Commissioner of Income-Tax, Andhra Pradesh

Vs

H. E. H. Mir Osman Ali Khan

Civil Appeals Nos. 46-49 of 1964

(K. Subba Rao, J. C. Shah, S. M. Sikri JJ)

25.10.1965

JUDGMENT

SUBBA RAO, J. –

These four appeals by special leave granted this Court are preferred against the judgment of a Division Bench of the Andhra Pradesh High Court at Hyderabad in a case refereed to it by the Income-tax Appeal Tribunal, Hyderabad Bench, under s. 66(1) of the Indian Income-tax Act, 1922, hereinafter called the Act, in respect of assessments made on H.E.H. the Nizam of Hyderabad for the assessment years 1950-51 and 1951-52.

The Income-tax Officer, B. Ward, Hyderabad-Deccan, by his orders dated February 15, 1955 and March 31, 1956, rejected the objections raised by the assessee and assessed him to income-tax for the said two years. Against the said orders the assessee filed two appeals before the appellate Assistant Commissioner, Hyderabad, who by his orders gave some relief on respect of the said assessment. On further appeals by the assessee, the Income-tax Appellate Tribunal, Hyderabad Bench, allowed the appeals of the assessee in part and ordered the assessment to be revised accordingly. At the instance of the assessee, the Income-tax Appellate Tribunal, drew up a statement of case and referred four questions to the High Court of Andhra Pradesh for its decision. On July 4, 1961, the High Court answered some of the questions in favour of the assessee and others against him. The Commissioner of Income-tax filed two appeals to this Court, being Civil Appeals Nos. 46 and 47 of 1964, insofar as the High Court's judgment went against the Revenue; and the assessee filed two appeals, being Civil Appeals Nos. 48 and 49 of 1964 against that part of the High Court's judgment which rejected which his contentions.

To avoid prolixity and repetition we shall state the relevant facts in considering each of the questions referred to the High Court.

Questions 1 and 3 may be considered together. The said questions read :

> Question 1. "Whether in the circumstances of the case and having regard to International Law and construction of Municipal Laws and/or the covenant dated 25-1-1950 between the Assessee and the Government of India, the Assessee was liable to tax under the Indian Income-tax Act, 1922, in respect of any part of his income."
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> Question 3. "Whether, in any event, the Assessee enjoyed immunity from taxation under the Indian Income-tax Act, 1922, in respect of income which accrued or arose to him or was received by him up to 26th January 1950."

These two questions raise the following points : (1) Whether under International Law the assessee is immune from taxation in respect of the assessment year 1950-51; and (2) whether, having regard to the said Covenant dated January 25, 1950, he was not liable to tax under the Indian Income-tax Act, 1922. The High Court held that under the International Law, the assessee being a sovereign up to January 25, 1950, his income up to that date was immune from taxation and that, the Indian Income-tax Act not having expressly amended the International Law in its application to India, his income till that date was not liable to tax under the Income-tax Act. As a corollary from the said conclusion, the High Court held that as the assessee ceased to be a sovereign from January 26, 1950, the income accrued to him thereafter was liable to tax. The High Court rejected the contention of the assessee that he was exempted from the liability to pay income-tax under the Covenant entered into by him with the Government of India at the merger.

The argument based upon the Covenant may easily be disposed of. The relevant articles of the Covenant read as follows :

> Article 3. His Exalted Highness the Nizam of Hyderabad and the members of his family shall be entitled to all the personal privileges, dignities and titles enjoyed by them whether within or outside the territories of the Dominion before the 15th August 1947.
>
> Article 4. The Government of India guarantees the succession according to the laws and customs of the Gaddi of the State and the personal rights, privileges, dignities and titles of His Exalted Highness the Nizam of Hyderabad.

The argument was that the assessee's immunity from taxation as a sovereign was a privilege guaranteed to him under the said articles of the covenant. This question need not detain us, as it was answered by this Court in Sri Sudhansu Shekhar Singh Deo v. The State of Orissa ([1961] 1 S.C.R. 779.) in the context of the claim of exemption from agricultural income-tax by an Ex-Ruler of an Indian State based upon articles in a merger agreement, similar to the one now in question. This Court held that the privileges guaranteed by the relevant articles of merger agreement were only personal privileges of the appellant as an Ex-Ruler and that those privileges did not justify his claim to immunity from taxation. Following this decision we reject the contention of the assessee based upon the said articles of the Covenant.

