Leading cases

Commissioner of income tax verses g. R. Karthikeyan

(prize money received by winning a highway motor rally was held to be 'income'.)

Facts: the assessee, g. R. Karthikeyan, assessed as an individual, was having income from various sources including salary and business income. During the accounting year relevant to the assessment year 1973-74, he participated in the all india highway motor rally. He was awarded the first prize of rs. 20,000 by the indian oil corporation and another sum of rs. 2,000 by the all india highway motor rally. The method of ascertaining the first prize was based on a system of penalty points for various violation. The competitor with the least penalty points was adjudged the first prize winner. The rally was designed to test endurance, driving and the reliability of the automobiles. One had to drive one's vehicle observing the traffic regulation at different places as also the regulation prescribed by the rally committee. The income tax officer included the said amounts of rs. 22,000 in the income of the respondent assessee relying upon the definition of "income" in clause 24 of section 2 of the income-tax act, 1961.

Issue: whether, on the facts and circumstances of the case, the total sum of rs. 22,000 received by the assessee from the indian oil corporation and all india highway motor rally should be treated as "income" under income-tax act, 1961.

Decision of the supreme court: *the supreme court held that the receipt in question does constitute "income* "as *defined in clause 24 of section 2 of the income tax act, 1961.* In the course of judgement the court said as follows: the definition in the act is an inclusive one. As said by lord wright in *raja bahadur kamaksya narain singh verses c.i.t.* (1943) 11 i.t.r. 513, 521 (pc), "income... Is a word difficult and perhaps impossible to define in any precise general formula; it is a word of the broadest connotation. In *maharaj kumar gopal saran verses* c.It. (1935) 3 i.t.r. 237, 242 (pc), the privy council pointed out that "anything which can properly be described as income, is taxable under the act unless expressly exempted. The supreme court quoted the following paragraph from the decision of *navin chandra mafatlal verses* c.It:

"what, then, is the ordinary natural and grammatical meaning of the word "income"? According to the dictionary it means a thing that comes in (see oxford dictionary, volume v, and page 162). In the united states of america and in australia both of which also are english speaking countries the word "income" is understood in a wide sense so as to include capital gain. ...its natural meaning embraces any profit or gain which is actually received. This is in consonance with the observations of lord wright to which reference lias already been made... As already observed, the word should' be given its widest connotation in view of the fact that it occurs in a legislative head conferring legislative power."

In *navinchandra mafatlal verses* c.i.t, the issue was whether section 12-b of the indian income-tax act 1922 authorized the imposition of a tax on capital gains was *ultra vires* the central legislature. The supreme court in that case held that section 12-b of the indian income-tax act, 1922 was *inter-vires* the central legislature as it fell within entry 54 (taxes on income other than agricultural income) of list i in the seventh schedule to the government of indian act, 1935. Entry 82 of list i in the seventh schedule to the constitution of india also empowers the parliament to levy taxes on income other than agricultural income.

In the present case their lordships of the supreme court held that the definition of income in section 2(24) to the income-tax act, 1961 is an inclusive one, its ambit should be the same as that of the word income occurring in entry 82 of list i of the seventh schedule to the constitution corresponding to entry 54 of list 1 of the seventh schedule to the government of india act, 1935.

In *bhagwan das jain verses* union *of india* (1981) 128 i.t.r. 315 (sc) the issue was whether it is open to the i.t.o. While computing the liability of an assessee to tax under the income-tax act, 1961 to include in the income of the assessee any amount calculated in accordance with section 23(2) of the act in respect of a house in the

occupation of the assessee for the purposes of his own residence. Entry 82 of list i of the seventh schedule to the constitution empowers parliament to levy "taxes on income other than agricultural income". The court stated in that case that words in the constitution conferring legislative power should receive a liberal construction arid should be interpreted in their widest amplitude. The court observed that "income" includes not merely what is received or what comes in by exploiting the use of property but also what one saves by using it oneself. The levy in question squarely falls under entry 82 of list 1 of the constitution. The tax levied under the act is on income, though, computed in an artificial *way from* house property and not *on* house property. In australia the annual value of the tax payer's residence owned by himself or used rent free is taken for consideration for the purpose of levy of income-tax. In england also in the case of a residence of the assessee, the computation of income is made on the basis of presumed income. The word "income" is of the widest amplitude and that it includes not merely what is received or what comes in by exploiting the use of the property but also that which can be converted into income.

Clause (9) of section 2 (24) of the act states that "income" includes any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever. The words 'other games of any sort' in clause (9) of section 2(24) are of wide amplitude. Their meaning is not confined to games of a gambling nature alone. Thus clause (9) is not confined to mere gambling or betting activities. Even assuming that the word 'winnings' occurring at the inception of clause (9) controls the meaning of the aforesaid words, it does not follow that merely because winnings from gambling/betting activities are included within the ambit of income, the moneys-received from non-gambling and non-betting activities are not so included. If moneys which are not earned - in the true sense of the word - constitute income, moneys earned by skill and toil would also constitute income. The rally in question was a contest, if not a race. The respondent - assessee entered the contest to win and to win the first prize. What he got was a 'return" for his skill and endurance. As such it is income. The word 'income' must be construed in *m* widest sense.

Further, if a receipt does not fall within sub-clause (ix), or for that matter, any of the sub-clauses in section 2(24), it may yet constitute income. Since the definition of income in section 2(24) is an inclusive one, its ambit, should be the same as that of the word income occurring in entry 82 of list i of the seventh schedule to the constitution. Even if a receipt does not fall within the ambit of any of the sub-clauses in section 2(24), it may still be income if it partakes of the nature of income. The idea behind providing inconclusive definition in section 2(24) is not to limit its meaning but to widen its net. The word "income" is of widest amplitude, it must be given its natural and grammatical meaning.

Judging from the above stand point, the receipt concerned in this present case is also income. May be it is casual in nature but it is income nevertheless. That even the casual income is "income" is evident from section 10(3).

CIT verses Sitaldas Tirathdas

HIDAYATULLAH, J. - The Commissioner of Income Tax, Bombay City II, has filed this appeal with a certificate under Section 66-A(2) of the Income Tax Act, against the judgment and order of the High Court of Bombay dated September 20, 1957, in Income Tax Reference No. 15 of 1957.

2. The question referred to the High Court for its opinion by the Income Tax Appellate Tribunal, Bombay was: "Whether the assessee is entitled to a deduction of Rs 1350 and Rs 18,000 from his total income of the previous year relevant to Assessment Years 1953-54, 1954-55?"

3. The assessee, Sitaldas Tirathdas of Bombay, has many sources of income, chief among them being property, stocks and shares, bank deposits and share in a Firm known as Messrs Sitaldas Tirathdas. He follows the financial year as his accounting year. For Assessment Years 1953-54 and 1954-55, his total income was respectively computed at Rs 50,375 and Rs 55,160. This computation was not disputed by him, but he sought to deduct therefrom a sum of Rs 1350 in the first assessment year and a sum of Rs 18,000 in the second assessment year on the ground that under a decree he was required to pay these sums as maintenance to his wife, Bai Deviben and his children. The suit was filed in the Bombay High Court (Suit No. 102 of 1951) for maintenance allowance, separate residence and marriage expenses for the daughters and for arrears of maintenance, etc. A decree by consent was passed on March 11, 1953, and maintenance allowance of Rs 1500 per month was decreed against him. For the account year ending March 31, 1953 only one payment was made, and deducting Rs 150 per month as the rent for the flat occupied by his wife and children, the amount paid as maintenance under the decree came to Rs 1350. For the second year, the maintenance at Rs 1500 per month came to Rs 18,000 which was claimed as a deduction. No charge on the property was created, and the matter does not fall to be considered under Section 9(1)(iv) of the Income Tax Act. The assessee, however, claimed this deduction on the strength of a ruling of the Privy Council in Bejoy Singh Dudhuria verses CIT [(1933) 1 ITR 135]. This contention of the assessee was disallowed by the Income Tax Officer, whose decision was affirmed on appeal by the Appellate Assistant Commissioner. On further appeal, the Tribunal observed: "This is a case, pure and simple, where an assessee is compelled to apply a portion of his income for the maintenance of persons whom he is under a personal and legal obligation to maintain. The Income Tax Act does not permit of any deduction from the total income in such circumstances." The Tribunal mentioned in the statement of the case that counsel for the assessee put his contention in the following words: "I claim a deduction of this amount from my total income because my real total income is whatever that is computed, which I do not dispute, less the maintenance amount paid under the decree."

Mohini Thapar (Dead) by L.RS. Verses. C.I.T. (Central) Calcutta 7 The assessee appears to have relied also upon a decision of the Lahore High Court in Diwan Kishen Kishore verses. CIT. The Tribunal, however, referred the above question for the opinion of the High Court.

4. The High Court followed two earlier decisions of the same Court reported in Seth Motilal Manekchand verses CIT and Prince Khanderao Gaekwar verses CIT and held that, as observed in those two cases, the test was the same, even though there was no specific charge upon property so long as there was an obligation upon the assessee to pay, which could be enforced in a court of law. In Bejoy Singh Dudhuria case, there was a charge for maintenance created against the assessee, and the Privy Council had observed that the income must be deemed to have never reached that assessee, having been diverted to the maintenance-holders. In the judgment under appeal, it was held that the income to the extent of the decree must be taken to have been diverted to the wife and children, and never became income in the hands of the assessee.

5. The Commissioner of Income Tax questions the correctness of this decision and also of the two earlier decisions of the Bombay High Court. We are of opinion that the contention raised by the Department is correct.

6. Before we state the principle on which this and similar cases are to be decided, we may refer to certain rulings, which illustrate the aspects the problem takes. The leading case on the subject is the decision of the Judicial Committee in Bejoy Singh Dudhuria case. There, the stepmother of the Raja had brought a suit for maintenance and a compromise decree was passed under which the stepmother was to be paid Rs 1100 per month, which amount was declared a charge upon the properties in the hands of the Raja, by the Court. The Raja sought to deduct this amount from his assessable income, which was disallowed by the High Court at Calcutta. On appeal to the Privy Council, Lord Macmillan observed as follows: "But Their Lordships do not agree with the learned Chief Justice in his rejection of the view that the sums paid by the appellant to his step-mother were not 'income' of the appellant at all. This in Their Lordships' opinion is the true view of the matter. When the Act by Section 3 subjects to charge 'all income' of an individual, it is what reaches the individual as income which it is intended to charge. In the present case the decree of the court by charging the appellant's whole resources with a specific payment to his step-mother has to that extent diverted his income from him and has directed it to his stepmother; to that extent what he receives for her is not his income. It is not a case of the application by the appellant of part of his income in a particular way, it is rather the allocation of a sum out of his revenue before it becomes income in his hands."

7. Another case of the Privy Council may well be seen in this connection. That case is reported in P.C. Mullick verses. CIT . There, a testator appointed the appellants as executors and directed them to pay Rs 10,000 out of the income on the occasion of his addya sradh. The executors paid Rs 5537 for such expenses, and sought to deduct the amount from the assessable income. The Judicial Committee confirmed the decision of the Calcutta High Court disallowing the deduction, and observed that the payments were made out of the income of the estate coming to the hands of the executors and in pursuance of an obligation Mohini Thapar (Dead) by L.RS. Verses. C.I.T. 8 (Central) Calcutta imposed upon them by the testator. It observed that it was not a case in which a portion of the income had been diverted by an overriding title from the person who would have received it otherwise, and distinguished the case in Bejoy Singh Dudhuria case.

8. These cases have been diversely applied in India, but the facts of some of the cases bring out the distinction clearly. In Diwan Kishen Kishore verses. CIT there was an impartible estate governed by the law of primogeniture, and under the custom applicable to the family, an allowance was payable to the junior member. Under an award given by the Deputy Commissioner acting as arbitrator and according to the will of the father of the holder of the estate and the junior member, a sum of Rs 7200 per year was payable to the junior member. This amount was sought to be deducted on the ground that it was a necessary and obligatory payment, and that the assessable income must, therefore, be taken to be pro tanto diminished. It was held that the income never became a part of the income of the family or of the eldest member but was a kind of a charge on the estate. The allowance given to the junior member, it was held, in the case of an impartible estate was the separate property of the younger member upon which he could be assessed and the rule that an allowance given by the head of a Hindu coparcenary to its members by way of maintenance was liable to be assessed as the income of the family, had no application. It was also observed that if the estate had been partible and partition could have taken place, the payment to the junior member out of the coparcenary funds would have stood on a different footing. In that case, the payment to the junior member was a kind of a charge which diverted a portion of the income from the assessee to the junior member in such a way that it could not be said that it became the income of the assessee.

9. In CIT verses. Makanji Lalji it was stated that in computing the income of a Hindu undivided family monies paid to the widow of a deceased coparcener of the family as maintenance could not be

deducted, even though the amount of maintenance had been decreed by the Court and had been made a charge on the properties belonging to the family. This case is open to serious doubt, because it falls within the rule stated in Bejoy Singh Dudhuria case; and though the High Court distinguished the case of the Judicial Committee, it appears that it was distinguished on a ground not truly relevant, namely, that in Bejoy Singh Dudhuria case the Advocate-General had abandoned the plea that the stepmother was still a member of the undivided Hindu family. It was also pointed out that this was a case of assessment as an individual and not an assessment of a Hindu undivided family.

10. In CIT verses. D.R. Naik the assessee was the sole surviving member of a Hindu undivided family. There was a decree of Court by which the assessee was entitled to receive properties as a residuary legatee, subject, however, to certain payments of maintenance to widows. The widows continued to be members of the family. It was held that though Section 9 of the Income Tax Act did not apply, the assessee's assessable income was only the balance left after payment of the maintenance charges. It appears from the facts of the case, however, that there was a charge for the maintenance upon the properties of the assessee. This case also brings out correctly the principles laid down by the Judicial Committee that if there be an overriding obligation which creates a charge and diverts the income to some one else, a deduction can be made of the amounts so paid. Mohini Thapar (Dead) by L.RS. Verses. C.I.T. (Central) Calcutta 9

11. The last case may be contrasted with the case reported in P.C. Mullick and D.C. Aich, In re . There, under a will certain payments had to be made to the beneficiaries. These payments were to be made gradually together with certain other annuities. It was held that the payments could only be made out of the income received by the executors and trustees from the property, and the sum was assessable to income tax in the hands of the executors. It was pointed out that under the will it was stated that the amounts were to be paid "out of the income of my property", and thus, what had been charged was the income of the assessees, the executors. The case is in line with the decision of the Privy Council in P.C. Mullick verses. CIT.

12. In Hira Lal, In re there was a joint Hindu family, and under two awards made by arbitrators which were made into a rule of the Court, certain maintenance allowances were payable to the widows. These payments were also made a charge upon the property. It was held that inasmuch as the payments were obligatory and subject to an overriding charge they must be excluded. Here too, the amount payable to the widows was diverted from the family to them by an overriding obligation in the nature of a charge, and the income could not be said to accrue to the joint Hindu family at all.

13. In Prince Khanderao Gaekwar verses. CIT, there was a family trust out of which two grandsons of the settler had to be paid a portion of the income. It was provided that if their mother lived separately, then the trustees were to pay her Rs 18,000 per year. The mother lived separately, and two deeds were executed by which the two grandsons agreed to pay Rs 15,000 per year to the mother, and created a charge on the property. The sons having paid Rs 6000 in excess of their obligations, sought to deduct the amount from their assessable income, and it was allowed by the Bombay High Court, observing that though the payment was a voluntary payment, it was subject to a valid and legal charge which could be enforced in a court of law and the amount was thus deductible under Section 9(1) (4). There is no distinction between a charge created by a decree of Court and one created by agreement of parties, provided that by that charge the income from property can be said to be diverted so as to bring the matter within Section 9(1)(4) of the Act. The case was one of application of the particular section of the Act and not one of an obligation created by a money decree, whether income accrued or not. The case is, therefore, distinguishable from the present, and we need not consider whether in the special circumstances of that case it was correctly decided.

14. In V M. Raghavalu Naidu & Sons verses CIT the assessees were the executors and trustees of a will, who were required to pay maintenance allowances to the mother and widow of the testator. The

amount of these allowances was sought to be deducted, but the claim was disallowed. Satyanarayana Rao and Viswanatha Sastri, JJ. Distinguished the case from that of the Privy Council in Bejoy Singh Dudhuria case. Viswanatha Sastri, J. Observed that the testator was under a personal obligation under the Hindu law to maintain his wife and mother, and if he had spent a portion of his income on such maintenance, he could not have deducted the amount from his assessable income, and that the position of the executor was no better. Satyanarayana Rao, J. Added that the amount was not an allowance which was charged upon the estate by a decree of Court or otherwise and which the testator himself had no right or title to receive. The income which was received by the executors Mohini Thapar (Dead) by L.RS. Verses. C.I.T. 10 (Central) Calcutta included the amount paid as maintenance, and a portion of it was thus applied in discharging the obligation.

15. The last cited case is again of the Bombay High Court, which seems to have influenced the decision in the instant case. That is reported in Seth Motilal Manekchand verses CIT. In that case, there was a managing agency, which belonged to a Hindu joint family consisting of A, his son B and A's wife. A partition took place, and it was agreed that the managing agency should be divided, A and B taking a moiety each of the managing agency remuneration but each of them paying A's wife 2 as. 8 pies out of their respective 8 as. Share in the managing agency remuneration. Chagla, C.J. and Tendolkar, J. Held that under the deed of partition A and B had really intended that they were to receive only a portion of the managing agency commission and that the amount paid to A's wife was diverted before it became the income of A and B and could be deducted. The learned Judge observed at p. 741 as follows:

"We are inclined to accept the submission of Mr Kolah that it does constitute a charge, but in our opinion, it is unnecessary to decide this question because this question can only have relevance and significance if we were considering a claim made for deduction under Section 9(1) (4) of the Income Tax Act where a claim is made in respect of immovable property where the immovable property is charged or mortgaged to pay a certain amount. It is sufficient for the purpose of this reference if we come to the conclusion that Bhagirathibai had a legal enforceable right against the partner in respect of her 2 annas and 8 pies share and that the partner was under a legal obligation to pay that amount."

16. These are the cases which have considered the problem from various angles. Some of them appear to have applied the principle correctly and some, not. But we do not propose to examine the correctness of the decisions in the light of the facts in them. In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable. In our opinion, the present case is one in which the wife and children of the assessee who continued to be members of the family received a portion of the income of the assessee, after the assessee had received the income as his own. The case is one of application of a portion of the income to discharge an obligation and not a case in which by an overriding charge the assessee became only a collector of another's income. The matter in the present case would have been different, if such an overriding charge had existed either upon the property or upon its income, which is not the Mohini Thapar (Dead) by L.RS. Verses C.I.T. (Central) Calcutta 11 case. In our opinion, the case falls outside the rule in Bejoy Singh Dudhuria case and rather falls within the rule stated by the Judicial Committee in P.C. Mullick case.

17. For these reasons, we hold that the question referred to the High Court ought to have been answered in the negative. We, accordingly, discharge the answer given by the High Court, and the question will be answered in the negative. The appeal is thus allowed with costs here and in the High Court.

C.i.t. Verses sunil j. Kinariwala

(whether there is diversion of income or application of income, the determining factor is the nature and effect of assessee's obligation in regard to the amount in question. Where such obligation entitles a third person to receive the amount before the assessee could lay a claim to receive the same as his income, there is diversion of income by an overriding title. But "where after the receipt of the income by the assessee, the same is passed on to a third person in discharge of an obligation that would be a case of application of income and not diversion of income.)

Facts: the assessee, a partner in the partnership firm, known as "m/s kinariwala r.j.k. Industries", ahmadabad, (for short, "the firm"). He was having ten per cent share in the firm. On 27-12-1973, he created a trust named "sunil jivanlal kinariwala trust" by a deed of settlement. He assigned to the trust fifty per cent of his ten per cent right, title and interest (excluding capital), as a partner in the firm, and a sum of rs. 5,000 out of his capital in favour of the said trust. There are three beneflcieries of the trust—the assessee's brother's wife, the assessee's niece and the assessee's mother. In assessment year 1974- 75, the assessee claimed that as fifty per cent of the income attributable to his share from the firm, stood transferred to the trust resulting in diversion of income at source, the same could not be included in his total income for the purposes of his assessment. The income-tax officer rejected the claim on the plea that it was a case of application of income and not diversion of income at source. Against the order of assessment, the assessee appealed before the appellate assistant commissioner of income-tax who allowed the appeal directing that a sum of rs. 20,141 which stood transferred to the trust under the settlement, be excluded from the total income of the assessee. However, on appeal by the revenue, the tribunal reversed the order of the appellate assistant commissioner. The high court held, *inter alia,* that on assignment of fifty per cent share of the assessee in the firm, it became the income of the trust by overriding title and it could not be added in the total income of the assessee.

Issues before the supreme court: (1) "whether, on the facts and the circumstances of the case, assignment of 50 per cent out of the assessee's ten per cent share in right, title and interest (excluding capital) in m/s kinariwala r.j.k. Industries in favour of sunil jivanlal kinariwala trust under a deed of trust dated 27-12-1973 creates an overriding title in favour of the trust and whether the income accruing to the trust can be treated as the income of the assessee?

(2) whether, on the facts and in the circumstances of the case, the sum of rs. 24,141 being the profits referable to 50 per cent, out of the assessee's right, title and interest of ten per cent, in the partnership firm of messrs kinariwala r.j.k. Industries is not the real income of the assessee, but of sunil jivanlal kinariwala trust and as such assessable only in the hands of the trust?"

Decision of the supreme court: the supreme court answered the above questions in favour of the revenue and against the assessee. *The court was of the view that the share of the income of the assessee assigned in favour of the trust has to be included in the total income of the assessee.*

The supreme court pointed out that under the scheme of the act, "it is the total income of an assessee, computed under the provisions of the act that is assessable to income-tax. So much of the income which an assessee is not entitled to receive by virtue of an overriding title created in favour of a third party would get diverted at source and the same cannot be added in computing the total income of the assessee. The principle is simple enough but more often than not, as in the instant case, the question arises as to what is the criterion to determine, when does the income attributable to an assessee get diverted by overriding title? *The*

determinative factor, in our view, is the nature and effect of the assessee's obligation in regard to the amount in question. When a third person becomes entitled, to receive the amount under an obligation of an assessee even before he could lay a claim to receive it as his income, there would be diversion of income by an overriding title; but when after receipt of income by the assessee, the same is passed on to a third person in discharge of the obligation of the assessee, it will be a case of application of income by the assessee and not diversion of income by overriding title."

