ELLERMAN LINES LTD.

v.

C.I.T. WEST BENGAL, CALCUTTA

October 22, 1971

[K. S. HEGDE AND A. N. GROVER, JJ.]

Income-tax Act, 1922, *ss.* 5(8), 10(2)(*vib*)—*Indian Income-tax Rules*, 1922, *r.* 33—*Non-resident shipping company—Computation of turnover—Ratio certificate issued by U.K. Chief Inspector of Taxes mentioning investment allowance granted by U.K. authorities—In assessing Indian income of non-resident whether such investment allowance (corresponding to development rebate under India Act) whether to be taken into consideration—Effect of circular by Central Board of Revenue.*

Under a circular issued in 1962 by the Central Board of Revenue under s. 5(8) of the Indian Income-tax Act, 1922 the assessing authorities were directed to permit British Shipping Companies to elect to be assessed on the basis of a ratio certificate granted by the U.K. authorities regarding the income or loss and the wear and tear allowance. In 1964 the Board instructed the taxing authorities to take into consideration the investment allowance granted by U.K. authorities in computing the taxable income of the British Shipping companies. The appellant was a non-resident British Shipping company whose ships plied all over the world including Indian waters. For the years 1960-61 and 1961-62 the Income-tax Officer computed its total income under the Indian Income-tax Act, 1922 by taking into account the ratio certificates issued by the Chief Inspector of Taxes U.K. which were based on the assessments made on the appellant in U.K. In making assessment the Income-tax Officer purported to proceed on the basis of r. 33 of the Indian Income-tax Rules, 1922. One of the points considered by the Income-tax Officer and the Appellate Assistant Commissioner was whether the investment allowance was to be taken into account in assessing the Indian income. Both of them rejected the contention of the appellant that it should be taken into account. The tribunal decided in favour of the appellant but the High Court in reference took the opposite view. In appeal to this Court by special leave.

HELD : (i) The authorities under the Act proceeded on the basis that the computation of the income of the assessee had to be made on the second of the three bases mentioned in r. 33. Admittedly the profits of the assessee were not computed in accordance with the provisions of the Act. That being so, the second basis mentioned in r. 33 could not be applied. This aspect was brought to the notice of the High Court. But the High Court refused to consider the same on the ground that both the Revenue as well as the assessee had proceeded before the authorities under the Act on the assumption that the second basis mentioned in r. 33 was the relevant basis. The High Court erred in adopting this approach. The fact that the authorities under the Act as well as the parties were under a mistaken impression could not alter the true position in law. [174 H-175 B]

(ii) The computation of appellant's income had to be made either under the first basis *viz.* the calculation of the profits and gains on such percentage of the turnover accruing or arising as the Income-tax Officer may consider to be reasonable, or on the third basis *i.e.* 'in such other manner as the Income-tax Officer may deem suitable'. [175 C]

A From the assessment orders it did not appear that the first basis was adopted. The most appropriate basis under which the income could have been computed was the last basis *viz.* "in such other manner as the Income-tax Officer may deem suitable". While adopting that basis the Income-tax Officer is not required to rigidly apply the various conditions prescribed in the Act in the matter of granting one or the other of the permissible allowances. He may adopt any equitable basis as long as the basis does not conflict either with r. 33 or with the instructions or directions given B by the Board of Revenue. The power given to the Income-tax Officer on that basis is a very wide power. That power is available not only to the Income-tax Officer but also to the Appellate Assistant Commissioner and the Tribunal. [175 D-F]

As the Tribunal had determined the tax due from the appellant on the basis of the ratio certificate given by the U.K. authorities, it could not be C said that the decision reached by the Tribunal was an unreasonable one. The Tribunal's decision was in accord with the instructions of the Board of Revenue. [175 F]

The fact that the proviso to s. 10(2) (vib) was incorporated into the Act after the Board issued its instructions could not affect either the validity of r. 33 or the force of the instructions issued by the Board of Revenue because neither r. 33 nor the instructions issued by the Board were strictly in accordance with s. 10(2). [175 G-H] D

Navnit Lal C. Javeri v. *K. K. Sen, Appellate Asstt. Commissioner, Bombay*, 56 I.T.R. 198, applied.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 2459 and 2460 of 1968 and 1161 and 1162 of 1971.

Appeals by certificate/special leave from the judgment and E order dated April 1, 1968 of the Calcutta High Court in Income-tax Reference No. 163 of 1964.

