PATNA HIGH COURT

Vishweshwar Singh

Vs

Commr. of Income-Tax

(Ramaswami, and Ahmad, J.)

03.08.1954

JUDGMENT

Ramaswami, J.

1. In this case the Income-tax Appellate Tribunal has submitted the following questions of law for the opinion of the High Court :

"(1) Whether any portion of the ground rent received from the assessee's tenants in respect of certain lands on which shops had been erected is agricultural income within the meaning of Section 2(l)(c), Income-tax Act, 1922, and is exempt from tax under Section 4(3)(viii) of the said Act?

(2) Whether the interest of Rs. 3,109, which the assessee received under Section 18A(5), Income-tax Act, was liable to be included in the assessee's total income for the year 1948-49? and (3) Whether any part of the dividend income of Rs. 36,229, received by the assessee from Tea companies, is agricultural income under Section 2(1), Income-tax Act, and is exempt from tax under Section 4(3)(viii) of the said Act and if so, what part of such dividend income is so exempt?"

2. It was pointed out by Mr. Mazumdar on behalf of the assessee that there is a mistake in the form in which the first question has been framed. On the request of the parties I reframe the first question in the following manner :

> "Whether any portion of the ground rent received from the assessee's tenants in respect of certain lands on which shops had been erected is agricultural income within the meaning of Section 2(1)(a), Income-tax Act, 1922, and is exempt from tax under Section 4(3)(viii) of the said Act?"

3. Question No. 1 : This question relates to the assessment years 1946-47, 1947-48 and 1948-49. It appears that the assessee received ground rent from various tenants in respect of certain lands

on which shop had been erected. The assessee split up the ground rent received from the tenants into two portions (1) for the floor area of the shops and (2) for the remaining area.

4. Having split up the rent, the assessee included in his return only that portion of the ground rent which was received in respect of the floor area on which shops had been erected. The assessee did not include in his return that portion of the ground rent which related to the ground which was vacant. The Income-tax Officer found that no agricultural operations were performed on the vacant land.

5. He accordingly held that the assessee should be taxed also on the income with respect to the vacant portion of the land. He accordingly, added a sum of Rs. 5,000, Rs. 5,000 and Rs. 585 for the three assessment years to the returns made by the assessee. The assessee preferred appeals to the Appellate Assistant Commissioner but the appeals were dismissed, though some reduction was made in the estimated amount of income for the three years.

The assessee took appeals to the Appellate Tribunal for all the three years and contended that the amounts in question were exempt from tax. The Tribunal rejected the contention but directed the Income-tax Officer to ascertain the actual amount of ground rent received by the assessee in regard to the vacant land and not to make any estimate of the income.

6. On behalf of the assessee Mr. Mazumdar put forward the argument that the homestead lands belonged to agricultural tenants who carried on agricultural operations elsewhere. It was contended that the homestead lands were part of the agricultural holdings of the tenants and the object of the lease granted to the tenants was wholly agricultural.

7. In my opinion the argument of the learned counsel is unsound.

8. In order to find out whether the income of the assessee is agricultural income, the test is not to find out the purpose of the lease but the test is actual use of the land for agricultural purpose. It is possible that the tenants had taken lease of the homestead lands for agricultural purposes from the zamindar but if the lessees had actually used the land not for agricultural purpose but for holding a shop or for a non-agricultural purpose, the income of the landlord would not be exempted from being taxed under the Income-tax Act. Section 2(1)(a) of the Act defines "agricultural income" to mean "any rent or revenue derived from land which is used for agricultural purposes".

