Commissioner Of Income-Tax, Madras vs T.S.P.L.P. Chidamebaram Chettiar ... on 21 January, 1971

Equivalent citations: 1971 AIR 2074, 1971 SCR (3) 428, AIR 1971 SUPREME COURT 2074, 1971 TAX. L. R. 1350, 80 ITR 467, 1972 (1) ITJ 40, 1971 3 SCR 428, 1972 (1) SCJ 115, 1971 UPTC 313, (1972) 2 S C J 115

Author: K.S. Hegde

Bench: K.S. Hegde, J.C. Shah, A.N. Grover

PETITIONER:
COMMISSIONER OF INCOME-TAX, MADRAS

Vs.

RESPONDENT:
T.S.P.L.P. CHIDAMEBARAM CHETTIAR (DEAD) THROUGHL. Rs.

DATE OF JUDGMENT21/01/1971

BENCH:
HEGDE, K.S.
BENCH:
HEGDE, K.S.
SHAH, J.C.
GROVER, A.N.

CITATION:
1971 AIR 2074 1971 SCR (3) 428

ACT:
Income Tax Act, 1922, s. 34(1) (a) Requirements of-Assessee not disclosing part of money repaid against loan and interest-If undisclosed amount not taxable and to be presumed adjusted against principal-System of accounts maintained by assessee-If relevant in relation to concealed income.

HEADNOTE:
The assessee's father made various loans to P in 1932. In July, 1932 P executed a mortgage of some of his properties in favour of the assessee's father for a sum of Rs. 2 . 76 lakhs. After the mortgagee had instituted a suit in December, 1940 claiming a sum of Rs. 5.50 lakhs inclusive of principal and interest, a compromise decree was passed in

October, 1943 for a sum of Rs. 3.50 lakhs in full satisfaction of the mortgagee's claim.

When the income-tax assessment proceedings of the assessee for the assessment year 1944 45 as karta of his Hindu Undivided Family were pending, the Income Tax Officer, Trichy, received information from the Income Tax Officer, Erode, that the mortgagor had secretly paid to the mortgagee a sum of Rs. 1.50 lakhs during the year ended on April 1, 1944, and that this was not included in the compromise decree. As the assessee denied receiving this amount and the Assessing Officer had no other material before him, he made a note in the order sheet that the I.T.O., Erode should be asked to give further details, and in the meantime the assessment for 1944-45 should not be held up. On receiving further information, the Assessing Officer came to believe that a sum of Rs. 1.50 lakhs had escaped assessment and after issuing the assessee a notice under s. 34(1) (a), he included the additional sum and taxed him on that basis. The Appellate Assistant Commissioner set aside the order and directed the I.T.O. to re-do the assessment after giving the assessee an opportunity to cross-examine the witnesses on the basis of whose statements he had reached his conclusion. After examination of further witnesses and other evidence, a fresh order of assessment was made on the, assessee under s. 23(3) read with s. 34 and this was affirmed by, the Appellate Assistant Commissioner as well as by the Tribunal. Although the High Court, upon a reference, found that the assessment under s. 34 was valid and the I.T.O. had rightly acted in giving effect to the order of the Appellate Assistant Commissioner to re-do the assessment, it held, purporting to rely on the decision in C.I.T. Bihar and Orissa v. Kameshwar duringthe relevant accounting year was not taxable as the assessee maintainedhis accounts according to the Chetty system and must be presumed to have appropriated the amount towards the principal amount due to the mortgagor.

On appeal to this Court by the assessee as well as by the department,

HELD : The assessee's appeal must be dismissed and that of the Department allowed;

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(i)There was no force in the contention that as the Income Tax Officer had before him the information about payment of a sum of Rs. 1.50 lakhs at the time he made the initial assessment and did not choose to act on the information, it was not open to him thereafter to initiate proceedings under s. 34.

