeal, and the decision in each case must of course depend upon its own facts. The exception is *The Commissioner of Income-tax* v. *The Remington Typewriter Co. (Bombay), Ltd.*, 58 I.A. 42. The headnote of that case is as follows:—

> " A company incorporated in the U.S.A. and hereinafter called 'the American company', carried on business in New York, and there manufactured and sold typewriter machines. The respondent company had been incorporated under the Indian Companies Act, 1913, and had purchased from the American company for shares the goodwill of that company in the Bombay Presidency and adjoining territory; the American company held all its shares except three issued to that company's nominees. Two other companies had been incorporated in India, each being in substance in the same position towards the American company as the Bombay company; their respective business territory covered the rest of India."

It was held that there was a business connection within the meaning of section 43 and section 42, sub-section 1, of the Indian Income-tax Act, 1922, between the American company and each of the Indian companies, and consequently under section 43 the respondent company could be deemed for the purposes of the Act to be the agent of the American company, and as its agent could be charged to tax under section 42, sub-section 1, in respect of profits made by the American company upon machines exported to British India.

The question whether the necessary business connection existed was argued before the Board, although no appeal had been lodged by the respondents and their Lordships had no doubt that the necessary business connection did exist. It was stated in the judgment that:—

> " The Bombay company was formed for the express purpose of acquiring from the American company and carrying on in a particular area the American company's business of selling the American company's manufactures. Although no contractual obligation exists by which the Bombay company is compelled to purchase any of the manufactures of the American company, the flow of business between the two companies is secured by the fact that the ultimate and complete control of the Bombay company is vested in the American company, which owns all its shares."

It was further held that the profits and gains in question accrued or arose to the American Company directly or indirectly through or from a business connection in British India.

This case is material, because in their Lordships' opinion, if the appellant's contention in this appeal were correct, viz., that the business connection existed only in respect of actual business which was transacted by the branches of the two banks outside British India, the above cited case should have been decided the other way in so far as it related to the matter now under consideration.

For the above-mentioned reasons their Lordships are of opinion that this appeal should be dismissed and that the appellant should pay the respondent's costs of this appeal. They will humbly advise His Majesty accordingly.

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In the Privy Council

THE BANK OF CHETTINAD LIMITED

v.

THE COMMISSIONER OF INCOME-TAX
AT MADRAS

DELIVERED BY
SIR LANCELOT SANDERSON

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