9. Section 2(1)(a) plainly means that the income must be derived from the land which is used for agricultural purposes and unless the income is so derived the assessee cannot claim exemption from being taxed. The proper test to apply whether the income has the quality of agricultural income is to find out whether the land from which rent is derived is used for agricultural

purposes or not.This view is supported by the decision in -- *'Bijay Chand Mahtab Bahadur[1],* It was held in that case that the question whether a certain income was agricultural income or not was a question of fact and had to be determined not with reference to the nature of the lease by which the lands were let out but by reference to the use to which the land had been put.Counsel for the asseasee alternatively contended that there was evidence in this case to show that the land was used for agricultural purpose. It was stated by the learned counsel that the assessee produced documents before the Income-tax authorities to show that the land was used for keeping bundle of grain and bundle of haystacks. I am unable to accept this argument as correct. It is well settled that the question whether a certain item of income is of agricultural nature or not is a question of fact and the burden of proving the exemption is upon the assessee.

10. In the present case the assessee did not produce material before the Income-tax authorities to show what was the nature of the use to which the tenants put the vacant land.

11. The finding of the Income-tax Officer is that "no agricultural operations were carried on this land which is situated in the heart of Jainagar town itself". Learned counsel on behalf of the assessee has not been able to show that any material was produced before the Income-tax authorities to prove that the land was actually used for agricultural purposes. It is clear that the assessee has not discharged the onus which lay upon him to prove that the land was put to agricultural use. In my opinion the finding of the Income-tax authorities is not vitiated by any error of law and the first question must be answered against the assessee and in favour of the Income-tax Department.

12. Question No. 2 : The question whether interest paid under Section 18A (5), Income-tax Act, is liable to be taxed was raised before a Division Bench of this Court in -- *'Commissioner of Income-tax v. Kameshwar Singh'[2],* It was held by the Division Bench in that case that interest on advance payment of tax was neither a capital receipt nor a casual receipt and was liable to be included in the assessee's total income for the purpose of being taxed. It is clear that the authority of this ruling is binding upon this Court and for the reasons stated in that case I hold that the interest of Rs. 3,109, received by the assessee under Section 18A(5) of the Act is liable to be taxed. I would accordingly answer this question in favour of the Department and against the assessee.

13. Question No. 3 : This question arises in the background of the following facts. During the Fasli year 1354 the assessee received dividends from Tea Companies to the extent of Rs. 31,700. The Income-tax Officer increased this amount by the income-tax of Rs. 529, which was deemed to have been paid by the company under Section 16(2), Income-tax Act, and held that the assessee was liable to be taxed on the entire amount of Rs. 36,229. The assessee preferred an appeal to the Appellate Assistant Commissioner on the ground that only 40 per cent. of the

amount should have been taxed.It was pointed out that under Rule 24 of the Income-tax Rules income derived from the sale of tea grown and manufactured by the seller in British India shall be computed as if it were income derived from business, and 40 per cent. of such income shall be deemed to be income liable to be taxed. It was argued on behalf of the assessee on the basis of this rule that only 40 per cent. of the amount of the dividends of the Tea Companies was liable to be taxed and the rest of the amount should be taken to be agricultural income. The argument was rejected by the Appellate Tribunal on the ground that the dividends of the Tea Companies cannot be identified with any particular class of income.

14. Mr. Mazumdar presented the argument that dividend merely represented the share of the profits of a share-holder in the company's income and source of the dividend was the same as the source of the profits made by the company.

15. Counsel made the submission that there was no reason in principles why 40 per cent. Of the amount of the dividend should not be treated as agricultural income and exempted from being taxed. In my opinion the argument of the learned counsel cannot be accepted as correct. The reason is that in the eye of law income from dividend is not identical in quality with the profits made by the company in the course of its business operations. In the first place, a company is a different juristic entity from a share-holder and the income of the company cannot be deemed to be the income of the share-holder, in the next place, a company cannot be treated in law as the agent of the share-holders.As observed by Viscount Cave in -- 'Commissioners of Inland Revenue v. Blott', 1921-2 AC 171 (C) :

> "plainly a company paying income-tax on its profits does not pay it as agent for its shareholders. It pays as a tax-payer, and if no dividend is declared the share-holders have no direct concern in the payment. If a dividend is declared, the company is entitled to deduct from such dividend a proportionate part of the amount of the tax previously paid by the company and in that case the payment by the company operates in relief of the share-holder. But no agency, properly so-called, is involved."