Now, we shall take the first question, excluding that part of it which refers to the said Covenant, and question 3.

Mr. A. V. Viswanatha Sastri, learned counsel for the Revenue, contended that under the International Law a foreign sovereign was not immune from taxation in respect of his private properties situated in the taxing State; even if there was such an immunity under the International Law, the assessee, being under the suzerainty or the paramountcy of the British Crown, had never enjoyed the status of a sovereign as understood in the International Law and, therefore, not governed by that law; and that, in any event, as on January 26, 1950, the date when he became liable to tax, he was no longer sovereign and therefore he could not claim exemption under the International Law.

Mr. Palkhiwala, learned counsel appearing for the assessee, while conceding that the assessee could not claim exemption under International Law in respect of the assessment year 1951-52, argued that he was not liable to income-tax for the assessment year 1950-51 on the ground that under the Indian

Income-tax Act, income-tax was charged on the assessee's income received during the accounting year and that as during the accounting year the assessee was a ruling chief, he was exempt from taxation under the International Law. He argued that under the International Law, as understood by English Courts, a foreign sovereign was exempt from taxation, that the said interpretation of the law had become the common law of England and that the said common law was the law of India before the Constitution and it continued to have force thereafter by reason of Art. 372.

The validity of Mr. Palkhivala's contention depends upon our acceptance of four premises, namely (i) the English Courts have finally accepted the view that under International Law a sovereign is immune from taxation in respect of his private property; (ii) that it had become a part of the common law of England; (iii) that before the Indian Constitution came into force, the said common law was accepted and applied by the Indian Courts; and (iv) that the said common law so accepted as the common law of this country continued to be in force by reason of Art. 372 of the Constitution.

International Law vis-a-vis the liability of a sovereign to taxation in respect of his private property is in a process of evolution. It has not yet become crystallized. It is true that some of the textbooks on the subject and some of the decisions support the view that sovereign rulers are exempt from taxation : see Halsbury's Laws of England. 3rd Edn., Vol. 20, p. 589; Oppenheim's International Law, 8th Edn., Vol. I, p. 759. But, even in England the House of Lords in Sultan of Johore v. Abubakar Tunku Bendahar (L.R. [1952] A.C. 318, 343.) observed :

> "Their Lordships do not consider that there has been finally established in England.....any absolute rule that a foreign independent sovereign cannot be impleaded in our courts in any circumstances."

Interesting and instructive discussion on the question of a foreign sovereign's immunity from taxation is respect of his private properties is found in the American Journal of International Law, Vol. 46, at p. 239, under the heading "Immunity from Taxation of Foreign State-owned property". After the elaborate consideration of the relevant material on the subject, the learned author concludes thus, at p. 258 :

> "Immunity from taxation should be the rule when the activities concerned are those normally and traditionally regarded as governmental in character; but when a foreign state engages in trading operations of a type generally open to private persons there seems no need to better its competitive position or to shift tax burdens to others through giving it exemption from taxes."

In dealing with taxation of property, the learned author says, at p. 256, thus :

> "The use of these agreements, combined with the practice discussed above, appears to be bringing about a situation in which it will become generally recognized that International Law provides for the tax exemption of foreign state-owned property used for functions generally accepted as public."
>
> "It is by no means clear, however, that the same result is either probable or desirable when we are dealing with property used for purposes which seem more commercial than governmental."

It may also be noticed that in India there is no absolute prohibition against a ruler of a foreign state

being sued in India : see ss. 86 and 87 of the Code of Civil Procedure. He can be sued with the consent of the Central Government. It is not necessary in this case to decide this question, as we are satisfied that H.E.H. the Nizam had never acquired international personality under International Law. We have noticed the aforesaid facts only to indicate that the question is not free from difficulty and that it requires serious consideration when it directly arises for decision. We shall, therefore, assume for the purpose of these appeals that a foreign sovereign who has acquired an international personality has such an immunity from taxation.

We shall now proceed to consider the question why in our view H.E.H. the Nizam had never acquired international personality. As a learned author puts it.

> "Every civilized State which is member of the family of nations is an International person. Recognition of a State as a member of the family of nations involves recognition of such State's (1) equality, (2) dignity, (3) independence, and (4) territorial and personal supremacy."