The supreme court after referring *bejoy singh dudhuria verses* c.i.t., *p.c. Mullick verses* c.i.t.) and *c.i.t. Verses* sitaldas *tirathdas* gave instances, *inter alia,* of the following cases:

In *k.a. Ramachar verses* c.i.t. (1961) , the assessee was a partner in a firm. He executed three deeds of settlement in favour of his wife, married daughter and a minor daughter, assigning to each of them one-fourth of his share of the profits in the firm. They were entitled to receive and collect their share from the firm under the settlement. The assessee contended that the amounts covered by the settlements could not be included in his total income for the purpose of assessment to income tax. Applying the principle laid down in *sitaldas tirathdas* it was held that under the law of partnership, it was the partner and the partner alone who was entitled to profits and that a stranger, even if he were an assignee, did not have and could not have any direct claim to the profits, the claim of the assessee was negatived on the ground that what was paid was in law a portion of his income, as such the amounts have to be included in his total income. The ratio of this case squarely applies to the facts of the case on hand.

In *moll lal chhadami laljain verses* c.i.t. (1991), a company took over the business of the hindu undivided family (referred to as "the landlord"). Under the agreement of lease with the landlord, the company was required to pay rupees ten thousand to a college, run by a trust out of the annual rent of rupees twenty-one thousand. In a subsequent agreement entered into between the landlord, the company, the trust and the college, it was stipulated, *inter alia,* that in the event of failure to pay the amount to the college, it would have full right to recover the said amount by recourse to the court and that the college shall have the first charge on the property. The landlord claimed that the amount paid to the college was the income of the college as it got diverted by an overriding title and ceased to be the income of the landlord. That contention was rejected by the tribunal as well as the high court. On appeal to the supreme court, applying the principle in *sitaldas tirathdas* it was held by a bench of three learned judges that the stipulation in the agreement to pay rupees ten thousand out of the annual rent directly to the college was only a mode of application of the income of the landlord, which made no difference to its liability to pay tax on the entire rent of rupees twenty-one thousand which had accrued to the landlord. The fact that the college was given the right to sue and recover rupees ten thousand directly from the company in case of default, it was observed, did not alter the position, nor would creation of charge in favour of the college make any difference.

In *murlidhar himatsingka* verses, *c.i.t.* (1966) , one of the partners of the firm constituted a sub-partnership firm with his two sons and a grandson. The deed of sub-partnership provided that the profits and losses of the partner in the main firm shall belong to the sub-partnership and shall be borne and divided in accordance with the shares specified therein. It was held that there was an overriding obligation which converted the income of the partner in the main firm into the income of the sub-partnership and, therefore, the income attributable to the share of the partner had to be included in the assessment of sub-partnership. That was on the principle that a partner in the sub-partnership and a definite enforceable right to claim a share in the profits accrued to or received by the other partners in the main partnership. The court distinguished *murlidhar himatsingka* from *k.a. Ramachar* and observed that there was no sub-partnership in *k.a. Ramachar.*

The supreme court further observed as follows:

"it is apt to notice that there is a clear distinction between a case where a partner of a firm assigns his share in favour of a third person and a case where a partner constitutes a sub-partnership with his share in the main partnership. The case on hand cannot be treated as one of a sub-partnership, though in view of section 29(1) of the indian partnership act, the trust, as an assignee, becomes entitled to receive the assigned share in the profits from

the firm not as a sub-partner because no sub-partnership came into existence but as an assignee of the share of the assigner-partner."

Maharaja Chintamani Saran Nath Sah Deo verses CIT

GROVER, J. - This is an appeal from a judgment of the Patna High Court in a reference made to it under Section 66(1) of the Income Tax Act, 1922, by the Appellate Tribunal by which the following question of law was referred for determination by the High Court: "Whether on the facts and circumstances of this case, the Tribunal was right in holding that the sum of Rs 2,20,000 was the income of the assessee assessable to tax under the provisions of the Income Tax Act?"

2. The original assessee was Maharaja Pratap Udainath Sah Deo, the holder of an impartible estate. On January 22, 1944 the assessee granted a lease of certain mining rights to Aluminium Production Company Ltd. In respect of 171.03 acres of land for a period of 30 years. The main terms were as follows:

(1) Salami (inclusive of Moharkari and Dewani Negi amounting to Rs. 5000) Rs 2,25,000

(2) Rent 8 per acre

(3) Royalty 6 per ton

(4) Minimum royalty Rs 22 per acre. Previously, the assessee had granted a prospecting lease of 311 acres of land to the same Company on March 20, 1941 for a period of one year. The area covered by that lease though larger included substantially the area leased out subsequently. The terms of the 1941 lease were that salami was payable at the rate of Rs 100 per acre and royalty at the rate of 8 annas per ton.

3. While making the assessment for the year 1944-45 the Income Tax Officer took the view that the assessee had chosen to take a large sum by way of salami while granting the lease in the year 1944 and had accepted lesser rate of royalty, the salami represented an advance payment of royalty. He treated Rs. 5000 out of the sum of Rs. 2,25,000 as Dewani Negi and Moharkari and the balance of Rs. 2,20,000 was treated by him as income of the assessee, and the assessment was made accordingly. On appeal the Appellate Assistant Commissioner held that the amount of Rs. 2,20,000 was paid by the Company to the assessee as salami and as such it was a capital receipt and not taxable. On appeal by the revenue the Appellate Tribunal by an order, dated August 7, 1952, remanded the case to the Appellate Assistant Commissioner for finding whether there were circumstances to indicate that the salami was really receipt of income. The Appellate Assistant Commissioner made a report, dated April 12, 1956. He gave a finding that the assessee had intentionally accepted lower royalty and taken higher Salami and therefore the major portion of the sum of Rs. 2,20,000 had been taken in exchange of royalty that would have accrued during the period of lease. The Tribunal by an order, dated July 26, 1956 allowed the appeal of the Revenue and restored the order of the Income Tax Officer. The High Court held that out of the sum of Rs. 2,20,000 the amount which could be regarded to be salami and treated as a capital receipt could reasonably be estimated at a sum of Rs. 20,000 which was assessable to tax but the remaining amount of Mohini Thapar (Dead) by L.RS. Verses C.I.T. 18 (Central) Calcutta Rs. 2,00,000 was revenue receipt and was taxable as such. The question referred was reframed as follows:

"Whether on the facts and the circumstances of this case, the Tribunal was right in holding that the sum of Rs. 2,20,000 or any portion thereof was the income of the assessee assessable to tax under the provisions of the Income Tax Act?" It was answered partly in favour of the assessee but substantially in favour of the Revenue.

4. The principles on which the courts have acted whenever a question has arisen whether a payment described as a salami is capital or revenue receipt are well settled. Salami is a single payment made for the acquisition of the right of the lessor by the lessee to enjoy the benefits granted to him by the lease. That general right may properly be regarded as a capital asset and the money paid to purchase it may properly be held to be a payment on capital account. But merely because a certain amount paid to the lessor is termed as Salami, it does not follow that no inquiry can be made to determine whether it has or has not an element of revenue receipt in the shape of advance payment of royalty or rent. The onus, however, is upon the Income Tax authorities to show that there exist facts and circumstances which would make payment of what has been called salami income. The position may be summed up in this way. When the interest of the lessor is parted for a price the price paid is premium or Salami but the periodical payments made for the continuous enjoyment of the benefits under the lease are in the nature of rent; the former is a capital receipt and the latter a revenue receipt. Parties may camouflage the real nature of the transaction by using clever phraseology and, therefore, it is not the form but the circumstances of the transaction that matter. The nomenclature used may not be decisive or conclusive but it helps the courts, having regard to the other circumstances to ascertain the intention of the parties. [See CIT, Assam, etc. Verses Panbari Tea Co. Ltd.].

5. Now the Appellate Tribunal appears to have based its decision only on the difference between the amount of salami and the rate of royalty between the prospecting lease which was granted in 1941 and the subsequent lease of 1944. This is what the Tribunal stated in Para 7 of its order:

"In 1941, the assessee had granted a prospecting lease in favour of the very lessee taking a much smaller premium fixing the royalty at 8 per ton. He has not shown any justifiable reason for fixing up a lower amount of 6 per ton by way of royalty in the later lease. We found that out of the area of 171 acres that was covered by the later lease a substantial portion of it about 140 acres were comprised in the area leased out by the earlier deed of 1941. A week argument was attempted by the assessee's representative the older lease was only for Bauxite whereas the later lease was for Laterite also. In view of the fact that major portion of the area that is covered in the new lease was in the older lease and as in the course of the producing Bauxite, Laterite also becomes available, we do not see any justification for the assessee agreeing to take a lesser amount by way of royalty."Mohini Thapar (Dead) by L.RS. Verses C.I.T. (Central) Calcutta 19 The Tribunal proceeded to say: "Here in the present case, what we find is that the assessee had chosen to take a large amount by way of premium but a lesser amount by way of royalty. The patent reason for the assessee to take a lesser amount by way of royalty was that the amount received by him as Salami was not taxable. There is, therefore, no doubt in this case that the sum received by the assessee by way of salami or premium was in substance an advance payment of royalty. We are, therefore, in entire agreement with the Income Tax Officer's Order."

We are unable to appreciate how a comparison of the terms of the lease of 1941 which was only for one year and which was for a different purpose, namely, prospecting could afford a reasonable basis for determining whether the terms of the 1944 lease were fixed in such manner that part of the proceedings of royalty were included in the figure of the salami. The object of a prospecting lease is entirely different and since the period was only one year it is quite reasonable to assume that the royalty was fixed at a higher rate because it was not known how much quantity of mineral would be extracted during that period. The lease of 1944 was for a much longer period i.e. 30 years. When a lessor creates a lease for that period it is legitimate for him to charge more amount by way of salami or premium as he is transferring possession of the demised land for a

considerably long period. A lessor may also think that the rate of royalty need not be the same as it was in the case of the prospecting lease and taking an over all business view royalty at a slightly less rate may be charged. The Tribunal's decision based as it was only on a comparison of the terms of the leases of 1941 and 1944 does not appear to take into consideration all these relevant matters. It must not be forgotten that the mere fact that the amount taken on account of salami was substantial and on the face it looked considerably large would not justify the view that that amount represented capitalized royalty. In the Panbari Tea case certain tea estates had been leased out for a period of 10 years. The lease was executed on a consideration of a sum of Rs. 2,25,000 as and by way of premium or salami and an annual rent of Rs. 54,000 to be paid by the lessee to the lessor. The payments were to be made by instalments. This court declined to assume that the parties had camouflaged their real intention and fixed a part of the rent in the shape of premium and it was observed that no material had been placed either direct or circumstantial to disbelieve the description given in the lease deed to the amount as premium and to hold that it was not in fact premium but only rent. The position does not seem to be different in the present case.

6. A good deal of emphasis has been laid on behalf of the Revenue on the statement in the order of the Tribunal towards the conclusion that it was in entire agreement with the Income Tax Officer's order. It is submitted that the Income Tax Officer had gone into the details of other leases which had been granted by the assessee of similar nature and after a comparison of the terms of those leases the Income Tax Officer had reached the conclusion that the amount of salami represented the capitalised royalty. We cannot read the order of the Tribunal in that way. The Tribunal agreed only with the operative part of the order of the Income Tax Officer but not with his reasoning. At any rate, the Appellate Assistant Commissioner had submitted a remand report pursuant to a previous order of the Tribunal and it does not appear that the facts given in that report were at all considered by the Tribunal although the High Mohini Thapar (Dead) by L.RS. Verses. C.I.T. 20 (Central) Calcutta Court based its decision largely on them. The terms of the leases on which the High Court relied, related to the years 1933, 1938 and 1945; the rate of royalty varied from 8 Annas to 12 Annas per ton and that of salami from Rs. 100 to Rs. 130 per acre. No attempt was made to examine anyone on behalf of the assessee to explain all the circumstances in which these leases had been granted. The High Court felt that it was for the assessee to furnish an explanation as to why salami in the case of 1944 lease was raised to Rs. 1284 per acre whereas in the other leases the figure was much less as stated before. This approach cannot be regarded as correct. The onus was on the Revenue to show what was stipulated in the indenture of lease as a payment by way of salami was some other kind of payment, namely, royalty, camouflaged as salami. In this situation it was open to the Appellate Assistant Commissioner at the stage of submitting the remand report to have examined the assessee or his representative and discovered all the reasons for the terms being different. Another factor that was relied upon was the report of the Mines Superintendent, dated January 7, 1956 according to whom the area leased out in 1944 contained commercial grade Bauxite of approximately 13 lakh tons. The Appellate Assistant commissioner at the stage of remand worked out the amount which would be payable as royalty on this estimated quantity of the total reserve of Bauxite in the dismissed area. The total amount of royalty was calculated at Rs 6,50,000 according to the rates fixed by the 1941 lease and at Rs 4,87,500 according to the rate agreed upon in the 1944 lease. The High Court was of the view that these figures showed that the major part of the salami of Rs. 2,25,000 had been taken in exchange of the royalty that would have accrued during the period of the lease. We have already pointed out that a comparison of the terms of the prospecting lease which was only for one year with the subsequent lease of 1944 which was for 30 years could not furnish a proper basis for determining the point in dispute. Moreover the High Court lost sight of the fact that the report of the Mines Superintendent was made long after the date of the 1944 lease and it could not be assumed that at the time of the granting of that lease the assessee knew how much quantity of the mineral could be extracted from the area which had been leased out. Even the High Court felt, in disagreement with the

Tribunal, that the entire amount of the Salami could not be regarded as representing the capitalized value of royalties. The High Court proceeded to assess the salami at Rs. 20,000 on the basis that for the other leases the rate agreed upon was Rs. 100 per acre. We are unable to concur in this method of computing the amount of the salami. Much more material was required for discharging the onus which lay on the Revenue to show that the assesssee was bound to charge only the same amount of salami which had been taken for the other leases about which the details of the quantity of minerals which could be extracted from the area covered by them were altogether lacking.

7. For the reasons given above the appeal is allowed and the order of the High Court is set aside. The answer to the question referred is returned in favour of the assessee and against the Revenue.

Bacha f. Guzdar verses comm. Of income-tax

(even if the entire profit of a company constitutes agricultural income, the dividends received by a share holder of that company from the company do not constitute agricultural income.)

Facts: the appellant was a shareholder in two companies and received from those companies dividends aggregating to rs. 27507- in the accounting year 1949-50. The two companies carried on business of growing and manufacturing tea. By rule 24 of the indian income-tax rules 1922, 40% of the income of the tea companies was taxed as income and 60% was exempt from tax as agriculture income. According to the appellant, the dividend income received was to the extent of 60% agricultural. On the other hand, revenue contended that dividend income was not agricultural and, therefore, whole of the income was liable to tax. The i.t.o. A.a.c., a.t. And the high court held that the dividend income was not agricultural.

Decision of the supreme court: the supreme court also decided that the dividend income was not agricultural because the shareholder did not derive his dividends from land, but that his income from dividend arose by virtue of his holding of shares in the company. The principle established was that in order to determine the character of certain income what one had to consider was the immediate and effective source and not the remote or ultimate source. In the course of the judgment, the supreme court said:

"agricultural income as defined in the act is obviously intended to refer to the revenue received by direct association with the land which is used for agricultural purpose and not by indirectly extending it to case where that revenue or part there of changes hands either by way of distribution of dividends or otherwise. In fact and truth dividend is derived from the investment made in the shares of the company and the foundation of it rests on the contractual relations between the company and the shareholders.

Dividend is not derived by a shareholder by his direct relationship with the land. There can be no doubt that the initial source which has produced the revenue is land used for agriculture purpose but to give to the words 'revenue derived from land" the unrestricted meaning, apart from its direct association or relation with the land, would be quite unwarranted...."

"a shareholder has got no interest in the property of the company though he has undoubtedly a right to participate in the profits if and when the company decides to divide them. The company is a juristic person and is distinct from the shareholder. It is the company which owns the property.

Premier construction co. Ltd. Verses c.i.t., bombay city

(receipt as remuneration a commission under the managing agency agreement at a certain percentage of the net profit of a company whose income was partially agricultural income was held not to be agricultural income even proportionately.)

Facts: the assessee (the appellant) was the managing agent of marsland price and company limited (hereinafter called the "principal company"). It was entitled to a commission under the managing agency agreement. The remuneration of the assessee was regulated by clause 2 of the agreement and under sub-clause (b) the assessee was entitled to:

"a commission at the rate of ten per cent per annum on the annual profits of the principal company after making all proper allowances and deductions from revenue for working expenses chargeable against profits but without making any deduction for depreciation or in respect of any amount carried to reserve or sinking fund or any payment on account of super-tax or any deduction for expenditure on capital account provided that such commission shall not in any year amount to a less sum than rupees ten thousand."

The year of assessment was the year 1942-43. The assessee received as remunenssion under the managing agency agreement a commission at the rate of ten per cent of the net profits of the principal company, that sum being in excess of the minimum salary secured by the agreement. The whole of this remuneration, less certain deduction which were not in question, was assessed to income-tax by the income-tax officer.

One of the sources of income of the principal company was the manufacture of sugar from sugarcane grown on its own farms and from surgarcane brought from outside, and it was not disputed that in so far as its income was derived from sugar manufactured from its own sugarcane such income was agricultural income and as such was exempt from income-tax. The assessee claimed that as its remuneration was calculated with reference to the income of the principal company, part of which was agricultural income, such part of the remuneration as was proportionate to the agricultural income of the principal company, was itself agricultural income and as such exempt from income-tax. The claim was rejected by the income-tax officer, and an appeal by the assistant commissioner of income-tax, the appellate tribunal and the high court.

Issue: whether, in the circumstances of this case, that portion of the income received by the assessee from the principal company of marshal price and company limited, which is proportionate to the 'agricultural income' earned by the principal company, is 'agricultural income' within the meaning of section 2(1) of the income-tax act, 1922 (corresponding to section 2 (1-a) of the income-tax act, 1961), and exempt form assessment?

Decision of the privy council: *their lordship held that where an assessee receives income not itself of a character to fall within the definition of agricultural income contained in the act, such income does not assume the character of agricultural income by reason of the source from which it is derived, or the method by which it is calculated. But if the income received falls within the definition of agricultural income it earns exemption, in*

whatever character the assessee receives it. In the present case the assessee received no agricultural income as defined by the act, it received remuneration under a contract for personal service calculated on the amount of profits earned by the employer, payable not in specie out of any item of such profits, but out of any money of the employer available for the purpose. The remuneration therefore is not agricultural income and is not exempt from tax.

In the course of the judgement their lordships referred the following cases: in *gopal saran narain singh verses commissioner of income-tax, bihar and orissa,* 3 itr 237, the assessee was entitled to an annuity under a contract, the annuity being made a charge upon agricultural land. The board held that the annuity was not rent or revenue derived from land; it was money payable under a contract imposing personal liability on the covenant or the discharge of which was secured by a charge on land. In *commissioner of income-tax, bihar and orissa verses* maharajadhiraj *of darbhanga,*, the assessee carried on business as a money-lender. As security for a debt due to him in respect of his business he was put into possession of agricultural land as a mortgage. It was held that the rents received by the assessee from the agricultural land were agricultural income and exempt from income-tax, and that the exemption was not affected by the circumstances that the rents were received as part of the money-lending business of the assessee, the exemption depending on the kind of income received and not on the character of the recipient. In *nawab habibulla verses commissioner of income-tax, bengal,* , the assessee as the mutawalli of a wakf received as remuneration for his sendees a monthly salary. It was build by the board that the fact that the income of the wakf was derived from agricultural land did not make the remuneration paid to the mutawalli "agricultural income" since the remuneration did not depend either on the nature of the properties which constituted the wakf estate, or on the amount of income derived there from by the estate. With this case the case may be compared is *muhammad ha verses commissioner of income-tax, central and united provinces,* (1942), where the high court of allahabad held that the assessee as mutawalli of a wakf was entitled, by way of remuneration for his services, to retain as a beneficiary,

C.i.t. Verses raja benoy kumar sahas roy

(the expression "land used for agricultural purposes" in the income-tax act does not extend to forest of spontaneous growth where nothing w *done to prepare the soil for trees to be planted therein and where growth of the trees is not fostered,)*

Facts: the respondent, raja benoy kumar sahas roy owned 600 acres of forest and was assessed to land revenue. In the forest there were sal and piyasal trees which were of spontaneous growth although the raja had employed a large number of workers and labour for weeding, felling, clearing, cutting of channels to help the flow of rain water, guarding the trees against pests and other destructive elements, and also for sowing seeds after digging of the soil in denuded areas.

The raja while submitting his return showed a certain amount as income which he derived from the sale of trees, but at the same time said that this income from the forest was not assessable under the income tax act. As it was purely agricultural income which was exempt under, section 4 (3) (vii) of the income-tax act, 1922 (corresponding to section 10(1) of the income-tax act, 1961). The income tax officer rejected the claim and added the net income from the sale of forest trees after allowing a deduction of the expenditure incurred on maintaining of forest. The appellate assistant commissioner confirmed the order of assessment and the income tax appellate tribunal also held that the said income was not agricultural income within the meaning of the act. At the instance the raja (assessee) a reference was made to the high court of calcutta on the point: "whether on the facts and in the circumstances of this case, the sum of rs. 51.9777- as agricultural income and as such is exempt from payment of tax"?

The ground on which the said income was assessed to income tax was that the income derived from the sale of sal and piyasal trees in the forest which was originally a forest of spontaneous growth and the trees were not grown with the aid of human skill and labour but on which forestry operations described above had been carried out.

Contentions of the assessee: the assessee contended that no doubt the forest was 150 years old, but that he was having a large number of workmen and labour whose job was to prune the trees, do the weeding, felling and clearing, cutting of channels for the supply of rain water, guarding the trees against pests, and also sowing the seeds after digging the soil in the denuded areas. Thus there was human skill and labour involved, until such operations were performed on the trees he could hardly derive any benefit there from. What he did on the trees with the aid of workmen and labour were indeed 'agricultural operations' if the expression was interpreted liberally, statute gives exemption to an assessee, such exemption clause should be liberally interpreted.

Decision: it was observed that "a fiscal statute should, no doubt, be construed strictly, and if there be any doubt about its construction the subject must be given the benefit. But we do not feel any doubt that the expression 'land used for agricultural purposes" in the income tax act *does not extend to forest of spontaneous growth*

where nothing is done to prepare the soil for trees to be planted therein and where the growth of the trees is not fostered ,.....".

According to their lordships the basic agricultural operations include weeding, digging, removal of undesirable under-growths, and all operations which foster the growth and preserve the same, apart from the primary operations such as tilling of the land, sowing of the seeds, planting and similar operations. The later operations must be in conjunction with the earlier operations. Thus mere performance of subsequent operations on the products of the land, where such products have not been raised on the land by the performance of the basic operations, would not be enough to characterize them as agricultural operations.

It was observed that there is no doubt that the forest in question was of spontaneous growth. If there were no other facts found that would entail the conclusion that the income is not agricultural income. But the tribunal has found that the forest is 150 years old though portions of the forest have from time to time been denuded and fresh trees have been planted in those areas and operations for the purpose of nursing the trees were performed. It cannot be denied that so far as those trees are concerned, the income derived there from would be agricultural income.

But the forest is said to be 150 years old and all the trees cannot be said to have been grown in this manner after employing human skill and labour. Therefore, the entire income from the forest trees cannot be termed agriculture income.