N. A. Palkhivala, T. A. Ramachandran and *D. N. Gupta*, for the appellant (in all the appeals).

Jagadish Swarup, Solicitor-General, B. B. Ahuja, R. N. Sachthey and *B. D. Sharma*, for the respondent (in all the appeals). F

The Judgment of the Court was delivered by

Hegde, J. The first two appeals have been brought by certificate and the other two by special leave. The later two appeals came to be filed because the certificates on the basis of which the G earlier appeals were brought, were found to be defective inasmuch as the High Court had not given any reason in support of those certificates. Hence it is sufficient, if we deal with the later two appeals.

The appellant is a non-resident British Shipping Co. whose ships ply in waters all over the world including the Indian waters. For the assessment years 1960-61, and 1961-62 (the relevant H accounting years being calendar years 1959 and 1960), the Income-tax Officer computed its total income taxable under the

Indian Income-tax Act, 1922 (which will hereinafter be referred to as the Act) by taking into account the ratio certificates issued by the Chief Inspector of Taxes, U.K. which were based on the assessments made on the appellant in U.K. During the relevant period, there was in U.K. "investment allowance" corresponding to "development rebate" under the Act. The certificates issued by the Chief Inspector contained the percentage ratio of the total world profits of the appellant to its world earnings and similarly the percentage ratio of the wear and tear allowance and the investment allowance to its total world earnings. In making the assessment, the Income-tax Officer purported to proceed on the basis of rule 33 of the Indian Income-tax Rules 1922. The said rule reads :

> "In any case in which the Income-tax Officer is of opinion that the actual amount of the income, profits or gains accruing or arising to any person residing out of the taxable territories whether directly or indirectly through or from any business connection in the taxable territories, or through or from any property in the taxable territories or through or from any assets or source of income in the taxable territories, or through or from any money lent at interest and brought into the taxable territories in cash or in kind cannot be ascertained, the amount of such income, profits or gains for the purposes of assessment to income-tax may be calculated on such percentage of the turnover so accruing or arising as the Income-tax Officer may consider to be reasonable, or on an amount which bears the same proportion to the total profits of the business of such person (such profits being computed in accordance with the provisions of the Indian Income-tax Act), as the receipts so accruing or arising bear to the total receipt of the business, or in such other manner as the Income-tax Officer may deem suitable."

The Income-tax Officer proceeded to assess the appellant-assessee on the second of the three bases mentioned in rule 33; but in computing Indian earnings, he did not include the destination earnings received in India *i.e.* freight received in Indian ports in respect of cargo loaded at non-Indian ports nor did he take into account the investment allowance granted to the appellant in its U.K. assessments.

Aggrieved by the order of the Income-tax Officer, the assessee took up the matter in appeal to the Appellate Assistant Commissioner. The Appellate Assistant Commissioner accepted the contention of the assessee as regards the inclusion of the desti-

A nation earnings in the computation of the Indian earnings of the assessee but rejected its contention as regards the investment allowance. Aggrieved by the order of the Appellate Assistant Commissioner both the assessee as well as the Revenue appealed to the Income-tax Appellate Tribunal. The Tribunal allowed the B appeal of the assessee and dismissed that of the Revenue. Thereafter at the instance of the Revenue, the following two questions of law were referred to the High Court under s. 66(1) of the Act.

> "1. Whether, on the facts and in the circumstances C of the case, the Tribunal was right in holding that the destination earnings collected in India should be considered as part of the Indian earnings in determining the assessee's Indian income under Rule 33 of the Income-tax Rules ?
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> Whether, on the facts and in the circumstances of D the case, the Tribunal was right in allowing the claim of the assessee for the investment allowance under the U.K. Act (corresponding to the development rebate under the Indian Income-tax Act, 1922) in the computation of its total world income for the purpose of determining the assessee's Indian income under rule 33 of E the Income-tax Rules, 1922 ?"

The High Court answered the first question in favour of the assessee and the second in favour of the Revenue. Hence these appeals by the assessee. The Revenue has not appealed against the decision of the High Court as regards Question No. 1. Hence we have only to consider whether the decision of the High Court F relating to Question No. 2 is in accordance with law.

At the commencement of his arguments Mr. Palkhivala, learned Counsel for the assessee indicated that rule 33 may not be applicable to the facts of the case; but he said that for the purpose of this case, he was prepared to proceed on the basis that G the said rule is the governing provision. The authorities under the Act as well as the High Court have examined the facts of this case on the basis of rule 33. The second question referred to the High Court requires the High Court to express its opinion whether on the facts and in the circumstances of the case, the Tribunal was right in allowing the claim of the assessee for the H investment allowance under the U.K. Act in the computation of the total world income for the purpose of determining the assessee's Indian income under rule 33. Under these circumstances, it would not be appropriate for us at this stage to ignore the earlier proceedings and examine the case afresh on a wholly diffe-

rent basis. Hence we have not gone into the question whether rule 33 is applicable to the facts of the case. We are proceeding on the assumption that it applies.

