Privy Council Appeal No. 67 *of* 1932.

The Bharat Insurance Company, Limited - - - - *Appellants*

v.

The Income Tax Commissioner, the Punjab, Lahore - - *Respondent*

FROM

THE HIGH COURT OF JUDICATURE AT LAHORE.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 15TH DECEMBER, 1933.

Present at the Hearing:

LORD MACMILLAN.
SIR JOHN WALLIS.
SIR GEORGE LOWNDES.

[*Delivered by* SIR JOHN WALLIS.]

This is an appeal from a judgment of the High Court of Judicature at Lahore on a reference made by the Commissioner of Income Tax, Lahore, under Section 66 (2) of the Indian Income Tax Act, 1922, on the question whether the appellant, the Bharat Insurance Company, was liable to be assessed under that Act to income tax in respect of the profits allotted to participating policy holders who were entitled under their contract to 90 per cent. of the profits made in the participating branch of the business.

The Bharat Insurance Company was incorporated under the Indian Companies Act in 1882, for the purpose of making and effecting assurances on lives and carrying on other insurance business.

Under the provisions of Sections 5 and 6 of the Indian Life Assurance Act, 1912, the Company's life assurance business has to be kept entirely separate from its other businesses, if any, and

under Section 8 (1) it is obliged to have a quinquennial valuation made by an actuary and to cause an abstract of the report of such actuary to be made in the form set forth in the Fourth Schedule to the Act.

The form of the resulting valuation balance-sheet is to be found at the end of the Fourth Schedule of the Act and is as follows :—

VALUATION BALANCE SHEET OF AS AT 19 .

Dr	Rs.	*Cr.*	Rs.
To net liability under life assurance and annuity transactions (as per summary statement provided in Fourth Schedule) ...		By life assurance and annuity funds (as per balance-sheet under Third Schedule) ...	
To surplus, if any		By deficiency, if any ...	

The actuarial valuation balance sheet as at the 31st December, 1923, for the previous quinquennium was drawn up in exactly this form and showed a surplus of Rs. 5,96,952, out of which Rs. 4,68,394 was allotted to the participating policy holders.

Under Rule 25 made under Section 59 of the Indian Income Tax Act, 1922—

> " the income, profits and gains of a life assurance business shall be the average annual net profits disclosed by the last preceding valuation " ;

that is to say, shall be arrived at by taking one-fifth of the surplus disclosed in the valuation balance-sheet already mentioned and treating it as the average annual income of the business for the next quinquennium.

The surplus shown in the valuation balance-sheet was so dealt with, and was raised to Rs. 6,61,935 by adding back, pursuant to the proviso to Rule 25, deductions made by the actuary which were inadmissible for income tax. One-fifth of this total was taken as the average annual income of the Company for the next quinquennium; and the Company was assessed and paid income tax on this sum in the year 1925–6 and the following years down to and inclusive of 1928–9. For 1929–30, the year now in question, the Company also returned this sum as the amount of its income under Section 22 (1) of the Act, and was assessed accordingly under Section 23 (1).

From this assessment they appealed to the Assistant Commissioner under Section 30, and raised the contention, which is the subject of the present appeal, that in working out its average annual income the sum of Rs. 4,68,394 paid to participating policy holders should have been deducted before arriving at the surplus already mentioned.

The Assistant Commissioner dismissed the appeal, and the Company thereupon applied to the Commissioner to review the

case under Section 33, and, in the alternative, to refer the question of law to the High Court under Section 66 (2) of the Act.

The Commissioner refused to interfere in review, but referred the following question to the High Court :—

> "Whether the sum of Rs. 4,68,394 distributed among participating policy holders represent part of the profits assessable to income tax, or an expenditure incurred for earning the profits of the Company ?"

As required by the Act, the Commissioner recorded his opinion that the first part of the question should be answered in the affirmative and the latter in the negative, in accordance with the decision of the House of Lords in *Last* v. *London Assurance Corporation*, 10 App. Cas. 438, which, he stated, had been re-affirmed in *Styles* v. *New York Life Insurance Company*, 14 App. Cas. 381.