According to Oppenheim, all the said qualities constitute, as a body, the international personality of a State. Unless the State of Hyderabad had the said qualities, its ruler could not claim any of the immunities sanctioned by International Law. A brief history of the status of the Hyderabad State vis-a-vis the British Crown would help us to ascertain its status in International Law.

In 1858 the British Crown took over from the East India Company the administration of the entire territory of India. Thereafter, while the British India was under the direct rule of the Crown, the Indian States remained under the personal rule of their Chiefs under the suzerainty of the Crown. In the Pronouncement of Lord Canning he clearly stated :

> "The Crown in England stands forth the unquestioned ruler and paramount power in all India."

This concept of suzerainty by the Crown was also described as "Paramountcy". The relationship between the paramount power and the Indian States was described in the "White Paper on Indian States", at p. 32, thus :

> "As already stated the paramountcy of the British Crown was not co-extensive with the rights of the Crown flowing from the Treaties. It was based on Treaties, Engagements, Sanads as supplemented by usage and sufferance and by decisions of the Government of India and the Secretary of State embodied in political practice."

The said White Paper further discloses that while the States were responsible for their own internal administration, the Crown accepted responsibility for their external relations and defence. The Indian States had no international status, and for external purposes, they were practically in the same position as British India. The Government of India Act, 1935, gave the Indian states an option to join the federation subject to certain conditions; but that part of the said Act was abandoned in 1939. The Indian Independence Act of 1947 introduced a change in the relationship between the Crown and the said States. Section 7(1)(b) of the Indian Independence Act of 1947, read :

> "As from the appointed day the suzerainty if His Majesty over the Indian States lapses, and with it, all treaties and agreements in force at the date of the passing of this Act between His Majesty and the rulers of Indian States, all functions exercisable by His Majesty at that date with respect to Indian States, all obligations of His

> Majesty existing at that date towards Indian States or the rulers thereof, and all powers, rights, authority, or jurisdiction exercisable by His Majesty at that date in or in relation to Indian States by treaty, grant, usage, sufferance or otherwise; and
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> Provided that notwithstanding anything in paragraph (b)..... of this sub-section, effect shall, as nearly as may be, continue to be given to the provisions of any such agreement as is therein referred to which relate to customs, transit and communications, posts and telegraphs, or other like matters, until the provisions in question are denounced by the Ruler of the Indian States..... on the one hand, or by the Dominion or Province or other part thereof concerned on the other hand, or are superseded by subsequent agreements."

Though under this Act the paramountcy of the Crown lapsed in regard to Hyderabad and other States, the pre-existing agreements with those States continued in respect of specified matters. The lapse of suzerainty or the breaking of ties with the British Crown did not ipso facto raise their status to that of international personality. It created a void and the position of the States was in a fluid state. No de facto or de jure recognition was given to the Hyderabad State or to any other State by the family of nations. But, after protracted negotiations, the Nizam issued a proclamation on November 23, 1949, accepting the Constitution of India, shortly to be adopted, subject to ratification by the constituent assembly of the Hyderabad State. The said constituent assembly ratified it and thereafter the Hyderabad State was included in Part B of the First Schedule to the Constitution : see Appendix LIV, White Paper on Indian States (N.S. 6), p. 369, and Basu's Commentary on the Constitution of India, 4th Edn., Vol. 4, pp. 32 - 34. It will be seen from the said history that Hyderabad was under the suzerainty of the British Crown till the Indian Independence Act of 1947 was passed and that thereafter, after negotiations with the Indian Dominion, it finally acceded to it. It was never recognized as an international personality by the family of nations. It was all through a vassal of the British Crown. Oppenheim says in his book in International Law, Vol. 1, 5th Edn, at pp. 165-166, that "the position of the Indian States to Great Britain is like that of vassal of States which have no international relations whatever either between themselves or with foreign States". In Hall's International Law, 8th Edn, the learned author says that the States of the Indian Empire of Great Britain were protected States and that they were not subject to international law. The decision in Sayce v. Ameer Ruler Sadiz Mohammad Abbasi Bahawalpur State ([1952] 2 All E.R. 64.) holding that the Ameer of Bahawalpur State was a foreign sovereign immune from the jurisdiction of the English Courts was solely based upon the certificate of the Commonwealth Relations Office and it does not help us in deciding the present case.

It is therefore, clear that Hyderabad State did not acquire international personality under the International law and so its ruler could not rely upon international law for claiming immunity from taxation of his personal properties.