Another important consideration is that a dividend when declared becomes a debt due to the share-holder and may be recovered from the company out of the assets it may hold which may not be necessarily agricultural in character.Lastly, it is important to notice that Section 17(2), Companies Act, provides that there shall be deemed to be included in all Articles of Association certain regulations contained in Table A to the First Schedule of that Act, and one of such regulations is Regulation 95 which provides that the company in general meeting may declare a dividend, but no dividend shall exceed the amount recommended by the directors. It is clear therefore that if the directors choose to recommend no dividend, no dividend can be declared by the shareholders in general meeting. The legal position is that the share-holders are not at liberty

to divide the company's profits between themselves as they liked; on the contrary, the directors can interpose between the share-holders and the profits and prevent any distribution of profits at all.

16. For these reasons I think that the immediate and effective source of the dividend is the statutory contract between the company and the share-holders and the statutory declaration of a dividend at the general meeting of the shareholders. The legal position is that the Articles of Association bind the company and the shareholders as a statutory covenant and the immediate and effective source of the dividend is the statutory covenant and not the agricultural operation carried on by the company. It may be that the source of the dividend is the agricultural operation of the company in the ultimate sense but in testing whether the income is agricultural within the meaning of Section 2(1) of the Act we must look not to the ultimate or remote source of the income but to the immediate and effective source.This view is borne out by the decision of the Judicial Committee in -- *'Commissioner of In-come-tax v. Kamakhaya Narayan Singh[3]',* The question at issue in that case was whether interest on arrears of rent in respect of agricultural land was agricultural income within the meaning of the Income-tax Act and was therefore exempt from tax. It was held by the Judicial Committee that interest on arrears of rent was not agricultural income and the argument of the assesses to the contrary effect was rejected as unsound.

At p. 2 Lord Uthwatt states :

> "Equally clearly the interest on rent is revenue, but in their Lordships' opinion it is not revenue derived from land. It is no doubt true that without the obligation to pay rent and rent is obviously derived from land there could be no arrears of rent and without arrears of rent there would the no interest. But the affirmative proposition that interest is derived from land does not emerge from this series of facts. All that emerges is that as regards the interest, land rent and non-payment of rent stand together as 'causas Sine quibus non'. The source from which the interest is derived has not thereby been ascertained."

Lord Uthwatt then proceeds to say :

> "The word 'derived' is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent, which has suffered the accident of non-payment. And rent is not land within the meaning of the definition."

17. The same principle is implicit in the decision of the Judicial Committee in -- *'Premier Construction Co. Ltd. v. Commissioner of Income-Tax, Bombay City[4]',* In that case a managing

agent was remunerated at 10 per cent. on the annual profits of the company. It was admitted that a part of the income of the company was agricultural income and the question arose whether the income of the managing agent was exempt from taxation of the agricultural income.It was held by the Judicial Committee that no part of the remuneration of the managing agent was exempt from being taxed as agricultural income. At p. 22 Sir John Beaumont states :

> "In their Lordships' view the principle to be derived from a consideration of the terms of the Income-tax Act and the authorities referred to is that where an assessee receives income, not itself of a character to fall within the definition of agricultural income contained in the Act, such income does not assume the character of agricultural income by reason of the source from which it is derived, or the method by which it is calculated. But if the income received falls within the definition of agricultural income it earns exemption, in whatever character the assessee receives it."

18. To the same effect is the decision of the Bombay High Court in -- *'Mrs. Bacha P. Guzdar v. Commissioner of Income-tax, Bombay City*[5]*,* The question which arose in that case for determination is identical with the question referred in the present case. The question was if assessee could validly claim 60 per cent. of the dividend income received on shares of Tea Companies as exempt from tax being agricultural income.

