
(1980) 09 CAL CK 0035

In the Calcutta High Court

Case No : Income-tax Reference No. 211 of 1974

Commissioner of Income Tax

APPELLANT

Vs

Smt. Prativa Devi

RESPONDENT

Date of Decision : 30-09-1980

Acts Referred:

Income Tax Act, 1961 — Section 147, 256(1)

Citation : (1982) 135 ITR 704

Hon'ble Judges : Sudhindra Mohan Guha, J;Sabyasachi Mukharji, J

Bench : Division Bench

Advocate : Suhas Sen, for the Appellant;Kalyan Roy and R.N. Dutta, for the Respondent

Judgement

Sudhindra Mohan Guha, J.—This reference u/s 256(1) of the I.T. Act, 1961, at the instance of the CIT, West Bengal V, Calcutta, relates to the assessment years 1963-64 and 1964-65. The following question was referred by the Tribunal to this court:

"Whether, on the facts and in the circumstances of the case and on a correct interpretation of the agreement dated February 24, 1964, between the assessee and M/s. Shreeram Chandanmull, the Tribunal was right in holding that the amount of the capital expenditure incurred by M/s. Shreeram Chandanmull as per Clause 5 of the said agreement did not represent the assessee's income derived from the letting out of the tea gardens and could not be taxed in her hands ?"

2. In order to appreciate the controversy, the facts of the case as found by the Tribunal and relevant for our purpose may be stated as follows :

The assessee who is a proprietrix of two tea gardens leased out the same to one M/s. Shreeram Chandanmull of Siliguri by a lease agreement dated February 24, 1963. The capital expenditure of Rs. 70,000 per year, which was agreed to be incurred by the lessee, was found by the ITO as payment to the assessee and

hence her income.

3. There was an appeal by the assessee to the AAC. According to the AAC, the development work, if carried out, would enure to the benefit of the assessee after the expiry of the contract period. This was found to be either a constructive or indirect receipt by the assessee herself. Thus the finding of the ITO, that the sum of Rs. 70,000 was the income and taxable in the hands of the assessee, was confirmed.

4. There was a further appeal to the Tribunal. It was urged that this amount had never been received by the assessee and was never agreed to be paid to her. It was in the interest of the assessee to see that the tea estates were properly maintained and to ensure that, a condition was embodied in the agreement. The orders under appeal were supported by the department.

5. In the opinion of the Tribunal, the authorities below were wrong in holding that the sum of Rs. 70,000 per year was the assessee's revenue income. The amount was admittedly never paid to her nor was it agreed to be paid. The Tribunal found no camouflage in the agreement to divert income accruing to the assessee at its source into different channels. The amount was required to be spent by the lessee to keep the two gardens running efficiently. Accordingly, it was held that the sum of Rs. 70,000 spent annually was not the income of the assessee either directly or indirectly. In fact, for the assessment year 1963-64, no such expenditure was incurred but in 1964-65, the sum of Rs. 44,029, incurred as expenditure, was added back by the ITO. This was deleted,

6. Mr. Suhas Sen, learned counsel for the revenue, argues that the purpose of the expenditure is to be examined and it is to be seen who is going to be benefited on the expiry of the lease. Under the agreement, the assessee was surely to get an advantage and if that be expressed in money's worth, then it would, according to Mr. Sen, be an income in the hands of assessee. Money applied for the benefit of the beneficiary is as much a benefit as money paid direct to him. Mr. Sen refers to the decision in the case *Gresham Life Assurance Society Ltd. v. Styles (Surveyor of Taxes)* [1892] 3 TC 185. In this case, reversing the decisions of the Divisional Court and the Court of Appeal, the House of Lords held that the annuities were not payable out of the profits and gains of the society within the meaning of r. 4 of Case 1 of Schedule D and that the amount of the annuities paid might be taken into account as a disbursement in estimating the balance of profits in respect of which the society was chargeable with Income Tax. He specially makes a reference in the judgment of Halsbury L. C. to the following few lines at pages 188-189 :

"The thing to be taxed is the amount of profits and gains. The word "profits" I think is to be understood in its natural and proper sense--in a sense which no commercial man would understand. But when once an individual or a company has in that proper sense ascertained what are the profits of his business or his trade, the destination of those profits, or the charge which has been made on

those profits by previous agreement or otherwise is perfectly immaterial.

The tax is payable upon the profits realised, and the meaning to my mind is rendered plain by the words "payable out of profits".

