CALCUTTA HIGH COURT

Commissioner of Income-tax

Vs.

Sandersons and Morgans

Income-tax Reference No. 69 of 1964

(B.N. Banerjee and K.L. Roy, JJ.)

24.04.1968

JUDGMENT

Banerjee, J.

1. This reference, under Section 66 (1) of the Indian Income-tax Act, 1922 raises an interesting question about solicitor-client relationship.

2. The institution of Solicitors is an English institution, which has been imported to or copied by this country. In dealing with the position of Solicitors in India, Marten, C. J., observed in *Tyabji Dayabhai and Co. v. Jetha Devsi and Co*[1]*.,*: -

> "In the first place it must be clearly understood that the rights and duties of attorney are in no way part of the indigenous law or practice in India. Their profession originates from England; it grew up under the English Common Law and it is clear that it was the Common Law which governed their rights and duties in the King's Courts established by the Supreme Court Charter of 1823 to which Courts our present High Court is the successor."

This Court quoted with approval the above observation in *Damodar Das v. Morgan and Co*[2]*.,* and Panckridge, J., observed :

> "Mutatis mutandis those words appear to me to apply to the Calcutta High Court. I take the learned Chief Justice's words as amounting to a statement that the rights of an attorney in India are the same as the rights of a solicitor in England, except in so far as the latter have been diminished or increased by statute." There are good reasons why the English Common Law principles should be applied in relation to Indian Solicitors. Those principles are based on justice, equity and good conscience and, in the absence of

statutory provisions in this country, should govern the relationship between solicitors and clients. This view was expressed by Jenkins, J., (as he then was) in *Khetter Kristo Mitter v. Kally Prosunno Ghose*[3], in the following language : -

"These principles appear to me to be the clear result of the authorities in England;

[1] AIR 1927 Bom 542 [3](1898) ILR 25 Cal 887

[2] AIR 1934 Cal 341

and founded, as they are, on justice, equity and good conscience, I see no reason why they should not apply in this country."

3. Now, the relationship in which a solicitor stands with his client, under the English Common Law, particularly in respect of client's money, has been described in Halsbury's Law of England (Simonds Edition), Volume 36 in the following language : -

(Article 85): "The relationship between solicitor and client is a fiduciary one, but it does not follow that a solicitor is in all respects a trustee in relation to his client. Ordinarily the relationship between solicitor and client is that of agent and principal and therefore time will run against the client in respect of money left in his solicitor's hands; but special circumstances, as where money is paid by the client to his solicitor for a particular purpose, may constitute the solicitor a trustee of that money in relation to the client, so that time will not run against the client to preclude his recovery of money, not applied for the particular purpose."

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(Article 131): "The obligations of a solicitor towards his client may be viewed from two aspects, namely, that of equity and that of the Common Law. In equity the relationship of solicitor and client is recognised as a fiduciary relationship and carries with it obligations on the solicitor's part to act with strict fairness and openness towards his client; for failure to fulfil this obligation a solicitor will be liable to make compensation in respect of any resulting loss to his client, though the circumstances are not such as would sustain an action for deceit at common law. By the common law a solicitor's retainer imposes on him an obligation to be skilful and careful; for failure to fulfil this obligation he may be made liable in contract for negligence, whether he is acting for reward or gratuitously and whether he has or has not a practising certificate in force at the time.

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A solicitor, like any other individual, is liable for his wrongful, acts, and, if the circumstances justify the charge, may be made liable to his client in tort as, for example, in an action for deceit or libel or conversion. So, too, when acting as agent for his client he is under the obligations ordinarily imposed by the law of agency upon an agent; for example, he is bound to allow his client to inspect documents relating to an action in which the solicitor acted for the clients."