It was held by the High Court that the immediate source of the assessee's income was not land but was the declaration of the dividend and so that assessee was not entitled to claim exemption from being taxed on the dividends of the Tea Companies.

19. Mr. Mazumdar challenged the correctness of the Bombay decision and in support of his argument referred to three authorities -- *'Commissioner of Income-tax, B. and O. v. Kameshwar Singh'*[6]*, -- 'Governor General in Council v. Raleigh Investment Co., Ltd.*[7]*',) and -- 'Commissioner of Income-tax v. Hungerford Investment Trust Ltd.'*[8]*,* In my opinion the principle laid down in these cases has no bearing on the question which is being investigated in the present case.In -- 'AIR 1935 PC 172 [G)' the assessee's father who carried on a money-lending business made a loan under an indenture described as "a zarpeshgi lease with usufructuary mortgage". A certain portion of the rent was reserved to the mortgagor as thika rent and the mortgagee was allowed to take the balance of the profits after deducting the expenses as thika profits in consideration of the loan. It was held by the Judicial Committee that thika profits received by the assessee as mortgagee-lessee were exempt from income-tax, being agricultural income.Mr. Mazumdar relied strongly on the following passage from the judgment of Lord Macmillan in this case.

> "The result, in their Lordships' opinion is to exclude 'agricultural income' altogether from the scope or the Act, howsoever or by whomsoever it may be received. As Ashworth, J.

> puts it in -- *'Makund Sarup v. Commissioner of Income-tax, United Provinces[9]',* 'The business of money-lending may bring in an income which is exempt from income-tax on the ground that it is derived from agricultural land.' The exemption is conferred and conferred indelibly on a particular kind of income and does not depend on the character of the recipient contrasting thus with the exemption conferred by the same subsection on the "income of local authorities".

But this passage must be read in the context of the material facts of that case. It was found that the mortgagee lessee was to be in possession of both properties, and in this relation to the cultivators of the soil he stood in the position of landlord dealing directly with them and collecting the rents. He had moreover to pay the Government revenue, cesses and taxes and his name was registered in the Land Registration Department. He alone was able to sue for rent whether current or arrears, to sue for enhancement or for ejectment and was able to settle land with raiyats and tenants in all the properties.

It is clear in the context of these facts that the assessee's father directly received the income as agricultural income, though he did so in his character as a money-lender. The immediate source of income was land and taking that view the Judicial Committee was of opinion that the assessee was exempt from being taxed upon that income which was of the character of agricultural income.

Counsel for the assessee next referred to -- 'AIR 1938 PC 219 (I)' in which the question at issue was the proper interpretation to be placed upon Section 14(2) (a), Income-tax Act. Mr. Mazumdar strongly relied upon the following passage from the judgment of Sir George Rankin:

> "Clause (a) of Sub-section (2) is a more or less similar provision in the case of a company paying dividends. Its object is to ensure that all tax shall not be paid more than once upon what the statute regards as the same thing. The company though a separate legal persona in the contemplation of law and liable to assessment as a subject chargeable with tax is not for all purposes to be regarded as entirely separate and distinct from the corporators. The underlying principle of the clause as the Commissioner in stating the present case has recognised is 'that the dividend represents merely the shareholders' share in the income of the company'."

This passage must however be read subject to the qualifying effect of the context of 'subjecta materies'. The question at issue in that case was as to the proper construction of Section 14(2)(a), Income-tax Act, and in the passage to which counsel has made reference Sir George Rankin was attempting to explain the principle underlying that section.In any case it is clear that if there is no distinction between the dividend income of the share-holder and the income of the company,

there would have been no need on the part of the Legislature to enact Section 14(2). The very fact that the section was enacted clearly indicates that but for the enactment of the section the share-holders would have been liable to pay tax on the dividend, though the company had already been assessed to tax.The dictum of Sir George Rankin does not, therefore, support the argument of the assessee in the present case.