The problem may be looked at from a different perspective, i.e., on the basis of the provisions of the Indian Income-tax Act. The Indian Income-tax Act, 1922, hereinafter called the Act, admittedly applied to Hyderabad State from January 26, 1950. Under s. 3 of the Act, where any Central Act enacts that income-tax shall be charged in any area at any rate or rates, tax at that rate or those rates shall be charged for that area in accordance with and subject to the provisions of the Act in respect of the total income of the previous year of every individual etc. Under s. 2 of the Finance Act of 1950 (Act 25 of 1950), subject to the provisions of sub-ss. (3), (4) and (5) for the year beginning on 1st day of April 1950, income-tax shall be charged at the rates specified in Part I of the First Schedule; under s. 13 thereof, if immediately before the 1st day of April 1950, there was in force in

any Part B States, other the States mentioned therein any law relating to income-tax or super-tax or profits of business etc., that law shall cease to have effect for the purposes of assessment under the Indian Income-tax Act, 1922, for the year ending March 31, 1951, or any subsequent year. Under section 2(14A), "taxable territories" shall be deemed to include the merged territories as respects any period after the 31st day of March, 1949, for any of the purposes of the Act and as respects any period included in the previous year, for the purpose of making any assessment for the year ending on the 31st day of March, 1950, or for any subsequent year. The effect of these provisions is that every individual was liable to income-tax from April 1, 1950, at the rates mentioned in the Finance Act in respect of his total income of the previous year in the merged territories. It is not, and it cannot be, disputed that on April 1, 1950, the assessee was not a ruling chief but an ordinary citizen of Indian, residing, within the meaning of s. 4 of the Act, in that part of Indian which was a part of Hyderabad State and so he would be liable to income-tax on April 1, 1950, in respect of the total income he received in the previous year in the merged territory. It cannot also be disputed that the said taxable income would be computed after giving the necessary allowances and deductions in the manner prescribed by Ch. III of the Act. But it is said that as the assessee was exempted under International Law from taxation of his income of the previous year, the Act could not reach that income. That conclusion, according to the learned counsel for the assessee, flows from the nature of the tax, namely, that though the year of assessment is 1950-51, the charge is not on the income of the year of assessment, but on the income of the previous year. Decided cases no doubt support the contention of the assessee that what is charged in the assessment year or the tax year is the income earned during the accounting year or the earning year. The Act of 1918 which followed the English Acts levied tax on the income of the year of assessment, taking the income of the previous years as a standard or as a measure. But by the Act if 1922 this principle was changed. Now under the Act, tax is assessed in the assessment year on the income of the previous year. The Judicial Committee in Maharaja of Pithapuram v. Commissioner of Income-tax, Madras ((1945) 13 I.T.R. 221, 223.) has brought out this distinction when it said :

> "In the first place, it is clear to their Lordships that under the express terms of Section 3 of Indian Income-tax Act, 1922, the subject of charge is not the income of the year of assessment, but the income of the previous year. This is in direct contrast to the English Income-tax Acts, under which the subject of assessment is the income of the year of assessment, though the amount is measured by a yardstick based on previous years."

This Court in Commissioner of Income-tax, Bombay City v. Amarchand N. Shroff ((1963) 48 I.T.R. 59.) rested that principle with approval.

Even so, the income of the assessee during the accounting year has to be computed only in the manner prescribed by the Act. Deductions and exemptions from the total income can only be those that are provided under the Act. This aspect of the case has been brought out with clarity in The Union of India v. Madam Gopal Kobra ((1954) 25 I.T.R. 58.). The facts in that case were : the respondent resided and carried on business in the District of Jodhpur in Rajasthan which was one of the States specified in Part B of the First Schedule to the Constitution of India, 1950. The Constitution came into force on January 26, 1950. The Indian Finance Act, 1950, amended the Indian Income-tax Act, 1922, in certain respects and made it applicable to the whole of India, except the State of Jammu and Kashmir. In May 1950, the respondent was required to file a return of his income for the year ending March 31, 1950. It was contended by the respondent that the income which accrued or arose to him or was received by him prior to April 1, 1950, was not liable to tax on the ground that such income was not liable to be charged under the provisions of any law validity