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(Article 275): "A solicitor who, as solicitor for a client, has received and has in his hands money of the client, may be ordered, on application being made by or on behalf of that

client or his personal representatives, under the Court's inherent jurisdiction over its officers, to account for money received or paid and to pay over to the client, or into Court, the balance due to the client after deducting any money owing to the solicitor by the client for costs or other reason. If misconduct was not alleged the application was formerly a proper one to make at chambers and it is now usually made there by summons under a special rule of Court and the order may be enforced by attachment if it comes within an exception to the Debtors Act, 1869 and the payment is defined with sufficient certainty."

4. In Cordery's 'Law Relating to Solicitors" (5th Edition) at pp. 144-145, the same view appears :

"The usual relation of solicitor and client is that of agent and principal and this is so in respect of the client's moneys received by the solicitor in the ordinary course of business. In the absence of special circumstances, therefore, the Limitation Act, 1939, Section 2 (q), which bars the action in six years, will run from the time of the receipt by the solicitor or last acknowledgment or part payment."

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"Special circumstances are needed to raise the relation of trustee and cestui que trust between solicitor and client, as where the solicitor receives his client's money not for remittance, nor as banker merely, but for a particular purpose and with the duty of holding it for the benefit of the client and keeping it until it is called for."

At p. 441 of the same book the following passage appears : -

"Every solicitor who holds or receives client's money including money proper to be paid in under Rule 4, is bound to keep and maintain separate bank account for clients' money and without delay to pay such money into his client account; and any solicitor may keep more than one client account.

Clients' money is trust money in the wider sense demanded by the general law of trusts; and thus, for example, on a solicitor's bankruptcy the chose in action represented by the client account is 'property held by the bankrupt on trust for another person' within Section 38 of the Bankruptcy Act, 1914 and does not vest in the trustee in bankruptcy."

The expression client's money has a well-known meaning, as appears from the definition of the expression in the English rules known as Solicitors' Accounts Rules, 1945. In the said rules client's money is defined as : -

"Client's money shall mean money held or received by a solicitor on account of a person for whom he is acting in relation to the holding or receipt of such money either as a solicitor or, in connection with his practice as a solicitor, as agent, bailee, stakeholder or in any other capacity; provided that the expression 'client's money' shall not include : -

(a) money held or received on account of the trustees of a trust of which the solicitor is solicitor-trustee, or

(b) money to which the only person entitled is the solicitor himself, or in the case of a firm of solicitors, one or more of the partners in the firm."

Although we have no rules like the Solicitor's Accounts Rules in this country, we think that the expression 'client's money' should not be given a different meaning in this country.

5. In this context we need remind ourselves of the provisions of Section 88 of the Indian Trusts Act, 1882, which reads as follows :

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> "Where a trustee, executor, partner, agent, director of a company, legal adviser, or other person bound in a fiduciary character to protect the interests of another person, by availing himself of his character, gains for himself any pecuniary advantage, or where any person so bound enters into any dealings under circumstances in which his own interests are, or may be, adverse to those of such other person and thereby gains for himself a pecuniary advantage, he must hold for the benefit of such other person the advantage so gained."

Now, a solicitor in this country fulfils the description of legal adviser and the advantages, if any, gained by him in his fiduciary character must be governed by the provisions of Section 88 of the Trusts Act. Although standing in a fiduciary capacity a solicitor, as agent of his principal, namely the client, has a lien on client money and over goods bailed to him for his costs. This appears from Section 171 of the Indian Contract Act. This is also so in England, as appears from *Loescher v. Dean*[4], What happened in this case was that a plaintiff obtained a decree for specific performance of a contract to convey certain property, subject to the payment by him of £ 268 4s. 9d. to the defendant and was awarded costs. On April 17, 1950, the money was paid to the defendant's solicitors who attended the completion on the defendant's behalf and the conveyance was made to the plaintiff. On the same day the plaintiff applied for and obtained an order nisi to garnishee all debts due from the defendant's solicitors to the defendant in respect of the plaintiff's costs, which had been taxed at £ 268 16s. 5d. On April 19, 1950, the garnishee order having been served on them, the defendant's solicitors took out a summons in the action for a charging order in respect of their own costs under Section 69 of the Solicitors' Act, 1932. On the above facts, Harnam, J., held that although, as they were bound to do, the solicitors had placed the money received by them from the plaintiff in the "client account" opened by them, they had a lien on it for the amount of their costs incurred on the defendant's behalf and as by a garnishee order the creditor could not be put in any better position than the debtor, the garnishee order nisi must be discharged to the extent of the solicitors' lien.