7. Reference is also made to the decision in the case of *Donaldson's Executors v. IRC* [1927] 13 TC 461. In this case, a widow of whose estate the appellants were executors, was entitled under her marriage settlement to the life rent of a house on her husband's death. Under her husband's trust disposition and settlement she was given an option, which was exercised by her, to give up the life rent of that house and to have instead "the free life rent use and enjoyment" of another house, on which all outgoings except tenant's taxes were to be paid by the trustees. Additional assessments to super-tax were made on the amounts expended by the trustees in respect of repairs, insurance, rates, Income Tax, etc. It was held that the widow's right in regard to the second house constituted a life rent, and that the additional assessments made to include the outgoings paid by the trustees, had increased by the appropriate addition for Income Tax, were properly made. He draws our attention to the passage of a judgment of Lord Sands at page 478, which reads as follows :

"The appellants contended further that the lady was not liable to super-tax because the payments here in question were not income received by her. The money did not come into her hands. It is on the same footing as such perquisites in kind as have been held not to be income. In my view, this argument fails. If the lady was a lifer enter of the house in the full sense, she was primarily liable in the payments in question. They were her debts, and I am unable to hold that it makes any difference whether the money was paid to her to discharge them or the trustees paid them on her behalf."

8. In support of his argument, Mr. Sen also cites a decision of the Court of Appeal in the case of *IRC v. Paterson* [1924] 9 TC, 163. In this case, a wife, in order to render her husband financial assistance, obtained a loan from an insurance company, applied the greater part of it in the purchase of shares from him, and gave the shares and a policy on her own life effected with an insurance company to the company as security for the loan. The dividends on the shares were to be received by the company, and applied in paying (a) interest on the loan, (b) premiums on the policy, and (c) an annual sum of ? 500 in reduction of the principal of the loan, any balance remaining being payable by the company to the wife. As collateral security she also charged her life interest under her marriage settlement with the amount (if any) by which the dividends fell short of the sum required to cover the interest and premiums, and, as her interest under the settlement was subject to restraint on anticipation, the sanction of the court was obtained to the whole scheme. In fact, the dividends considerably exceeded the payments (a), (b) and (c) and the balances were duly paid to the wife.

9. The husband contended that only the said balances of dividends paid to his wife should be included in the computation of his liability to super tax, while the

revenue contended that the full amount of the dividends should be included, subject only to a deduction of the interest paid on the loan. It was held that the full amount of the dividends on the said shares, less only the loan interest was the income of the wife and must be included in the computation of the liability to super-tax. In this case, Scrutton L.J., at pages 182-183, observed as follows:

"The question is whether, when a debtor buys property with borrowed money and charges the proceeds of the property in favour of creditors to repay the debt, those proceeds are income of the debtor on which he must pay super-tax; and I may ask, if they are not income of the debtor whose income are they ?

Here the lady wanted to help her husband by buying some shares from him. She borrowed from the insurance company some money to buy the shares. She borrowed by giving them the security of, amongst other things, the dividends on the shares, out of which, in the language of Clause 6 of the Scheme, "So long as any money remains owing on the securities of these presents the dividends on all the said shares shall be, received by the estate trustees and applied by them in paying the debt". The result in any year was that debts of the debtor were discharged to the extent of the dividends--the interest for the year, the premium for the year and repayment of part of the principal. Whose income was it that paid those debts? It seems to me that in any ordinary sense it was the income of the debtor, the lady, which discharged the debts and which she was obliged to allow to be used to discharge the debts by the charge she had given on that income to the creditor.

I think the Scotch case, *Commissioners of Inland Revenue v. Wemyss* [1924] 8 TC 551 says that it does not make it a man's income that somebody else's money pays his debts. The money of another person applied to pay his debts is not necessarily the income of the debtor. Lord Skerrington puts that at the end of his judgment in the Scotch case. He says (ibid at page 581): "While it is true that Captain Wemyss derived a direct and immediate advantage from the income in question being applied in paying a debt for which he was personally liable, it is equally true that the income so applied was not his income but that of his marriage contract trustees", who held it for other people, children and third parties, not the debtor. And it appears to me that Lord Sands put this case when he put the case of the application of money which would otherwise be enjoyed by a debtor year by year under the debtor's irrevocable mandate for the purpose of liquidating his debt. He said (ibid at p. 589): "It may be that the money so applied would fall to be treated as part of his income". I go further than "may be" and say I should have thought it must be treated as part of his income applied in paying the debt because of the charge he had given to the creditor to whom he owed the money. It appears to me, if it is not the debtor's income, it must be the creditor's income and I am not sufficiently topsy-turvy to think of a creditor discharging debts due to him out of his own income.