in force in Rajasthan. This Court held that under sub-cl. (1) of cl. (b) of s. 2(14A) of the Income-tax Act, Rajasthan was to be deemed to be a taxable territory for the purpose of s. 4A as respects any period before or after March 31, 1950. On that fiction, as the respondent was a resident in such territories within the meaning of s. 4A, the income accruing or arising to him in Rajasthan during the year 1949-50 would be taxable. This Court further pointed out that Parliament under Arts. 245 and 246 of the Constitution, read with entry No. 82 of List 1 of the Seventh Schedule thereof, can make laws with respect to taxes on income for the whole of the territory of India with retrospective effect. The effect of the said decision is that though by reason of the Finance Act of 1950 the assessee was assessable to income-tax only from April 1, 1950, his income of the previous year was taxable even though the said income was not liable to tax before the Indian Income-tax Act was made applicable to Rajasthan. To that limited extent it had retrospective operation. If so, we do not see how a person, who was exempted from tax before the Act was extended under the State law or under the International Law, would be in a better position.

The legal position as we apprehend may be stated thus : Under the Act an individual is assessed to income-tax on the income of the previous year at the rate or rates fixed for the year by the annual Finance Act. The total income of the assessee during the previous year is computed in accordance with the provisions of the Income-tax Act after giving the relevant allowance and deductions therefrom. If during the assessment year an individual is assessable to tax, the fact that during the previous year he was not liable to tax at all because there was no income-tax Act in the area to which the Act was extended or because that under an Income-tax Act in force therein during that year his income was exempted from tax or because of any other law, including International Law, he was so exempt from tax, would not be of any relevance. After the extension of the Act to the Hyderabad State the charge was under the Act and not under the provisions of the previous law. Thereafter, the charge as well as the manner of computation of income did not depend upon the pre-existing law, but only upon the provisions of the Act. Applying the said principles to the instant case, it is manifest that after January 26, 1950, the assessee ceased to be a ruling chief and he was, therefore, liable to assessment under the Act. If he was assessable to tax, the statutory charge on his income during the previous year was only traceable to the Act, which was retroactive in operation to that extent. His right to exemption, if any, under International Law during the accounting year was relevant to the question of taxation under the Act, as the said law ceased to apply to him during the assessment year.

We, therefore, hold that the High Court went wrong in holding that the income received by the assessee up to January 26, 1950, was not liable to tax under the Act.

The second question reads :

> "Whether, having regard to the provisions of Part B States (Taxation Concessions) Order, 1950, the assessee's income during the year of account was totally exempt from tax."

The High Court answered the question against the assessee. The facts relevant to the question are as follows : The assessee was assessed to income-tax in respect of his income arising in Hyderabad in connection with the assessment years 1950-51 and 1951-52, having regard to the provisions of Part B States (Taxation Concession) Order, 1950. It was contended that the assessee was immune from liability to tax under the law of income-tax of Hyderabad and, therefore, the rate payable by him in terms of the order would be nil; with the result that he would not be liable to any tax. The question turns upon the relevant provisions of the said Order. The said Order was issued by the Central

Government in exercise of the power conferred on it under s. 60-A of the Act. Under that section, the Central Government has the power, if it considers necessary or expedient so to do, to avoid any hardship or anomaly, or removing any difficulty, that may arise as a result of the extension of the Act to the merged territories, by general or special law to make an exemption, reduction in rate or other modification in respect of income-tax in favour of any class of income, or in regard to the whole or any part of the income of any person or class of persons. Pursuant to that power the Central Government issued Part B States (Taxation Concession) Order, 1950, making exemptions, reductions in the rate of tax and modifications specified in that Order. At the outset it may be noticed that under this Order no exemption was given to an Ex-Ruler from paying income-tax or super-tax in respect of income accrued to him in the Hyderabad State. A perusal of paragraphs 3(ii)(a), 3(iii), 3(iv), 3(v) and 3(vi), para 4(iii), para 5 and para 6 of the Order shows that the Order was made mainly to give relief to assessees in Part B States where the rates of tax were less than the rates prescribed in the Act. "Indian rate of tax" was defined in para 3(iii) and "State rate of tax" was defined in para 3(v). Under the Explanation to para 3(v), if there was no State law relating to charge of income-tax and super-tax, the Schedule annexed to the Order prescribed the rates. The tax on the basis of "Indian rate of tax" and the "State rate of tax" before the appointed day were calculated and the lesser rate was made payable : see paras 5 and 6 of the Order. The entire scheme evolved a machinery to give a rebate on the difference of tax calculated on the basis of the said two rates. The said scheme had nothing to do with exemptions either under the said Order or under the Act. It was argued that, as under the State law the assessee was immune from liability to tax, he was in effect liable to pay only nil tax under the State law. On the basis of nil tax under the State law, the argument proceeded, by applying the principles of the said Order, no tax would be payable by the assessee. We cannot accept this argument. The Order was only intended to provide machinery for scaling down the rates of tax in relation to the State rates. If there was a state law prescribing rates, it would afford the criterion for scaling down the Indian rate of tax; if there was no State law prescribing the rate, the schedule of rates annexed to the Order would govern the taxation. If the assessee was not liable to pay tax under the State law, his non-liability related only to the domain of exemption. It would be incongruous to say that a person exempted from taxation was paying a nil rate. This would be an obvious attempt to subvert the scheme of the Order to reach a desired result. We, therefore, hold, agreeing with the High Court, that the assessee was not entitled to any exemptions under the said Order.