6. Bearing in mind the above legal position, we have now to turn to the facts involved in the present case.

7. The assessee is a well-known firm of solicitors in Calcutta. The assessment year involved is the year 1957-58, corresponding to the previous year ended on December 31, 1956. In its profit and loss account, the respondent assessee had credited a sum of Rs. 4078, representing the

aggregate of the unclaimed balances in as many as 83 personal ledger accounts of the assessee's clients, who had advanced money to them in connection with cases entrusted with the assessee some years back. Even after final adjustments of bills small balances continued to be carried forward from year to year till December 31, 1956, when the assessee thought of closing the accounts of the clients and transferred the balances to the profit and loss account. This amount of Rs. 4078 inflated the net profit of the assessee to the same extent and was ultimately apportioned as between the partners of the assessee in their respective profit sharing ratio. The Income-tax Officer added back the said amount to the total assessable income of the assessee with the following observation :

> "Client's unclaimed balances written off being in the nature of professional income."

8. The assessee appealed before the Appellate Assistant Commissioner and contended that the relationship between solicitors and clients was the relationship between a trustee

[4](1950) 2 All England Reporter 124

and a beneficiary and since the Limitation Act did not apply in the matter of recovery of amount deposited by clients, the liability of the assessee continued in spite of the fact that certain unclaimed balances had been written off and transferred to the profit and loss account . The Appellate Assistant Commissioner accepted the asssessee's contention and directed the deletion of a sum of Rs. 4078 from the total income of the assessee.

9. Thereupon, the Revenue preferred an appeal before the Appellate Tribunal. It was contended by the Revenue that the conduct of the assessee in appropriating the unclaimed balances in the constituents' account raised a strong presumption that the sum of Rs. 4078 had been earned as professional income. The Revenue relied on the decision of the Punjab High Court in *Punjab Distilling Industries Ltd. v. Commissioner of Income-tax, Simla*[5]*,* The Tribunal distinguished the facts of the Punjab case from the facts of the instant case and following the principles laid down in *Morley (Inspector of Taxes) v. Tattersall*[6]*,* came to the conclusion that the unclaimed balances in the clients' accounts were "obviously liabilities" of the assessee firm, when first received and no subsequent operations could turn them into "professional receipts". The Tribunal further observed that the mere fact that the unclaimed balances had been credited to the profit and loss account of the assessee would not change the character of the amount, which were "evidently the clients' money". In that view of the matter, the Tribunal dismissed the appeal.

10. Thereupon, the Revenue obtained reference of the following question of law to this Court : -

> "Whether, on the facts and in the circumstances of the case, a sum of Rs. 4,078 representing unclaimed balances in the accounts of the clients and credited to the profit and loss account of the assessee firm were revenue receipts and as such liable to tax under the Indian Income-tax Act, 1922?"

11. It was contended by Mr. B. L. Pal, learned Counsel for the Revenue, that the assessee carried on a business or profession and the different sums of money received by the assessee from its clientele were trading receipts and the balance thereof, if transferred to the profit and loss account, would constitute income of the assessee. Mr. Pal, in his fairness, did not dispute that the assessee was bound to refund the balance of the money if demanded by the client, but nevertheless contended that if the unrefunded money be taken to the profit and loss account, resulting in augmentation of the profit, that would constitute income. He argued that the case of 22 Tax Cas 51 : 7 ITR 316 (C. A.) (supra) was distinguishable on facts and the Tribunal was in error being guided thereby. He contended that the case of (1953) 24 ITR 597 : AIR 1954 Punjab 61 (supra) was nearer the facts of the present case and should have been followed and the Tribunal was in error in electing to be misguided by the English decision in Tattersall case, (1939) 22 Tax Cas 51 : 7 ITR 316 (C. A.) (supra) which was distinguishable.