An mentioned earlier, the assessee is a non-resident. Its liability to pay tax arises under ss. 3 and 4 of the Act. The total income that arose or accrued or deemed to have arisen or accrued to it in this country in the relevant previous years is liable to be taxed in this country. Section 10(2) provides for certain allowances to be deducted while computing the taxable income. Section 10(2)(vib) deals with the development rebate. The material part of that section reads:

> "In respect of a new ship acquired or new machinery or plant installed after the 31st day of March, 1954 which is wholly used for the purposes of the business carried on by the assessee, a sum by way of development rebate in respect of the year of acquisition of the ship or of the installation of the machinery or plant, equivalent to,—
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> (i) in the case of a ship acquired after the 31st day of December, 1957, forty per cent of the actual cost of the ship to assessee, and
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> (ii) in the case of a ship acquired before the 1st day of January, 1958 and in the case of any machinery or plant, twenty-five per cent. of the actual cost of the ship or machinery or plant to the assessee."

The proviso to that clause says :

> "Provided that no allowance under this clause shall be made unless—
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> (a) the particulars prescribed for the purpose of clause (vi) have been furnished by the assessee in respect of the ship or machinery or plant; and
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> (b) except where the assessee is a company being a licensee within the meaning of the Electricity (Supply) Act, 1948 (54 of 1948), or where the ship has been acquired or the machinery or plant has been installed before the 1st day of January, 1948 an amount equal to seventy-five per cent of the development rebate to be actually allowed is debited to the profit and loss account of the relevant previous year and credited to a reserve account to be utilised by him

A during a period of ten years next following for the purposes of the business of the undertaking except—

(i) for distribution by way of dividends or profits, or

B (ii) for remittance outside India as profits or for the creation of any asset outside India,

and if any such ship, machinery, or plant is sold or otherwise transferred by the assessee to any person other than the Government at any time before the expiry of ten years from the end of C the year in which it was acquired or installed, any allowance made under this clause shall be deemed to have been wrongly allowed for the purposes of this Act."

It may be noted that in the case of a shipping company like the appellant before us, whose ships ply all over the world, it D may not be possible to strictly comply with the provisions contained in s. 4 of s. 10(2). The provisions dealing with the levy of Income-tax are not identical in all countries. It may well nigh be impossible for a shipping company like the appellant to rigidly comply with the requirements of the laws in force in the numerous countries where it can be said to have earned income. E Possibly to get over such a difficulty rule 33 was enacted. That is how the Revenue had proceeded in assessing the appellant.

Evidently in exercise of its power under s. 5(8) of the Act, which says that "all officers and persons employed in the execution of this Act shall observe and follow the orders, instructions and directions of the Central Board of Revenue....", the F Central Board of Revenue had issued the notification dated February 10, 1942. Under that notification instructions had been issued to the assessing authorities laying down the principles to be applied in assessing the foreign shipping companies. As regards the British Shipping Companies, they were directed to permit those companies "to elect to be assessed on the basis of a G ratio certificate granted by the U.K. authorities regarding the income or loss and the wear and tear allowance".

At the time that notification was issued the Act did not provide for a development rebate. Therefore that notification does not refer to any development rebate. But it is made clear by that notification that a British Shipping Company can elect to H be assessed on the basis of a ratio certificate granted by the U.K. authorities regarding the income or loss which means the net income or net loss. During the relevant previous years, the Act

provided for deduction of the development rebate in the computation of the taxable income. During those years the U.K. Income-tax Act provided for a similar allowance; but that allowance was known as investment allowance. We were informed at the bar that in those years, the percentage of devlopment rebate allowed under the Act was the same as that allowed under the U.K. law as investment allowance.

In about the beginning of 1964 M/s. Turner Morrison & Co. which was the agent of several British Shipping Companies in India appears to have written to the Board of Revenue seeking its advice as to how the British Shipping Companies could claim development rebate. In reply to that letter, the Board of Revenue wrote to them as follows :

> "Sub : Assessment of British Shipping Companies on the basis of ratio certificates—Treatment of investment allowance granted in the U.K.
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> I am directed to reply your letter dated 8th Feb. 1957 on the above subject and to state that as the development rebate which corresponds to the investment allowance granted in the U.K. is allowed under the Indian Income-tax Act from the assessment year 1956-57, there is no objection to allow the investment allowances for the purpose of the computation of the Indian Income of British Shipping Companies. This would, however be subject to the condition that the investment allowance would be permitted as a deduction only to the extent to which the rate of the allowance granted in the U.K. is not greater than the rate of development rebate allowed under the Indian Income-tax Act."