We shall now take up the first part of the 4th question which reads :

> "Whether on the facts of the case the interest received by the Assessee in respect of 3% Nizam Government Income-tax free loan, 1360-70 Fasli of the face value of Rs. 1,45,200, the 2 1/2% Nizam Government Income-tax free development loan, 1364-69 fasli of the face value of Rs. 1.05 crores, the 2 1/2% Nizam Government loan, 1363-73 fasli of the face value of Rs. 200, and the 2 3/4% Hyderabad Government loan, 1384 fasli of the face value of Rs. 8 crores was exempt from tax."

This question relates only to the assessment year 1951-52. The securities were issued by the Hyderabad State free from income-tax. The High Court held that they were exempt from income-tax under s. 8 of the Act. Under s. 8 of the Act, tax shall by payable by an assessee under the head "interest on securities" in respect of the interest receivable by him on any of the securities of the State Government. But, under the third proviso thereto, the income-tax payable on the interest receivable on the securities of the State Government issued income-tax free shall be payable by the State Government. It was argued for the Revenue that the expression "securities of a State Government" in the proviso does not include the securities issued by the Hyderabad State. This

contention was sought to be sustained on the basis of the definition of "Government securities" in s. 3(24) of the General Clauses Act, 1897, which read :

> "Government securities" shall mean securities of the Central Government or of any State Government, but in any Act or Regulation made before the commencement of the Constitution shall not include securities of the Government of any Part B State."

Relying upon this clause it was contended that the securities issued by the Government were not covered by the said proviso. There is an obvious fallacy in this argument. To ascertain the meaning of an expression in a Central Act, it is permissible to look into the General Clauses Act to find out how that expression is defined in the General Clauses Act. The General Clauses Act affords a dictionary for words used in the Central Acts to the extent provided thereunder. Proviso 3 to s. 8 of the Act does not use the expression "Government securities", but only mentions "securities" of a State Government. There is, therefore, no scope to ascertain the meaning of the latter expression with reference to the definition given to a different expression in s. 3(24) of the General Clauses Act. On the other hand, the expression "State Government" is defined in cl. (60) of s. 3 of the General Clauses Act and it reads :

> ""State Government", - (a) as respects anything done before the commencement of the Constitution, shall mean, in a Part A State, the Provincial Government of the corresponding Province, in a Part B State, the authority or person authorised at the relevant date to exercise executive government in the corresponding Acceding State, and in a Part C State, the Central Government."

Clause (58) of s. 3 of the General Clauses Act defines "State" to mean as respects any period before the commencement of the Constitution (Seventh Amendment) Act, 1956, a Part A State, a Part B State or Part C State. With the aid of the said definitions it will be clear that the expression "State Government" used in the proviso to s. 8 of the Act takes in the Government of the Hyderabad State. If so, in terms of that proviso, the income-tax payable on the interest receivable on the securities of the Hyderabad Government issued income-tax free shall be payable by the State Government. Therefore, there are no merits in the contention and the High Court rightly rejected it.

In regard to the same securities the assessee claimed exemption from payment of income-tax and super-tax under item 8 of the Notification dated March 21, 1922, issued by the Finance Department of the Government of India. It reads :

> "The interest on Government securities held by, or on behalf of, Ruling Chiefs and Princes of India as their private property."

This exemption applies both for income-tax and super-tax. If the assessee was entitled to this exemption, he would get a larger relief than he would under the third proviso to s. 8 of the Act. The said securities were held by the assessee as his private property and, therefore, he was clearly entitled to this exemption. We, therefore, hold, agreeing with the High Court, that the assessee was entitled to the exemption under the said item in respect of the said securities.

