

ALLAHABAD HIGH COURT

Commissioner of Income-tax, U.P

Vs.

Maheshwari Saran Singh

Misc. Cases Nos. 201 of 1948 and 12 of 1949

(Malik, C.J. and V. Bhargava, J.)

04.10.1950

JUDGMENT

Malik, C. J

1. These are two references made under Section 66 (1), Income-tax Act, and though the questions have been differently framed in them, the point raised is the same. The assessee had lent money to certain persons who applied under Section 4, U. P. Encumbered Estates Act. In due course decrees were passed under Section 14 of the Act. These decrees carried interest at a rate mentioned in the decrees. Bonds were issued by the Collector under Section 30, U. P. Encumbered Estates Act, to the creditors in satisfaction of the decrees in their favor. These bonds included not only the principal amount due under the decrees but also the accumulated interest between the date of the decree and the date on which the bonds were issued; so that the total amount of the principal and interest due under a decree was the amount for which the bounds were issued and they carried interest at $3\frac{1}{4}$ per cent. per annum.
2. In both the cases the Income-tax Officer, after deducting certain expenses incurred by the assessee, held that the amount, which covered the interest due under the decree, was assessable income.
3. The Appellate Assistant Commissioner upheld the decision of the Income tax Officer that the amount of interest included in a bond must be deemed to be income received by the assessee and was thus taxable.
4. The Appellate Income-tax Tribunal, however, came to a different conclusion and on applications made by the Commissioner these references were made.
5. In Misc. Case No. 201 of 1948 the assessee was a Hindu undivided family of Shri Maheshwari

Saran Singh of Anapur. His father had lent money to Rai Bajrang Bahadur Singh who applied under the Encumbered Estates Act. A decree for Rs. 60,280 was passed in favor of the Hindu undivided family against the landlord applicant, Rai Bajrang Bahadur Singh and the amount carried interest at 4 per cent per annum. On 9-3-1943, the final award was passed under which bonds worth Rs. 78,100 were given by the Collector to the assessee in satisfaction of the decree against the landlord applicant. These bonds consisted of the principal sum for which the decree was passed and the interest thereon. After deducting certain expenses the difference of Rs. 23,715 was treated as receipt in lieu of interest and was assessed to income-tax. The assessee follows the cash system of accounting in respect of his money-lending business and on receipt of the bonds he credited the account of his debtor, Rai Bajrang Bahadur Singh, with Rs. 78,100 and debited the account standing in the name of his father, Shri Bindeshwari Saran Singh, the original creditor, to the same extent.

6. The facts of the other Misc. case No. 12 of 1949 are similar. In that case Shri R.C. Bhateley is the assessee and the principal amount of the money lent by the assessee was Rs. 78,089. The bonds issued to him were for Rs. 1,45,364. After deducting certain expenses the surplus of Rs. 52,558, which represented the accumulated interest, was held by the Income tax Officer to be income received by the assessee which was liable to income-tax.

7. In the case of Shri Maheshwari Saran Singh the questions framed by the Tribunal are as follows :

"(I) Whether in the circumstances of the case, receipt of the U. P. Govt. bonds issued under Section 27, Encumbered Estates Act, in lieu of his decrees under the Encumbered Estates Act in the course of his money-lending business amounts to a receipt of interest as income assessable under the Act?

(II) Whether the squaring up of the dues of the principal on receipt of the bonds in the books of account maintained on cash basis amounted to realization of interest for the purposes of determining assessable income under Section 13, of the Act and estops the respondent from contending otherwise?"

In the case of Shri R.C. Bhateley the question has probably been better framed and is as follows :
"Whether on the facts stated above, the bonds issued by the Collector under Section 30, Encumbered Estates Act, which were redeemable after a fixed time amounted to a receipt of income during the year of account from interest assessable under the Income-tax Act?"

8. It may be necessary, before we deal with the question of law referred to us, to mention the scheme of the U. P. Encumbered Estates Act. Under that Act, a landlord, which word has the same meaning as in the U. P. Tenancy Act, may apply under Section 4, to the Collector stating the amount of his private and public debts and requesting that the provisions of the Act be applied to him. The Collector then transfers the proceedings to the Special Judge. Before the

Special Judge the landlord, who is called the landlord applicant, files a written statement giving the list of his creditors and the list of his assets. Notices are then published and the creditors have to put in written claims and if they do not do so within a certain time, their claims are deemed to have been discharged. After the claims are put in, no matter whether the claim is on the basis of a secured or an unsecured debt, simple money decrees are passed in favor of the creditors under Section 14 of the Act. Before considering the claims and passing decrees under Section 14, the Special Judge has to determine the properties belonging to the landlord applicant. After the Special Judge has prepared a list of the properties and a list of the debts, he ranks the debts in order of priority in accordance with the provisions of Section 16 and then sends the decrees to the Collector for execution in accordance with the provisions of Chap. 5 of the Act. It is not necessary to deal with all the modes of execution provided for in Chap.