It was observed that the income tax authorities should have directed an enquiry to ascertain how much of the income is attributable to forest of spontaneous growth and how much to trees planted by the assessee. Since a lot of time had elapsed, their lordships did not feel like ordering any such enquiry at this stage. Having regard to expenditure incurred on maintaining forest relation to the total income, their lordships felt that a "substantial portion of the income must have been derived from trees planted by the proprietors themselves". As the department has made no attempt to establish which portion of income is attributable to forest of spontaneous growth, there are no materials on which we could say that the judgment of the court below is wrong.

C.I.t. Verses maddi venkatasubbaya

(where the assessee purchases a standing crop and sell it immediately after its harvest or after performing subsequent operations, the income derived from such sale cannot be treated as agricultural income because the assessee has ***not derived the income by cultivating the land or performing basic operations.)***

Facts: the assessee, a firm of merchants, purchased a standing crop of tobacco on an area of 93 acres 12 cents for rs. 13,833 in january 1943, from the person who had raised the tobacc6 on the land. The tobacco was harvested, cured and sold in the market by the assessee before 21st march, 1943, for rs. 33,498. The plucking of the ripe leaves, the pruning and flue-curing of the harvested tobacco were all done by the assessee firm. It is also stated that there was some sort of ploughing on the land by the assessee. The curing of tobacco is said to be a process which is ordinarily employed by a cultivator of tobacco to render it fit for sale in the market. The income-tax officer and the appellate assistant commissioner held that a part of the profits, namely rs. 7500, of the assessee realized by the sale of the tobacco was derived from non-agricultural sources or operations and therefore liable to income-tax. The appellate tribunals held that the entire profits of the assessee from the tobacco dealer calculated in the sum of rs. 12000 was agricultural income and was exempt from income-tax under section 4(3) of the income-tax act, 1922 (corresponding to section 10(1) of the income-tax act, 1961). The commissioner of income-tax appealed to the high court against the decision of the appellate tribunal

Observation: the assessee was not a landholder or a ryot or a lessee of the land on which the tobacco crop stood. The tobacco plants had been raised on the land by its owner or lessee and they had reached such a degree of maturity as to render them saleable as standing crops to tobacco merchants in the locality. It is not uncommon for merchants and traders in agricultural produce to purchase standing crops of tobacco, sugarcane, groundnut, etc., when the crop is ready or nearly ready for harvest. The purchaser in such a case may have to do some pruning work with reference to the crops as in this case and then cut the crops and market the produce. The operations said to have been performed by the purchaser in the present case were evidently performed with the consent of the person who raised the standing crop. They are incidental to the reaping the fruits of the purchase.

Issue: whether, in the circumstances of the case, the tribunal was right in holding that the sum of rs, 7500 was 'agricultural income', within the meaning of section 2(1)(b) of the income-tax act, 1922 (corresponding to section 2(1-a) of the income-tax act, 1961) and exempt from taxation under section 4(3) of the income-tax act, 1922 (corresponding to section 10(1) of the income-tax act, 1961)?

Decision of the high court: the burden is on the assessee who claims exemption to prove that the income is 'agricultural income' as defined in the act as held in *raja mustafa alt khan verses c.i.t.,* (1948) .

In *c.i.t. Verses* sir *kameswar singh,* (1935) and *raja mustafa all khan verses* c.i.t*.,* (1948) , agricultural income has been held not to be assessable as business profits merely because the recipient of the income is a money-lender who has lent monies on a mortgage with possession and is receiving the rents and profits of agricultural land in lieu of interest and loan. But this line of argument is not of assistance to the assessee in the present case.

It was agreed that the land on which the tobacco crop was raised was assessed to land revenue and was used for agricultural purposes. The income of the assessee was obviously not "rent" or "revenue" derived from such land within the meaning of section 2(1)(a) of the income-tax act, 1922 (corresponding to section 2(l-a)(a) of the income-tax act, 1961). The only question was whether it was "income derived form such land by agriculture" within the meaning of section 2(l)(b)(i) of the income-tax act, 1922 (corresponding to section 2(a)(b)(i) of the income-tax act, 1961). Rent, revenue or income derived from land by agriculture in section 2 has reference to the rent, revenue or income derived by a person having some interest in land and by virtue of the fact that he is the owner of that interest, a profit accruing to a firm of merchants having no interest in land but having a mere licence to enter upon land and gather the produce as incidental to a transaction of purchase of standing crops, by a sale of the crops after harvest, differs radically in its character from income derived by way of rent or revenue or by the performance of agricultural operations by a person having an interest therein as owner, tenant or mortgagee with possession etc. The profits in the instant case derived by entering into contracts for the purchase of a commodity and by the resale of that commodity for a higher price.

The fact that the movable property now in question springs from, or is the product of agricultural operations carried out by the owner or tenant of agricultural land, does not lead to the conclusion that the profit of a trader who has no interest in the land but who buys and sells the movable property in the course of his trade is [fl] agricultural income" defined in the act. A fruit merchant may purchase only the produce of an orchard belonging to another and a timber merchant may purchase only the trees planted by the owner of the grove. In these cases he gets the right to gather the fruits or the timber on the land but the profit realized by the merchant on a sale of the commodity is not agricultural income derived from land but is business profit.

Thus it was held that the sum of rs. 7500 crores was not exempt from liability to assessment to income-tax.

Sakarlal Naranlal verses. C.I.T.

N.H. BHAGWATI, J. – Ordinarily we find cases where the assessee relies on section 4(3) (8) and the revenue contests the claim of the assessee, but here in this reference the position is reversed and we find the revenue relying on section 4(3)(3) and the assessee disputing that position. The reference relates to assessment year 1954-55, 1955-56 and 1956-57 the corresponding previous years being Samvat Years 2009, 2010 and 2011. The assessee is an individual and he holds certain agricultural lands. In or about 1952, a friend of the assessee suggested to him the idea of growing a vegetable product commonly called galka, the botanical name being luffa pentendra and the assessee accordingly obtained galka seeds from abroad and, after preparing the lands for cultivation, raised galka on the lands in 1952. Now the kind of galka prown by the assessee was not an indigenous kind but was a kind grown fairly widely in Formosa, Japan and other places. After the galkas were fully grown, they were removed from the plants and the assessee then subjected them to a process for preparing what are called loofahs. The process consisted of various steps taken in the following order:

(1) tapping dry galkas for taking out the seeds;

(2) deskinning them;

(3) giving them an acetic acid bath;

(4) holding them in salicylic acid;

(5) drying them in the sun;

(6) putting them in cold water for two days; and

(7) lastly, pressing them for the purpose of packing. The final product which emerges as a result of subjecting galkas to this process is known as loofah. It is fibrous product in the nature of a pad and we are told that it is commonly used in the manufacture of shoes.

The foreign loofahs are about 16" in length and 4" in width. The loofahs prepared by the assessee were, however, only 5" in length and 2-1/2" in width. The assessee tried to market these loofahs abroad and sent them to England on consignment basis for sale, but it was found that it was not possible to sell them. The position was that even if they were sold at the lowest possible rate, the assessee would have been liable to pay purchase tax and that would have caused considerable loss to the assessee. The loofahs were, therefore, reshipped in India. The result was that loss was suffered by the assessee in this transaction. The assessee claimed a loss of Rs. 1,85,932-8-0 in the assessment for the assessment year 1954-55 and similar losses were also claimed in the assessment for the subsequent assessment years 1955- 56 and 1956-57.

2. We may point out at this stage that the accounts in respect of the activities relating to the cultivation of galkas were entered by the assessee in the books of account of a business carried on by him in the name of Sakarlal Sons and Company. After the galkas were raised and removed from the plants, they were transferred by the assessee to the books of account of another business carried on by the assessee in the name of Minaxi Trading Company at a particular value determined by the assessee and it was Minaxi Trading Company which processed the galkas and exported loofahs prepared out of them. The losses set out above were, therefore, suffered by the business of Minaxi Trading Company and they were obviously arrived at on the basis of the cost of the galkas being taken at the value of which they were shown to have been taken over from Sakarlal Sons and Company. These losses were claimed by the assessee as business arising out of non-agricultural operations but the Mohini Thapar (Dead) by L.RS. Verses C.I.T. (Central) Calcutta 49 revenue contended that they were agricultural losses and were, therefore, not liable to be taken into account in computing the income of the assessee from business. That is a question which we shall presently consider, but it is clear that even if the contention of the assessee is accepted and it is held that the operation of Minaxi Trading Company were non-agricultural operations, a question might well arise as to the correct amount of losses suffered by the assessee attributable to these non-agricultural operations. Both the business, namely, Sakarlal Sons and Company and Minaxi Trading Company being the proprietary business of the assessee, the revenue may in that event have to apportion the losses suffered by the assessee in the entire transaction between the agricultural operations carried on in the name of Sakarlal Sons and Company and the non-agricultural operations carried on in the name of Minaxi Trading Company by resort to rule 7 of the Rules made under section 59 of the Act. We are, however, not concerned with that question and we do not wish to express any opinion upon it. These facts have been set out by us namely because an argument was founded upon them on behalf of the assessee for showing the conduct of the assessee as a cultivator.

3. The losses claimed by the assessee were disallowed by the Income-tax Officer on the ground that they were agricultural losses. The Income-tax Officer took the view that the raising of galkas was ultimately an agricultural operation and so far as the processing of galkas resulting in the preparation of loofahs was concerned, it was a process ordinarily employed by a cultivator to render galkas produced by him fit to be taken to market and the losses resulting from these operations were, therefore, agricultural losses within the meaning of section 2(1) (b) (2). The assessee carried the matter in appeal, but the Appellate Assistant Commissioner upheld the disallowance of these losses. The matter was then taken to the Tribunal. The Tribunal also came to the conclusion that the process employed by the assessee was a process which came within section 2(1) (b) (2) and the losses suffered by the assessee were therefore, agricultural losses which were not liable to be dedicated in computing the income of the assessee. Much argument turned upon the question as to what findings of fact were actually reached by the Tribunal and it would, therefore, be desirable to set out the relevant portion of paragraph 5 and the whole of paragraph 6 of the order of the Tribunal which were in the following terms:

"[I]t was submitted that this was a case where the product galka has a market by itself and that subsequent operations are in the nature of manufacturing operations which do not come within the scope of the definition of agricultural income in section 2(1) (b) (2). Reliance for this purpose is placed on evidence in the shape of letters written by an entity called Messrs. M. Kawanishi of Kobe, Japan. This is a letter, which was written to the assessee on September 21, 1959, in which it is stated that looking to the quality of the stuff, texture and size, they would have been in a position to purchase the stuff on assorted basis in the year 1952, round about the 12s per dozen on C.I.F. Japanese port basis. Another letter written on October 8, 1959, by another party of Japan was also relief upon for showing that the price in 1952 would have been round about 15-1/2s, a dozen. It is stated that on the basis of these letters, even dried fruits had a market by themselves and that, therefore, the rest of the activity was not one which would be an agricultural operations.

Mohini Thapar (Dead) by L.RS. Verses C.I.T. 50 (Central) Calcutta We are unable to agree with this submission. In order to find out whether there was a market for the produce as such or whether it had to be processed before it could be sold, what is necessary is to see whether there is a market at which it could be absorbed. The existence of a theoretical market in a place like Japan is not one that has to be taken into account for this purpose. The section postulates the performance of any process ordinarily employed by a cultivator so as to render the produce fit to be taken to market. The expression "ordinarily employed" would appear to postulate the existence of certain

conditions at or about the locality in which the produce is grown. The item marketed by the assessee was a stranger to the Indian market. Therefore, there could have been no ready market in India. Indeed, this position was not disputed by the assessee. Therefore, merely because there was some possibility of a sale at its original stage, in a distant country, it does not follow that the fruit by itself had a market, which is relevant for our purpose. If a produce is grown, say in Kerala, and it does not have a ready market in its original stage there, then merely because there is some market, say in Punjab, for the produce in its original stage, it does not follow that the process ordinarily employed by cultivators in Kerala would cease to be agricultural process. In all these matters, what is liable to be looked into is the area in which the produce is grown and the customary process employed to render it fit for market, if it is not marketable in its original stage. That is why it is a question of fact of each case: see Brihan Maharashtra Sugar Syndicate Ltd., verses. Commissioner of Income-tax [(1946)]. In our opinion, therefore, in this case, there was no market it could be sold in its original stage.

The assessee thereupon made an application to the Tribunal for a reference and on the application the Tribunal made an order referring the following question for the opinion of this court:

Whether on the facts here, where the galka produced does not have a market in India, the process employed on it for purposes of exporting and selling it abroad satisfies the requirements of section 2(1) (b)(2) of the Act? This was the form in which the question was framed, but an argument was addressed to us that this question did not bring out the real controversy between the parties inasmuch as it was based on a very limited postulate, namely, that the galkas did not have a market in India whereas the actual finding of the Tribunal was that there was no market at all for the galkas and that the question, should, therefore, be reframed so as to bring out the real controversy between the parties. We shall consider this argument at the appropriate stage.

4. It is evident that the question depends for its determination on the true construction of section 2(1) (b) (2) of the Income-tax Act,1922. The question whether the process employed by the assessee for the purpose of preparing loofahs out of galkas with a view to exporting and selling loofahs abroad satisfies the requirements of section 2(1)(b)(2) becomes material because if the process is covered by section 2(1)(b)(2), the whole of the loss suffered by the assessee would be agricultural loss and would by reason of section 4(3)(8) be liable to the excluded in computing the income of the assessee. Section 4(3) (8) provides that agricultural income shall not be included in the total income of an assessee.

Mohini Thapar (Dead) by L.RS. Verses. C.I.T. (Central) Calcutta 51 Section 2 refers to income derived from land which means arising from land and denotes income, the immediate and effective cause of which is land. It is divided into three clauses. Clause (1) in terms takes in income derived from agricultural land by agriculture which would include agricultural produce as held by the Supreme Court in Dooars Tea Co. Ltd., verses Commissioner of Income-tax . Clause (2) includes cases of income derived from the performance of any process ordinarily employed by a cultivator to render the produce fit to be taken to market. The reason behind this provision is not far to seek and it really provides a clue to its interpretation. A cultivator raises produce from the land with a view to selling it. If there is a market for the produce as grown, there is no difficulty; the cultivator can in such a case sell the produce without anything more and he need not perform any process on the produce. But if there is no market for the produce as grown and it can be sold only by performing some process on it, the cultivator would have to perform such process in order to be able to sell the produce; otherwise the produce would not be marketable and the raising of it would be futile. Where such is the case, the legislature says that, though strictly the agricultural operations ceases when the produce is raised and removed from the soil, the performance of the process should be regarded as a continuation of the agricultural operations since the process has to be performed by the cultivator for the purpose of enabling him to sell the produce which the otherwise cannot. It is because the performance of the process is essential in order to render the produce marketable, which it is otherwise not, that the law regards it as a part of the agricultural operations carried on by the cultivator. This reason also explains the other requirement of the section, namely, that the process must be such as is ordinarily employed by cultivators to make the produce saleable. The performance of the process is assimilated to agricultural operations and must, therefore, like agricultural operations stricto sensu, be an operation which is ordinarily done by cultivators. If some special or unusual process is employed by a cultivator, which is not ordinarily employed by cultivators to render the produce marketable, it cannot be regarded as part of the agricultural operations and the benefit of the income being treated as agricultural income

would not be available to the cultivator. It will be clear from this discussion that there are two conditions which are required to be fulfilled before a process performed by the assessee can be said to be a process within the meaning of section 2(1) (b) (2). The first condition is that the process must be necessary to render the produce fit to be taken to market and that involves the proposition that there must be no market for the produce in its raw state. If there is already a market for the produce in its raw state, then the process cannot be said to be a process employed to render the produce fit to be taken to market or, in other words, to make it marketable. That which is already marketable does not need any process to render it marketable. The second condition is that the process must be one which is ordinarily employed by a cultivator of the produce to render it marketable. But even if these two conditions are satisfied, it is not sufficient to attract the applicability of section 2(1) (b) (2). There is an additional requirement which must be satisfied and that requirement springs directly from the language and the reason of the enactment. It follows as a necessary corollary from what is stated above that, even where the produce is subjected to a process ordinarily employed by cultivators to render it fit to be taken to market, the produce must not change its original character. The cultivator is permitted to subject the produce to a process in order to make it marketable and what is ultimately marketed must, therefore, be that produce. The character of the produce must not Mohini Thapar (Dead) by L.RS. Verses. C.I.T. 52 (Central) Calcutta be altered as a result of the process. Of course when we say this we must make it clear that there may by changes brought about in the produce for the purpose of making the produce marketable but those changes must not amount to altering the original character of the produce: the vide Dooars Tea Company case.

5. Turning now to the authorities, the first decision to which our attention was invited was the decision of the Patna High Court in In re Bhikanpur Sugar Concern. The question which arose in this case was whether income derived from sale of sugar manufactured from sugarcane grown by the assessee on its lands was agricultural income within the meaning of section 2(1)(b) of the Income-tax Act, 1918, which was in identical terms with section 2(1)(b) of the income-tax Act, 1922. The assessee contended that the income was agricultural income, but a Full Bench of the Patna High Court consisting of three judges held that it was not, on the ground that the process employed by the assessee for manufacturing sugar was not a process ordinarily employed by cultivators of sugarcane for rendering it fit for marketing. Dawson-Miller C.J. said that the market of the vast majority of cultivators of sugarcane was the sugar factory or the country mill and they did not manufacture sugar out of it in order to make it marketable and that the process employed by the assessee was, therefore, not a process ordinarily employed by cultivators so as to bring the case within the section 2(1)(b)(2). The other learned judges also expressed the same view. This decision clearly proceeded on the basis that the process employed by the assessee not being a process ordinarily employed by cultivators to render the sugarcane produced by them marketable, one of the two conditions specified in section 2(1) (b)(2) was not fulfilled.

6. We were then referred to a decision of the Calcutta High Court in Killing Valley Tea Company Ltd. Verses Secretary of State . The assessee in this case grew green leaf tea in a tea garden owned by it and manufactured tea by performing a process on green leaves plucked from the tea garden. In its assessment to income-tax, the assessee contended that the entire income from the sale of manufactured tea was agricultural income within the meaning of section 2(1) (b) (2) of the Income-tax Act, 1918. The Calcutta High Court, however, held that though the green leaf from the tea plant was not a marketable commodity for immediate use as an article of food, it was certainly "a marketable commodity to be manufactured by people who possess the requisite machinery into tea fit for human consumption" and the manufacturing process could not, therefore, properly be said to be employed to render the tea leaves fit to be taken to market as required by the section. This decision, therefore proceeded on the basis that if there is a market for the produce grown by the assessee and despite that, some process is performed on it, such process cannot be said to be a process to render the produce fit to be taken to market so as to attract the applicability of section 2(1)(b)(2).

7. The next decision which was cited before us was the decision of the Patna High Court in J.M. Casey verses Commissioner of Income-Tax . The facts in this case were that the assessee cultivated aloe plants and from them by means of machinery prepared sisal fibre which he sold in the market. The question arose whether the whole of the income derived by the assessee was exempt from tax as being agricultural income. The Patna High Court held that it was exempt and the ground on which the Patna High Court based its decision was that aloe leaves had no market

and that the process performed on aloe leaved for Mohini Thapar (Dead) by L.RS. Verses. C.I.T. (Central) Calcutta 53 preparing sisal fibre was a process ordinarily employed to render aloe leaves fit to be taken to market. Courtney-Terrell C.J. who delivered the main judgment, observed that no cultivation of aloe plant appeared to have been practiced save in connection with the process of manufacture of sisal fibre and, moreover, there was no market for aloe leaves. Of course aloe leaves could be supplied to jails but the learned Chief Justice observed, that did not make any difference since the leaves so bought by the jail authorities were treated by the prisoners by means of the same laborious and uneconomic process which was employed by some villagers in treating the leaves of the wild and uncultivated plant and that the object of the manufacture in jails was not the conducting of an economic process which rendered profitable the cultivation of the aloe plant but merely to keep the prisoners employed on sufficiently laborious and punitive work. It was thus definitely found that the aloe leaves were not ordinarily marketable and they could normally be sold only by converting them into sisal fibre. The learned Chief Justice made it clear that the decision of the court was based on these conditions which existed at the time and observed:

It may be that in the future the economic conditions may change. If the growth of the aloe leaf should become established as an agricultural industry by itself and if the manufacturers of sisal fibre should cease to cultivate the plant themselves and should purchase the leaves in an open market then and such circumstances may possibly require reconsideration in the light of the income-tax law.

An argument was also advanced on behalf of the revenue that the assessee being the only cultivator, the process employed by him could not be said to be a process ordinarily employed by a cultivator to render aloe leaves marketable, but this argument was met by the learned Chief Justice by saying that since there was no cultivation of the aloe plant save in connection with the economic process involving the use of machinery such as was employed by the assessee, the process ordinarily employed would in fact be that used by the assessee. This decision thus laid down two propositions: (1) that in order to attract the applicability of section 2(1) (3)(2) the produce in its state must not have a ready and available market where goods of that kind are bought and sold; and (2) that even if the assessee is the only cultivator, a generalization can be made from the single instance of the assessee and the process employed by the assessee can be regarded as a process ordinarily employed by a cultivator in render the produce marketable. The second proposition laid down in this decision would meet the difficulty pointed out on behalf of the assessee, namely, that the assessee being the only cultivator of galkas in the present case, the process employed by him could not be appropriately described as a process ordinarily employed by a cultivator to render gankas fit to be taken to market.

8. Reference was also made to a decision of the Court of the Judicial Commissioner, Nagpur, in Sheolal verses Commissioner of Income-tax where the question was whether the process of ginning applied by the assessee could be said to be a process within the meaning of section 2(1) (b) (2). The court held that the process of ginning was not a process ordinarily employed by cultivators to render cotton grown by them fit to be taken to market since unginned cotton was sold by the cultivators and ginning was not essential in order to render the cotton fit to be taken to market. The fact that there was a market for cotton grown on the land was thus taken into account for the purpose of holding that the process of Mohini Thapar (Dead) by L.RS. Verses. C.I.T. 54 (Central) Calcutta ginning could not be said to be a process necessary to render the produce fit to be taken to market.