20. I next turn to the decision in -- 'AIR 1944 FC 51 (H)'. The question for consideration in that case was whether Section 4(1) (c) and Explanation 3 of the Income-tax Act were ultra vires in so far as it purported to authorise the levy of the income-tax on non-resident companies in respect of income from dividends which had accrued to them outside British India.

It was held by the Federal Court that the Indian Legislature in enacting the particular provision was not giving any extra-territorial operation to its law. At page 57 the Chief Justice states-

> "In both the cases the Court held that though no individual corporator could lay claim to any portion of the profits made by the company, every corporator had an interest in them. The very observation of Fletcher Moulton L. J. in -- *'The Gramophone and Typewriter Ltd. v. Stantey'*[10], quoted above recognises that the share-holder 'is entitled to the profits of that business to a certain extent.' The language used by Brett and Cotton L. JJ. *in -- 'Gillberton v. Ferguson'*[11], shows that dividends are paid out of profits and in that sense must have the same source -- and this is not affected by the remarks made on that case in -- 'Barnes v. Hely Kutchinson', 1940 AC 81 (M). It is true that the profits of a company may not materialise into a dividend for the share-holder tin a dividend is declared, but that is different from saying that when the dividend is declared, the 'source' of the dividends is not the same as the source of the profits made by the company."

Mr. Mazumdar on behalf of the assessee placed much reliance on this passage and argued that the source of the dividends was the same as the source of the profits made by the company and the dividend income must therefore be exempted from taxation as agricultural income.In my opinion, the argument of the learned counsel is not sound. In the case before the Federal Court the question for determination was the proper construction of Section 4(1)(c), Income-tax Act and Explanation 3 to Sub-section (1). Section 4 (1) (c) provided that the total assessable income of a non-resident shall include income which accrues or arises or is deemed to accrue or arise to him in British India. By way of amplification of this provision, Explanation 3 to Sub-section (1) enacted "that a dividend paid without British India shall be deemed to be income accruing and arising in British India to the extent to which it has been paid out of profits subjected to income-tax in British India."The question was whether Section 4(1) (c) read with Explanation 3 had extra-territorial operation. It was while considering this question that the Chief Justice observed that the source of income (not necessarily the immediate and effective source) was the profits

made in British India and this circumstance was a sufficient territorial nexus between the tax-payer and the taxing authorities and therefore the legislative provisions cannot be declared to be invalid on the ground of extraterritorial effect. It is obvious that the passage from the judgment of the Chief Justice of India must be read subject to the qualifying effect of its context. For the purpose of testing the extraterritorial character of a taxing provision, the source of dividends may be the same as the source of the company's profits. But that is not equivalent to saying that the same test must be applied in examining whether the quality of the income is 'agricultural' within the meaning of Section 2(1)(a) of the Act. The dictum of the learned Chief Justice cannot be applied in the context of the present case where the question at issue is of an entirely different character.

21. For the reasons I have assigned I hold that no part of the dividend income of Rs. 36,229 received by the assessee from Tea Companies is agricultural income within the meaning of Section 2 (1) or is exempt from being taxed under the Income-tax Act. I would accordingly answer this question also against the assessee and in favour of the Income-tax Department.

22. In the result I would answer all the three questions referred by the Income-tax Appellate Tribunal against the assessee and in favour of the Income-tax Department. The assessee must pay the cost of this reference. Hearing fee Rs. 250/-.

Ahmad, J.

23. I agree.

Cases Referred.

1In re, 8 ITR 378 (Cal) (A)
2AIR 1953 Pat 217 (B)
3AIR 1949 PC 1 (D)
4AIR 1949 PC 20 (E)
5AIR 1953 Bom 1 (P)
6AIR 1935 PC 172 (G)
7 AIR 1044 PC 51 (H_
8AIR 1936 PC 219 (I)
9AIR 1928 All 81 (FB) (J)
10(1908) 2 KB 89 at p. 98 (K)
11(1881) 7 QBD 562 (L)