On the facts found, under assessment due to non-disclosure of material facts was established. At the time he issued notice under s. 34(1) (a)on the basis of the material before him, the Income-tax Officer could have 'formed the necessary belief and stated in the notice that he had formed such belief; the requirements of s. 34(1) (a) were therefore

fully satisfied. [432 F]
Calcutta Discount Co. Ltd. v. Income-tax Officer, Companies District 1, Calcutta and anr. [1961] 41, I.T.R. 191; referred to.
(ii)The only ground on which the assessment order was set aside by the Appellate Assistant Commissioner was that the assessee had not been given a proper opportunity to put forward his case. He did not hold that the notice under s. 34(1)(a) was invalid. There was therefore no assessee under s. 34(1) (a). [433 D]
(iii)The High Court was in error in thinking that the decision of the JudicialCommittee in Kameshwar Singh's case had laid down the rule that whenever any amount is received by a creditor which he has not specifically appropriated either towards the principal or the interest due to him, the taxing authorities should proceed on the basis of the presumption that it has ,been appropriated towards the principal. In the present case it was evident that after secretly receiving the amount of Rs. 1.50 lakhs, the creditor did not enter it in his account-books with a view to evade tax. If he intended to appropriate that amount towards the principal, there was no. need for him not to enter that receipt in his accounts. The fact that the assessee was maintaining the Chetty system of accounts was immaterial on the facts of the case. The system of maintaining accounts is wholly irrelevant because the receipt in question had not been entered in the accounts at all. [437 Al

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 365 and 671 of 1967.

Appeals from the judgment and order dated January 6, 1966 of the Madras High Court in Tax Case No. 143 of 1963 (Reference No. 37 of 1963).

B Sen, B. D. Sharma and R. N. Sachthey, for appellant (in C.A. No. 365 of 1967) and the respondent (in C A.. No. 671 of 1967)'.

T.A. Ramachandran and D. N. Gupta, for the respondents (in C.A. No. 365 of 1967) and the appellants (in C.A No.671 of 1967).

The Judgment of the Court was delivered by Hegde J.-The first of these two appeals (both by certificate) viz. that filed by the Commissioner of Income Tax - and the second, that filed by the legal representatives of assessee fails. The facts as found by the Tribunal and set out in the statement of the case, relevant for the purpose of these appeals are as follows :

The relevant assessment year is 1944-45, corresponding to the accounting year ended on April 12, 1944. The assessee is one Chidambaram Chettiar (since deceased). The father of the assessee Palaniappa Chettiar was a money lender. He had made various advances to one Nallathambi Sakkarai Manradiar, who will hereinafter be referred to as the Pattayagar, a prominent landlord in Coimbatore District, on promissory notes. The total principal advanced by the father of the assessee upto July 6, 1932 amounted to Rs. 1,38,535. The interest on the same came to Rs. 1,34,965. On July 6, 1932, a further advance of Rs. 2500 was made to the Pattayagar and for the amounts due from him, the Pattayagar executed a mortgage of some of his properties in favour of the assessee's father for a sum of Rs. 2,76,000. Till 1938, only a sum of Rs. 13,620 was paid by the mortgagor in part payment of the debt due from him. On December 14, 1940 the mortgagee instituted a suit on the foot of the mortgage bond claiming a sum of Rs. 5,50,573 inclusive of principal and interest. On September 19, 1943, the claim was compromised and on October 5, 1943, a compromise decree was passed for a sum of Rs. 3,50,500 in full satisfaction of the mortgagee's claim. The decree amount was made payable on or before October 1, 1944. The debt under the compromise decree was subsequently discharged.