9. Then we were referred to a decision of the Bombay High Court in Brihan Maharashtra Sugar Syndicate Ltd., verses. Commissioner of Income-tax. The question which arose in this case was whether income realized as a sale of gul manufactured by the assessee out of sugarcane grown by it, was agricultural income within the meaning of section 2(1) (b)(2). The Tribunal found that the requirements of the section were satisfied, but on a reference to the High Court a Division Bench of the High Court held that though there was evidence to support the finding of the Tribunal that the process employed by the assessee in the manufacture of gul was a process ordinarily employed by a cultivator, the finding that the process was one ordinarily employed by a cultivator to render the produce fit to be taken to market was erroneous inasmuch as there was a market for the sale of sugarcane before it was turned into gul. Kania J., as he then was, after referring to section 2(1) (b) (2), said: Reading the words used in the definition section with their mutual meaning they must mean that the produce must retain its original character in spite of the process unless there is no market for selling it in that condition. If there is no market to sell the produce then any process which is ordinarily employed to render it fit to reach the market, where it can be sold, would be covered by

the definition…. The learned judge agreed with the Patna High Court in J.M. Casey case that market must mean a ready and available market where produce of the kind grown by the assessee is bought and sold and observed that since the statement of the case itself showed that there was a market for sugarcane, the process employed by the assesses in converting it into gul could not be said to be a process ordinarily employed to render it fit to be taken to market where it can be sold. Now it must be conceded straightway that, in view of the decision of the Supreme Court in Dooars Tea Company Ltd. Case, the statement contained in the passage quoted above can no longer be regarded as good law in so far as it says that if there is no market for selling the produce in its original character, the character of the produce may be altered by performing a process necessary to render it fit to be taken to market and such a process too would be covered by section 2(1)(b)(2). It is now clear that the produce must retain its original character and if the effect of the process is to alter the character of the produce, the process would not be a process within the intendment of section 2(1) (b)(2). But this much is certainly established by this decision, namely, if there is a market for the produce, no process performed on it can be said to be a process necessary for rendering it fit to be taken to market.

10. We were also referred to a decision of the Mysore High Court in A.T. Parthasarathiah & Bros. Verses. Commissioner of Income-tax [(1963))]. That decision does not help us very much for it merely applies section 2(1)(b)(2) as construed by us above to the facts of that case. The question there arose in regard to tamarind plucked by the assessee from trees owned by him and converted into "flower tamarind" by a process of cleaning which involved removal of fibre and seeds. The Mysore High Court held that inasmuch as the Tribunal had not addressed itself to the question as to what was the process ordinarily employed by cultivators in the locality where the assessee resides to render the tamarind grown by them fit to be taken to market, it was necessary to call for a further Mohini Thapar (Dead) by L.RS. Verses C.I.T. (Central) Calcutta 55 statement of the case and the Tribunal was accordingly required to submit a further statement of the case in order to enable the court to dispose of the question.

11. The last decision to which we must refer is the decision of the Andhra Pradesh High Court in Boggavarapu Peda Ammaiah verses. Commissioner of Income-tax. The assessee in this case carried on the business of export of tobacco grown on his lands and he claimed exemption in respect of income arising on the sale of tobacco as agricultural income. The revenue authorities treated the income derived from operations up to the stage of the "flue-curing" as agricultural income but regarded the subsequent activities which involved the performance of the process of re-drying, stripping and grading and sale of tobacco subjected to such process as non-agricultural operations and treated the income attributable to those operations as income from business subject to tax. The Andhra Pradesh High Court before whom the question came on a reference took the view that the tobacco after flue-curing had a large market in the country and the operations of re-drying, stripping and grading were, therefore, not quite essential to make the tobacco marketable. The High Court also took the view that these operations could not be regarded as a process ordinarily employed by cultivators in order to make the tobacco marketable. Since in the opinion of the High Court both the conditions of section 2(1)(b) (2) were not satisfied, the High Court held that the income attributable to the operations of re-drying, stripping, and grading could not be described as agricultural income but should be treated as income liable to tax.

12. It would thus be seen that in all these decisions the various High Courts applied section 2(1) (b)(2) to the facts of the case before them and examined the question whether the two conditions of the section were satisfied so as to make the income agricultural income.

We will, therefore, now proceed to consider how far these two conditions could be said to be fulfilled in the present case in regard to the process employed by the assessee for the purpose of preparing loofahs out of galkas.

13. Before, however, we do so, it would be convenient to dispose of one short argument advanced by Mr. Kaji on behalf of the assessee and that argument was that galkas when subjected to the process for converting them into loofahs did not retain their original character but underwent a change in character, since loofahs were goods of a different character from galkas and section 2(1)(b)(2) was, therefore, not attracted. Now it is undoubtedly true that if galkas did not retain their original character on being subjected to the process for converting them into loofahs, the process would not be a process within the meaning of section 2(1)(b)(2). But unfortunately for the assessee it is not open to Mr. Kaji to urge this contention before us since the contention raises a question of fact and not having

been advanced before the Tribunal and their being no finding of the Tribunal on the question and the question not being the subject-matter of reference before us, the assessee cannot be permitted to raise the contention before us.

14. Going back to the main question, Mr. Kaji contended that the Tribunal had misdirected itself in law in proceeding on the basis that for the purpose of determining whether there was no market for galkas in raw state which would make the performance of the process for converting them into loofahs necessary to render them marketable, the only market which the Tribunal was required to take into account was the market in India. He urged that even if there was no market for galkas in India, but there was a market abroad, say Mohini Thapar (Dead) by L.RS. Verses. C.I.T. 56 (Central) Calcutta for example, in Japan, as the contention of the assessee was, the performance of the process for converting them into loofahs could not be said to be necessary in order to render them fit to be taken to market and the Tribunal should have therefore considered whether there was no market for galkas outside India. This contention is, in our opinion, well-founded. We do not think it can be seriously disputed that if there was a market for galkas-and by galkas we mean the commodity of galkas in raw state-even outside India, the performance of the process for converting them into loofahs could not be said to be necessary in order to make them marketable. It is in this connection important to bear in mind that even loofahs had no market in India and the process of converting into loofahs was performed on the galkas with a view to exporting and selling them abroad. Both in the case of galkas and in the case of loofahs, therefore, there was no market in India and the market had to be found outside India. It is possible that if loofahs had a market in India, an argument could with some plausibility have been advanced that even if galkas had a market outside, a cultivator of galkas in India would ordinarily convert them into loofahs which would be saleable in India rather than sell galkas in their raw state outside India. But where, as in the present case, the markets, if any, could only be outside India, both for galkas and loofahs, it must be concluded that if galkas had a market outside India, the process employed for converting galkas into loofahs for a market which was also outside India could not be said to be employed in order to make galkas fit for being taken to market. In such a case both the markets being out of India and galkas being marketable, no process performed on them could be said to be a process essential to make them marketable. It was, therefore, not enough for the Tribunal to find that there was no market for galkas in India. The Tribunal should have also considered whether there was no market for galkas outside India and it was only if the Tribunal found that there was no market for galkas outside India, that the Tribunal could come to the conclusion that the process employed for the purpose of converting galkas into loofahs was a process covered by section 2(1) (b) (2).

15. But the learned Advocate-General contended that even if that be the view which we are inclined to take, there was a finding of the Tribunal that there was no market for galkas and that in view of that finding the process employed by the assessee must be regarded as a process necessary to render galkas fit to be taken to market. This contention involves a consideration of the order of the Tribunal. But before we examine this contention, we say dispose of another argument advanced by Mr. Kaji, namely, that the process employed by the assessee could not be said to be process ordinarily employed by a cultivator to render galkas fit to be taken to market. There were two circumstances relied on by Mr. Kaji in this connection. The first was that the assessee was the only cultivator of galkas and there could not, therefore, be any standard with reference to which it could be said whether the process was a process ordinarily employed by a cultivator. But this argument is sufficiently met by the reasoning of the Patna High Court in J.M. Casey case to which we have already referred.

As a matter of fact if galkas in their raw state had no market at all, a cultivator of galkas could not do otherwise than make loofahs out of them and the process of making loofahs would, therefore, be a process ordinarily employed by a cultivator of galkas. The second circumstance on which the reliance was placed was the fact that the accounts in respect of the cultivation of galkas were maintained by the assessee in one set of books while the accounts in respect of the processing of galkas and sale of loofahs made out of them were maintained Mohini Thapar (Dead) by L.RS. Verses. C.I.T. (Central) Calcutta 57 in other set of books. This, argued Mr. Kaji, showed that the intention of the assessee as a cultivator was not to make loofahs out of galkas but to sell galkas in their raw state and if the conduct of assessee be taken as a test, the process of making loofahs out of galkas could not be said to be a process which would be ordinarily employed by the cultivator. This argument is, in our opinion, totally devoid of force. It cannot be overlooked that both the concerns belonged to the assessee and it is not possible to infer from a mere bifurcation of the two activities of the assessee that an ordinary cultivator of galkas would sell galkas in their raw state and would

not prepare loofahs out of them. The determining factor must be whether there was a market for galkas as a commodity. If there was a market for galkas as a commodity, it would be possible to take the view that a cultivator would ordinarily sell galkas in raw state for he would be interested merely in selling his produce and not in performing processes which are not necessary in order to render the produce marketable. But if there was no such market, then obviously the cultivator would have no choice but to make loofahs out of them for the purpose of sale. We must, therefore, come back to the question whether there was no market for galkas in the sense that there was no place in India or abroad where galkas as a commodity were bought or sold.

16. Now turning to the order of the Tribunal, the portion of the paragraph 5 of the order which we have reproduced above shows that before the Tribunal it was the contention of the assessee that galkas had a market by themselves and that the subsequent operations were in the nature of manufacturing operations. The assessee for the purpose of establishing this plea produced evidence in the shape of letters addressed by parties in Japan to the assessee and contended on the basis of these letters that there was a market for galkas. The Tribunal after setting out this contention of the assessee in paragraph 5 proceeded to deal with it in paragraph 6. The Tribunal started by saying that they were unable to agree with this contention of the assessee, namely, that galkas had a market. The Tribunal then proceeded to give its reasons for coming to this conclusion. The Tribunal first stated that in order to find out whether there was a market for the produce, what was necessary to be seen was whether there was a market at which it could be absorbed. This is no doubt a correct proposition, but in the way in which it is put, it is likely to be misunderstood and we would, therefore, like to clarify it by saying that what is required to be considered is not whether the particular produce grown by the assessee is saleable but whether there is a market where the produce ordinarily grown by a cultivator is bought or sold as a commodity so that a cultivator of the produce would ordinarily sell the produce as such and not perform any process on it. The Tribunal after setting out this proposition observed that the existence of "a theoretical market in a place like Japan is not one that has to be taken into account for this purpose." The learned Advocate-General relied strongly on this observation and contended that this observation showed that the Tribunal found as a fact there was no real market in Japan. Mr. Kaji, on the other hand, contended that all that the Tribunal meant to say in making this observation was that the existence of a theoretical market in a place like Japan was not relevant but what was relevant was the existence of a market in India. He urged that the word "theoretical" was used by the Tribunal to describe the market in Japan because the Tribunal considered that the real market to be considered was the market in India and all markets outside India were theoretical markets for the purpose of determination of the present question. We think Mr. Kaji is right in his reading of this observation of the Tribunal. The observations of the Mohini Thapar (Dead) by L.RS. Verses C.I.T. 58 (Central) Calcutta Tribunal which immediately follow upon this observation clearly support the interpretation sought to be placed by Mr. Kaji. The Tribunal, after making this observations, proceeded to examine what is the market in reference to which the question whether it exists or does not exist is required to be considered. The Tribunal observed that the expression "ordinarily employed" would appear to postulate the existence of certain conditions at or about the locality in which the produce is grown, meaning thereby that whether there is a market for the produce must be judged in relation to the area in which the produce is grown. The Tribunal then stated that the item marketed by the assessee, namely galkas, was a stranger to the Indian market and, therefore, held that there could not be ready market for galkas in India. This position was as a matter of fact not disputed by the assessee. The Tribunal emphasized the necessity of the market in India by observing that merely because there was some possibility of a sale at its original stage in a distant country, it did not follow that galkas by themselves had a market. The Tribunal then gave an illustration to reinforce its point of view. The Tribunal observed that if a produce is grown, say in Kerala, and it does not have a ready market in its original stage there, then merely because there was some market, say in Punjab, for the produce in its original stage, it does not follow that the process ordinarily employed by cultivators in Kerala would cease to be agricultural process. The Tribunal then stated that what was required to be looked at was the area in which the produce is grown and the customary process employed to render it fit for market, if it is not marketable in its original stage. This process of reasoning of the Tribunal which we have set out above clearly shows that what the Tribunal considered to be the correct position in law was that the market to be taken into account must be the market in the area in which the produce is grown, that is, the Indian market, and since there was no ready market for galkas in India, it must be concluded that galkas had no market so as to attract the applicability of

section 2(1)(b)(2). And that conclusion was set out by the Tribunal in the last sentence of the paragraph. Reading the paragraph as a whole we think that though there are one or two observations in the paragraph which read in isolation appear to lend some support to the argument that the Tribunal found as a fact that there was no market for galkas in Japan and, therefore, no market at all in India or abroad since the market in Japan was the only market put forward on behalf of the assessee, if those observations are read in the context of the rest of the paragraph, it is clear that those observations were made not for recording a finding that there was no market for galkas as a commodity in Japan but merely for the purpose of emphasizing that what must be looked at is the market in India and not the market in a distant place like Japan. The word "theoretical" also appears to have been used in order to emphasize that the real market to be considered is the Indian market and that the rest of the markets would be mere theoretical markets. The word "theoretical" was not used in order to record a finding that there was no real market in Japan. It appears that in the view of the law which it took, the Tribunal did not concern itself to examine and find whether there was a market for galkas as a commodity in Japan and this becomes clear if we refer to the statement of the case and the question referred to us for our opinion. The statement of the case clearly shows that according to the Tribunal what it held was, to quote its own words:

(That what was liable to be looked into for the purpose of finding out whether there was a market is the area in which the produce is grown and the customary process employed to render it fit for market if it is not marketable in its original stage. Mohini Thapar (Dead) by L.RS. Verses. C.I.T. (Central) Calcutta 59 The Tribunal found also that there was no market in India in which it could be sold in its original stage. Under these circumstances, it was held....

The question which has been referred to us also shows that according to the Tribunal the basis on which its decision was founded was that galkas did not have a market in India. Even if, therefore, there were any doubt as to what the Tribunal found in its order, such doubt is clearly laid at rest by the statement of the case and the question referred by the Tribunal. We, therefore, think that reading the order of the Tribunal as a whole along with the statement of the case and the question referred for our opinion, it must be held that the only finding reached by the Tribunal was that there was no market for galkas in raw stage in India and that there was no finding of the Tribunal that galkas as a commodity had no market even outside India.

17. Now the real controversy between the parties was whether the process employed by the assessee was a process within the meaning of section 2(1)(b)(2) and in order to the proper determination of that controversy it was necessary for the Tribunal to give a finding on the question whether there was no market for galkas in India or outside India, for it is only if there was no market for galkas in India or abroad, that the process employed by the assessee could be said to be a process covered by section 2(1)(b)(2) as contended by the revenue. The question as framed is however based on the postulate that it would be sufficient to attract the applicability of section 2(1) (b) (2) if there was no market for galkas in India. It is, therefore, necessary to reframe the question in order to bring out the real controversy between the parties and the question as reframed will be as follows:

Whether, on the facts and circumstances of the case, the process employed on galkas for purposes of exporting and selling them aboard satisfies the requirements of section 2(1) (b)(2) of the Act?

In order to properly and effectively answer this question it is necessary to have the finding of the Tribunal on the question whether there was no market for galkas as a commodity in India or abroad. We, therefore, direct the Tribunal to give its finding on this question after hearing the parties and to submit a further statement of the case in relation to that finding. The Tribunal will of course confine itself to the record of the case in giving the finding. We, however, do not express any opinion on the question as to on whom would lie the burden of proof in regard to the question on which the Tribunal is directed to give the finding. That would be a matter for the Tribunal to consider. The reference will be placed on board for hearing after the supplementary statement of the case is received from the Tribunal.

C.i.t. Poona verses **h. G. Date**

(the existence of a single mill would not constitute market for the assessee's sugarcane. If the mill refuses to buy sugarcane the agriculturist has to convert it into 'gur'. In such a case the agriculturist can claim exemption.)

Facts

The assessee h.g. Date sold jaggery in the market and earned some income. I.t.o. Made assessment of such income. For the assessment years 1952-53 and 1954-55, being the accounting years samvat year 2007 and samvat year 2008 he claimed the income to be agricultural income. The tribunal found that the quality of the sugarcane cultivated by the assessee was such that it could not be used for chewing. Sugarcane cannot be stored as a crop as it starts losing its sugar content within 48 hours of being cut. The tribunal further found that there was no market for the sale of sugarcane in its natural condition. On the basis of above, the tribunal held that since there was only one sugar mill and which had refused in past to buy from the assessee, it could not be said that there existed market and such as conversion of sugarcane of jaggery is a process to render the sugarcane fit to be sold in the market. It was also held that the process of such conversion has been the process ordinarily employed in this country.

The matter came to high court by way of reference u/s 66 of the old act. The department contended that there was no evidence before the tribunal to justify the finding that there was no market of sugarcane produced by the assessee. H.c. Observed that a finding of fact given by the tribunal is open to attack as erroneous in law when there is no material to support it or if it is perverse or has been reached without due

consideration of several matters relevant for such a determination, it was not open to the court to scrutinize details of evidence to ascertain whether the findings made by the tribunal were justified. Taking the facts into consideration it was held that findings made by the tribunal were not unwarranted having regard to the inadequacy of the evidence on record.

Decision: on the merits it was observed by the h.c. That agricultural income to fall u/s 2(1) (b) (3) of the old act, first condition required to be satisfied is that the process employed by the assessee must be one which is ordinarily employed by a cultivator for making his agricultural produce marketable. The second condition required to be satisfied is that the produce must retain its original character in spite of process unless there is no market for selling it in that condition, if there is no market to sell the produce then any process which is ordinarily employed to render it fit to reach the market, where it can be sold, would be covered by the definition.

The sugarcane, by conversion, no doubt changed its character or condition into jaggery (gur) and as such the question for decision is whether the sugarcane produced in its original condition was having market or not? Relying on the following statements extracted from the tribunal's order it was held by the h.c. That tribunal was justified in concluding that there was no market for the sale of sugarcane in its original condition:— -

(1) the sugarcane grown by the assessee in, his farm cannot be used for chewing. The only other use to which it can be put is the production of sugar.

(2) sugarcane is a crop which has certain peculiarities. If sugarcane after being cut is not crushed within 48 hours, it starts losing its sugar content.

(3) mills buy sugarcane near the mills as far possible. If no mill buys sugarcane, an agriculturist has to convert into gur.

(4) there is no market as such where sugarcane of this quality can be sent and sold.

(5) the mills buy their requirement at price fixed by the government or at such other price at which sugarcane can be purchased according to their requirements.

(6) the existence of a mill in our opinion, does not mean that there is a market for the sale of sugarcane.

Note: in *banarsidas gupta verses* c.i.t., it was held by the supreme court that where there is a market for sugarcane as such and there are sugar manufacturing industries, which purchase sugar, the process of extraction of juice or conversion to 'gur' is not a process necessary to render the produce fit to be taken to the market. Therefore, the profit derived by such a process would not be excluded as agriculture income.

K. Lakshmanan & co. Verses c.i.t.

(where the assessee is growing mulberry leaves and feeding such leaves to silk worms and is obtaining silk cocoons, income from sale of silk cocoons is not agricultural income.)

Facts: the appellant is a partnership firm constituted for the purpose of carrying out agricultural activities. During the course of its business it indulges in the activity of groverseslng mulberry leaves and rearing silkworms. The assessee purchases silkworm eggs and when they are hatched the worms are principally fed on mulberry leaves. The mulberry leaves are plucked from the trees grown by the appellant and these leaves are cut into stripes which are fed to the silkworms. The worms wind around themselves the saliva which oozes from the mouth and the hardened saliva forms the protective cocoons. These cocoons are then sold in the market by the appellant.

Issue: whether, on the facts and circumstances of the case, income derived by the assessee from the sale of silk cocoons is an agricultural income?

Decision of the supreme court: in view of section 2(a)(b) of the income-tax act, "agricultural income" means an income derived from such land by the performance by a cultivator of any process ordinarily employed by him to render the produce raised by him fit to be taken to market. What is taken to the market and sold must be the produce which is raised by the cultivator even though for the purpose of making it marketable or fit for sale, some process may have to be undertaken, the section does not contemplate the sale of an item or a commodity which is different from what is cultivated and processed. Had the mulberry leaves been subjected to some process and

sold in the market as such then certainly the income derived there from would be regarded as agricultural income but the case of the appellant before the authorities, and in the supreme court, has been that mulberry leaves cannot be sold in the market and they can only be fed to the silkworms. The agricultural produce of the cultivator will be mulberry leaves and by no stretch of imagination can the silkworms, and certainly not the silk cocoons, be regarded as the agricultural produce of the cultivator.

Note: in *k. Lakshmanan & co. Verses c.i.t., 5* taxman 272 (karn), the high court held that just as milk yielded by a cow cannot be considered as marketable form of grass/fodder eaten up by the cows, the silk produced by silk worm cannot be considered as marketable form of mulberry leaves.

V.v.n.m. Subayya chettiar verses c.i.t.

(if karta permanently lives in ceylon and the mere fact that he has a house in india where his mother lives, cannot constitute that place the seat of power. If he comes to india for family litigation, there is no shift of seat of power or there is no second centre. However, the assessee was unable to adduce evidence to show that the control was wholly outside india. Therefore the presumption that normally a hindu undivided family will be taken to be resident in taxable territory was held to be the legitimate conclusion.)

Facts: the *karta* of a joint hindu family had been living in ceylon with his wife, son and daughters and they had domiciled in that country. The, *karta* carried on business in colombo and owned a house, some immovable property and investments in british india. In the year of account, 1941-42 he visited british india on seven occasions for a total period of 101 days. During such stays, he personally attended to a litigation relating to the family lands and proceedings relating to the assessment of the family income. He had started two partnership firms in india on 25.3.1942 and remained in india for sometime after the commencement of those businesses.

Under section 4a(b) of the income-tax act 1922 "a hindu undivided family, firm or other association of persons is resident in british india unless the control and management of its affairs is situated wholly without british india.

Issue: whether in the circumstances of the case, the assessee (a hindu undivided family) was resident in british india under section 4a(b) of the income-tax act, 1922 [section 6(2) of the income-tax act, 1961)]?

Decision of the tribunal: the income-tax officer and the assistant commissioner of income tax held that the appellant was resident within the meaning of section 4a (b) income-tax act, 1922. The appellate tribunal overruled the decision of assistant commissioner and that of the i.t.o.

Decision of the supreme court: under section 4a (b) of the income-tax act. 1922 "a hindu undivided family, firm or other association of persons is resident in british india unless the control and management of its affairs is situated wholly without british india'.

The real business is carried on where the central management and control actually abides. Explaining the provisions of section 4a(b). Patanjali shasrti j., said in *swedish central railway co. Ltd. Verses* thompson*, 9* tax cases 342 (e) "that control and management "signifies in the present context, the controlling and directing power, "the head and brain" as it is sometimes called, and "situated" implies the functioning of such power at a particular place with some degree of permanence while "wholly" would seen to recognize the possibility of the seat of such power being divided between two distinct and separated place".

The words used in section 4a(b), according to the supreme court, clearly show "firstly, that *normally a hindu undivided family will be taken to be resident in the taxable territories, but such presumption will not apply if the case can be brought under the second part of the provision.* Secondly, we take it that the word "affairs" which are relevant for the purpose of the income-tax act, and which have some relation to income. Thirdly, in order to bring the case under the exception, we have to ask whether the seat of the direction and control of the affairs of the family is inside or outside british india. Lastly, the word "wholly" suggests that hindu undivided family have more than one "resident" in the same way as a corporation may have".