12. The argument of Mr. Pal necessitates the examination of the two decisions in some details. In (1939) 22 Tax Cas 51 : 7 ITR 316 (C.A.) the facts were like this. Messrs. Tattersall, a firm which carried on the business of auctioneers of horses, had as one of the

[5](1953) 24 ITR 597 : AIR 1954 Pun 61

[6](1939) 22 Tax Cas 51 : 7 ITR 316 (C.A.)

conditions of sale that no purchase money would be paid or remittance sent by post without written order. Unclaimed balances amounting, in course of time, to considerable sums remained in the firm's hands; at all times the firm considered itself liable to pay such balances as and when claims were made. Under the partnership deed by which the firm was constituted, part of the unclaimed balance was transferred to the credit of the partners and provision was made for subsequent annual transfers. The deed provided also that any payments which might be claimed and made in respect of the balances should be borne by the partners in proportion to their shares of profits at the date of payment. The question arose whether the unclaimed balances transferred to the partners were trading receipts in respect of which the assessee was assessable to Income-tax under Case I, Schedule D of the English Income-tax Act. Giving a negative answer to the question Sir Wilfrid Greene, M. R. observed : -

> "Now the Crown put forward two arguments. The learned Solicitor-General put forward one argument and adumbrated another argument, which he only sketched and did not develop. Mr. Hills would have none of the Solicitor-General's argument and developed at considerable length the argument which the learned Solicitor-General had only adumbrated. Both arguments proceeded on the footing that it was impossible to say that the sums when received were trade receipts. That was subject to a qualification, I think, in the Solicitor-General's argument, as will appear when I came to describe it . It might, I think, be more convenient to deal with Mr. Hill's argument first, because that is the one which starts off with this perfectly clear admission, that the money when received from the purchasers was not a trade receipt. That proposition, I should have thought, in any case, was quite incontestable. The money which was received was money which had not got any profit-making quality about it; it was money which, in a business sense, was the

client's money and nobody else's. It was money for which they were liable to account to the client and the fact that they paid it into their own account, as they clearly did and the fact that it remained among their assets until paid out do not alter that circumstance. It would have been for income-tax purposes, in my judgment, entirely improper to have brought those receipts into the account at all for the purpose of ascertaining the balance of profits and gains. Indeed, as I have said, the Crown did not suggest that that would have been proper. But what was said was this: Mr. Hills' argument was to the effect that, although they were not trading receipts at the moment of receipt, they had at that moment the potentiality of becoming trading receipts. That proposition involves a view of Income-tax Law in which I can discover no merit except that of novelty. I invited Mr. Hills to point to any authority which in any way supported the proposition that a receipt which at the time of its receipt was not a trading receipt could by some subsequent operation ex post facto be turned into a trading receipt, not, be it observed, as at the date of receipt, but as at the date of the subsequent operation. It seems to me with all respect to that argument, that it is based on a complete misapprehension of what is meant by a trading receipt in Income Tax Law. No case has been cited to us in which anything like that proposition appears. It seems to me that the quality and nature of a receipt for Income-tax purposes is fixed once and for all when it is received. What the partners did in this case, as I have said, was to decide among themselves that what they had previously regarded as a liability of the firm they would not, for practical reasons, regard it as a liability; but that does not mean that at that moment they received something, nor does it mean that at that moment they imprinted upon some existing asset a quality different from what it had possessed before. There was no existing asset at all at that time. All that they did, as I have already pointed out, was to write down a liability item in their balance-sheet and how in the world by effecting that operation you can be said to have converted a sum received years and years ago into something which it never was in a thing which, with all respect, passes my comprehension."