We were informed that the copies of that letter were sent to the Income-tax Commissioners in the various States. From this letter, it is clear that the Board of Revenue had instructed the taxing authorities to take into consideration the investment allowance granted by the U.K. authorities in computing the taxable income of the British Shipping Companies. At this stage, it is necessary to mention that the proviso to cl. (vib) of s. 10(2) referred to earlier was incorporated into the Act sometime after the above instructions were issued by the Board of Revenue.

The authorities under the Act have proceeded on the basis that the computation of the income of the assessee has to be made on the second of the three bases mentioned in rule 33. This assumption appears to be incorrect. Admittedly the profits of the assessee company were not computed in accordance with the provisions of the Act. That being so, the second basis mentioned

A in rule 33 cannot be applied. This aspect was brought to the notice of the High Court. But the High Court refused to consider the same on the ground that both the Revenue as well as the assessee had proceeded before the authorities under the Act on the assumption that the second basis mentioned in rule 33 is the relevant basis. In our opinion the High Court erred in adopt-
B ing that approach. The fact that the authorities under the Act as well as the parties were under a mistaken impression cannot alter the true position in law. It is obvious that that basis could not have been applied. That being so the computation of the appellant's income had to be made either under the first basis *viz.* the calculation of the profits and gains on such percentage of the
C turnover accruing or arising as the Income-tax Officer may consider to be reasonable or on the third basis *i.e.* 'in such other manner as the Income-tax Officer may deem suitable'.

From the assessment orders made by the Income-tax Officer, it does not appear that in computing the taxable income of the
D assessee, he adopted the first basis. The most appropriate basis under which he could have computed the income was the last basis *viz.* "in such other manner as the Income-tax Officer may deem suitable." While adopting that basis, the Income-tax Officer is not required to rigidly apply the various conditions prescribed in the Act in the matter of granting one or the other of the
E permissible allowances. He may adopt any equitable basis so long as that basis does not conflict either with rule 33 or with the instructions or directions given by the Board of Revenue. The power given to the Income-tax Officer under that basis is a very wide power. That power is available not only to the Income-tax Officer but also to the Appellate Assistant Commissioner and the Tribunal. As the Tribunal had determined the tax due from
F the appellant on the basis of the ratio certificate given by the U.K. authorities, it cannot be said that the decision reached by the Tribunal was an unreasonable one. The Tribunal's decision accords with the instructions given by the Board of Revenue.

G The fact that the proviso to s. 10(2)(vib) was incorporated into the Act after the Board issued its instructions cannot affect either the validity of rule 33 or the force of the instructions issued by the Board of Revenue because neither rule 33 nor the instructions issued were strictly in accordance with s. 10(2). They merely lay down certain just and fair methods of approach to a difficult problem.

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The learned Solicitor-General appearing for the Revenue at one stage of his arguments contended that the instructions issued

by the Board of Revenue cannot have any binding effect and those instructions cannot abrogate or modify the provisions of the Act. But he did not contend that rule 33 is *ultra vires* the Act. The instructions in question merely lay down the manner of applying rule 33.

Now coming to the question as to the effect of instructions issued under s. 5(8) of the Act, this Court observed in *Navnit Lal C. Javeri* v. *K. K. Sen, Appellate Asstt. Commissioner Bombay* :(1)

> "It is clear that a circular of the kind which was issued by the Board would be binding on all officers and persons employed in the execution of the Act under section 5(8) of the Act. This circular pointed out to all the officers that it was likely that some of the companies might have advanced loans to their share-holders as a result of genuine transactions of loans, and the idea was not to affect such transactions and not to bring them within the mischief of the new provison."

The directions given in that circular clearly deviated from the provisions of the Act, yet this Court held that the circular was binding on the Income-tax Officer.

For the reasons mentioned above, Civil Appeals Nos. 1161 and 1162 of 1971 are allowed and in substitution of the answer given by the High Court to question No. 2, we answer that question in the affirmative and in favour of the assessee. The assessee is entitled to its costs in those appeals both in this Court as well as in the High Court—costs one set. Civil Appeals Nos. 2459 and 2460 of 1968 are dismissed as being not maintainable. In those appeals, there will be no order as to costs.

G.C. *C.A.s Nos.* 1161 *and* 1162/71 *allowed.*

C.A.s Nos. 2459 *and* 2460/68 *dismissed.*

(1) 56 I.T.R. 198.