Commenting upon the facts of the case the supreme court observed that "the mere fact that the assessee has a house at danadukathan, where his mother lives, cannot constitute that place the seat of control and management of the affairs of the family. Now we are inclined in the circumstances of the present case to attach much importance to the fact that the assessee had to stay in british india for 101 days in a particular year. He was undoubtedly interested in the litigation with regards to his family property as well as in income-tax proceeding and by merely coming out of india to take part in them he cannot be said to have shifted the seat of management and control of the affairs of his family or to have started a second centre for such control and management. The same remark must apply to the starting of two partnership businesses, as mere "activity" cannot be the test of residence".

As observed earlier the *"onus of proving facts would bring the assessee's case within the exception which is provided by the latter part of section 4a(b) was on the assessee. The assessee was called upon to adduce evidence to show that the control and management of the affairs of the family was situated wholly outside the taxable territories, but file correspondence to which the assistant commissioner of income tax refers and other material evidence which might have shown that normally and as matter of course the affairs in india were also being controlled from colombo were not produced.* The position, therefore, is this. On the one hand we have the fact that the head and *karta* of the assessee's family who controls and manages its affairs permanently lives in colombo and the family is domiciled in ceylon. On the other hand, we have certain acts done by the *karta* himself in british india, which though not conclusive by themselves to establish the existence of more than one seat of control for the affairs of the family are by no means irrelevant to the matter in the issue and, therefore, cannot be completely ruled out of consideration in determining it. In these circumstance and in the absence of material evidence to which reference has been made and the finding of the assistant commissioner that *the onus of proving such facts as would bring his case within the exception had not been discharged by the assessee and the normal presumption must be given effect to appear to us to be legitimate conclusion".* Thus the supreme court dismissed the appeal.

Narottam and parekh ltd. Verses c.i.t.

(what has to be considered is not the power or capacity to manage and control, but the actual control and management or in other words, not the de jure control and management but the de facto control and management and in order to hold that the company was resident during the year of account it must be established that the company de facto controlled and managed its affairs in bombay. It was held that in this case the assessee company was not only dejure controlled and managed its affairs in bombay but also dejure controlled and managed its affairs in bombay.)

Facts: the assessee company was a subsidiary company of the scindia steam navigation co. Ltd. And its business was stevedoring in ceylon. It was registered in bombay and its registered office was also in bombay. The meetings of the board of directors were held in bombay and also the meeting of the shareholders. Two managers under two powers of attorney looked after all the affairs of the assessee company in ceylon and the widest possible power and authority has been conferred upon those two managers under these powers of attorney. But the central management and control has been kept in bombay and has been exercised by the directors in bombay.

Issue: whether the assessee company was a resident company?

Decision: in order that a company should be resident in india it is necessary that the control and management should be situated wholly in the taxable territories. In construing the expression "control and management" it is necessary to bear in mind the distinction between doing of business and the control and management of business. Business and the whole of it may be done outside india and yet the control and management of that business may be wholly within india. It is strictly irrelevant where the business is done and from which place the income has been earned. What is relevant and material is from which place that business been controlled and managed.

The bombay high court observed that "the test to be applied is where is the controlling and directing power, or rather, where does the controlling and directing power function or to put it in a different language there is always a seat of power or the head and brain, and what has got to be ascertained is, where is this seat of power, or the head and brain? A company or a firm or an undivided hindu family has got to work through servants, and agents, but it is not the servants and agents that constitute the seat of power or the controlling and directing power. It is that authority to which the servants, employees and agents are subject, it is that authority which controls and manages them which is the central authority, and it is at the place where the central authority functions that the company resides..... A company may have a dozen local

Branches at different places outside india, it may sent out agents fully armed with authority to deal with and carry on business at these branches and yet it may retain the central management and control in bombay and manage and control all the affairs of these branches from bombay and at bombay."

Coming to the facts of the case the high court observed, *"it is perfectly true that these two managers do all the business of the company in ceylon and in doing that business naturally a large amount of discretion is given to them and a considerable amount of authority. But the mere doing of business does not constitute these managers the controlling and directing power. Their powers of attorney can be concelled at any moment; they must carry out any orders given to them from bombay; they must submit to bombay an explanation of what they have been doing; and throughout the time that they are- working in ceylon a vigilant eye is kept over their work from the directors' board room in bombay. "directors have from time to time given directions to the managers as to how things should be done or managed.*

The high court agreed with the counsel of the assessee company that what we have to consider in this case was not the power or capacity to manage and control, but the actual control and management, or in other words, not the *dejure* control and management but the *de facto* control and management, and in order to hold that the company was resident during the year of account it must be established that 'the company *de facto* controlled and managed its affairs in bombay. On the basis of the facts the high court found that the assessee company was not only *de jure* controlled and managed its affairs in bombay but also *de jure* controlled and managed its affairs in bombay.

Thus the high court came to the conclusion that the head and the brain of the company with regard to its affairs was in bombay and not in ceylon and thus the company was held to be resident in the year of account.

Ram prasad verses c.i.t. (1972)

(whether a director is a servant or an agent may be determined by the articles of association of a company and/or the agreement if any under such a contractual relationship between the director and the company has been brought about. In this case the director was held an employee of the company and therefore his remuneration was assessable as salary.)

Facts

By virtue of article 109 of the articles of association of a company the assessee became its first managing director for a period of 20 years on the terms and conditions in an agreement dated November. 20. 1955. Under article 136 the general management of the company was in his hands. Article 107 expressly enabled the managing director generally to work for and contract with the company and specifically to do the work of agent to and manager of and also to do any other work for the company upon such terms and conditions and on such remuneration as may from time to time be agreed upon between him and the directors of the company.

Article, 150 empowered the board of directors to exercise control over the managing director in certain specific instances. Article 142 provided that the managing director shall work for the execution of the decisions arrived at by the board of directors of the company from time to time. One of the clause {clause (k)} of the agreement provided that the assessee was at liberty to resign his office upon giving three months notice and that the company in general meeting could terminate his services before the expiry of the period of 20 years if the assessee was found to be acting otherwise than in the interest of the company or was found to be not diligent in his duties.

Under the said agreement, the assessee was to receive rs 2,000 per month, a fixed sum of rs. 500/-p.m. As allowance, 10% of the gross profits of the company and he and his wife were entitled to free boarding and lodging in the hotel. For the accounting year ending sept. 20, 1955 relevant to the assessment year 1956-57, the assessee was assessed in respect of rs. 53,913 payable to him as 10% of the profits of the company which he gave up soon after the accounts were finalized but before they were passed by general meeting of the shareholders. The assessee claimed that the amount given up by him was not liable to be included in his total income because the amount had not accrued to him at all and that even assuming that it had accrued in the accounting year ending 31st march, 1956 is not taxable as salary in his hands under section 7 or as business income under section 10 of the income-tax act, 1922.

The income-tax officer, the appellate assistant commissioner, the tribunal, and on a reference the high court all held that the amount was taxable as "salary" under section 7 of the income-tax act, 1922 (section 15 of the income-tax act, 1961) and that the income had accrued to the assessee during the previous year.

Issue before the supreme court

1. Whether the sum of rs. 53,913 was a revenue receipt of the assessee of the previous year?

2. Whether the amount was chargeable as salary under section 7 or as business income under section 10 of the income-tax act, 1922?

Decision of the supreme court

The supreme court held that the sum of rs. 53., 913 payable to the assessee was a avenue receipt and it was payable to him as salary and was chargeable under section 7 of the income-tax act, 1922 (corresponding to section 15 of the income-tax act 1961). Under the articles and the agreement the assessee was not an agent company but a servant.

With regard to the test for distinguishing from servant supreme court observed as follows:

"there is no doubt that for ascertaining whether a person is servant or an agent, a rough and ready test is, whether under the terms of his employment, the employer exercises a supervisory control in respect of the work entrusted to him. A servant act., under the direct control of his master, an agent on the other hand; in the exercise of his work, is not subject to direct control and supervision of the principal though he is bound to exercise his authority in accordance with all lawful orders and instructions which may be given to him from time to time by his principal. But, this test is not universal in its application and does not determine in every case having regard to the nature of employment, that he is a servant..... The nature of the particular business and the nature of the duties of the employee will require to be considered in each case in order to arrive at a conclusion as to whether the person employed is a servant or an agent. In each case the principle for ascertainment remains the same."

The directors of the company are not servants but agents in as much as the company cannot act in its own person but has only to act through directors.

A managing director may have a dual capacity. He may both be a director as well as an employee. Whether or not a managing director is a servant of the company apart from being a director can only be determined by the articles of association and terms of employment. The nature of his employment may be determined by the articles of association of a company and agreement, if any, under which a contractual relationship between the director and the employee has been brought about, where under the director is constituted an employee of the company. If such be the case, his remuneration will be assessable as salary under the income-tax act.

In the present case a perusal of the articles and terms and conditions of the agreement definitely indicated that the powers of the assessee had to be exercised within the terms and limitations prescribed in the articles and subject to the control arid supervision of the directors which was indicative of his being employed as a servant of the company.

The sum of rs. 53,913 was a revenue receipt and had accrued to the assessee in the year of account and payable to him as 'salary' and thus taxable. The voluntary foregoing of the amount was mere application of income.

C.It. Verses l.w. Russel

(one cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payments to which the employee has no right till the contingency occurs.)

Facts

The respondent, l.w. Russel, was an employee of the english and scottish joint co-operative wholesale society ltd. Kozhikode, which was incorporated in england. The society established a superannuation scheme for the benefit of the male european members of the society staff employed in india, ceylon and africa by means of deferred annuities. Every european employee of the society shall become a member of the scheme as a condition of employment. Under the terms of the scheme the trustee has to effect a policy of insurance for the purpose of

insuring an annuity of every member of the society on his attaining the age of superannuation or on the happening of a specified contingency. The society was to contribute one-third of the premium payable by such employee. During the year 1956-57 the society contributed. Rs. 3,334/- towards the premium payable by the respondent. The i.t.o., kozhikode circle, included the said amount in the taxable income of the respondent for the year 1956-57 under section 7(1), explanation 1, sub-clause (v) of the income tax act, 1922. The appeal, preferred by the respondent against the said inclusion to the assistant commissioner of income tax and appellate tribunal received the same fate. But the high court decided in favour of the respondent. Therefore, the revenue preferred an appeal to the supreme court.

Decision

The section 7(1) and explanation 1, sub-clause (5) of the income tax act, 1922 provided as follows:

Section 7(1):- the tax shall be payable by an assessee under the head "salaries" in respect of any salary or wages, any annuity pension or gratuity and any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages, which are *allowed* to him by or are *due* to him whether paid or not, or, *paid* by or on behalf of.... A company.

Explanation 1. For the purposes of this section "perquisite", includes (v) any sum payable by the employer, whether directly or through a fund to which the provisions of chapters ix-a and ix-b do not apply, to effect an assurance on the life of the assessee or in respect of a contract of annuity on the life of the assessee".

Commenting upon the section the supreme court said, this section imposes a tax on the remuneration of an employee. It presupposes existence of the relationship of employer and employee. The present case is sought to be brought under the head "perquisite in lieu of, or in addition to, any salary or wages, which are allowed to him by or are due to him, whether paid or not, or are paid by on behalf of the company." the expression "perquisite" is defined in the oxford dictionary as "causal emoluments, fee or profit attached to an office or position in addition to salary or wages." explanation 1 sub-section (1) of the act gives an inclusive definition. Clause (x) thereof includes within the meaning of "perquisite" any sum payable by the employee whether directly or through a fund to which the provision of chapters ix-a and ix-b do not apply, to effect an assurance on the life of assessee. A combined readings of the substantive part of section 7 (1) and clause (v) of explanation 1, thereto makes it clear that *if a sum of money is allowed by the employer to the employee or is due to him from or is paid to enable the latter to effect an insurance on his life, the said sum would be perquisite within the meaning of section 7 (1) of the act and, therefore, would be eligible to tax. But before such sum becomes so eligible, it shall either be paid to the employee or allowed to him by or due to him from the employer.* So far as the expression "paid" is concerned, there is no difficulty for it takes in every receipt of the employee from the employer whether it was due to him or not. The expression 'due" followed by the qualifying clause "whether paid or not" shows that there shall be an obligation on the part of the employer to pay the amount and a right on the employee to claim the same. The expression "allowed" was introduced in the section by the finance act of 1955. The said expression in the legal terminology is equivalent to fixed, taken into account, set apart, granted. It takes in perquisites given in cash or in kind or in money or money's worth and also amenities which are not convertible into money. It implies that a right is conferred on the employee in respect of those perquisites. *One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payments to which the employer has no right till the contingency occurs. In short, the employee must have a vested right therein."* in the present case, according to the rules framed under the scheme, till the respondent reached the age of superannuation the amounts vested in the trustees and the beneficiary under the trust could be ascertained only on the happening of one or other of the contingencies provided for under the trust deed. On the happening of one contingency, the *employer* was to become the beneficiary and on the happening of another contingency, the *employee* was to become the beneficiary.

Thus no interest in the sum contributed by the employer under the scheme vested in the employee, as it was only a contingent interest depending upon the reaching of the age of superannuation by the respondent. Therefore, the court held that it was not a perquisite allowed to him by the employer within the meaning of section 7 (1) of the income-tax act. 1922. Thus appeal was dismissed.

C.I.t. Verses beman behari shah

(the annual value of house property will be included in the total income of the owner even if he received no income or there is no possibility of his receiving any income from house property.)

Facts

By a bill dated the 24th november, 1925 shri banku behari shah founded a rebutter estate comprising of a large number of properties dedicated to two deities namely, shri iswar benode behari shah and shri iswar benedeswar mahadeverses the testator appointed his eldest son, sri bone behari shah "the only shebalt of the deities and the only trustee of the debutter properties'etc, "shri beman behari shah, who was the respondent, was the sole sewak of the said deities and trustees to the debutter properties, having been duly appointed as such in terms of the said will. The debutter properties included *inter alia* two houses in calcutta, being premises no. 122. A, manicktola street and 12, benode behari shah lane, in which the two deities were installed. According to clause (17) of the will 'no body save and except the brahmin performing the worship of the deity and servants shall ever be .competent to reside in the said "thakur bati at no. 12, benode behari shah lane and the said thakur bati shall never be used as a place of agitation and meeting or for the sake of interiors or for any public functions".

Decision of l.t.o, a.a.c., and a.t.

The income-tax officer computed the bonafide annual value of the premises no. 12 benode behari shah and 122-a, manicktola street, at the amounts which they were likely to fetch if let out a the open market. The assessee objected to the assessment of annual value on the two premises on the ground that they were not let out and no income accrued there from. The appellate assistant commissioner allowed the objection of assistant commissioner and observed that in view of injunctions contained in clause (17) the premises had no letting value.

Issue before the high court

"whether on the facts and in the circumstances of the case, the tribunal misdirected itself in law in holding that premises no. 12 benode behari shah lane, calcutta and no. 122a, manicktola street, calcutta had no bonafide annual value within the meaning of section 9 (2) of the income tax act, 1922" (section 23 of the income tax act, 1961)?

Decision of the high court

Section 9 (1) and 9 (2) of the income tax act, 1922, provided as follows: "9 (1) the tax shall be payable by an assessee under the head "income from property" in respect of the bonafide annual value of property consisting of any building or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to tax subject to the following allowances, namely.....

(2) for the purposes of the section, the annual value of any property shall be deemed to be the sum for which the property might reasonably be expected to let from year to year".

Commenting upon the above provisions of the income-tax act, 1922 (sections 22 and 23 of the income tax act, 1961), the calcutta high court said, 'it is apparent from the section quoted above, that even where a property is not let and even where it does not produce any income, the income tax officer is to proceed on the basis of a notional income which the property might reasonably be expected to yield from year to year".

The court quoted with approval the following paragraph from the judgment of a.g. Kania, c.j. Of bombay high court in *d.m. Vakil verses* c.i.t.

"the legislature has, therefore expressly provided that the tax shall be payable by the assessee in respect of the bonafide annual value irrespective of the question whether he receives that value or not. Section 9 (2) provides that for the purposes of this section, the expression "annual value shall" be deemed to mean the sum for which the property might reasonably be expected to let from year to year. It is again significant to note that the word used is 'might' and not 'can' or 'is'. Reading these two paragraphs of section together, it is clear that the *income from property is thus an artificially defined income and the liability arises from the fact that the assessee is the owner of the property.* It is further provided in the section that if the owner occupies the property he has to pay tax calculated in the manner provided therein.

Thus the court upheld the contention of the revenue that the tribunal was not correct in holding that, in view of the injunction, contained in the will against the residence of anybody in premises (apart from the priest performing the worship of the deity and its servants), the premises have no letting value. The court observed that the injunction would be relevant consideration in finding out the bonafide letting value of the premises. Therefore, the court answered the question referred to in the affirmative and in favour of the revenue.

East India housing and land development trust ltd, verses. Commissioner of income-tax, west. Bengal

(where a company is incorporated with the object to develop market consisting of shops, stalls etc. The income derived by letting out the shops and stalls was held to be income from property.)

Facts

The appellant company was incorporated with the objects of buying and developing markets. The company purchased 10 bighas of land in calcutta in 1946 and set up a market therein. The company constructed shops and stalls on platforms on that land. The company received rs. 82,866 from the tenants of the shops and stalls for the assessment year 1953-54.

The income-tax officer assessed the aforesaid income under section 9 of the income-tax act, 1922 (section 22 of the income-tax act, 1961) as "income from property'. The order of the income-tax officer was confirmed in appeal by the appellate assistant commissioner and the tribunal. The appellant appealed to the supreme court by special leave.

Issue

Whether the income realized from the tenants of the shops and stalls was liable to be taxed as "business income" under section 10 of the income-tax act, 1922 (section 28 of the income-tax act, 1961) or as income from property under section 9 of the income-tax act, 1922 (section 22 of the income-tax act, 1961).

Decision of the supreme court

The supreme court held that income realized by the appellant company from shops and stalls was income from property and fell under the specific head described in section 9 of the income-tax act. 1922 (section 22 of the income-tax act, 1961), the character of the income was not altered even when it was received by a company formed with the object of developing and setting up markets. Although the company was, under the provisions of the calcutta municipal act, 1951, required to obtain a licence from the corporation of calcutta and to attain sanitary and other services in accordance with provisions of the act, and for that purpose to maintain a staff and to incur expenditure, but the income, only for that reason, did not become "profits or gains" from business within the meaning of section. 10 of the income-tax act 1922 (section 28 of the income-tax act, 1961). The character of the income was not changed merely because some stalls were occupied by the same occupants and the remaining stalls were occupied by shifting class of occupants.

The court further held that the distinct heads specified in section 6 of the income-tax act, 1922 (section 14 of the income-tax act, 1961) are mutually exclusive and income derived from different sources falling under the specific heads has to be computed for the purpose of taxation in manner provided by the relevant provisions. If the income from a source falls within a specific head [v] prescribed in the act, the fact that it may indirectly be covered by another head will not make the income taxable under the latter head.

R.b. Jodhamal kuthiala verses c.i.t.

(for the purposes of section 22, *the owner must be that person who can exercise the rights of the owner, not on behalf of the owner but in his own right)*

Facts

The concerned assessment year were 1952-53, 1955-56 and 1965-57, the relevant accounting periods being financial years ending march 31, 1952, march 31, 1955 and march 31, 1956. The assessee was a registered firm deriving income from interest on securities, property, business and other sources. Sometime in the year 1946 it purchased the nedous hotel in lahore for a sum of rs. 46 lakhs. For that purpose it raised a loan of rs. 30 lakhs from m/s bharat bank ltd., lahore and a loan of rs. 18 lakhs from the raja of jubbal. The loan taken from the bank was partly repaid but as regards the loan taken from the raja, the assessee came to an agreement with the raja under which the raja accepted a half share in the said property in lieu of the loan advanced and also l/3rd of the outstanding liability of the bank. This arrangement came into effect on november 1, 1951. After the creation of pakistan, lahore became a part of pakistan. The nedous hotel was declared an evacuee property and consequently vested in the custodian in the pakistan.

In its return for the relevant assessment years, the assessee claimed losses of rs. 1,00,723, rs. 1,16.599 and rs. 1,16,599 respectively but showed the gross annual letting value from the said property at nil. The loss claimed was stated to be on account of interest payable to the bank. Since the property in question had vested in the custodian of evacuee property, in pakistan, the income-tax officer held that no income or loss from that property can be considered in the assessee's case. He accordingly disallowed the assessee's claim in respect of the interest paid to the bank. The appellate assistant commissioner confirmed the order of the income-tax officer. In second appeal the tribunal came to the conclusion that the assessee still continued to be the owner of the property for the purpose of computation of loss. The tribunal held that the interest paid is a deductible allowance under section 9(l)(iv) of the act. In arriving at that conclusion, the tribunal relied on its earlier decision in the case of the assessee in respect of the assessment year 1951-52. Thereafter at the instance of the assessee, the tribunal submitted the question set out earlier. The high court on an analysis of the various provisions of the pakistan (administration of evacuee property) ordinance, 1949 (xv of 1949) came to the conclusion that for the purpose of section 9 of the act, the assessee cannot be considered as the owner of that property.

Issue

Whether on the facts and circumstances of the case, the assessee continued to be the owner of the property for the purpose of computation of income under section 9 of the income-tax act, 1922 (corresponding to section 22 of the income-tax act, 1961)?

Decision of the supreme court

Section 9(1) of the income-tax act, 1922 says:

"the tax shall be payable by an assessee under the head 'income from property' in respect of the bona fide annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to tax subject to the following allowances namely:—

Section 9 of the income-tax act, 1922 brought to tax the "income from property and not the interest of a person in the property." a property cannot be owned by two persons, each having independent and exclusive right over it. Hence for the purposes of the aforesaid section the person must be that person who can exercise the rights of the owner, not on behalf of the owner but in his own right.

The question as to who is the owner of a house under section 9 of the income-tax act, 1922 (corresponding to section 22 of the income-tax act, 1961) in circumstances similar to those before the court in this case came up for consideration before the calcutta high court in the matter of *the official assignee for bengal (estate of jnanendra nath pramanik),* . In that case on the adjudication of a person as insolvent under the presidency towns insolvency act, 1909, certain house property of the insolvent vested in the official assignee. The

question arose whether the official assignee could be taxed in respect of the income of the property under section 9. The high court held that the property did not by reason of the adjudication of the debtor cease to be a subject fit for taxation and in view of the provisions of section 17 of the presidency towns insolvency act, reads:

"on the making of an order of adjudication, the property of the insolvent wherever situate shall vest in the official assignee and shall become divisible among his creditors, and thereafter, except as directed by-this act, no creditor to whom the insolvent is indebted in respect of any debt provable in insolvency shall, during the pendency of the insolvency proceedings, have any remedy against the property of the insolvent in respect of the debt or shall commence any suit or other legal proceedings except with the leave of the court and on such terms as the court may impose: provided that this section shall not affect the power of any secured creditor to realize or otherwise deal with his security in the same manner as he would have been entitled to realize or deal with it if this section had not been passed."

