1958

April 22.

THE ERIN ESTATE, GALAH, CEYLON

v.

THE COMMISSIONER OF INCOME-TAX, MADRAS

(VENKATARAMA AIYAR, GAJENDRAGADKAR and A. K. SARKAR JJ.)

Income-tax—Assessment—Firm owning tea estate outside India —Partners residing within taxable territories—Residence of firm—Presumption—If and when rebuttable—Onus—Control and management—Test—Indian Income-tax Act (XI of 1922), s. 4A(b).

Section 4A(b) of the Indian Income-tax Act, 1922, provides inter alia that " for the purpose of the Act, a firm is resident in the taxable territories unless the control and management of its affairs is situated wholly without the taxable territories ". The appellant was a registered firm owning a tea estate in Ceylon. All the partners of the firm were permanent residents in India. The superintendent of the estate who resided permanently in Ceylon had the management and control of the affairs of the estate from day to day, but the partners had the right to check him and give him directions if anything appeared irregular; they also approved the budget sent by him concerning important matters every year, after which the superintendent was at liberty to act upon it. The appellant claimed before the Income-tax Officer that the firm was not resident in the taxable territories, and so the income arising in Ceylon from the appellant's estate was not assessable to tax in India. The question was whether the appellant was resident in the taxable territories within the meaning of s. 4A(b) of the Indian Income-tax Act, 1922 :

Held, (1) Whether a firm is resident within the taxable territories under s. 4A(b) of the Indian Income-tax Act, 1922, is a mixed question of fact and law, and depends upon the legal effect of the facts proved in each case.

(2) Where the partners of a firm are residents in the taxable territories the normal presumption is that the firm is resident in the taxable territories, but this can be rebutted by the assessee, on whom the onus lies, by showing that the control and management of the affairs of the firm are wholly without the taxable territories.

(3) The exercise of the control and management even in part in the taxable territories would be enough to fix the assessee with the character of a resident within s. 4A(b), but such control and management must be *de facto* and not mere *de jure* and it is not relevant to enquire whether it amounted to a substantial part.

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(4) The appellant was a firm resident in the taxable territories within the meaning of s. 4A(b) of the Indian Income-tax Act.

B. R. Naik v. *Commissioner of Income-tax, Bombay*, [1945] 13 I.T.R. 124; [1946] 14 I.T.R. 334 and *Subbayya Chettiar* v. *Commissioner of Income-tax, Madras*, [1950] S.C.R. 961, referred to.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 255 of 1953.

Appeal from the judgment and decree dated March 27, 1951, of the Madras High Court in C. R. No. 62 of 1946.

R. J. Kolah and *R. Ganapathy Iyer*, for the appellant.

H. N. Sanyal, Additional Solicitor-General of India, K. N. Rajagopala Sastri and *R. H. Dhebar*, for the respondent.

1958. April 22. The Judgment of the Court was delivered by

Gajendragadkar J.

GAJENDRAGADKAR J.—The short question which this appeal raises for our decision is whether the appellant assessee is resident in the taxable territories within the meaning of s. 4A(b) of the Indian Income-tax Act, 1922. This question arises in this way.

The appellant is a registered firm owning a tea estate called 'The Erin Estate' at Galah in Ceylon. The firm consists of seven partners all of whom are permanent residents of certain villages in Tiruchirapalli District. The total sum paid by the partners amounts to Rs. 25,00,000 and the same is divided into 147 shares. Out of these 147 shares, Andiappa Pillai owns 50 shares, Veerappa Pillai owns 43 shares, Nagalingam Pillai owns 18 shares and the remaining four partners own 9 shares each. The estate owned by the firm produces tea which is sold to the authorities under the regulations prevailing in Ceylon. Under cl. (3) of the Partnership Deed, the superintendent Ponnambalam Pillai, who was himself a co-owner in the said estate previously, manages the estate and looks after its working from day to day. Ponnambalam Pillai permanently stays in Ceylon. He looks

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after the estate from day to day and it is by him that all sales are effected through commission agents by name Gordon and Company. The pass books for the bank account for the estate are kept in his name and he receives the income and makes the requisite disbursements from time to time.