13. Mr. Pal argued that we should not be guided by Tattersall's case, (1939) 22 Tax Cas 51: 7 ITR 316 (C. A.) because in that case there was no money initially paid, as was done in the instant case. He submitted that what was done in that case was to put a horse belonging to a client to auction. The proceeds of the sale was money belonging to the auctioneer's client, as much as the animal itself had belonged to the client. The auctioneer might have been entitled to some remuneration out of the money received but for all practical purposes the sale proceeds did not belong to the auctioneer but to the client. On the other hand, he submitted, when money was made over to the solicitor, in the instant case, the solicitor received the money as trading receipt. That character, he submitted, was impressed upon the money throughout and the balance of that money, even though refundable to the client, when transferred to the profit and loss account would be profit out of trading receipt and consequently assessable to Income-tax. In our opinion, this argument should not be accepted. The argument proceeds on an entire misconception of the character of client's money received by a solicitor. The solicitor is the agent of the client. The

client makes over the money to the solicitor for some work being done by the Solicitor as his agent. The money must be employed to that purpose and must not be treated as money received for any other purpose. This position is not altered by the fact that the solicitor retains a lien upon the balance of the money for his costs. The result of solicitor having a lien on the balance of the money is no more than a person having a charge on somebody else's money. We are of the opinion that when a solicitor receives money from his client, he does not do so as a trading receipt but he receives the money of the principal in his capacity as an agent and that also in a fiduciary capacity. The money so received does not have any profit-making quality about it when received. It remains money received by a solicitor as "client's money" for being employed in the client's cause. The solicitor remains liable to account by this money to his client. The fact that, in Tattersall's case, 22 Tax Cas 51: 7 ITR 316 (C. A.) there was an animal entrusted to an auctioneer for auction and, in the instant case, there was money paid to solicitor by a client will not make any difference, if initially the money was not received as trade receipt. In the case of *Punjab Distilling Industries Ltd. v. Commissioner of Income-tax, Simla*[7], the Supreme Court had occasion to consider the case of Tattersall, (1939) 22 Tax Cas 51 : 7 ITR 316 (C. A.) (Supra) and observed : -

> "All that this case decided was that moneys which were not when received, income - and as to this there was no question - could never latter become income."

Since we are convinced that money received by the assessee from its clients were not trading receipts but were clients' money, to be held in a fiduciary capacity, we are of the opinion that the decision in Tattersall's case will apply to the facts of the instant case and should not be ignored as was contended by Mr. Pal.

[7](1959) 35 ITR 519

14. We now turn to examine the Supreme Court decision in Punjab Distilling Industries Ltd., case, (1959) 35 ITR 519 , on which Mr. Pal so much relied, being the decision in appeal from the Punjab High Court, decision on which the Revenue relied before the Tribunal. What happened in that case was that the assessee carried on business as a distiller of country liquor and sold the produce of its distillery to licensed wholesalers. After World War II difficulty was felt in finding bottles in which liquor was to be sold. To relieve the scarcity, the Government devised a scheme whereby the distiller was entitled to charge the wholesaler a price for the bottles in which liquor was supplied, at rates fixed by the Government, which he was bound to repay when the bottles were returned. In addition to the price fixed under the Government scheme, the assessee took from the wholesalers certain further amounts, described as "security deposits", without the Government's sanction and entirely as a condition imposed by the assessee itself for the sale of its liquor. The moneys described as "security deposits" were also returned as and when the bottles were returned but in this case the entire sum taken in one transaction was refunded when 90 per cent of the bottles covered by it were returned. The price of the bottles received by the assessee was entered by it in its general trading account while the additional sum was entered in the general ledger under the heading "empty bottles return security deposit account". The question

arose whether the assessee could be assessed to tax on the balance of the amounts of these additional sums left after the refunds made thereout. In proposing an affirmative answer to the question the Supreme Court held, (i) that in realizing the additional amount described as security deposit the assessee was really charging an extra price for the bottles and the additional amount was actually a part of the consideration for the sale of the liquor and was part of the price of what was sold; it did not make any difference that the additional amount was entered in a separate ledger termed "empty bottles return deposit account", for what was a consideration for the sale did not cease to be so by being written up in the books in a particular manner; nor did the fact that the price of the bottles was repaid as and when the bottles were returned whereas the additional sums were repaid in full when 90 per cent of the bottles were returned affect the question;