The learned Judges, in a carefully considered judgment, agreed with the Commissioner that the sum in question was part of the profits of the Company and so assessable to income tax, and did not come under the description of expenditure incurred by the Company. In support of this opinion they referred to the decisions of the House of Lords in *Mersey Docks and Harbour Board* v. *Lucas*, 8 App. Cas. 891, and *Last* v. *The London Assurance Corporation* (*supra*). In the first of these cases it had been held that the liability of the Mersey Docks and Harbour Board to be assessed to income tax in respect of the profits earned by it in carrying on its business, that is to say, the sum by which the income earned in the business exceeded the expenditure incurred in earning it, was not affected by the fact that the Board was bound by statute to apply such surplus for the creation of a sinking fund and afterwards in reduction of its dues. In *Last's* case it was held that the liability of the London Assurance Corporation to pay income tax on the whole of the profits earned in its business was not affected by the fact that it had bound itself by its contract with the participating policy holders to pay them two-thirds of the profits earned in the participating part of its business, and it was accordingly held that this share was part of the profits earned by the Company in carrying on its business and so assessable to income tax, and could not be regarded as expenditure incurred by the Corporation in earning its own profits.

In England the income tax payable on a trade or business has "to be computed on the full balance of the profits or gains," phraseology which, as pointed out by Lord Blackburn in *Coltness Iron Company* v. *Black*, 6 App. Cas. 315, has remained unaltered since its insertion in 46 Geo. III, c. 15. This balance or sum has always been interpreted as meaning the difference between the income earned in the business and the expenditure incurred in earning it. Section 10 of the Indian Income Tax Act, 1922, is substantially to the same effect, as it provides that under the head "Business" the tax is to be payable "in respect

of the profits or gains of any business," and that " such profits or gains shall be computed after meeting the following allowances, namely :—

". : . ix. Any expenditure (not being capital expenditure) incurred solely for the purpose of earning such profits or gains."

Prima facie, therefore, *Last's* case is decisive of the present case, as it directly decides the question referred for the opinion of the Court. Relying. however, on the fact that this question had given rise to differences of opinion in the Queen's Bench Division and the Court of Appeal, and that in the House of Lords Lord Bramwell dissented from the opinions of Lord Blackburn and Lord Fitzgerald, Mr. de Gruyther, for the appellant, has argued that this case was wrongly decided and has invited the Board not to follow it, but to decide the other way. This suggestion their Lordships are wholly unable to accept. *Last's* case has now been treated as settled law for nearly fifty years, not only here, but also, presumably, in the Dominions and Colonies, and very serious consequences might follow if this Board were now to lay down a different rule.

It is, however, necessary to refer to the grounds of Lord Blackburn's judgment with reference to the objection taken here and before the High Court that it was based on the provisions of Section 54, 5 & 6 Vict., c. 35, the Act of 1842, which has no equivalent in India. Lord Blackburn's judgment was really based on his view as to the nature of the bargain between the parties and would have been to the same effect if there had been no such statutory provision. In his view, stating it briefly, what the Company got in the shape of extra payments made by participating policy holders was an addition to its premium income which was almost all pure profit, as the extra expenditure involved was small and the Company incurred no liability whatever in respect of the extra payments by the participating policy holders unless there was a profit. This accounted for the large share of the profits offered to the participating policy holders. On the other hand, all the participating policy holders got was a share of any profit there might be, and, if there was no profit, they got nothing. They might, therefore, Lord Blackburn said, be regarded as having purchased a share of the profits. If that was the right view, income tax was payable by the Corporation on those profits, whatever they might be bound to do with them, as held in the *Mersey Docks* case. This, he proceeded to say, seemed to be expressly enacted by 5 & 6 Vict., c. 35, Section 54, which requires the estimate of the profits of a corporation to be made " before any dividend shall have been made thereof to any other persons having any share right or title in or to such profits."

Lord Blackburn, and Lord Justice Cotton in the Court of Appeal, were both of opinion that if the participating policy holders were to be considered as having a share of the profits of the corporation within the meaning of this section, that would go to

show that the share of the profits allotted to them formed part of the profits assessable to income tax; but Lord Justice Cotton had held that they were not within the section, whereas Lord Blackburn was of opinion that they were. In their Lordships' opinion, it is unnecessary to pursue this question, as it is clear that Lord Blackburn would have been of the same opinion if there had been no such section, and this section was not referred to either by Lord Fitzgerald or by Lord Justice Lindley, as he then was, in his short dissenting judgment in the Court of Appeal, on which Mr. Hills in his argument for the respondent has invited the Board to base their decision in this case. In that judgment Lord Justice Lindley summed up the whole question in three sentences, which their Lordships will proceed to quote, merely premising that "bonus" was the inappropriate name given by the insurance company to the share of profits which the participating policy holders were entitled to receive under their contracts in consideration of the additional payments they had made:—

> "These bonuses are not like the expenses of management or anything that must be necessarily incurred for the purpose of carrying on the business. I cannot see how the fund for division can be spent in earning itself. In my view the fund which is divided partly among the shareholders and partly among the policy holders is the excess of the earnings over the expenses incurred in earning that excess."