For the assessment year 1944-45, the assessee Chidambaram Chettiar, as karta of his Undivided Hindu Family was assessed under S. 23(3) of the Income Tax Act, 1922 (to be hereinafter referred to as the Act), on February 12, 1946, on a total income of Rs. 78,556 which, on appeal was reduced to Rs. 53,153. When the assessment proceedings of the assessee were pending before the Income-tax Officer, Trichy, that Income-tax Officer received information from the Income-tax Officer, Erode that the mortgagor had paid secretly to the mortgagee a sum of Rs. 1,50,000 during the year ended on April 1, 1944 and that the same was not included in the compromise decree. When the Income-tax Officer asked the assessee about the same, he denied having received any amount secretly. Apart from the information conveyed by the Income tax Officer, Erode, the Assessing Officer had no other material before him to show that any amount had been paid secretly by the mortgagor to the mortgagee. Hence on May 27, 1945, the Income-tax Officer made the following note in the order sheet "It is denied that there was any secret understanding not to show the payment of Rs. 1,50,000. The receipt of this amount is entirely denied.. The Incometax Officer, Erode should be asked to give further details and to ask the Pattayagar to produce evidence of the payment. In any event, this should come up for consideration only in the assessment year 1944-45 as only the excess over Rs. 2,76,000 plus legal expenses can be treated as interest income in the hands of the assessee and so, the assessment for 1944-45 should not be held up pending further investigation."

After sometime the Assessing Officer made further enquiry into the information given by the Income-tax Officer, Erode and thereafter he came to believe that a sum of Rs. 1,50,000 had escaped assessment by reason of the omission of the assessee to disclose fully and truly all material facts necessary for his assessment for the assessment year 1944-

45. He accordingly issued a notice under s. 34(1)(a) on March 9, 1953. In reply to that notice, the assessee filed a return similar to the one filed by him earlier. He denied having received Rs. 1,50,000 secretly from the mortgagor.

The Income-tax Officer did not accept the plea of the assessee. He accordingly included an additional sum of Rs. 1,50,000 to the income of the assessee earlier determined for the assessment year 1944-45 and taxed him on that basis. In appeal, the Appellate Assistant Commissioner set aside the order of the Income-tax Officer and directed the Income- tax Officer to re-do the assessment after giving the assessee an opportunity to cross-examine the parties examined by the Income-tax Officer on the basis of whose statements he had come to the conclusion that a sum of Rs. 1,50,000 had been secretly paid to the mortgagee by the mortgagor. Thereafter the Income-tax Officer further in- quired into the matter; Pattayagar's books of account were got produced to prove that an additional sum of Rs. 1,50,000 had been paid to the assessee. Some witnesses were also examined in the presence of the assessee to prove that fact. After doing so, a fresh order of assessment was made on the assessee under s. 23(3) read with s. 34. His order was affirmed by the Appellate Assistant Commissioner as well as by the Tribunal. At the instance of the assessee, the following three questions were submitted to the High Court under s. 66(1) of the Act.

"(1) Whether assessment under section 34 was valid and proper. ?

(2) Whether the Income-tax Officer rightly acted in giving effect to the order of the Appellate Assistant Commissioner setting aside the assessment to re-do the same according to law after Living an opportunity to the appellant to place all his cards before the Department ?

(3) Whether Rs. 1,50,000 is taxable as income of the year of account ?"

The High Court answered the first two questions against the assessee and the third question against the Department. The legal representatives of the assessee are challenging the High Court's ,,decision on the first two questions and the Commissioner is challenging the High Court's decision on the third question.

We shall first take up the assessee's appeal. There is hardly any merit in that appeal. It was urged on behalf of the representatives of the assessee that as, even when the original assessment proceedings for the relevant year were before the Income-tax Officer, he had before him the information given by the Incometax Officer, Erode, but yet, he did not choose to act on that information, it was not open to him thereafter to initiate proceedings under s. 34. We are unable to accept this contention. On the facts found by the Tribunal, it is established that the assessee's father had clearly suppressed the receipt of Rs. 1,50,000 from the mortgagor. The assesses had a duty to disclose fully and truly all material facts necessary for his assessment. Herein we are not dealing with. a case coming under s. 34(1)(b). All that we have to see is whether the requirements of s. 34(1)(a) are satisfied. This Court in Calcutta Discount Co. Ltd. v. Income-tax Officer, Companies District I, Calcutta and anr., (1) ruled that to confer jurisdiction on the Income-tax Officer to take action under S. 34, (1) (a), two conditions must be satisfied viz. (1) he has reason to believe that there was under-assessment and

