

# **BOMBAY HIGH COURT**

Metro Theatre Bombay Ltd

Vs

Commissioner of Income-Tax

(Stone, C.J.)

09.11.1944

## **JUDGMENT**

**Stone, C.J.**

1. This is a reference under Section 66 of the Indian Income-tax Act in respect of an assessment order for the year 1942-43 and the sum in dispute is Rs. 9,825 which the appellant claims to be a deduction. The matter arises in this way. The appellant entered into a building agreement with the Government by which is consideration of building upon the land and the paying a sum of three lacs and odd rupees it was to receive a lease for 999 years. The agreement provides for the payment of the amount by six-monthly instalments with interest on the instalments outstanding from time to time. It is in respect of Rs. 9,825 which was the interest payable in the relevant year that the reference is made. It is agreed by both the parties that the sum of Rs. 9,825 has in fact to be split in two sums, since it is in respect of the building which has now been built upon the land and which is used partly as a cinema in the occupation of the appellant and partly let out to others for rent, so that the total sum is made up of two sums of Rs. 1,361 in respect of the portion let out which is assessable to tax under Section 9 under the heading "Income from property" and Rs. 8,464 in respect of the cinema which is assessable under Section 10 under the heading "Profits and gains from business, profession or vocation." Now before turning to the two sections and permissible deductions which may be made thereunder it is necessary to say something about the building agreement which is dated 24th June, 1937. It is between the Governor-General of Indian in Council of the one part and the appellant of the other part. It first of all recites that "whereas the licensee (i.e., the appellant) has offered to purchase from the grantor (the Governor-General) a lease for 999 years of the piece of land described in the first Schedule hereto for the sum of Rs. 3,81,796 on the terms and conditions hereinafter contained....." Then there is a recital with regard to a deposit and a further recital that the appellant had agreed to pay the purchase money by instalments of Rs. 19,090 as therein mentioned. Then comes the operative part of the agreement, clause 1 of which is as follows :-

"In consideration of the premises and of the licensee agreeing to pay the sum of Rs. 3,81,796 to the grantor by instalments with interest as hereinafter mentioned and on the

conditions agreements hereinafter contained on the part of the licensee to be observed and performed, the grantor grants to the licensee licence and authority only to enter upon the piece of land described in the first Schedule hereunder written and delineated on the plan annexed hereto and thereon surrounded with a red line for the purpose of building and executing works thereon as hereinafter mentioned and for no other purpose whatever and until the grant of such lease as is hereinafter mentioned the licensee shall be deemed to be a bare licensee only of the premises but subject to the terms of the lease as if it had actually been executed in so far as the same is applicable to these presents."

Then the paragraph goes on to provide for a power of revocation :-

"..... provided the grantor shall have given to the licensee ninety days previous notice of his intention so to do specifying the default complained of and provided the licensee shall not have remedied such default within such period and upon the revocation thereof the licensee shall have three months from the date of revocation in which to vacate the premises and remove its property....."

Clause 2 provides for the conditions which the licensee has to observe and perform and the first condition is to pay to the grantor the purchase money and the instalments. The periods during which they are to be paid, including the amount of the first deposit, are there set out. That clause contains the following relevant and important proviso :-

"..... provided always that if the licensee shall make default in the payment of any instalment on the days when the same are payable it shall be lawful for the grantor without prejudice to his other rights and remedies to recover the same under the Bombay City Land Revenue Act (II of 1876) as amended and after notice of demand thereunder in the same manner as if the same were an arrear of land revenue due in respect of the said land."

Clause 3 provides for a certificate of completion in these terms :-

"As soon as the grantor has certified that all buildings have been erected in accordance with the terms hereof and provided that the licensee shall have paid all sums payable under these presents and shall have observed all the stipulations and conditions hereinafter contained the grantor will grant and the licensee or its approved nominee (if any) will accept a lease..... of the said land and its building erected thereon for the term of 999 years from the date hereof at the yearly rent of rupee one (if demanded)....."

The agreement contains a number of other provisions such as are usually found in such agreements. Schedule II contains the building rules and finally in Schedule III the form of lease,

which was ultimately to be granted when the lessee had performed the conditions which he had covenanted to observe and perform, is set out. That being the agreement to which the appellant is a party and under which he holds land the building, a part of which is let out, it is now necessary to look at the exemptions of deductions to the two relevant sections of the Income-tax Act. Section 9 is the section which deals with that head of income called "Income from property," and taxes chargeable under it are subject to certain allowances. Sub-section 9(1)(iv) is as follows :-

"Where the property is subject to a mortgage or other capital charge, the amount of any interest on such mortgage or charge (is exempted)."