5. We may, however, refer to Section 27 which is relevant and is as follows :

"If the amount still due by the debtor is less than the installment value of his proprietary rights in land as determined under Section 26 the Collector shall, in accordance with rules framed by the Provincial Govt. order him to pay such amount to the Provincial Govt. in installments with future interest at a rate to be determined by the Provincial Govt. which shall not be higher than 4½ per cent. per annum, provided that such installment shall not extend beyond a period of 20 years."

We may also refer to Section 29 (1) which provides that

"The installments ordered under Section 27 ... shall be paid by the debtor to the Provincial Govt. along with his land revenue and cesses and any such installment not paid on due date shall be recoverable as an arrear of land revenue."

9. Then we come to the important Section 80 which is as follows :

"If the Collector has proceeded under Section 27 he shall, in accordance with rules framed by the Provincial Govt., give to each creditor a bond or bonds for the amount due to him. Such bond or bonds shall bear interest at one per cent. less than the rate fixed under Section 27 and shall be payable by the Provincial Govt. within a period which shall not exceed 20 years.

Provided that the Provincial Govt. may at any time pay to the creditor the whole amount remaining due at the date of payment."

10. The bonds issued under this section are exactly similar to the Govt. promissory notes. They carry interest at 3¼ per cent. per annum, are issued by the Public Debt Office, Reserve Bank of India, and are as follows :

"The United Provinces Encumbered Estates Act Bond. The Governor of the United

Provinces hereby promises to pay to.....or order at any Treasury in the United Provinces or at the General Treasury at Fort Williams or at Bombay on the . . . day of 19 .. on the application of the holder, or earlier at the entire option of the Govt. of the United Provinces, the sum ofand in the meantime to pay at the said Treasury interest on such sum at the rate of three and one quarter per cent. per annum, such interest to be paid half yearly on the 20th day of February and the 20th day of August in every year, commencing from the 20th day of . . 19 . . . , on which date the whole interest due from the date hereof shall be paid."

It is signed for and on behalf of the Governor of the United Provinces, by the Governor of the Reserve Bank of India. On the back there are columns for half yearly payments of interest and another column for recording the transfers. These bonds are for round figures of ten, hundred and so on.

11. The result, therefore, is that the decree passed against the landlord applicant is satisfied by issue of the bonds by the Govt. which undertakes the liability to pay to the creditors in twenty years, or earlier, the amount mentioned in the bonds and in the meantime to pay interest at 3¼ per cent. per annum every half year. The bonds are transferable like any other Govt. promissory notes. Under Sections 27 and 29, Encumbered Estates Act, Govt. has in its turn the right to realise the money from the landlord debtor.

12. The contention of the assesseees was that the amount received was not payment of interest but was merely substitution of one security for another.

13. It is now well settled that if instead of cash something equivalent to cash, that is where money or money's worth is given it amounts to payment of interest. In the *Westminster Bank, Ltd v. Osler (Inspector of Taxes¹)*, the Westminster Bank while carrying on their business had, from time to time, to vary large investments. They had in 1929, to vary their investments and invested in War Loan in place of 1919 and 1918 National War Bonds. It was contended that there had in fact been a mere accretion of capital value which could not be brought into account until in fact it had been realized. Lord Buckmaster held :

"The exchange effected in the present case was in fact the exact equivalent of what would have taken place had instructions been given to sell the original stock and invest the proceeds in the new security. The investment represented by the original War Bonds, came to an end as soon as the new securities were taken in its place, when a new venture was begun in relation to the new holding, and the fact that this transformation took place by the process of exchange does not in my opinion avoid the conclusion that there has been what is described as a realization of the security."

The decision in *California Copper Syndicate v. Harris²*, was quoted with approval, where Lord

Trayner had observed :

"A profit is realised when the seller gets the price he has bargained for. No doubt here the price took the form of fully paid shares in another Company, but, if there can be no realised profit, except when that is paid in cash, the shares were realisable and could have been turned into cash, if the appellants had been pleased to do so. I cannot think that Income-tax is due or not according to the manner in which the person making the profit pleases to deal with it. Suppose for example, a seller made a profit on a trade transaction, but leaves the price (including the profit) in the hands of the buyer at so much per cent. interest. That he so deals with it, rather than take the cash into his own pocket, would not affect the claim of the Revenue for the tax payable on the profit. No more, in my opinion does it affect the liability for the tax that the Appellants left their profit in the hands of the Company they sold to and took the Company's shares as their voucher."