(2) that he must have reason to believe that the under- assessment has resulted from nondisclosure of material facts. On the facts found, under assessment is established and it is also established that the under assessment was due to non-disclosure of material facts. There can be no doubt that at the time he issued notice under s. 34(1)(a) on the basis of the material before him, the Income-tax Officer could have formed the necessary belief. In the notice issued he says that he had formed that belief. In our opinion the requirements of S. 34(1)(a) are fully satisfied. The fact that there was some vague information before the Income-tax Officer that the assessee's father had secretly received a sum of Rs. 1,50,000 from the mortgagor was by itself not sufficient to bring to tax that amount parti- cularly in view of the fact that the assessee had stoutly denied that fact and the court records did not support that information. It is true that the Income-tax Officer could have made further enquiry into the matter but the fact that he did not make any further enquiry does not take the case out of S. 34(1)(a) particularly when the assessee had failed to place truly and fully all the material 'facts before him. The remark of the Income-tax Officer that "in (1) [1961] 41 I.T.R. 191 any event this (the receipt of Rs. 1,50,000) should come up for consideration only in the assessment year 1944-45 as only the excess over Rs. 2,76,000 plus legal expenses can be treated as interest income in the hands of the assessee and so, the assessment for 1944-45 should not be held up pending further investigation" in the order sheet does not amount to a decision taken by him. It may be noted that those remarks were not made in the order assessing the income of the assessee. It must also be remembered that the Income-tax Officer, at the time he made those remarks was not satisfied about the correctness of the information given by the Income-tax Officer, Erode. Hence those remarks must be treated as casual observations and not a decision taken on the basis of facts found.

We see no substance in the contention that the Income-tax Officer did not give effect to the order of the Appellate Assistant Commissioner when the latter asked him to reassess the income of the assessee. The only ground on which the assessment order was set aside by the Appellate Assistant Commissioner was that the assessee had not been given a proper opportunity to put forward his case. The Appellate Assistant Commissioner did not hold that the notice issued by the Income-tax Officer under s. 34(1)(a) was an invalid notice. Therefore there was no need for the Incometax Officer, Trichy to issue a fresh notice to the assessee under s. 34(1)(a) as contended on behalf of the assessee's representatives. All that the Income-tax Officer had to do was to afford proper opportunity to the assessee to show that in fact he had not received the aforementioned sum of Rs. 1,50,000. That opportunity had been given. In view of our above conclusion Civil Appeal No. 671 of 1967 fails and the same is dismiss ed.

Now coming to the appeal filed by the Commissioner of Income-tax, the High Court came to the conclusion that the sum of Rs. 1,50,000 received by the assessee during the relevant account year must be presumed to have been appropriated by the assessee towards the principal amount due to the mortgagor and hence the same cannot be considered as an income of the assessee during that year. The assessee was maintaining his accounts in accordance with what is known as Chetty system of accounts. The material on record shows that according to the Chetty system of accounts, the creditor appropriates a receipt first towards the cost of litigation, then towards the principal amount due and the balance towards the arrears of interest. The High Court was of the view that the sum of Rs. 1,50,000 secretly received by the creditor must be deemed to have been kept in suspense. As the debator had not given any direction about the appropriation of that amount it was open to the