In *Gresham Life Assurance Company* v. *Sykes* [1892], A.C. 309, the grounds on which that case was decided were the same as in *Last's* case, though the result was different as the claim of the income tax authorities to treat as profits the payments made to the Company in consideration for the grant of annuities was disallowed by the House of Lords, as they went to form part of its life assurance and annuity funds.

Lastly, their Lordships will refer to the decision of this Board in *Pondicherry Railway Company* v. *Income Tax Commissioners*, 58 I.A. 239, which was decided subsequently to the date of the judgment under appeal. The main question in that case was whether the appellant, a British Company which had been licensed to construct and operate a railway in French territory from the pier head at Pondicherry to a junction with the South Indian Railway at the British frontier, was liable to be assessed to Indian income tax; but it was also contended that, even if the Company was liable to be assessed, they were entitled under Section 10, Subsection 2, Clause ix, to deduct as expenditure incurred solely for the purpose of earning their profits, the half-share of their profits which they were bound by their convention with the French Government to pay to the French Colony, and the two cases last mentioned were cited at the Bar. This contention was rejected by the Board in a judgment delivered by Lord Macmillan on much the same grounds as had been taken in *Last's* case:—

> "It is claimed for the company that when it makes over to the Colonial Government their half of the net profits it is making an expenditure incurred solely for the purpose of earning its own profits. The Court below has

> unanimously negatived this contention, and, in their Lordships' opinion, has rightly done so. A payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits. It assumes that profits have first come into existence. But profits on their coming into existence attract tax at that point, and the revenue is not concerned with the subsequent application of the profits."

If *Last's* case had never been decided, this decision would, in their Lordships' opinion, be decisive of the present case, as the share of profits allotted to the policy holders really stands on the same footing as the half of the profits of the railway company payable to the French Colony.

It was further contended for the appellants that in England the decision in *Last's* case must be considered to have been overruled by the Legislature, as under the provisions of Section 16 of the Finance Act, 1923, 13 & 14 Geo. V, c. 14, the share of profits allotted to participating policy holders is exempted from payment of income tax. As to this contention, it is sufficient for their Lordships to say that an alteration by the Legislature of the law as settled by the decisions of the Courts does not raise any inference that those decisions were wrong or even that those who had proposed the alteration were of that opinion.

The last contention was that the participating policy holders' share of profits is not assessable because, as already stated, Rule 25 of the Income Tax Rules provides that " the income, profits and gains of life assurance business shall be the average annual *net* profits disclosed by the last preceding valuation." The contention, however, is negatived by the proviso that any deductions made from the gross income in arriving at the actuarial valuation which are not admissible for the purposes of income tax assessment shall be added to the net profits disclosed by the valuation.

The " net profits " in this rule clearly mean the " surplus, if any " in the statutory form of Valuation Balance Sheet set out above, of " life assurance and annuity funds (as per balance-sheet under Third Schedule) " over the " net liability under life assurance and annuity transactions (as per summary statement provided in Fourth Schedule)." In the present case, as already stated, the Rs. 4,68,394 allotted to participating policy holders was taken from the surplus or net profits shown in the Valuation Balance Sheet, but, if they had been deducted before arriving at such surplus, they would have to be added under Rule 25 to such surplus shown therein " as deductions not admissible for income tax assessment," not being expenditure incurred solely for the purpose of earning such profits, within the meaning of Section 10, Subsection 2, Clause ix of the Act.

Their Lordships are therefore of opinion that the learned Judges were right in following *Last's* case and that the appeal fails, and they will humbly advise His Majesty accordingly. The appellant Company will pay the respondent's costs.

In the Privy Council.

THE BHARAT INSURANCE COMPANY, LIMITED

v.

THE INCOME TAX COMMISSIONER, THE PUNJAB, LAHORE.

DELIVERED BY SIR JOHN WALLIS.

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