The assessment proceedings for the assessment years 1939-40 to 1942-43 were started by the Additional Income-tax Officer, Tiruchirapalli Circle. The appellant submitted its returns before the Income-tax Officer and claimed that the firm was not resident in British India and so the income arising in Ceylon from the appellant's estate was not assessable to tax in India. The Income-tax Officer rejected the appellant's contention and held that the appellant was a resident under the provisions of s. 4A(b) of the Act and so he proceeded to tax the entire income accruing to and arising from the appellant's estate in Ceylon. The returns submitted by the appellant were accepted as substantially accurate and the appellant was assessed on its income from Ceylon with some minor adjustments considered necessary by the Income-tax Officer. The appellant filed appeals against the several assessments thus made before the Appellate Assistant Commissioner of Income-tax, Tiruchirapalli. These appeals, however, failed and were dismissed. The appellant then went in appeal before the Income-tax Appellate Tribunal, Madras; the Tribunal dealt with the appeal for 1941-42 assessment in the first instance and allowed it. The Tribunal took the view that the evidence produced in the case showed that the control and management of the appellant's affairs was situated wholly without the taxable territories and so it reversed the finding of the Income-tax authorities that the appellant was a firm resident in the taxable territories. For the other years in question the same order was passed by the Tribunal.

Against these orders of the Tribunal reference applications were filed by the Commissioner of Income-Tax but these applications were dismissed by the Tribunal under s. 66(1) of the Act. Then the Commissioner took up the matter to the High Court of Madras

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under s. 66(2); the High Court directed the Tribunal to refer the question as to "whether the assessee firm was resident in British India within the meaning of s. 4A(b) of the Act". Accordingly a consolidated reference was made to the High Court and, on March 27, 1951, the High Court held that the appellant was a resident in British India and answered the question referred to it in the affirmative. Subsequently the appellant applied for and obtained a certificate from the High Court under s. 66A(2) that the present case is a fit one to appeal to the Supreme Court of India. That is how this appeal has come before us; and the only point which it raises for decision is whether the appellant is a firm resident in the taxable territories under s. 4A(b) of the Act.

This appeal was argued before this Court on February 9, 1956; but after arguments were heard for some time, the Court adjourned the hearing of the appeal *sine die*, "to enable the parties to compile an agreed paper-book containing letters which they respectively relied upon in support of their respective cases". In pursuance of this direction, by consent the parties have filed an additional paper-book containing some more correspondence.

There is no doubt that the question raised for our decision is a question of law. Whether or not the appellant is a resident firm under s. 4A(b) would depend upon the legal effect of the facts proved in the case. The status of the appellant which has to be determined by reference to the relevant section of the Act is a mixed question of fact and law and in determining this question the principles of law deducible from the provisions of the said section will have to be applied. This position has not been disputed before us in the present proceedings. Section 4A(b) provides inter alia that "for the purpose of the Act, a firm is resident in the taxable territories unless the control and management of its affairs is situated wholly without the taxable territories". This provision shows that, where the partners of a firm are residents of this country, the normal presumption would be that the firm is resident in the taxable territories. This

presumption is rebuttable and it can be effectively rebutted by the assessee showing that the control and management of the affairs of the firm is situated wholly without the taxable territories. The onus to rebut the initial presumption is on the assessee. The control and management contemplated by the section evidently refers to the controlling and directing power. Often enough, this power has been described in judicial decisions as the 'head and brain'; the affairs of the firm which are subject to the said control and management refer to the affairs which are relevant for the purpose of taxation and so they must have some relation to the income of the firm. When the section refers to the control and management being situated wholly without the taxable territories it implies that the control and management can be situated in more places than one. Where the control and management are situated wholly outside India the initial presumption arising under the section is effectively rebutted. It is true that the control and management which must be shown to be situated at least partially in India is not the merely theoretical control and power, not a *de jure* control and power but the *de facto* control and power actually exercised in the course of the conduct and management of the affairs of the firm. Theoretically, if the partners reside in India they would naturally have the legal right to control the affairs of the firm which carries on its operations outside India. The presence of this theoretical *de jure* right to control and manage the affairs of the firm which inevitably vests in all the partners would not by itself show that the requisite control and management is situated in India. It must be shown by evidence that control and management in the affairs of the firm is exercised, may be to a small extent, in India before it can be held that the control and management is not situated wholly without the taxable territories. (Vide *B. R. Naik* v. *Commissioner of Income-tax, Bombay* (1)). The effect and scope of the provisions of s. 4A(b) has been considered by this Court in *V.V.R.N.M. Subbayya Chettiar* v. *Commissioner of Income-tax, Madras* (2).

(1) [1945] 13 I.T.R. 124; [1946] 14 I.T.R. 334.
(2) [1950] S.C.R. 961, 965.