creditor to appropriate the same towards the principal amount and further he must be presumed to have appropriated that amount towards the principal amount before s. 34 proceedings were started against him firstly because of the system of accounts maintained by him and secondly because every one must be deemed to have acted in a manner least disadvantageous to him. In support of this conclusion reliance was placed by the High Court on the decision of the Judicial Committee in The Commissioner of Income-Tax, Bihar and Orissa v. Kameshwar Singh(1). In that case, nature of several receipts by the assessee came up for consideration. For our present purpose we need only refer to two of them. One Damodar Das Burman owed to the assessee in the Fasli year 1332 Rs. 3,09,281. During the currency of the debt the debtor had made regular payments to the assessee over a number of years, the total of which payments was not stated. Those payments were entered in the deposit register maintained by the assessee but no allocation thereof were made as between principal and interest, and no part of those payments were carried to the interest register maintained by the assessee. Consequently no part of these payments was subjected to tax until the Fasli year 1331, in which year for the first time the Income-tax Officer came to know about the deposit register maintained by the assesse,e. In that year, the deposit register showed a receipt of Rs. 38,091 and on this the officer claimed and was paid tax on the footing that it was attributable to interest and not to principal. The result is that against the total interest on the debt, viz. Rs. 3,09,281, no sums had been attributed by the assessee to interest out of the payments made to him by the debtor. But the Income-tax Officer had himself treated the sum of Rs. 38,091 received in the year Fasli 1331 as interest and taxed it accordingly. That left Rs. 2,71,190 as the balance of the total interest on the debt, during its currency towards which balance the assessee made no attributions of interest out of the payments received by him from the debtor during its currency. No tax accordingly had been paid in respect of any of these receipts other than on Rs. 38,091. Therefore the question before the Court was how in those circumstances should be received of Rs. 2,78,000 in the Fasli year 1332 be treated. Dealing with that question the Judicial Committee observed :

> "Now, where interest is outstanding on a principal sum due and the creditor receives an open payment from the debtor without any appropriation of the payment as between capital and interest, by either debtor or creditor, the presumption is that the payment is attributable in the first instance towards the outstanding interest..... This presumption is no doubt operative primarily in questions between debtor and creditor, but (1) [1933] 2 I.T.R. 94.

in their Lordship's view, the Income-= Officer, finding that the assessee received a payment from his debtor of Rs. 2,78,000 in the year Fasli 1332 and that the assessee had not up till then credited himself as having received, any interest receipts to the Revenue Authorities was entitled in the circumstances to treat this sum of Rs. 2,78,000 as applicable to the outstanding interest to the extent of Rs. 2,71,190 and accordingly to treat the payment to that extent as income of the assessee in the year of payment." From the facts noted above, it is clear that what presumption should be drawn in regard to appropriation of an open payment depends on the circumstances of a case. Now we shall proceed to deal with the second receipt namely that from Kumar Ganesh Singh. In the Fasli year 1332 Kumar Ganesh Singh owed the assessee 32 lacs as principal and Rs. 6,09,571 as interest, or a total of Rs. 38,09,571 in all, in respect of an unsecured loan. In that year the assessee and his debtor entered into an arrangement whereby, as the Commissioner stated "the assessee took over

from the debtor in satisfaction of this amount the following items of property movable. or immovable:-

1. The Kajora Colliery valued atRs.7,37,339/-

2. Shares in different companies valued atRs.94,125/-

3. Bills received by the above brokers (i.e. Ganesh Singh's firm)Rs.48,809,-

4. DecreeRs.1,42,594/-

5. Transfer of loan to the Agra United Co.Rs.10,00,000/-

6. Pronotes and hand-notes (of third parties)S.

7. Hand-notes from Kumar Ganesh SinghRs.17,34,596-

Rs. 38,09,569/ The question for decision was whether as a result of the above settlement, it could be said that in the account year the assessee had received a sum of Rs. 6,09,571-due to him as interest. The Judicial Committee came to the conclusion that the first six items mentioned above amounting to Rs. 20,74,973 may perhaps reasonably enough be regarded as the equivalent of cash, but the seventh item of Rs. 17,34,596 consisting of the debtor's own promissory notes, was clearly not the equivalent of cash. A debtor who gives his creditor a promissory note for the sum he owes can in no sense be said to pay his creditor; he merely gives him a document or voucher of debt possessing certain legal attributes. The next question was whether the receipt of Rs. 20,74,973 can be said to include a receipt of interest of Rs. 6,09,571 ? The Judicial Committee answered that question thus :