> (ii) that as the wholesalers were clearly under no obligation to return the bottles, the additional sums taken were not security deposits and the fact that they were described as such was alone not sufficient to create an obligation to return the bottles; there could be no security given for the return of bottles unless there was a right to their return;
> (iii) that as the additional amounts taken were integral part of the commercial transaction of the sale of liquor in bottles and when they were paid were the moneys of the assessee and remained thereafter the moneys of the assessee, they were the assessee's trading receipts; and, therefore, the balance of these additional sums left after the refunds made thereout were assessable to tax.

15. Towards the end of the judgment the Supreme Court observed :

> "If we are right in our view that the amounts were trading receipts, it follows that they must have a profit-making quality about them. Their payment was insisted upon as a condition upon which alone the liquor would be supplied with an agreement that they would be repaid on the return of the bottles. They were part of the transactions of sale of liquor which produced the profit and therefore they had a profit-making quality. Again, a wholesaler was quite free to return the bottles or not as he liked and if he did not return them, the appellant had no liability to refund. It would then keep the moneys as its own and they would then certainly be profit. The moneys when paid were the moneys of the appellant and were thereafter in no sense the moneys of the persons who paid them."

16. We do not think that the principles laid down by the Supreme Court can be applied to the facts of the instant case. In Punjab Distilling Industries case, (1959) 35 ITR 519 (supra) what was received was price of the bottles, which price included the security deposit. There only remained a contingency for which a part of the price was to be returned to the wholesalers. Since the money so received was impressed with the character of price, from the inception, the contingency that the part of the money was refundable did not change the character of the unrefunded money. The receipt thus constituted trading receipt. In the instant case, we have

already observed, the money received was money of the principal received by the agent in a fiduciary capacity, for being employed for the work of the principal entrusted to the agent . We have already seen that the balance of the money was refundable by the agent to the principal. Since the money was impressed with the character of somebody else's money, namely, clients' money, it did not become the income of the assessee. It may be, in the absence of a Rule like the Solicitors' Account Rules in this country, the assessee mixed up this money with its own money and may have deposited the money in its own bank account; it may be that this money remained part of the general assets of the assessee for a long time; but this mixing up did not have the result of converting the money into the assessee's money or trading receipt or income. That being the position, we do not think that the Tribunal was wrong in not relying upon the Punjab case, (1953) 24 ITR 597 : AIR 1954 Punjab 61 and being guided by Tattersall case, (1939) 22 Tax Cas 51 : 7 ITR 316 (C. A.) in this matter.

17. It was lastly contended, on behalf of the Revenue, that since the solicitor did not stand in the position of a trustee to the client and since Limitation Act applied, the remedy of the clients to recover sum of the balances may have become barred by limitation. We do not think that this consideration in any way alters the legal position. In the case of *Kohinoor Mills Co. Ltd. v. Commissioner of Income-tax, Bombay City*[8], a question similar to that which we have to consider came up for consideration. There certain wages were payable but they were unclaimed and their recovery became barred by limitation. Nevertheless, the Bombay High Court held that the debt subsisted, notwithstanding that the recovery had become barred by limitation. There was no 'cessation of trading liability" within the meaning of Section 10 (2A) and the amount of such wages could not be added to income. Thus even though the remedy of some of the clients may have become barred by limitation, even then the barred debt did not become income of the assessee and could not be taxed under the Income-tax Act.

18. In the view that we take, we answer the question referred to this Court in the negative and in favor of the assessee. The assessee is entitled to costs of this Reference.

K. L. Roy, J.

19. I agree.

Reference answered in the negative.

[8](1963) 49 ITR 578 (Bom)