It is therefore necessary to consider whether this property is subject to a capital charge. Mr. Coltman on behalf of the appellant submits that because of the proviso in clause 2 of the building agreement the provisions of the Bombay City Land Revenue Act, 1876, are applicable and he points out that under Section 10 of that Act "the arrears of land revenue due on account of land shall, on failure by the persons interested therein to pay the same within the date specified in that behalf in a notice demanding payment posted on or near the land, be a permanent charge on the land and every part thereof." Section 13 of that Act is also relied on. That section gives power to collect arrears of land revenue in default of payment by attachment and sale. Mr. Setalvads answer on behalf of the respondent is that there is no charge as it does not arise unless and until, not only has there been a default but also a certain notice has been given. Turning again to the relevant paragraph in the building agreement it is to be observed that the proviso is that if the lessee shall make default in the payment of any instalment on the dates when the same are payable the respondent is given the right, without prejudice to his other rights and remedies to recover the same, to proceed to recover the same under the Land Revenue Act. So that before Section 10 of that Act can operate and make the arrears a permanent charge there has not only got to be a default but there has got to be a notice served pursuant to the agreement. That being so there is no existing charge at the present time and therefore no capital charge within the meaning of Section 9(1)(iv) of the Indian Income-tax Act.

It is now necessary to consider the other sum of Rs. 8,464 in respect of that portion of the building which is now in the occupation of the appellant and upon which he carries on the cinema business. Section 10 deals with profits and gains of business, profession or vocation and it provides that such profits and gains shall be computed after making certain allowances. Now there are various heads of these allowances and two of them are relied upon by Mr. Coltman. The first is contained in sub-section (2), clause (iii), which reads as follows :- "In respect of capital borrowed for the purposes of the business, profession or vocation, the amount of the interest paid (is exempted)." Dealing with this question the Appellate Tribunal in its judgment has stated :-

"The analogy of this transaction to a borrowing pure and simple may sound plausible but in interpreting a taxing statute one cannot go merely on analogies when the language of the relevant enactment bears a plain and unambiguous meaning. What Section 10(2)(iii) speaks of is interest on capital borrowed for the purpose of business. A mere purchase of capital asset on a long term credit with a stipulation for the payment of interest on the reduced balance does not, in our opinion, amount to the borrowing of capital within the meaning of Section 10(2)(iii)." I agree with the passage quoted above and the short answer to Mr. Coltmans argument is that when the building agreement is analysed it is found that no capital is borrowed by it. The other head is under sub-section (2)(xii) and the allowance made by it is this : "Any expenditure (not being in the nature of capital expenditure or the personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation (is exempted)." In my judgment this interest payment on unpaid instalments cannot be stated to be wholly or exclusively a payment for the purpose of such business. No doubt the payment of interest on the arrears of purchase price of this leasehold interest in which the business is carried on may be said to be for the purposes of the business but it is not wholly or exclusively for the purposes of the business. For example, if the cinema business had to be closed down the appellant would still have to make this payment unless he was prepared to have the licence forfeited. For that reason I do not think the sum of Rs. 8,464 falls within clause (xii) of sub-section (2). The result is that the question submitted to us by the Tribunal must be answered in the negative. The assessee to pay the costs of the reference.

**KANIA, J.**

The relevant portions of the Income-tax Act and the agreement under which the assessee obtained the premises to erect the building and acquired the right to obtain the lease have been set out in the judgment of the learned Chief Justice. The question referred to us involves a sum of Rs. 9,825 which the assessee paid by way of interest on the balance of the premium payable under the agreement, in the accounting year. The building is partly let out and partly used for the business of the assessee. The result is that in his assessment in respect of the income of this building, the assessment is made partly under Section 9 and partly under Section 10. Having regard to the terms of the agreement, in respect of the income allocated to his business, he claims exemption for payment of interest under Section 10(2)(iii). Before the Income-tax authorities and the Tribunal the claim was made only under that sub-section. Before us a further additional ground was urged and Mr. Coltman claimed that the exemption was covered by Section 10(2)(xii) also. In respect of his income from property he claimed exemption under Section 9(1)(iv) on the ground that the property was subject to a capital charge and the amount of interest was paid on the amount of such charge. In the alternative he claimed exemption under the last