The powers of the custodian were no less than that of the official assignee under the presidency towns insolvency act, 1909. The official assignee was held owner for the purposes of section 9 of the income-tax act, 1922. In arriving at this decision the high court relied on *sir currimbhoy ebrahim baronetcy trust verses c.i.t., bombay,*.

Pollock on jurispendence (6th ed. 1929) pages 178-80 observes: "ownership may be described as the entirety of the powers of use and disposal allowed by law.....the owner of a thing is not necessarily the person who at a given time has the whole power of use and disposal; very often there is no such person. We must look for the person having the residue of all such power when we have accounted for every detached and limited portion of it; and he will be the owner even if the immediate power of control and use is elsewhere."

In *raja rc. Lal chaudhry verses* c.i.t*.,* itr 123 (patna), it was held that the receiver of property appointed by court was not the owner of the property for the purposes of section 9 of the income-tax act, 1922.

The supreme court came to the conclusion that the assessee was not the owner of nedous hotel during the relevant assessment year for the purposes of section 9 of the income-tax act, 1922.

B.d. Bharucha verses c.i.t.

(bad debts: *the assessee found that a balance of rs. 80,759 was irrecoverable from the film distributors and he accordingly wrote it off as a bad debt in the ledger account. He was held entitled to claim the said amount as a bad debt and the loss suffered by him was held not a loss of capital but a revenue loss.)*

Facts

The appellant was an individual having income from house property, government securities, cinema exhibition and financing film producers and distributors. During the period from march 3, 1952 to november 5, 1952 the appellant advanced a sum of rs. 40,000 to a firm of film distributors known as tarachand pictures. The appellant thereafter entered into an agreement dated january 5, 1953 with tarachand pictures under which the appellant advanced a further sum of rs. 60,000 in respect of the distribution, exploitation and exhibition of a picture called *agricultural income* 'shabab'. According to clause 2 of the agreement the distributors were to pay a lumpsum of rs. 1750 by way of interest on the initial advance of rs. 40,000. Clause 3 of the agreement read as follows:

"no interest will run henceforth on this sum of rs. 40,000 as also on the advances to be made as provided hereinabove but in lieu of interest it is agreed that the distributors will share with the financier profit and loss of the distribution, exploitation and exhibition of the picture shabab in the bombay circuit, two-third going to the financier and one-third to the distributors."

Clauses 4 and 5 were to the following effect:

"the distributors shall on or before the 15th of every month submit to the financier a statement of account of the business done during the previous month in respect of the picture 'shabab' in the territories of bombay circuit.

The distributors shall keep the proper accounts of the business of the picture 'shabab' and the same as well as all documents, reports and contracts will be available to the financier or his agent for inspection."

Clause 7 read as follows:

"in case the picture is not released in bombay within 15 months from the date hereof the distributors shall be bound to immediately return all the moneys so far advanced to them by the financier. In that event the distributors shall be bound to return all the moneys together with interest thereon @ 9% per annum."

Clause 8 stated:

"in case of any breach being committed by the distributors of any of the terms herein provided this agreement shall at once terminate and the moneys paid by the financier shall be at once repaid by the distributors to the financier with interest @ 9% per annum."

The distributors were not in a position to exhibit the film in bombay within the stipulated time. When the film was ultimately released for exhibition it proved to be unsuccessful. The matter was taken to the city civil court and ultimately a consent decree was obtained in suit no. 2061 of 1954 in the bombay city civil court. In the end the appellant found that there was a balance of rs. 80,759 which was irrecoverable and he accordingly wrote it off as a bad debt on december 31, 1955 in the ledger account. For the assessment Year 1957-57, the corresponding previous year being the calendar year 1955, the appellant claimed a loss of rs. 80,759 which he had written off as bad debt, under section 10(2)(11) of the income-tax act, 1972 [corresponding to section 36(I)(7) of the income-tax act, 1961].

Issue

Whether the aforesaid loss of rs. 80,759 was deductible under any of the provisions of the act?

Decision of the supreme court

The supreme court held that the appellant was entitled to claim the amount of rs. 80,759 *as a bad debt under section 10(2)(xi) of the income-tax act, 1922 [corresponding to section 36(l)(7) of the income-tax act, 1961] and the loss suffered by the appellant was not a loss of capital but a revenue loss. The transaction between the parties under the agreement dated january* 5, 7953 *was a money lending transaction.* In the course of his judgement verses ramaswami 3. Said:

"if clause 3 of the agreement is taken in isolation there may be some force in the contention of the respondent that the term under which the appellant undertook to share the loss took the transaction out of the category of a money lending transaction and the loss suffered by the appellant was therefore a capital loss. In the present case, however, clause 3 of the agreement dated january 5, 1953 cannot be read in isolation but it must be construed in the context of clause 7 which provides that in case the picture was not released in bombay within 15 months from the date of the agreement, the distributors will return all the moneys so far advanced to them by the appellant together with interest thereon at 9% per annum. It is the admitted position in the present case that the picture was not released by the distributors till the stipulated date, namely, april 4, 1954 but it was released on may 28, 1954 and clause of the agreement therefore came into operation. The result therefore is that on and from april 4, 1954 there was a contract of loan between the parties in terms of clause 7 of the agreement and the principal amount became repayable from that date to the appellant with interest thereon at 9% per annum."

C.i.t. Verses mysore **sugar co. Ltd., bangalore**

(bad debts: *there is distinction between expenditure by way of investment and expenditure in the course of the business. The first may truly be regarded as on the capital side but not the second. The amount paid to sugarcane growers in this case was advance against price of crop. The amount, so for as the assessee company was concerned, represented the current expenditure towards the purchase of sugarcane and it makes no difference that the sugarcane zs purchased was grown by oppigedars with the seedlings, fertilizer and money taken an account from the assessee company. There was hardly any element of investment which contemplates more than payment of advance price.)*

Facts

The assessee company purchases sugarcane from the sugarcane growers, and crushes them in its factory to prepare sugar. As a part of its business operations it enters into agreements with the sugarcane growers, who are known locally as "oppigedars," and advances them sugarcane seedlings fertiluersand also cash. The oppigedars enter into a written agreement called the oppige, by which they agree to sell sugarcane exclusively to the assessee company at current market rates and to have the advances adjusted towards the price of sugarcane, agreeing to pay interest in the meantime. For this purpose, an account of each oppigedars is opened by the assessee company. A crop of sugarcane takes about 18 months to mature and these agreements take place at the harvest season each year, in preparation for the next crop.

In the year 1948-49 due to drought, the assessee company could not work its sugar mills and the oppigedars could not grow or deliver the sugarcane. The advances made in 1948-49 thus remained unrecovered, because they could only be recovered by the supply of sugarcane to the assessee company. The mysore government realizing the hardship appointed a committee to investigate the matter and to make a report and recommendations. The committee recommended that the assessee company should ex-gratia forego some of its dues, and in the year of account ending june 30, 1952, the company waived its rights in respect of rs. 2,87,422. The company claimed this as a deduction under section 10(2)(11) and 10(2)(15) of the indian income-tax act, 1922 (corresponding to section 36(l)(7) and section 37 of the income-tax act, 1961). The income-tax officer declined to make the deduction, because, in his opinion, this was neither a trade debt nor even a bad debt but an ex-gratia payment almost like a gift. An appeal to the appellate assistant commissioner also failed. Before the income-tax appellate tribunal, madras bench, these two arguments were again raised, but were rejected, the tribunal holding that the payments were not with an eye to any commercial profit and could not thus be said to have been made out of commercial expediency, so as to attract section 10(2)(15) of the act. The tribunal also held that these were not bad debts, because they were "advances, pure and simple, not arising out of sales" and did not contribute to the profits of the businesses. From the order of reference, it appears that the appellate tribunal was also of the opinion that these advances were made to ensure a steady supply of quality sugarcane, and that the loss if any, must be taken to represent a capital loss and not a trading loss.

Decision of the high court

The high court held that the expenditure was not in the nature of a capital expenditure, and was deductible as a revenue expenditure. It relied upon the decision of the supreme court in *badridas daga verses* c.i.t*.,* to hold that this amount was deductible in computing the profits of the business for the year in question under section 10(1) of the indian income-tax act, 1922.

Issue before the supreme court

Whether the money which was given up, represented a loss of capital, or revenue expenditure?

Decision of the supreme court

M. Hidayatullah, j. On behalf of the bench said: "to find out whether expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss of capital. But this is not true of all losses. The questions to consider in this connection are: for what was the money laid out? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an out-going in the doing of the business? If money be lost in the first circumstance, it is a loss of capital, but if lost in, the second circumstance, it is a revenue loss. In the first, it bears the character of an investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses." his lordship referred to the following cases:

In *english crown spelter co. Ltd. Verses baker,* (1908) the english crown spelter co. Carried on the business of zinc smelting for which it required large quantities of blende.' to get supplies of blende, a new company called the welsh crown spelter company was formed, which received assistance from the english company in the shape of advances on loan. Later, the english company was required to write off £ 38,000 odd. The question arose whether the advance could be said to be an investment of capital, because if they were, the english company would have no right to deduct the amount. If, on the other hand, it was money employed for the business, it could be deducted. Bray, j. Who considered these questions, observed:

> "if this were an ordinary business transaction of a contract by which the welsh company were to deliver certain blende, it may be at prices to be settled hereafter, and that this was really nothing more than an advance on account of the price of that blende, there would be a great deal to be said in favour of the appellants...it is impossible to look upon this as an ordinary business transaction of an advance against goods to be delivered...! Can come to no other conclusion but that this was an investment of capital in the welsh company and was not an ordinary trade transaction of an advance against goods."

The second case, *charles marsden and sons ltd. Verses commissioner of inland revenue,* (1919) , is under the excess profits duty in england, and the question arose in the following circumstances: an english company carried on the business of paper making. To arrange for supplies of wood pulp, it entered into an agreement with a canadian company for supply of 3,000 tons per year between 1917-1927. The english company made an advance of £ 30,000 against future deliveries to be recouped at the rate of £ 1 per ton delivered. The canadian company was to pay interest in the meantime. Later, the importation of wood pulp was stopped, and the canadian company neither delivered the pulp nor returned the money. Rowlatt, j. Held this to be a capital expenditure not admissible as a deduction. He was of opinion that the payment was not an advance payment for goods, observing that no one pays for goods ten years in advance, and that it was a venture to establish a source and money was adventured as capital.

Facts

In assessment year 1977-78 the appellant, a state government corporation, derived its income from interest, letting out the warehouses and administrative charges for procurement of foodgrains while working for the food corporation of india as well as the state government. It claimed deduction of expenditure of rs. 38,13,555.17 under section 37 of the act in computing its income under the head "profits and gains of business or profession". The income-tax officer allowed only so much of the expenditure as could be allocated to the taxable income and disallowed the rest of it which was referable to the non-taxable income, being exempt under section 10(29) of the act. On appeal, the commissioner of income tax (appeals) ii accepted the claim of the appellant that the entire expenditure was deductible. The revenue's appeal there from to the income tax appellate tribunal was allowed upholding the order of the income-tax officer on 17-7-1986. At the instance of the appellant the question noted below was referred to the high court. By order under challenge the high court confirmed the order of the income tax appellate tribunal.

Issue

"whether on the facts and in the circumstances of the case and the business of the assessee being one and indivisible, the tribunal was right in law in holding that the expenses have to be allocated in the same

percentage as the different sources of income and are not to be allowed in entirety as allowed by the commissioner of income tax (appeals) after following decisions noted in para 11 of the order dated 31-1-1985 for assessment years 1974-75, 1975-76 and 1980-81?"

Decision of the supreme court

A plain reading of section 37 makes it clear that it is a residuary provision and allows expenditure, not covered under sections 30 to 36, in computing the income chargeable under the head "profits and gains of business or profession", provided its other requirements are satisfied. They are: (i) the expenditure should not be in the nature of capital expenditure or personal expenses of the assessee; (ii) it should have been laid out or expended wholly and exclusively for the purposes of the business or profession; and (iii) it should have been expended in the previous year.

The disallowance of the expenditure was not for non-compliance with the requirement of section 37(1) of the act but for the reason that the expenditure was incurred on an activity from which income was exempted under the act. A similar question arose in the case of *indian bank limited.* In that case the respondent assessee, in the course of its business, borrowed moneys for investment in securities. Part of its income, derived from securities, was exempt under the income-tax act, 1922. It sought to deduct the interest paid on the entire borrowed amount. *The question before the supreme court was whether a portion of interest, which was referable to investment on securities from which income was exempt, was allowable. Section 10 (2) (hi) and (xv) of the act of 1922 was precursor of section 37(1) of the act. It was held by the supreme court that in allowing a deduction which was permissible one need not look beyond the expenditure to see whether it had the quality of directly or indirectly producing taxable income and, therefore, there was no warrant for disallowing a proportionate part of the interest referable to money borrowed for the purchase of securities yielding tax-free interest.*

In *maharashtra sugar mills ltd.* The assessee company was manufacturing sugar in its factory and was also growing sugarcane for the purposes of the factory. The supreme court held that managing agency commission referable to the income from growing of sugarcane (i.e. Agricultural income not liable to tax) as well as the income from manufacturing of sugar was laid out for the purposes of the business carried on by the assessee and was allowable under section 10(2)(15) of the act of 1922.

In *punjab state co-operative supply and marketing federation ltd.* The punjab and haryana high court held that the business of the assessee being indivisible, the entire expenditure incurred by the assessee was deductible and not only the proportionate amount relating to the activity which yielded income.

In *waterfall estates ltd. Verses c.i.t.,* (1996): (1996) , it was held that the question as to whether the activities carried on the assessee constituted one business or different business, is essentially a question of fact. No single test can be devised as universal and conclusive. The question has to be taken and a conclusion arrived at. The assessee in this case was carrying on different ventures, profits from some of them were taxable and from others were exempt under the act. The tribunal found that there was no proof that different ventures constituted the same business. On that finding the tribunal took the view that the apportionment of expenditure was valid which was upheld by the high court and the supreme court. There was no nexus between the venture in question and the business comprising of other ventures carried on from the head office and therefore so much of the expenditure incurred on head office which was attributable to that venture was not a permissible deduction in computing profits of the business.

In view of the aforesaid cases, the following principles were laid down by the supreme court in the instant case:

"(1) if income of an assessee is derived from various head of income, he is entitled to claim deduction permissible under the respective heads whether or not computation under each head results in taxable income;

(2) if income of an assessee arises under any of the heads of income but from different items e.g. Different house properties or different securities etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the act, the entire permissible expenditure in earning the income from that head is deductible; and

(3) in computing "profits and gains of business or profession" when an assessee is carrying on business in various ventures and some among them yield taxable income and the others do not, the question of allow ability of the expenditure under section 37 of the act will depend on:

(a) fulfilment of requirements of that provision noted above; and

(b) on the fact whether all the ventures carried on by him constituted one indivisible business or not;

If they do, the entire expenditure will be a permissible deduction but if they do not, the principle of apportionment of the expenditure will apply because there will be no nexus between the expenditure attributable to the venture not forming an integral part of the business and the expenditure sought to be deducted as the business expenditure of the assessee. "

The apportionment of the expenditure was held not valid. Income from various ventures was earned in course of one and indivisible business. Therefore, the question was answered in the negative, in favour of the assessee.

C.i.t. Verses the travancore sugar and chemicals ltd. (1973)

(the stipulation that the assessee had to pay 20% (later reduced to 10%) of the net profit to the government was a concession granted to the assessee and was therefore, deductible at its inception. The decision was based on the peculiar facts of the case. The tests indicated in this case were not intended to be of general application but were given to bring into fold the special aspects of the case.)

Facts

The respondent company was floated to take over the assets of three undertaking run by the government—a sugar manufacturing concern, a distillery and a tincture factory. The first was to be purchased for rs. 3.15 lakhs, the second one a joint valuation of the parties, and the third at the book value of the assets. The agreement provided, *inter alia,* that apart from the cash consideration the government would be entitled to 20% (later reduced to 10%) of the net profits earned by the company in every year subject to a maximum of rs. 40,000 after providing for depreciation and the remuneration payable to the company's treasures and secretaries. A sum of rs. 42,480 became payable to government in pursuance to this agreement in the previous year (may 1 1956 to april 30 1957). For the assessment year 1951-59 this sum of rs. 42,480 was not allowed by the high court as it considered that it was a capital expenditure and not a revenue expenditure. On appeal the supreme court held that the payment was in the nature of revenue expenditure but reminded the case to be high court for determining the following questions:

(1) whether the payment was tantamount to diversion of profits by a paramount title?

(2) whether the transaction was a joint venture with an agreement to share profits?

(3) whether the requirements of section 10 (2) (15) of indian income-tax act, 1922 (section 37 of the income-tax act, 1961)

The revenue did not press the contention that the transaction was a joint venture with an agreement to share profits. The high court by majority, held that the amount could be said to be diverted by paramount title and that the amount was an allowable deduction under section 10 (2) (15) of the indian income tax act. 1922 (section 37 of the income tax act, 1961). The department appealed to the supreme court.

Decision of the supreme court

The supreme court affirmed the decision of the high court. It held that viewed from any point of view, whether as a revenue expenditure or as an overriding charge on the whole of the profit making apparatus, or as expenditure laid out and expended wholly and exclusively for the purposes of trade, the amount was an allowable deduction under the income tax act.

The supreme court further held that "the amount to be paid by reference to profits can either be that it is paid after the profits become divisible or. Distributable or that the amount is payable prior to such distribution or division to be computed by reference to notional or as in some decisions what is termed as apparent net profits. In the former instance it will certainly be a distribution of profits and not deductible as an expenditure incurred in running the business but in the later it may, on the facts and circumstances of the case, and the agreement or the nature of the obligation under the particular instrument, which govern the obligation, be an expenditure incurred as a contribution to the profits-earning apparatus or as it is said, incurred at the inception and deductible

as an overriding charge of the profit making apparatus or is one laid out and expended wholly and exclusively for the purpose of such business."

Section 10 (1) and 10 (2) (15) of the income-tax act 1922 (corresponding to section 28 and section 37 of the income-tax act, 1961 provides as follows;

"(1) the tax shall be payable by an assessee under the head "profits and gains of business, profession or vocation, in respect of the profits and gains of any business, profession or vocation carried on by him.

(2) such profits or gains shall be computed after making the following allowances, namely:

(15) any expenditure (not being an allowance of the nature described in any of the clauses (1) to (14) inclusive, and not being in the nature of capital expenditure or personal expenses of the assessee} laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

The section 10 (1) of the income-tax act, 1922 (section 28 of the income-tax act, 1961) imposes a charge on the profits and gains of a business which accrue to the assessee while section 10 (2) enumerates various items which are admissible as deduction. The supreme court held that "where income which accrues to the assessee is not his income, the question of admissible deduction would not arise. Again income can be said to be diverted only when it is diverted at source so that when it accrues it is not really the income of the assessee but it is somebody else's income. It is thus clear that whereby the obligation income is diverted before it reaches the asessee, it is deductible. But, where the income is required to be applied to discharge an obligation after such income reaches the assessee it is merely a case of application of income to satisfy an obligation of payment and is therefore not deductible.

In the present case the assessee had no option at the time of inception and had to accept the terms stipulated by the government for transferring to the assessee the profit earning assets. The court held that the stipulation that the assessee had to pay 20% (later reduced to 10%) of the net profit to the government was a concession granted to the assessee and was therefore, deductible at its inception.

Empire jute co. Ltd. Verses c.i.t. (1980)

(the amount paid by the assessee company for the purchase of loom hours was held to be in the nature of revenue expenditure.)

Facts

The assessee (the appellant) was a limited company carrying on business of manufacture of jute. It had a factory with a certain number of looms in the state of w. Bengal. It was a member of the indian jute mills association. With a view to adjusting the production of the mills to the demand in the world market a working time agreement was reached between the members of the association to restrict the number of working hours per week for which the mills were entitled to work their looms. The agreement also enabled the members to be registered as a "group of mills" if they happened to be under the control of the same managing agents or were combined by any arrangement or agreement and it was open to any member of the group of mills so registered to utilise the allotment of hours of work per week of other members in the same group who were not fully utilizing the hours of work allowable to them under the working time agreement. The assessee purchased loom hours from four different jute manufacturing concerns under the agreement for the aggregate sum of rs. 2,03,255/- during the year august. 1, 1958 to july 31, 1959.

The income-tax officer did not allow the claim of deduction of the expenditure of rs. 2,03 255/- but on appeal appellate assistant commissioner accepted the claim and allowed the deduction and the same view was taken by the tribunal. The high court, on reference by the revenue, was inclined to take the same view as the tribunal, but it felt compelled by the decision of the supreme court in *c.It. Verses maheshwari devi jute mills ltd.,* 57 itr 36 to decide in favour of the revenue. The assessee thereupon preferred to appeal to the supreme court.

Issue

Whether the amount paid by the assessee for purchase of loom hours was in the nature of capital expenditure?

Decision of the supreme court

The court held that an expenditure incurred by an assessee can qualify for deduction under section 10 (2) (xv) of the income-tax act, 1922 (corresponding to section 37 (1) of the income-tax act. 1961} only if it is incurred wholly and exclusively for the purpose of his business, but even if it fulfills this requirement, it is not enough; it must further be of revenue as distinguished from capital nature.

The court quoted the observations of macnaghten *j. In race course betting control board verses wild* (1938) 22 tax. Case 182 that a "payment may be a revenue payment from the point of view of the receiver and vice versa." thus the court held that the decision in *maheshwari jute mills case* could not be regarded as an authority for the proposition that payment made by the assessee for the purchase of loom hours would be capital expenditure or revenue expenditure. It would have to be determined taking into consideration the nature of the

transaction and other relevant factors. (in *maheshwari jute mills* case an amount received by an assessee for the sale of loom hours was held to be a capital receipt.

The court held that the purchase of loom hours by the assessee had the effect of relaxing the restriction on the operation of looms to the extent of the number of working hours per week transferred to it, so that assessee could work its looms for longer hours than permitted under the working time agreement and increase its profitability. The amount paid for the purchase of loom hours was a consideration for being able to work the looms for longer number of hours. Therefore the payment was not of capital nature. By purchase of loom hours no new asset had been created. There was no addition to or expansion of the profit making apparatus of the assessee. The income earning machinery remained what it was before the purchase of the loom hours. The assessee had merely been enabled to operate the profit making structure for more number of hours. This advantage was clearly not of an enduring nature. It was limited in its duration to six months and moreover the hours transferred during a weak to the assessee had to be utilized within the weak and could not be carried forward to the next weak. Payment made by the assessee for the purchase of loom hours which enabled it to use the profit making structure for more hours would also form part of the cost of operating the profit making structure and hence revenue in character.