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After examining the relevant decisions on this point, Fazl Ali J. who delivered the judgment of the Court, has observed "(1) that the conception of residence in the case of a fictitious "person" such as a company, is as artificial as the company itself and the locality of the residence can only be determined by analogy, by asking where is the head and seat and directing power of the affairs of the company."....(2) "Mere activity by the company in a place does not create residence, with the result that the company may be "residing" in one place and doing a great deal of business in another." (3) "The central management and control of a company may be divided and it may keep house and do business in more than one place, and, if so, it may have more than one residence." (4) "In case of dual residence it is necessary to show that the company performs some of the vital organic functions incidental to its existence as such in both the places so that in fact there are two centres of management." It is in the light of these principles that s. 4 A (b) has to be construed. Thus the only question which remains to be considered is whether the High Court of Madras was right in holding that the appellant was resident in India under s. 4 A (b).

On behalf of the appellant, Mr. Kolah has contended that the only conclusion which can be legitimately drawn from the evidence in the case is that the control and management of the appellant's affairs resided wholly in Ceylon. In support of this argument he has laid considerable emphasis on cl. (3) of the Partnership Deed. This clause provides that the estate (of the firm) shall be managed "by the superintendent Shriman A.B.S.T. Ponnambalam Pillai who has hitherto been in charge of the same and managing the same or by a person appointed by a majority of the partners". The appellant's case is that, since the partners had specifically left the superintendent in charge of the management of the estate, the control and management was entirely entrusted to him and thus it is wholly situated in Ceylon. It is no doubt true that the substantial part of the management of the estate

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was left to the superintendent. The superintendent was staying near the estate and was looking after its management and its affairs from day to day. Prima facie the material clause in the Partnership Deed and the evidence adduced in regard to the general management of the affairs of the estate are no doubt in favour of the appellant; but it has been held by the High Court that the correspondence produced in the case conclusively showed that the control and management was not wholly situated in Ceylon and that at least a part of the control and management was situated in India because the partners who resided in the District of Tiruchirapalli are shown to have exercised control and management of the affairs of the firm from time to time. It is this conclusion which has been challenged by Mr. Kolah. We must, therefore, proceed to examine the evidence given by the parties and the correspondence produced by the appellant in the case.

Andiappa Pillai stated before the Income-tax Officer that the Superintendent looked after the entire management of the estate and the entire control of the affairs of the firm had been left to him by the partners. He, however, admitted that, if anything done by him appeared to them to be irregular, they had the right to check him or to give him directions as to how he should carry on the business. He also added that so far there had been no occasion for them to disagree with anything done by him. Whilst Andiappa Pillai thus claimed that no control has been exercised from India, he had to concede that at the beginning of every year the superintendent sends to the four partners mentioned by him a budget concerning any important or big matter to be attended to in connection with the estate. It was usual for them, said Pillai, to approve of the budget. It would thus be clear that this statement shows that in regard to important and big matters a budget was required to be submitted by the superintendent to the four principal partners and it was after the budget was approved by them that the superintendent was at liberty to act upon it. In our opinion,

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the fact that the budget thus submitted by the superintendent was usually approved by the partners does not detract from the position that the budget had to be submitted and could be acted upon only after it was approved. The act of approval in the context is undoubtedly an act of exercising the right of control and management of the affairs of the firm. That the estimate for 1940 had been submitted to the partners appears from the letter written by Veerappa Pillai to the superintendent on January 2, 1940. In this letter Veerappa Pillai had told the superintendent that only the school building should be built during the year and that the plan about the stable may be considered and attended to after April or May. Andiappa Pillai's letter to the superintendent written on December 31, 1939, gives instructions about manuring and asks the superintendent to undertake the building works mentioned in the letter as economically as possible even though the estimated cost of the building had been approved. Then instructions are given as to how the salary of the three accountants should be adjusted in the account. He was also told that Periasamy had complained that his salary was insufficient and the superintendent was required to give his opinion about the merits of the complaint. A direction was also given to the superintendent that tea should be taken in accordance with what is mentioned in the estimate so as not to go behind the quantity stated there. In other words, the superintendent was asked to confine the purchase of the tea within the limits mentioned in the estimate which had been approved. It appears that, on receiving the opinion of the superintendent about the complaint made by Periasamy in regard to his salary, the superintendent was told to pay him Rs. 2 more per month. This no doubt is a small item but it shows that even where the salary of a clerk had to be increased by Rs. 2, the clerk made a representation to the partner, the partner called for the opinion of the superintendent and, on considering the representation and the opinion together, the partner directed the superintendent to pay the clerk Rs. 2 more per month. By his letter dated July 11, 1940, Andiappa