Then we come to questions 4(ii) and 4(iii). They read :

> Question 4(ii) "Whether on the facts of the case the interest in respect of securities of the Government of India or of the Government of Hyderabad (including Nizam Government Promissory Note), which became payable to the Assessee under the trust

created by him known as "the Family Trust", was exempt from payment of tax in his hands."

Question 4(iii) "Whether the interest in respect of securities of the Government of India or of the Government of Hyderabad (including Nizam Government Promissory Note), which became payable to the Assessee under the trust created by him known as "the Miscellaneous Trust" was exempt from payment of tax in his hands."

These two questions relate to Government securities settled by the assessee in trust, but the income whereof was payable to him under the provisions of the relevant deeds of trust. The assessee executed the two trusts - one dated May 10, 1950, known as H.E.H. Nizam's "Family Trust" and the other dated August 6, 1950, known as H.E.H. Nizam's "Miscellaneous Trust". Under cl. 3 of the deed of trust relating to the Family Trust, the net income of the trust fund, after defraying the expenses and charges of collection, had to be paid by the trustees thereunder to the assessee for and during the term of his natural life. Under the Miscellaneous Trust it was provided that subject to the provisions of sub-cls. (a) to (j) of cl. 2 of the said deed, the trustees should pay the balance of the interest and income of the trust fund to the assessee for and during the term of his natural life. At this stage it is not necessary to notice the other recitals in the deeds. We shall have to consider the recitals in the said two deeds in greater detail at a later stage. The assessee claimed exemption in regard to the said interest on the ground that he was exempted under the third proviso to s. 8 of the Act and under item No. 8 of the notification issued by the Finance Department of Government of India on March 21, 1922. The High Court held that after the execution of the trust deed, the assessee was divested of his ownership of the securities and the trustees became their owners. On that basis, it further held that, though the income was interest on securities in the hands of the trustees, it was in the hands of the assessee only the income which he got from the trustees. Briefly stated, the High Court held that the character of the income, namely, interest on securities, had changed when it reached the hands of the assessee.

The question falls to be decided on a construction of s. 41 of the Act. The relevant part of s. 41 reads :

"(1) In the case of income, profits or gains chargeable under this Act which..... trustee or trustees appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise..... are entitled to receive on behalf of any person, the tax shall be levied upon and recoverable from such..... trustee or trustees, in the like manner and to the same amount as it would be leviable upon and recoverable from the person on whose behalf such income, profits or gains are receivable, and all the provisions of this Act shall apply accordingly :

. . . . . .

(2) Nothing contained in sub-section (1) shall prevent either the direct assessment of the person on whose behalf income, profits or gains therein referred to are receivable, or the recovery from such person of the tax payable in respect of such income, profits or gains."

Under this section the Revenue has the option to levy or collect tax from the trustee or the beneficiary; the tax can be levied upon and recoverable from the trustee in the like manner and to the same amount as it would be leviable upon and recoverable from the person on whose behalf

such income, profits or gains are receivable. In short, it imposes a vicarious liability on the trustee. The expression "all the provisions of this Act shall apply accordingly" indicates that there is no distinction in the matter of assessability of the income in the hands of a trustee or the beneficiary, as the case may be. Indeed, s. 41 of the Act comes into play only after the income is computed in accordance with Ch. III of the Act. In the case of income from securities s. 8 applies, and under the second proviso thereto, the income-tax payable on the interest receivable on any security of the State Government issued income-tax free shall be payable by the State Government. No tax on interest on such securities is payable by the assessee. After ascertaining the income and after giving the exemptions, the income-tax authority has the option to assess the beneficiary directly or, in respect of the same income, the trustee on behalf of the beneficiary. This construction finds support in the decision of the Bombay High Court in Commissioner of Income-tax, Ahmedabad v. Balwantrai Jethalal Vaidya ((1958) 34 I.T.R. 187.). If that be the scope of the assessment under s. 41 of the Act, we find it difficult to appreciate the contention that the interest on securities in the hands of the trustee becomes an income other than such interest in the hands of the beneficiary. The interest retains its character whether the assessment is made on the trustee or the beneficiary. We cannot, therefore, accept the construction put upon s. 41 of the Act by the High Court.