Thus the payment of rs. 2,03,255/- made by the assessee for the purchase of loom hours was revenue expenditure and was allowable as a deduction under section 10 (2) (15) of the income tax act. 1922 (corresponding in section 37 (1) of the income tax act, 1961}.

L.b. Sugar factory and oil mills verses c.i.t.

(the amount of rs. 50,000/~ contributed by the assessee under the sugarcane development scheme towards meeting a part of the cost of construction of roads in the area around the factory was held to be in the nature of revenue expenditure. The construction of roads was clearly connected with the business activity of the assessee and advantageous to him because of the facilities for transportation of sugarcane. But, by such expenditure, the assessee did not acquire any asset of an enduring nature. The roads belonged to the government.)

Facts

The assesse (appellant) was a private limited company carrying on business of manufacture and sale of crystal sugar in a factory situated in pllibhit in the state of uttar pradesh at a place called deoni and a road deoni dam majhala was constructed connecting the deoni dam with majhala. On the request of the collector the assessee contributed a sum of rs. 22,332 during the accounting year ending 30th sept. 1955 for constructing deoni dam and the deoni dam majhala road. The assessee also contributed a sum of rs. 50,000/- to the state of uttar pradesh during the same accounting year towards meeting the cost of construction of roads in the area around its factory under a sugarcane development scheme promoted by the uttar pradesh government. It was provided under that scheme that one third of the cost of construction of roads would be met by the central government, one third by the state government and the remaining one third by sugar factories and sugarcane growers and it was under the scheme that the sum of rs. 50,000/- was contributed by the assessee.

The income tax officer disallowed the claim for deduction of these two amounts of rs. 22,332/- and 50,000/- on the ground that the expenditure incurred was of capital nature and was not allowable as a deduction under section 10 (2) (15) of the income-tax act, 1922. {corresponding to section 37 (1) of the income-tax act, 1961). The appeal of the assessee was rejected by the tribunal. On reference the high court held that since the expenditure was not related to the business activity of the assessee as such, the tribunal was justified in concluding that it was not wholly and exclusively laid out for the business and that the deduction claimed by the assessee therefore did not come within the ambit of section 10 (2) (15)". The assessee thereupon appealed in the supreme court.

(1) whether the sums of rs. 22,332/- and rs. 50,000/- contributed by the assessee represented expenditure wholly and exclusively for the purpose of the business of the assessee?

(2) whether the expenditure was in the nature of capital or revenue expenditure.

Decision of the supreme court

The court held that the amount of rs. 22,332/- was contributed by the assessee long after the deoni dam and the deoni dam majhala roads were constructed. The contribution of this amount had nothing to do with business of the assessee. The construction of the deoni dam or the deoni dam majhala road was in no way advantageous to the assessee's business. The amount was contributed without any legal obligation to do so, purely as an act of good citizenship, and it could not be said to have been laid out wholly and exclusively for the

purpose of the business of the assessee. Therefore, the expenditure of the amount of rs. 22,332 was not deductible under section 10 (2) (15) of the income-tax act, 1961}.

Regarding the second item it was held that the expenditure of the amount of rs. 50,000/- was in the nature of revenue expenditure laid out wholly and exclusively for the purpose of the business of the assessee and was therefore allowable under section 10 (2) (15) of the income-tax act, 1922 {corresponding to section 37 (1) of the income-tax act, 1961} the amount of rs. 50,000/- was contributed by the assessee under the sugarcane development scheme towards meeting the cost of construction of road in the area around the factory. The construction of roads in the area around the factory was considerably advantageous to the business of the assessee, because it facilitated the running of its motor vehicles for transportation of sugarcane so necessary for its manufacturing activity. The construction of the roads was clearly connected with the business activity of the assessee and thus the amount was laid out wholly and exclusively for the purpose of the business of the assessee. By spending the amount rs. 50,000/- the assessee did not acquire any asset of an enduring nature. The roads which were constructed around the factory with the help of the amount of rs. 50,000/- contributed by the assessee belonged to the government of uttar pradesh and not to the assessee. The amount contributed by the assessee was only a part of the cost of construction. The advantage secured for the business of the assessee was of a long duration but it was not an advantage in the capital field, because no tangible and intangible asset was acquired by the assessee nor was there any addition to or expansion of the profit multiplying apparatus of the assessee. Thus the expenditure of the sum of rs. 50,000/-was in the nature of revenue laid out exclusively for the purposes of the business of the assessee and was, therefore, allowable as deduction under section 10 (2) (15) of the income-tax act, 1922 (corresponding to section 37 (1) of the income-tax act, 1961}.

C.i.t. Verses jalan trading co, (p) ltd. (1985)

(the aim and object of the expenditure would determine the character of the expenditure. The source or the manner of payment would be of no consequence. In this case the amount of rs. 7,93,837/- paid by the assessee to the firm in pursuance of the instrument of assignment was held to be of capital nature and thus not deductible under the income-tax act.)

Facts

M/s bharat barrel & drum manufacturing co. Ltd ("bharat barrel" for short) gave its sole selling agency to a firm, jalan trading co. By an agreement dated may 1, 1951 for two years with a right of renewal. The assessee (respondent) is a private company incorporated on october 16, 1952. Under a deed of assignment dated december, 1952, the benefits under the agreement dated may 1, 1951, were assigned to the assessee and from january i, 1953, under the agreement, the respondent carried on the business as selling agents of bharat barrel. From may 1, 1953, on the basis of the option for renewal exercised by the assessee, an agreement was entered into between bharat barrel and the assessee in respect of the sole selling agency and with a renewal clause. According to the new agreement the assignors as beneficial owners assigned to the assignees the full benefit of the sole selling agency business from january 1, 1953. In consideration of the aforesaid, the assignees covenanted with the assignors to pay to the assignors as and by way of royalty an amount equivalent to 75% of their profits and commission, remuneration and other moneys received from the manufacturers under the said agreement or any further agreement that may be entered into by the manufacturers with the assignees in pursuance of option to renew the agreement contained in the said agreement dated may 1, 1951,

Assessee claimed to have paid rs. 7, 93,837/- being 75% of its net profits in the assessment year 1954-55, and claimed it as a business deduction but the same was rejected by the assessing officer as also the appellate authorities. The high court also negatived the assessee's stand that no enduring asset was acquired.

Issue

Whether the payment of rs. 7, 93,837/- was made by the assessee for acquisition of an asset or benefit of an enduring nature and, therefore, was of capital nature?

Decision of the supreme court

The supreme court referred to the four-judge bench of the court in *assam bengal cement co. Ltd.* Verses, *c.lt.* (1955). In that case it was indicated that the line of demarcation between capital expenditure is very thin. In that case the supreme court approved the opinion of the full bench of the lahore high court in the *beharidas jagannath* (1947) 15 itr 185 where mahajan j. Speaking for the high court successfully attempted a synthesis. The supreme court observed at page 45 of 27 itr as follows:

"in case where the expenditure is made for the initial outlay or for extension of a business or for a substantial replacement of the equipment, there is no doubt that it is capital expenditure. A capital asset of the business is either acquired or extended or substantially replaced and that outlaw whatever be its source whether it is drawn from the capital or the income of the concern is certainly in the nature of capital expenditure. The question however arises for consideration where expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment. Such expenditure can be looked at either from the point of view of what is acquired or from the point of view of what is the source from which the expenditure is incurred. If the expenditure is made for acquiring or bringing into existence an asset or an advantage for the enduring benefit of the business, it is properly attributable to capital and is of the nature of capital expenditure. If, on the other hand, it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is a revenue expenditure. *If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence, it would be immaterial whether the source of the payment was the capital or the income in the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. It is only in those cases where this test is of no avail that one may go to the test of fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital if it was part of the fixed capital of the business, it would be of the nature of capital expenditure. These tests are thus manually exclusive and have to be applied to the facts of each particular case in the manner above indicated. It has been rightly observed that in the great diversity of human affairs and the complicated nature of business operations it is difficult to lay down a test which would apply to all situations. One has therefore got to apply these criteria one after the other from the business point of view and come to the conclusion whether on a fair appreciation of the whole situation, the expenditure incurred in a particular case is of the nature of capital expenditure or revenue expenditure.* In latter event only it would be a deductible allowance under section 10 (2) (xv) of the income-tax act 1922. The question has all along been considered to be a question of fact to be determined by the income tax authorities on an application of die broad principles laid down above and the courts of law would not ordinarily interfere with such findings of fact if they have been arrived at on a proper application of those principles."

In that case before this court, a lease was obtained with certain stipulations including the payment of a sum of rs. 5,000/- per year. The court found that it was an enduring for the benefit of the whole business of the company. The fact that it was a recurring payment was immaterial because one had got to look to the nature of the asset which the company had acquired. The asset which the company had acquired in consideration of this recurring payment the right to carry on its business unfettered by any competition from outsiders within the area was in the nature of a capital asset and therefore, the payment was not deductible under section 10 (2) (15) of the old act. The broad tests laid down by the court in *assam bengal cement co. Ltd.* Case (1955) have been accepted in several subsequent decisions of the supreme court as also by the high courts in india.

The facts of travancore sugars & chemicals' case (1966) were peculiar. The assessee in that case purchased travancore sugars ltd, a government distillery at nagercoil, and the business assets of a government tincture factory at trivandrum under an agreement dated june 18, 1937, entered into between the government of travancore and the promoters of the assessee company. Under the agreement, cash consideration of rs. 3,25,000/- was to be paid for buying the assets of travancore sugars ltd. In regard to the distillery, the sale price had to be arrived at on the basis of joint valuation by the engineers to be appointed by the parties. As regards the tincture factory, the book valuation was to be adopted for fixing the consideration. The existing distillery licence was agreed to stand recognized in the hands of the assessee for a period of five years after its termination. Government also undertook to purchase pharmaceutical products manufactured by the assessee at the tincture factory. Government reserved the right to nominate a director on the board of directors of the assessee company without voting powers. The agreement further stipulated payment to the government of 20% of the net profits earned by the company every year subject to a limit of rs. 40,000/- per annum and certain other payments were also undertaken. The 20% stipulation was reduced to 10% by a subsequent agreement. The question that fell for consideration was whether payment of rs. 42,480 by the assessee company to the travancore government in terms

of the agreement referred to above as modified, was allowable expenditure under section 10 of the old act in the year under consideration. The supreme court in that case stated:

"it is often difficult, in any particular case, to decide and determine whether a particular expenditure is in the nature of revenue expenditure. It is not easy to distinguish whether an agreement is for the payment of price stipulated in instalments or for making annual payments in the nature of income. The court has to look not only into the documents but also at the surrounding circumstances so as to arrive at a decision as to what was the real nature of the transaction from the commercial point of view. No single test of universal application can be discovered for a solution of the question. The name which the parties may give to the transaction which is the source of the receipt and the characterization of the receipt by them are of little consequences. The court has to ascertain the true nature and character of the transaction from the convenants of the agreement tested in the light of surrounding circumstances."

The supreme court said that so far as these observations formulating the tests are concerned. They are not different from those laid down by this court in *assam bengal cement co's* case (1955) , the court then proceeded to apply these tests to the facts of the case and observed (p. 571 of 62 itr) : "examining the transaction from this point of view, it is clear in the present case that the consideration for the sale of the three undertakings in favour of the appellant was : (1) the cash consideration mentioned in the principal agreement, viz, clauses 3, 4 (a) and 5 (a), and (2) the consideration that government shall be entitled to twenty per cent of the net profits earned by the appellant in every year subject to a maximum of rs. 40,000 per annum. With regard to the second part of the consideration there are three important points to be noticed. In the first place, the payment of commission of twenty per cent on the net profits by the appellant in favour of the government is for an indefinite period and has no limitation of time attached to it. In the second place, the payment of the commission is related to the annual profits which flow from the trading activities of the appellant-company and the payment has no relation to the capital value of the assets. In the third place, the annual payment of 20 per cent commission every year is not related to or tied up, in any way, to any fixed sum agreed between the parties as part of the purchase price of the three undertaking. There is no reference to any capital sum in this part of the agreement. On the contrary, the very nature of the payments excludes the idea that any connection with the capital sum was intended by the parties. It is true that the purchaser may buy a running concern and fix a certain price and the price may be payable in a lump sum or may be payable by instalments. *The mere fact that the capital sum is payable by instalments spread over a certain length of time will not convert the nature of that payment from capital expenditure into a revenue expenditure but the payment of instalments in such a case would always have some relationship to the actual price fixed for the sale of the particular undertaking,* as we have already mentioned, there is no specific sum fixed in the present case as an additional amount of price payable in addition to the cash consideration and payable by instalments or by any particular method. In view of these facts we are of the opinion that the payment of the annual sum of rs. 42, 480/- in the present case is not in the nature of capital expenditure but is in the nature of revenue expenditure and the judgment of the high court of kerala on this point must be overruled."

The facts of this case were peculiar. There was a substantial amount of outright cash payment over and above which the indefinite annual payment had been stipulated."

It is interesting to note that the supreme court by its judgment in *travancore sugars & chemicals ltd case* (1966) 62 itr 566 had sent down the matter to the high court for a redisposal and the very matter again came before this court, this time at the instance of the revenue and the judgment is reported in *c.lt. Verses 'travancore sugars & chemicals ltd.* (1973). At page 10 of the report, the supreme court observed:

"in considering the nature of the expenditure incurred in the discharge of an obligation under a contract or a statute or a decree or some similar binding covenant, one must avoid being caught in the maze of judicial decisions rendered on different facts and which always present distinguishing features for a comparison with the facts and circumstances, of the case in hand. Nor would it be conducive for clarity or for reaching a logical result if we were to concentrate on the facts of the decided cases with a view to match the colour of that case with that of the case which requires determination. The surer way of arriving at a just conclusion would be to first ascertain by reference to the document under which the obligation for incurring the expenditure is created and thereafter to apply the principle embodied in the decisions of those facts. Judicial statements on the facts of a particular case

can never assist courts in the construction of an agreement or a statute which was not considered in those judgments or to ascertain what the intention of the legislature was. What we must look at the contract is or the statute or the decree, in relation to its terms, the obligation imposed and the purpose for which the transaction was entered into."

The supreme court agreed with these observations. The tests indicated by the supreme court in *travancore sugars & chemicals ltd.* Case (1973) were not intended to be of general application but were given to bring into fold the special aspects of the case as the learned judges themselves stated. The high court committed a mistake in importing these reasoning as tests of general application to be applied to the facts of the present case, though the facts were indeed quite different. As already pointed out, there was a definite sum of cash consideration in *travancore sugars & chemicals* case (1973), and the special features were taken into account. In the dispute before us, the high court has categorically found that a capital asset had been acquired under the arrangement. Admittedly, the assessee was a new company and it had no other business. It acquired under the contract, stipulating to pay 75% of its annual net profits the right to carry on the business on a long-term basis, subject to the renewal of the agreement. The first of the broad tests laid down in *assam bengal cement co.'s case* (1955) 27 itr 34 (sc) that the expenditure was made for the initial outlay squarely applies and on the finding that a capital asset had been acquired. It was held that the expenditure related to the acquisition of a capital asset and was not admissible as a deduction under section 10 (2) (15) of the old act.

Therefore the assessee was not entitled to claim the amount as a deduction under section 10 (1) of the act.

Bikaner gypsum ltd. Verses c.i.t.

(capital or revenue expenditure: *expenditure made for removal of obstruction or disability in carrying on business of mining within an area in respect of which the assessee having existing right was held to be revenue expenditure.)*

Facts

The assessee company had been granted a mining lease in respect of an area under which it had the right to dig the surface of the entire area, quarry and extract mineral viz. The gypsum. Clause 3 of part iii of the lease, however, placed a restriction on its right to mining operations to the effect that no mining operation shall be carried on by it within 100 yards from the railway area, without permission of the authorities. The railway authorities extended the railway area laying down fresh track, providing railway siding and constructing quarters in the lease area without the permission of the assessee. However, as a result of the negotiation between the assessee, the railways, the state of rajasthan which had 45 per cent share of the assessee company and the sindri fertilisers which required the gypsum as raw material, it was agreed that railways would shift the station and all its establishments to an alternative site and all the four parties to the negotiation would equally bear the total expenses of rs. 12 lakhs incurred by the railways in the shifting. Pursuant to the agreement, the assessee company paid a sum of rs. 3 lakhs as its share to the northern railway towards the cost of the shifting. On the shifting of the railway trade the assessee carried out mining in the erstwhile mining area and it raised gypsum and supplied the same to sindri fertilisers. The assessee claimed deduction of rs, 3 lakhs which was rejected by the ito on the ground that it was capital expenditure. The high court also took the same view.

Decision of the supreme court

Where the assessee has an existing right to carry on a business, any expenditure made by it during the course of business for the purpose of removal of any restriction would be on the revenue account, provided the assessee does not acquire any capital asset. Payments made for removal of restriction, obstruction or disability may result in acquiring benefits to the business, but that by itself would not acquire any capital asset.

The test for considering the expenditure for the purposes of bringing into existence an asset or an advantage for the enduring benefit of a trade is not always true and conclusive. There may be circumstances where expenditure, even if incurred for obtaining advantage of enduring benefit may not amount to acquisition

of an asset. The facts of each case have to be borne in mind in considering the question having regard to the nature of the business, its requirement and the nature of the advantage in commercial sense.

In considering the cases of mining business the nature of the lease, the purpose for which expenditure is made, it relation to the carrying on the business in a profitable manner should be considered. In the instant case existence of railway station, yard and buildings on the surface of the demised land operated as an obstruction to the assessee's business of mining. The payment made by the assessee towards the cost of shifting the railway construction was thus for removal of disability and obstacle and it enabled the assessee to carry on its business of mining in an area which had already been leased out to it for that purpose. It did not bring into existence any advantage of enduring nature. There was, therefore, no acquisition of any capital asset.

C.i.t. Verses general insurance corporation

Facts

The respondent assessee had during the accounting year 1990-91 (assessment year 1991-92), incurred expenditure in respect of stamp duty and registration fee separately for (1) the increase of its authorized share capital, and (2) the issue of bonus shares. The assessing officer disallowed both the items of expenditure as revenue expenditure. Cit (appeals) and the tribunal held that the expenditure in respect of increase in authorized share capital was not allowed as revenue expenditure and expenditure incurred on account of issue of bonus issue was allowed as revenue expenditure. The bombay high court affirmed the tribunal's judgement.

Issue

Whether on the facts and in the circumstances of the case and in law the tribunal was right in holding that the expenditure incurred on account of bonus share issue is allowable expenditure?

Contentions of the parties

On behalf of the appellant it was contended, relying on the judgements of the gujarat high court and andhra pradesh high court, that the issuance of bonus shares increases the issued and paid-up capital of the company and the bonus shares of the company are directly connected with the acquisition of capital and gives an advantage of enduring nature. The expenses incurred towards issue of bonus shares confer an enduring benefit to the company which has a resultant impact on the capital structure of the company and therefore, it should be regarded as the capital expenditure. As against this, on behalf of the respondent assessee it was contended, relying on the judgements of the bombay high court and calcutta high court, that undoubtedly increase in share capital by the *issue of fresh shares* leads to an inflow of fresh funds into the company which expands or adds to its capital employed resulting in expansion of its profit-making apparatus, but the *issue of bonus shares* by capitalization of reserves in merely a reallocation of a company's funds. There is no inflow of fresh funds or increase in capital employed, which remains the same. The issue of bonus shares leaves the capital employed unchanged and, therefore, does not result in conferring an enduring benefit to the company and the same should be regarded as revenue expenditure. Decision of the supreme court

Expenditure incurred for the purpose of increasing company's share capital by the issue of fresh shares would certainly be a capital expenditure as has been held by the supreme court in *punjab state industrial development corporation ltd's* case.

Issue of bonus shares by capitalization of reserves is merely a reallocation of the company's funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same. If that be so, then it cannot be held that the company has acquired a benefit or advantage of enduring nature. The total funds available with the company will remain the same and the issue of bonus shares will not result in any change in the capital structure of the company. Issue of bonus shares does not result in the expansion of the capital base of the company. *Therefore, the expenditure on issuance of bonus shares is revenue expenditure.* The contrary judgements of the gujarat and andhra pradesh high court are erroneous and do not lay down the correct law.

The question referred to the supreme court was answered in the affirmative i.e. In favour of the assessee and against the revenue.

N. Bagavathy animal verses c.i.t. Jt 2003

[definition of "capital asset" contained in section 2(14) was held irrelevant for construing the words "assets" in section 46(2). Plain meaning applied to the section]

Two sisters, the assessee-appellants were shareholders in m/s estate (private) ltd., nagarcoil. The company went into liquidation in 1964. Pursuant to a compromise decree dated 22nd december, 1969 in litigation between the assessees and their brother (who was also a shareholder in the company), and the company represented by the liquidator, the assets of the company which included agricultural lands were distributed to the appellants and eight others. Consequently the appellants received 479 sq. Acres of agricultural lands prior to the end of the relevant accounting year that was 31-3-70. The assessment in respect of the year 1970-71 had been completed on 27-2-1971. The income-tax officer reopened the assessments under section 148 of the income-tax act, 1961. The appellants filed their returns in respect of the two notices under section 148. The contention of the appellants that in terms of the definition of 'assets' in section 2(14), agricultural lands were entitled to be excluded while computing capital gains on assets received by the shareholder from a company in liquidation under section 46(2) was not accepted. According to the assessing officer, section 46(2) refers only to money received on liquidation or the market value of the assets on the date of distribution and it was immaterial whether the asset was agricultural lands or otherwise. The value of the share of agricultural lands transferred to each appellant was, therefore, included as income subject to capital gains and subject to tax. On appeal commissioner of income-tax (appeals) and the tribunal accepted the contention of the assessee but the high court decided in favour of the revenue.

Issue

Whether on the facts and circumstances of the case, the appellate tribunal is right in law in holding that the assets mentioned in section 46(2) would mean 'capital asset' as defined in section 2(14) and that consequently, the value of agricultural lands received by the assessee on the liquidation of palkulam estate (p) ltd. Cannot be charged to be tax under section 46(2) of the income-tax act, 1960?

Decision of the supreme court

In *c.l.t.* Verses, *madurai mills co. Ltd.,* (1973) it was held that when a shareholder receives money representing his share on distribution of the net assets of the company in liquidation, he receives that money in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to sale, exchange, relinquishment or transfer within the meaning of section 12-b of the income-tax act, 1922.

Section 45(1) of the 1961 act which substantially corresponds with section 12-b of the 1922 act continues to provide that:

"any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54, 54b, 54d, 54ea, 54eb, 54f, 54g and 54h be chargeable to income tax under the head 'capital gains', and shall be deemed to be the income of the previous year in which the transfer took place."

The expression 'capital assets' has been defmed in section 2(14) of the act it does not include agricultural land in india.

It has been held by the supreme court that the principle of *madurai mills* that a distribution of assets of a company in liquidation does not amount to a transfer continues to apply to the 1961 act (see *commissioner of income tax verses r.m. Amin,*].