Pillai directed the superintendent as to how the garden income should be adjusted. Once in six months Rs. 7,500 to Rs. 10,000 should be retained as reserve and the balance distributed amongst the partners in proportion to their shares. That is the direction given. Then the superintendent is told to engage labourers and to send Vaidyalingam and the labourers to cut the wild plant growth in both the said garden and Konangodai garden. Certain other directions as to the work to be assigned to the other clerks are also given. On July 13, 1940, Andiappa Pillai told the superintendent to pack and send 70 lbs. F. B. O. P. tea and suggested that, if the tea had not been sent already to Veerappa Pillai, be should carry out the said instruction. In this letter the superintendent is also asked to enquire from other companies the price of Nevvil and he is told that, having regard to the nature of the current sales of tea, manuring need not be stopped. On July 29, 1940, the superintendent is told as to how the account is to be made in regard to the charges for the guards. On August 8, 1940, Andiappa Pillai tells the superintendent that "when the coupon price goes down purchase for our garden 20,000 lbs." This correspondence shows that the entire control and management of the affairs of the firm had not been left with the superintendent. In regard to the manuring of tea gardens, the salary to be paid to the clerk, the purchase to be made, the expenditure to be incurred in constructing a building, the manner in which the goods should be packed and sent, all these are subjects discussed by the partners in their letters to the superintendent and in respect of all these, presumably the superintendent had asked for directions and the partners gave him the directions. Besides, we have already referred to the admission made by Andiappa Pillai that, at the beginning of every year, the superintendent sent to the four important partners a budget concerning important and big matters to be attended to during the course of the year. Having regard to this evidence we are unable to accept the appellant's

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argument that the control and management of the appellant's affairs was situated wholly in Ceylon. In dealing with this question it would be relevant to bear in mind that the appellant would not succeed even if it is shown that a part of the control and management of the affairs of the company rested in India. The control and management must no doubt be shown to have been actually exercised; and the exercise of the control and management should not be illusory or merely notional. Once it is shown that control and management in the affairs of the firm was exercised by the partners residing in India, it would not be relevant to enquire whether the control and management thus exercised amounted to a substantial part of the control and management of the affairs of the firm. The exercise of the control and management even in part in the taxable territories would be enough to fix the appellant with the character of a resident within s. 4A(b). We must accordingly hold that the High Court of Madras was justified in holding that the appellant is a firm resident in the taxable territories.

Mr. Kolah then raised a further point which had not been urged before the High Court. He contended that the control and management mentioned in s. 4A(b) must be control and management valid and effective in law. Under s. 12 of the Partnership Act, it is only the majority of partners who could have given effective directions to the superintendent and since there is no evidence that the alleged control and management has been exercised by the majority of partners acting in concert it would not be possible to hold that any control and management of the firm's affairs resided in India. We do not think there is any substance in this argument. Under s. 12(a), every partner has a right to take part in the conduct of the business and it is only where difference arises as to ordinary matters connected with the business of the firm that the same has to be decided by majority of partners under sub-s. (c) of the said section. It has not been suggested or shown that there was any difference between the partners in regard to the matters covered by the individual partner's letters of instruction to the superintendent.

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Indeed the course of conduct evidenced by these letters shows that Andiappa Pillai who holds the maximum number of individual shares has purported to act for the partnership and usually gave instructions in regard to the conduct and management of the firm's affairs. On the record we see no trace of any protest against, or disagreement with, this conduct of Andiappa Pillai. Besides, it was never suggested during the course of the enquiry before the Income-tax Officers that the directions given by Andiappa Pillai were not valid or effective and had not been agreed upon by the remaining partners. That is why we think this technical point raised by Mr. Kolah must fail.

The result is the appeal fails and must be dismissed with costs.

Appeal dismissed.

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K. KAMARAJA NADAR

v.

KUNJU THEVAR AND OTHERS

(and connected appeals)

(BHAGWATI, J. L. KAPUR and A. K. SARKAR JJ.)

Election Petition—Claim for seat—Candidate retiring from contest, whether a necessary party—Withdrawal of claim for seat, if cures defect of parties—Provisions relating to security deposit, if mandatory—Representation of the People Act, 1951 (43 of 1951), ss. 82 and 117.

There were seven candidates duly nominated for election, and four out of them withdrew their candidature by the due date. The names of the remaining three were placed on the list of contesting candidates prepared by the Returning Officer under s. 38 of the Representation of the People Act, 1951. Out of the three candidates one Pillai retired from the contest under s. 55A(2) of the Act leaving the appellant and the second respondent to contest the election. After the appellant was declared duly elected the first respondent, an elector in the constituency, filed an election petition praying that the election of the appellant be declared void and further that the second respondent be declared