This legal position only gives the assessee relief in regard to income-tax payable on the interest from securities; but the third proviso to s. 8 of the Act does not transfer the liability of the assessee to pay super-tax to the State Government. The exemption from super-tax was claimed under item 8 of the notification issued under s. 60 of the Act. We have extracted that item earlier in another context. The interest mentioned in this item is exempt from both income-tax and super-tax. The short question, therefore, is whether the interest payable to the assessee was in respect of Government securities held by or on behalf of the assessee as his private property. The answer to this question depends upon the provisions of the said two trusts, namely, the Family Trust and the Miscellaneous Trust. The Family Trust was executed by the assessee on May 10, 1950, in respect of the Government securities of aggregate face value of Rs. 9 crores which were his private properties. Under the deed of trust, the trustees were appointed and the securities were handed over to them. The trustees so appointed were to collect and recover the interest and other income from the securities and were, after meeting the overhead charges, to pay the residue of the income of the trust fund to the assessee absolutely for and during the term of his natural life. After the death of the assessee, the trustees should divide the trust fund and allot it to the innumerable relatives and others mentioned in the trust deed. The trust deed also gave various other directions to the trustees. In short, under the said trust deed the title to the securities was transferred to the trustees and they were under an obligation to pay the interest or to give the corpus in the manner prescribed thereunder during the life time of the assessee or thereafter. Under the trust deed the securities were not held by the trustees on behalf of the assessee as his private property : they were held by the trustees for carrying out the trust in terms of the trust deed. After the execution of the trust deed, the securities ceased to be the private property of the assessee and thereafter he would only be entitled to the interest on the securities during his life time in the manner prescribed thereunder. We cannot, therefore, hold that the securities were held by the trustees as private property of the assessee.

The Miscellaneous Trust consisted of Hyderabad and Government of India Loans. Under this trust deed, trustees were appointed and the said amounts were transferred to them. Under the document the trustees were under an obligation to manage the said fund, recover interest and other income therefrom, and, after bearing the overhead charges, pay the income therefrom in different proportions to the relatives of the assessee and other persons mentioned therein. It is not necessary to consider the complicated provisions of this document. It would be enough to state that under this trust deed also the amounts representing the loans mentioned therein ceased to be the private

property of the assessee and the trustees thereunder held the said property for discharging the various obligations imposed on them and for paying the income therefrom to the different persons mentioned therein and in the manner prescribed thereunder. The Government loans, therefore, ceased to be the private property of the assessee and after the execution of the trust deed they were held by the trustees not on behalf of the assessee as his private property but for the purpose of discharging the obligations imposed on them under the deed.

We, therefore, hold that the income from the said two trusts did not earn the exemption under item 8 of the said notification.

The result of our view is that in regard to the interest receivable by the assessee from the said securities and loans, he was not liable to pay income-tax, but he was not exempt from payment of super-tax under item 8 of the said notification.

The next question, as recast by the High Court, reads :

> Question 4(iv) "Whether on the facts of the case, the interest at Rs. 1,97,180/- on the Government of India securities should be regarded as having accrued in the Hyderabad State and therefore chargeable at the rate obtaining under the Hyderabad Income-tax Act."

It was argued that the income sought to be taxed accrued in Hyderabad, because the securities were enforced to be payable in Hyderabad and, therefore, chargeable only at the rate obtaining under the Hyderabad Income-tax Act. The High Court negatived the contention. It held that the said interest accrued only in British India. Though the assessee raised the question of the correctness of the view expressed by the High Court in the special leave petition, at the time of arguments the learned counsel for the assessee did not press this point. Therefore, the opinion expressed by the High Court in this regard stands. We should not be understood to have expressed our view one way or other. In the result, we answer the questions as follows :

> Question 1 : in the affirmative.
>
> Question 2 : in the negative.
>
> Question 3 : in the negative.
>
> Question 4(i) : in the affirmative.
>
> Question 4(ii) : the assessee was exempt from payment of income-tax, but he was not exempt from payment of super-tax.
>
> Question 4(iii) : the assessee was exempt from payment of income-tax, but he was not exempt from payment of super-tax.
>
> Question 4(iv) : in the negative.

The aforesaid answers given by us to the 4 questions referred to the High Court by the Income-tax Appellate Tribunal will be substituted in the place of those given by the High Court. We modify the order of the High Court accordingly in all the appeals. As the parties failed in part and succeeded in part, they will bear their own costs here and in the High Court.

Appeals allowed in part.

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