The view in *madurai mills co. Ltd.* Has also been statutorily affirmed in section 46(1) which provides:

"46. (1) notwithstanding anything contained in section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45."

In other words a distinction is drawn between a "transfer" of assets and a distribution of the assets of liquidation. Where there is "transfer" of assets and not a "distribution" on liquidation then having regard to section 47(8) which provides that "nothing contained in section 45 shall apply to the following transfers:"

"(8) any transfer of agricultural land in india effected before the 1st day of march, 1970".

Section 46(2) provides as follows:

"46(2) where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of sub-clause (c) of clause (22) of section 2 and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48."

C.I.T. verses. Rajendra Prasad Moody

P.N. BHAGWATI, J. – These are two references made by the Tribunal to this court under s. 256 of the I.T. Act, 1961 in view of a conflict in the decisions of the High Courts on the question as to whether interest on moneys borrowed for investment in shares is allowable expenditure under s. 57(3) when the shares have not yielded any return in the shape of dividend during the relevant assessment year. The preponderance of judicial opinion is in favour of the view that such interest is admissible, even though no dividend is received on the shares, but there are two High Courts which have taken a different view and hence it is necessary for this court to set the controversy at rest by finally deciding the question. It would be sufficient to state that the assessees in these two references are brothers and each of them had borrowed monies for the purpose of making investment in shares of certain companies and during the assessment year 1965-66 for which the relevant accounting year ended on 10th April 1965, each of the two assessees paid interest on the monies borrowed but did not receive any dividend on the shares purchased with those monies. Each of the two assessees made a claim for deduction of the amount of interest paid on the borrowed monies but this claim was negatived by the ITO and on appeal by the AAC on the ground that during the relevant assessment year the shares did not yield any dividend and, therefore, interest paid on the borrowed monies could not be regarded as expenditure laid out or expended wholly and exclusively for the purpose of making or earning income chargeable under the head "Income from other sources" so as to be allowable as a permissible deduction under s. 57(3). The Tribunal, however, on further appeal, disagreed with the view taken by the taxing authorities and upheld the claim of each of the two assessees for deduction under s. 57(3). The revenue being aggrieved by the decision of the Tribunal made an application in each case for reference of the following question of law, namely: Whether, on the facts and in the circumstances of the case, interest on money borrowed for investment in shares which had not yielded any dividend is admissible under s. 57(3)?

And since there was divergence of judicial opinion on this question, the Tribunal referred it directly for the opinion of this court. The determination of the question before us turns on the true interpretation of s. 57(3) and it would, therefore, be convenient to refer to that section, but before we do so, we may point out that s. 57(3) occurs in a fasciculus of sections under the heading, "F – Income from other sources." S. 56, which is the first in this group of sections, enacts in sub-s. (1) that income of every kind which is not chargeable to tax under any of the heads specified in s. 14, Item A to E, shall be chargeable to tax under the head "Income from other sources" and sub-s. (2) includes in such income various items, one of which is "dividends." Dividend on shares is thus income chargeable under the head "Income from other sources." S. 57 provides for certain deductions to be made in computing the income chargeable under the head "Income from other sources" and one of such deductions is that set out in cl. (3), which reads as follows:

Mohini Thapar (Dead) by L.RS. Verses C.I.T. (Central) Calcutta 159 Any other expenditure (not being in the nature of capital expenditure) laid out or expended, wholly and exclusively for the purpose of making or earning such income.

The expenditure to be deductible under s. 57(3) must be laid out or expended wholly and exclusively for the purpose of making or earning such income. The argument of the revenue was that unless the expenditure sought to be deducted resulted in the making or earning of income, it could not be said to be laid out or expended for the purpose of making or earning such income. The making or earning of income, said the revenue, was a sine qua non to the admissibility of the expenditure under s. 57(3) and, therefore, if in a particular assessment year there was no income, the expenditure would not be deductible under that section. The revenue relied strongly on the language of s. 37(1) and, contrasting the phraseology employed in s. 57(3) with that in s. 37(1), pointed out that the legislature had deliberately used words of narrower import in granting the deduction under s. 57(3). S. 37(1) provided for deduction of expenditure laid out or expended wholly and exclusively for the purpose of the business or profession in computing the income chargeable under the head "Profits or gains of business or profession." The language used in s. 37(1) was "laid out or expended – for purpose of the business or profession" and not "laid out or expended – for the purpose of making or earning such income" as set out in s. 57(3). The words in s. 57(3) being narrower, contended the revenue, they cannot be given the same wide meaning as the words in s. 37(1) and hence no deduction of expenditure could be claimed under s. 57(3) unless it was productive of income in the assessment year in question. This contention of the revenue undoubtedly found favour with the High Court but we do not think we can accept it. Our reasons for saying so are as follows:

What s. 57(3) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. It is the purpose of the expenditure that is relevant in determining the applicability of s. 57(3) and that purpose must be making or earning of income. S. 57(3) does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction. It does not say that the expenditure shall be deductible only if any income is made or earned. There is in fact nothing in the language of s. 57(3) to suggest that the purpose for which the expenditure is made should fructify into any benefit by way of return in the shape of income. The plain natural construction of the language of s. 57(3) irresistibly leads to the conclusion that to bring a case within the section, it is not necessary that any income should in fact have been earned as a result of expenditure. It may be pointed out that an identical view was taken by this Court in Eastern Investments Ltd. Verses CIT [(1951)], where interpreting the corresponding provision in s. 12(2) of the Indian I.T. Act, 1922, which was ipsissima verba in the same terms as s. 57(3), Bose J., speaking on behalf of the court, observed: It is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned. It is indeed

difficult to see how, after this observation of the court, there can be any scope for controversy in regard to the interpretation of s. 57(3). Mohini Thapar (Dead) by L.RS. Verses C.I.T. 160 (Central) Calcutta It is also interesting to note that, according to the revenue, the expenditure would disqualify for deduction only if no income results from such expenditure in a particular assessment year, but if there is some income, howsoever small or meagre, the expenditure would be eligible for deduction. This means that in a case where the expenditure is Rs. 1000, if there is income of even Re. 1, the expenditure would be deductible and there would be resulting loss of Rs. 999 under the head "Income from other sources." But if there is no income, then, on the argument of the revenue, the expenditure would have to be ignored as it would not be liable to be deducted. This would indeed be a strange and highly anomalous result and it is difficult to believe that the legislature could have ever intended to produce such illogicality. Moreover, it must be remembered that when a profit and loss account is cast in respect of any source of income, what is allowed by the statute as proper expenditure would be debited as an outgoing and income would be credited as a receipt and the resulting income or loss would be determined. It would make no difference to this process whether the expenditure is X or Y or nil; whatever is the proper expenditure allowed by the statute would be debited. Equally, it would make no difference whether there is any income and if so, what, since whatever it be, X or Y or nil, would be credited. And the ultimate income or loss would be found. We fail to appreciate how expenditure which is otherwise a proper expenditure cancease to be such merely because there is no receipt of income. Whatever is a proper outgoing by way of expenditure must be debited irrespective of whether there is receipt of income or not. That is the plain requirement of proper accounting and the interpretation of s. 57(3) cannot be different. The deduction of the expenditure cannot, in the circumstances, be held to be conditional upon the making or earning of the income. It is true that the language of s. 37(1) is a little wider than that of s. 57(3), but we do not see how that can make any difference in the true interpretation of s. 57(iii). The language of s. 57(3) is clear and unambiguous and it has to be construed according to its plain natural meaning and merely because a slightly wider phraseology is employed in another section which may take in something more, it does not mean that s. 57(3) should be given a narrow and constricted meaning nor warranted by the language of the section and, in fact, contrary to such language.

This view which we are taking is clearly supported by the observations of Lord Thankerton in Hughes verses Bank of New Zealand [(1938)], where the learned Law Lord said:

Expenditure in course of the trade which is unremunerative is none the less a proper deduction, if wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense.

This view is eminently correct as it is not only justified by the language of s. 57(3) but it also accords with the principles of commercial accounting. The contrary view taken by the Patna High Court in Maharajadhiraj Sir Kameshwar Singh verses CIT and the Calcutta High Court in Sohanlal verses Madanlal CIT [(1963)] must in the circumstances be held to be incorrect. We accordingly answer the question referred to us for our opinion in each of these two references in favour of the assessee and against the revenue.

Philip john flasket thomas verses c.i.t.

[relationship of husband and wife must also subsist when transfer of asset is made to attract section 64(1)(4)].

Facts

The appellant assessee entered an engagement to marry one mrs. Judith knight stated to be a divorcee and the engagement was announced in certain newspapers on september 3, 1947. On december 18, 1947 the assessee transferred by a transfer deed, his 750 'a' shares in a company to his would be wife mrs. Judith knight. The deed stated that the assessee in consideration of his forthcoming marriage with mrs. Judith knight, did thereby transfer the shares to the said transferee. On december 15, 1947, the company transferred the shares to mrs. Judith knight and registered her as the owner of the shares. On december 18, 1947 the marriage was solemnized. On january 26, 1948 the fact of the marriage was communicated to the company and the name of the share holder was changed in the books of the company to mrs. Judith thomas. During the relevant periods the shares stood registered in the name of the assessee's wife and when the income in question arose to her she was the wife of the assessee. For the assessment year 1951-52 and 1952-53, accounting periods ending april 30,1950 and april 30,1951, the income-tax officer included in the total income of p.j.p. Thomas. The appellate assistant commissioner, the appellate tribunal and the high court gave the decisions against the assessee.

Issue before the supreme court

On the facts and circumstances of the case whether the dividends paid by the company to mrs. Judith thomas could be included in the income of p.j.p. Thomas and be taxed in his hands under the provisions of section (16(3) (a) (3) of the income-tax act, 1922 [section 64(I) (4) of the income-tax act, 1961]?

Decision of the supreme court

According to section 15(3)(a)(3) of the income-tax act, 1922 [now section 64(1)(4) of the income-tax act, 1961] in computing the total income of any individual for the purpose of assessment there shall be included so much of the income of the *wife* or minor child of such individual as arises directly or indirectly *from the assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration* or in the connection with an agreement to live apart.

On a proper reading of section 16(3)(a)(3) of the income-tax act 1972, it seems clear enough, according to the supreme court, that the relationship of husband and wife must also subsist when the transfer of assets is made in order to fulfil the condition that the transfer is "directly or indirectly to the wife by the husband."

On the date of the transfer of shares, e.g. December 10, 1947 the assessee and mrs. Knight were not married. They were engaged to be married and the engagement was announced on september 3, 1957. The transfer deed contained no words which indicated that the transfer took affect immediately. The expression in the transfer deed "in consideration of the forthcoming marriage" can have very little meaning as a real consideration because on september 3, 1947 the parties have mutually promised to marry each other and thus the transfer was a gift made to mrs. Knight in contemplation of the forthcoming marriage subject to a condition subsequent namely that of marriage which if not performed would put an end to the put. But if the gift had already taken effect on december 10,1947 and the condition subsequent has been later fulfilled then the gift is effective as from december 10, 1947 when the assessee and mrs. Knight were not husband and wife.

Thus the supreme court held that section 16(3)(a)(3) of the income-tax act, 1922 [corresponding to section 64(1)(4) of the income-tax act, 1961] was not attracted to the case as the transfer of shares was not made by the husband to his wife.

Batta kalyani verses commissioner of income tax

[the words "technical or professional qualification" occuring in the first part of the proviso to section 64(1)(2) do not necessarily relate to the technical or professional qualification acquired by a certificate or a degree or in any other form from recognized body like university or an institute.]

Facts

The assessee, smt batta kalyani, ran hardware and paint shops. She employed her husband, b. Venkataramaiah, to manage the business and paid him salary for services rendered. The business was carried on by the assessee as a sole proprietrix. The ito included in the total income of the assessee, the salary paid by the assessee to her husband by the provisions of section 64(1) (2) of the act. The ito held that the assessee's husband who employed to manage the business did not possess any technical or professional qualification and the income delivered by the assessee's husband was not attributable to the application of the technical or professional knowledge and experience of the assessee's husband. In that view, ito came to the conclusion that the proviso to section 64(1) (2) has no application to the facts of the present case. The assessee appealed to the aac, who allowed the assessee's appeal, holding that the sum paid by way of salary to the assessee's husband is governed by the proviso to section 64(1) (2) of the act and, consequently, the salary paid to the assessee's husband was not liable to be inlcuded in the total income of the assessee. The tribunal reversed the decision of the acc.

Issue

Whether, on the facts and circumstances of the case, the appellate tribunal is justified in holding that the income of the assessee's husband is includible in the assessment of the assessee under section 64(1) (2) of the act?

Decision of the andhra pradesh high court

The court said:

"the words *technical or professional qualification* occuring in the first part of the proviso to section 64(l)(2) of the income tax act, 1961, do not necessarily related to technical or professional qualifications acquired by obtaining a certificate, diploma or a degree or in any other form from a recognized body like university or an institute. That this was the intention of the legislature is clear from the use of the expression *knowledge and experience* in the latter part of the proviso, as otherwise it would have been permissible for the legislature to use the same expression as occuring in the first part of the proviso to section 64(l)(2). A harmonious construction of the two parts of the proviso shows that if a person possesses technical professional knowledge and the income is solely attributable to the application of such technical or professional knowledge and experience, the requirements for the application of the proviso is satisfied, although the person concerned may not possess any qualification issued by a recognized body. In our opinion, the tribunal erred in coming to the conclusion that unless a recognized body conferred a qualification, it should not be considered that a person possessed technical or professional qualification. It is enough, in our opinion, for the purpose of the proviso, if the recipients of the salary possess the attributes of technical or professional qualification, in the sense that he has got expertise in such profession or techique. If by the use of that expertise in the profession or technique, the person concerned earns salary, then the part of the proviso is also satisfied."

Coming, however, to the facts of the present case, the court was riot satisfied that the second part of the proviso is complied with based on the findings of the tribunal.

J.m. Mokashi verses commissioner of income tax (1994)

[the expression "concern" appearing in section 64(1) (it) of the income tax act is a word of wide import and takes within its sweep and ambit all organization or establishments engaged in business or profession, whether owned by a company, partnership or individual or any other entity. The two conditions mentioned in the proviso to section 64(1) (2) are cumulative and not alternative.]

Facts

The assessee was a practising physician and cardiologist. His wife, smt. Jayshree j. Mokashi had passed first year arts of the bombay university and was employed by him as a receptionist-cum-accountant. During the accounting period, relevant to the assessment year 1978-79, the assessee paid a sum of rs. 8,100 to her by way of salary. This amount was included by the income tax officer in the income of the assessee by applying the provisions of section 64(1) (2).of the act. The appellate assistant commissioner and the tribunal confirmed the decision of the income-tax officer.

Issue

Whether, on the facts and circumstances of the case, the income-tax appellate tribunal has rightly held that the income of the assessee's wife is includible in the income of the assessee under section 64(1) (2) of the income-tax act, 1961?

Decision of the bombay high court

The word "concern" is a wide of wide import. It has various shades and meanings. According to the dictionaries, it means "something which pertains to a person; business affairs;". It also means "a matter that engages a person's attention, interest or care or that affects his welfare or happiness". In black's law dictionary (sixth edition), it has been defined thus:

"concern. To pertain, relate or belong to; be of interest or importance to; have connection with; to have reference to; to involve; to affect the interest of."

From the above definitions, it is evident that the word "concern" is a word of wide import and it conveys different ideas and meanings depending upon the context and setting in which it appears. In the context of section 64(1) (2) of the act read with explanation 2 thereto, it is clear that "concern" includes any company, firm, individual or any other entity carrying on business or professional activity. It cannot be given any restricted meaning to take out of its ambit professional organization or organization run as proprietary establishment. It covers all establishments or organizations—whether engaged in business activities or professional activities. This is also because the word "business" itself is a word of wide import and has been broadly interpreted to include "professions, vocations and callings".

Explanation 2 to section 64(1)(2) provides that in a case where the concern is a company, the assessee shall be deemed to have substantial interest therein if he holds not less than twenty per cent of its shares and in other cases, if he is entitled to not less than twenty per cent of the profits of such concerns. It sets out the lowest limit of interest of the individual in the concern for the purposes of applicability of section 64(l)(2). Its object is to widen the net of the section— not to restrict it. No outer limit of interest of the individual has, therefore, been specified. It will be a most unreasonable and unnatural interpretation of explanation 2 to hold that though persons having "not less than twenty per cent of the profits of the concern" shall be deemed to be have substantial interest in the concern, persons having cent per cent interest will not be deemed so. Therefore, an individual entitled to cent per cent of the profits of a concern is a person having substantial interest within the ordinary meaning of the expression itself,

Section 64(l)(2) provides for clubbing with income of an individual, the income of the spouse of such individual by way of salary, commission, remuneration, etc. Derived from a concern in which the individual has substantial interest. The only exception is contained in the proviso thereto. If the spouse possesses technical or professional qualification, any income derived by such spouse even from a concern falling in section 64(1)(2) read with explanation 2 thereto will not be liable to be clubbed with the income of the spouse if the following requirements of the proviso to section 64(1)(2) are satisfied:

(1) the spouse possesses 'technical or professional qualifications'; and

(2) the income is solely attributable to the application of his or her technical or professional knowledge and experience."

In order to claim the benefit of the proviso to avoid clubbing of income under section 64(1)(2) of the act, both the conditions specified in the proviso must be satisfied. The first condition relates to the spouse of the individual who must possess "technical or professional qualifications". If this condition is not satisfied, the proviso will not apply and reference to the second requirement will be unnecessary. If the first condition in regard to the qualification of the spouse is satisfied, it will be necessary to refer to the second condition which pertains to the income that will not be clubbed. Even in case of a spouse possessing technical or professional qualification, only the income arising to such spouse which is solely attributable to the application of his or her technical or professional knowledge will be out of the purview of section 64(1)(2) and not the whole of the income of such spouse. It is in this context that the words "technical or professional knowledge and experience" have been used in the latter part of the proviso in contradistinction to "technical or professional qualifications" used in the earlier part.

The expression "technical or professional qualification" used in the proviso to section 64(l)(2) must be such which makes a person eligible for technical or professional work. For example, the requisite qualifications for carrying on the legal profession have been laid down by the statute. Knowledge of the law or experience is not relevant for that purpose. Similarly, a person cannot carry on medical profession unless he possesses the requisite degree. Similarly, there are technical jobs which require degrees and diplomas—whereas, there are few others where university degree or diploma is not necessary. Adequate training and evidence thereof might be sufficient. Thus, the nature of technical qualification will also vary depending on the nature of the technical job. What is technical or professional qualification, therefore, will have to be decided in each case depending on the nature of the profession or the technical work. A spouse, well-versed in law and experienced in the working of legal profession, cannot be said to be in possession of professional qualification for carrying on the legal profession if he or she does not possess the requisite degree or diploma. Payments made to the spouse in such a case for any legal services cannot be brought within the purview of the proviso by reference to. The words "knowledge and experience" occurring in the latter part thereof. Thus possession of technical or professional qualification is a condition precedent on fulfilment of which that part of the income which falls in the second part of the proviso is excluded from the operation of the clubbing provision. The object of the second part of the proviso is to restrict the benefit of the proviso only to reasonable payments for professional services and to put a check on diversion of income to the spouses possessing technical or professional qualification in the guise of salary, fees, etc. For professional or technical services with a view to reduce the incidence of tax.

Take for example, the case of the wife of the individual who has just passed ll.b. Examination and enrolled herself as an advocate or having passed the ll.b. Examination did not practice law for long but has started doing so just a year or two back. Her professional services as a lawyer are utilized in the concern of her husband and she is paid remuneration therefore. In such a case, when the assessee claims the benefit of the proviso to avoid clubbing of such income of his wife with his own income he will be required to satisfy that the remuneration so paid to her for her legal services was "solely attributable to the application of her professional knowledge and experience" as a lawyer. If the taxing authorities find that the remuneration paid for the legal services was excessive or high having regard to her limited professional knowledge and experience, he may determine the amount of remuneration which can be solely attributable to the application of her professional knowledge and experience and exclude only that part of her income from clubbing provision contained in section 64(1)(2).

The two conditions mentioned in the proviso are cumulative and not alternative. They deal with two ^different aspects—one pertains to the eligibility of the spouse to claim the benefit of the proviso, the other to the income which would qualify' for exclusion from clubbing. Both are relevant and equally important. There is no scope for mixing up the two and dienting the first condition relating to qualification of the spouse by reference to the expression "knowledge and experience" in the second condition. The interpretation of the proviso by the andhra pradesh high court in *batta kalyani verses c.i.t* is not correct.

In the instant case, the spouse of the assessee neither possessed any technical or professional qualification nor was she paid for any technical or professional services rendered by her. The proviso to section 64(1)(2) is not applicable to her and, as such, the assessee is not entitled to get the benefit thereof to bring her income out of the purview of the clubbing provision contained in section

Mohini thaper verses cit

[the income that can be brought to tax under section 64(1)(4) must have a nexus with the asset transferred directly or indirectly].

Facts

One karam chand thaper made certain cash gift to his wife. Smt. Mohini devi thaper, the appellant. She invested the gift money partly in shares and partly in other interest-yielding securities. An income of rs. 21,225 was earned from deposits and shares held by her. The interest realized and the dividends earned were included in the income of karam chand thaper for the purpose of assessment by the income-tax officer in respect of the assessment year 1949-50. On appeal the assistant commissioner and the tribunal and, on reference, the high court held in favour of the revenue. In the meantime karam chand thaper who was the assessee in this case, died. Smt. Mohini thaper appealed to the supreme court.

Issue

Whether, on the facts and circumstances of the case, the income of rs. 21,225 derived from deposits and shares held the assessee's wife was income from the assets directly or indirectly transferred by the assessee to his wife within the meaning section 16 (3) of the indian income-tax act, 1922 {section 64 (1) (4) of the income-tax act, 1961]}?

Decision of the supreme court

Section 16 (3) (a) (3) of the income-tax act, 1922 {corresponding to section 64 (1) (4) of the income-tax act, 1961} provides that "in computing the total income of any individual for the purpose of assessment, there shall be included .... So much of the income of a wife or minor child or such individual as arises directly or indirectly.... From assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration or in connection with an agreement to live apart...."

The supreme court said that the section 16 (3) (a) (3) of the income-tax act, 1922 {section 64 (3) (4) of the income-tax act, 1961} "includes not merely the income that arises directly from the assets transferred but also that arises indirectly from the assets transferred". The court further observed that the income that can be brought to tax under section 16 (3) (a) (3) of the income-tax act, 1922 {section 64 (1) (4) of the income-tax act, 1961} must have a nexus with the assets transferred directly or indirectly.

In the present case assets transferred, is the gift of the cash made by the assessee to his wife. Therefore, the transfer was a direct transfer. The cash was invested by the assessee's wife in shares and other interest yielding securities. The court held that the income earned by the assessee's wife as dividends and interest from the shares and other securities purchased out of the gift money has a proximate connection with the transfer of assets made by the assessee. Thus the impugned income has a nexus with the assets transferred.

Therefore, the appeal was dismissed by the court.