sentence of the same sub-clause, viz., that the amount of interest was payable on the capital by the use of which the property has been acquired. Rs. 8,464 are allocated in respect of his business income while Rs. 1,361 are allocated in respect of his property income out of this interest payment. I shall first consider the claim to exemption under Section 10(2)(iii). Mr. Coltman claimed that the transaction amounted to payment of interest on the capital borrowed for the purposes of business. It was urged that the Court need not look only at the words used in the agreement. He relied on *Secretary of State v. Sir Andrew Scoble* in support of the contention that the Court should look at the real nature of the transaction. That proposition is not disputed. A scrutiny of the agreement shows that till the lease was obtained the assessee is only a licensee. He has agreed to purchase this property on payment of a sum of Rs. 3,81,796. He is given some facility in payment of the same by instalments as provided in clause 2. It is recognized that the obligation is to pay the whole amount and therefore for the facility granted for deferred payments interest has to be paid by the assessee in respect of the balance which remained unpaid. The minimum amount of instalment is also stipulated, but the assessee has the right, if he so chooses, to pay a larger amount and reduce his liability to that extent, both for payment of the price and the payment of interest. I am unable to accept the contention of the assessee that the transaction amounts to capital borrowed for the purposes of the business. The transaction is not a loan transaction, secondly it is not for the purposes of business. It was argued that the assessee could have gone to a bank, borrowed the money and paid off the grantor the amount due under the agreement and in that event he would have been entitled to claim a deduction in respect of the interest paid. The short answer to this contention is that it has not been so done. I should not be understood as accepting that argument even if a loan was so taken, because I am not sure that the loan would be considered as taken for the purposes of the business. On the materials before us it is not shown that the purpose of the business of the assessee is to acquire immovable properties. That aspect of the case is not before us and I do not pronounce any opinion on that aspect. On the construction of the agreement it is clear that no loan of any amount was taken from the grantor and the interest was not paid on such capital borrowed for the purpose of the business. The alternative ground of exemption under Section 10(2)(xii), as I have pointed out, was not argued before the Tribunal. Fundamentally it is a question of fact because it has first to be ascertained that the expenditure was wholly and exclusively for the purposes of business. On the footing that certain facts are found which there is a conclusion that the expenditure was wholly or exclusively for the purposes of such business, and that conclusion being an inference would be a question of law, we have permitted counsel to urge this argument. On that point also the assessee cannot get the exemption claimed. The business is of showing cinema films. That business can be conducted in rented premises and it cannot be argued that this amount was the payment of rent. In *Hudson Bay Co. v. Thew*, an argument was advanced that the payment was in the nature of rent but was rejected. This payment again can in no event be stated to an expenditure "wholly or

exclusively for the purposes of business." If the interest was not paid the result would be not necessarily the stoppage of the business of showing cinema films, but the assessee will not acquire the lease of this property. It is therefore clear that this new ground urged by Mr. Colman does not help the assessee. The ground for exemption claimed under Section 9 can be sustained only if the assessee shows that the property is subject to a capital charge and the interest is paid on such capital charge. This argument is based on the contention firstly that on a true construction of clause 2 of the agreement, because the grantor has a right to resort to remedies to recover unpaid instalments after notice of demand in the same manner as if the same were an arrear of land revenue under the Bombay City Land Revenue Act, the instalments are a charge on the land in question, and interest is paid in respect of the said charge. In my opinion this whole contention is founded on an assumption which does not exist. The right of the grantor to resort to remedies under Act II of 1876 arises only on default of payment of any instalment. On the facts on record it is common ground that there has occurred no default in payment of any instalment. Therefore no occasion has arisen to resort to the remedies to recover the said instalments. Reading Sections 10 and 13 of the Land Revenue Code it is clear that in order to bring into existence the paramount charge contemplated by Section 10 two conditions are necessary : (1) omission to pay the land revenue by the time it has become due, and (2) affixing of a notice in or about the property as mentioned in the second paragraph of that section. A perusal of Section 13 shows that the notice required under Section 10 is altogether of a different nature from the notice required to be served under Section 13. The notice under the last mentioned section has to be served on the person liable to pay the land revenue primarily. On default, the Collector is entitled to proceed to sell the land. When proceedings are adopted under Section 13 only, no question of a paramount charge arises. If the Collector desires to secure priority in respect of land revenue, by resorting to Section 10, he must first take the necessary steps and thereupon only, in respect of the amount of the land revenue, a paramount charge comes into existence. In the present case there has been no default in payment of instalments and consequently there has arisen no occasion to serve a notice of demand, much less a notice of demand as prescribed in Section 10. The argument is quite unsustainable. The second branch of this argument was that under the Transfer of Property Act, as the vendor was unpaid he has a charge in respect of the balance of the purchase price. This contention can be supported only if there has occurred passing of ownership of the property to the buyer before payment of the whole of the purchase money. A perusal of the agreement in question shows clearly that the ownership of this property cannot pass to the assessee until the lease is granted to him. Under clauses 3 and 5 of the agreement read with Schedule III the right of the assessee to obtain the lease arises only on his completing the property according to the agreement and the approved plans and paying all sums due under the agreement. It was argued on behalf of the assessee that the payments must be of the instalments due till the completion of the structure. In my opinion, that argument is

unsound because clause 3 does not limit the payments till the completion of the building. Moreover the terms of the lease only provide for payment of Rs. 1 per year, if demanded. The form of the lease annexed to the agreement does not provide for payment of the instalments for the years mentioned in the agreement between the parties. It seems that the right to obtain the lease arises only on payment of the full amount of the premium and not on payment of certain instalments only. The agreement read as a whole does not show that there has ever been any intention of passing of ownership of the leasehold to the assessee till the whole premium is paid. It seems therefore clear that as there is no question of passing of ownership till all the instalments are paid the question of creation of a charge under the Transfer of Property Act does not arise. As no charge is thus created, either under the Land Revenue Code or the Transfer of Property Act, the interest paid cannot be considered as paid in respect of the charge subsisting on the property. On the same reasoning the interest cannot be considered as paid in respect of the property "acquired" under the last sentence of Section 9(1)(iv) of the Act. The property is not acquired till all the installments and all interest due are paid. I therefore agree that the answer to the question referred to us should be in the negative. The assessee to pay the costs of the reference.

Reference answered in the negative.