14. In the *Commr. of Income-tax, B. and O. v. Kameshwar Singh*³, the assessee had a sum
¹1933 ITR 65 (HLC) ³1933-1 ITR 94 (PC)
²(1905-11) 5 Tax Cas 159

of Rs. 38,09,569 due from Kumar Ganesh Singh. An arrangement was entered into between the assessee and his debtor and the assessee took over from the debtor in satisfaction of this amount a colliery, certain shares in different companies, unrealised bills, a decree, certain loans due to the debtor from others, promissory notes and hand notes of third parties and also fresh hand notes from the debtor himself. Their Lordships held that the fresh hand notes from the debtor himself were not payment but as for the rest they approved the opinion of the Commissioner that the transaction when rightly viewed amounted to

"the acceptance by the assessee from his debtor, in lieu and satisfaction of the capital and interest due to him, of assets and securities prima facie worth the valuation put upon them and that as the assessee had thus received payment in kind of the interest due to him in full, he should be assessed accordingly."

Their Lordships went on to observe

"that a liability to pay interest, like a liability to make any other payment, may be satisfied by a transference of assets other than cash and that a receipt in kind may be taxable income,"

This case is distinguished on the ground that while the Maharaja of Darbhanga had agreed to the adjustment and it may, therefore, be deemed that he had decided to accept payment in kind instead of in cash, in the case before us the creditor has no option and, under the Encumbered Estates Act, he is bound to accept the bonds given by the Government in satisfaction of the

decree. This would not, to our minds, make any difference. If the law entitles the Government to pay, on behalf of a debtor, discharge that debtor's liability and take the liability on itself and if, instead of paying in cash, the Government pays in money's worth, it is nonetheless payment.

15. In *Raghunandan Prasad Singh v. Commissioner of Income Tax, B. and O⁴*. their Lordships of the Privy Council said that :

"They fully recognize that income may be received in kind as well as in cash and that the receipt of an equivalent of cash may be a receipt of income."

In that case certain shares in a company had been given and it was held by their Lordships that the shares taken in exchange were realisable and were thus money's worth and the equivalent of cash."

16. In the Scottish and *Canadian General Investment Com. Ltd. v. A. Easson (Surveyor of Taxes⁵)*, it was held that

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"If instead of receiving cash the Company get a saleable security, that saleable security is just part and parcel of the Company's profits and gains.

⁴1933-1 ITR 113 PC

⁵(1922) 8 Tax. Cas 265

It must be assessed as increasing its value and if that is fairly and properly done then that represents just so much profits or gain to the Company."

It may be mentioned that the debentures which were given in payment in that case were for a period of ten years.

17. An important factor in considering the question whether it is substitution of security or payment, is whether the bonds were transferable and could, therefore, be deemed to be money's worth. We have already said that these Encumbered Estates bonds were just as much saleable in the market as any other Government security and the assessee could, therefore, have sold them in the market if he wanted to, of course at the market price. It is not suggested that the market price of these bonds was less than their face value.

18. Another important factor in considering the question whether it is substitution of security or payment, is the question whether the debtor is the same. In the two cases before us the liabilities of the debtors were wiped out and it was the State that took upon itself the liability. In *Cross (Inspector of Taxes) v. London Provincial Trust, Ltd⁶*., Greene, M.R. said :

"It is not open to question that income can be in the form of money's worth. Nor it is open

to question that if the holder of a security, the contractual income from which is money, receives from the person liable to pay that money something of money's worth (for example, goods) instead of money, such goods are income arising from the security. ... On the other hand, where there is a mere substitution of a promise to pay at a later date for the obligation to make an interest payment presently due, the owner of the security cannot be said to have received income from it."

His Lordships quoted the following passage from the decision in *Westminster Bank, Ltd. v. Osler*⁷,

"From these cases it is plain that the essence of the matter is that there must be an actually realised or realisable profit or loss."

The Master of the Rolls pointed out :

"It is one thing to say that income is nonetheless income because it is received in the shape of money's worth instead of money- this proposition is true; it is a totally different thing to say that the receipt of money's worth is necessarily a receipt of income."

In the judgment of Mackinnon, L.J., it was pointed out that

"a debtor may pay his debt by giving the promise of a third party to pay; indeed the best form of payment in the world, Bank of England notes, if subjected to the unusual treatment of being read, will be found to be promises by a third party to pay. But I am satisfied that there can never be payment of his debt by a debtor by giving his own promise to pay at a future date."

19. We are, therefore, of the opinion that the receipt of the U. P. Government bonds issued under Section 30, Encumbered Estates Act, in lieu of interest due was receipt of income during the year of account and was assessable to income-tax.

20. The Commissioner is entitled to his costs which we assess at a figure of Rs. 400 in each case.

References answered.

⁶1939-7 ITR 109

⁷(1933-1 ITR 65)