> "He (Counsel for the Crown) relied on the already invoked in the case of Damodar Das Burman above, that a creditor is presumed to apply payments received from his debtor towards the extinction of interest claims before capital claims. But the situation which their Lordships are now considering differs materially from that which existed in the case of Damodar Das Burman. In that case, apart from other specialities there was no settlement, but merely an open payment to account. Here there was an arrangement effecting the whole indebetedness whereby certain assets were accepted in part satisfaction and promissory notes were taken for the balance. The basis of the presumption, namely, that it is to the creditor's advantage to attribute payments to interest in the first place, leaving the interest-bearing capital outstanding, is gone. Moreover, if the question were one between Kumar Ganesh Singh and the assessee, i.e.,- between debtor and the creditor, the assessee might up to the last moment appropriate 'the Rs. 20,74,973 to capital account..... Their Lordships have also not omitted to bear in mind the provisions of ss. 60 and 61 of the Indian Contract Act, though these were not relied on in argument as applicable to the case. In the result their Lordships are of opinion that having regard to the nature of the transaction, the assessee is entitled to say that he has accepted the first six items

> in discharge pro tanto of his debtor's capital liability and that the capital debt now stands discharged to that extent. No part of the sum of Rs. 20,74,9 73 accordingly was received by the assessee as taxable income in the year of computation."

Here again we notice that the conclusion drawn by the Judicial ,Committee depended on the facts and circumstances before them. Though the factum of settlement of the debt was relied upon as one of the circumstances, for finding out the meaning of appropriation, it was by no means a conclusive circumstance. Evidently their Lordships bore in mind the possibility of the assessee not being able to realise the debts under the hand-notes. Under those circumstances it was advantageous to the assessee to appropriate the money value of the properties received towards, the capital, otherwise there was a possibility of his having to pay income-tax ;on a receipt which ultimately may not prove to be an income. It is under those circumstances their Lordships observed :

> "that in a question with the revenue the tax-payer is entitled to appropriate payments as between capital and interest in the manner least disadvantageous to himself."

In our opinion the High Court was in error in thinking that the decision of the Judicial Committee in Kameshwar Singh's case(1) has laid down a firm rule that whenever an assessee receives a payment and does not appropriate the same either towards the principal or interest, he must be deemed to have appropriated the same towards the principal. The decision in question, in our opinion, does not lay down the rule that whenever any amount is received by a creditor which he has not specifically appropriated either towards the principal or the- interest due to him, the taxing authorities should proceed on the basis of the presumption that it has been appropriated towards the principal. On the facts of that case it was clear that 'it was advantageous to the creditor to appropriate the receipt towards the principal. But turning to the facts of the present case the total amount due to the assessee was over 6 lakhs. Out of that the principal amount was less than 3 lakhs. The compromise decree was for Rs. 3,50,500. The creditor secretly received Rs. 1,50,000/-. He does not enter the same in his account books. Evidently he did not enter the same in his account- books with a view to evade tax. If he intended to appropriate that amount towards the principal, there was no need for him not to enter that receipt in his accounts. Obviously he appropriated the amount towards the interest due to him and that is why he did not enter that receipt in the accounts so as to facilitate evading payment of tax on that amount. The fact that the assessee was maintaining Chetty system of accounts is immaterial on the facts of the case. The system of maintaining accounts is wholly irrele- vant because the receipt in question had not been entered in the account at all. Hence, in our opinion, the High Court erred in answering the third question against the Department.

We accordingly allow Civil Appeal No. 365 of 1967 and answer the third question referred to the High Court in favour of the Revenue namely that the receipt of Rs. 1,50,000/- is taxable as income of the year of account. The assessee shall pay the costs of these appeals-hearing fee one set. Civil Appeal 365 of 1967 allowed.

Civil Appeal 671 of 1967 dismissed-

R.K.P.S. (1) [1933] 2 I.T.R.94.