Under these circumstances I think the Commissioners came to a wrong conclusion, and, with great respect to the learned judge, I think he did not

entirely appreciate the effect of the Scotch case which he purported to follow. For these reasons I agree that the appeal must be allowed."

10. Mr. Sen also makes a reference to the decision in the case of WILKINS (INSPECTOR OF TAXES) Vs. ROGERSON., . At page 400 of the report, a special reference was made to the following lines, which we may quote:

"Where trustees raise part of the corpus of fund for the purpose of increasing the income of a cestui que trust that is analogous to this case. The source of the income is the trustees' discretionary power to raise money from the corpus for maintenance, and moneys derived from that source is as much taxable as money derived for the employer and paid to the third party for the benefit of the employee. The cestui que trust is taxed on the money's worth applied for his benefit and not on the worth of the thing procured by the expenditure. Money applied for the benefit of the beneficiary is as much a benefit as money paid direct to him."

11. Lastly, Mr. Sen makes a reference to the case of Skinner (Inspector of Taxes) v. Berry Head Lands Ltd. [1971] 1 All ER 222 ; 46 TC 377, wherein Goff J. makes a reference to the case of Petrotim Securities Ltd. (formerly Gresham Trust Ltd.) v. Ayres (Inspector of Taxes) [1963] 41 TC 389. In that case Ungood-Thomas J. reviewed the facts and said (at p. 384 ,of 46 TC):

"All these transactions were completely out of character with the rest of the company's trading operations and the way in which it conducted its trade. The sales were genuine in the sense that the prices were paid, but the conclusion appears irresistible that each sale was, in the words of Lord Radcliffe in Sharkey v. Wernher, 36 TC 275 ; [1955] 3 All ER 493, "a dictated sale at a prescribed price". This company trading normally for profit, as it did, never sold such assets at such prices except at such dictation. It is only the intrusion of another body into its affairs that produces such an odd operation. As I have already said, what I am concerned with in this case is whether this company, as a separate entity, is conducting its own trade in respect of which it is assessed for its own Income Tax liability. In this transaction the company was not acting in the course of its own trade, which is the subject of taxation, but out of that course. These transactions, when seen in their context of the company's trading operations, cry aloud for an explanation."

12. On the basis of these decisions, it is argued by Mr. Sen that there might not be any payment in cash to the assessee, but it is to be seen who is going to be ultimately benefited by the proposed development or improvement in the gardens. This advantage would enure to the benefit of the assessee on the expiry of the period of the lease. If such advantages or benefits be converted into monetary considerations that might be taken to be an income in the hands of the assessee. The money spent for development or improvement is for the assessee's ultimate benefit and is as much a benefit as money paid to her in cash. . It is also asserted by him that, in the facts and circumstances of a case

like this, it is expected that the assessee would offer an explanation. , In the absence of any explanation, the assessee was rightly assessed to tax by the department.

13. Mr. Kalyan Roy, the learned advocate for the assessee, in reply points out that the development or improvement in the gardens on an expenditure of Rs. 70,000 was a term embodied as a condition in the lease. Even if it be taken to be "an advantage for argument"s sake, all advantages, according to Mr. Roy, are not income. In order to assess income to tax, it requires also to be proved that such an income was revenue in nature. But if such advantage is capital in nature, it goes beyond the scope of assessment.

14. As to the decisions cited by Mr. Sen, it is contended that these decisions have no application to the facts and circumstances of the present case. As to the decision in 3 TC 185, it is stated that it deals with the disposition of income or profit but in the present case there was no accrual of income. As to the decision in 13 TC 461, it is pointed out that in that case debts were discharged by somebody else. Without disputing the principle as enunciated in 9 TC 163, he draws our attention to the fact that this was a case of application of income. So far as the decision in the case in WILKINS (INSPECTOR OF TAXES) Vs. ROGERSON., is concerned, it is pointed out that the money applied for the beneficiary was considered as an income of the beneficiary. Lastly, he characterises the sale in the case of 46 TC 378 as a sham transaction. At the same time he cites the decision in the case of Commissioner of Income Tax, Gujarat Vs. A. Raman and Company, . He points out at page 17 of the report wherein the Supreme Court observes that "the law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrued to him. By adopting a device, if it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous assessment, a case for commencing a proceeding for reassessment u/s 147(b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him." According to Mr. Roy, the advantage in the lease if it be converted in terms of money did not accrue to the assessee in the year under assessment.

15. Mr. Roy also cites the decision in the case of Commissioner of Income Tax, West Bengal Vs. Calcutta Discont Co. Ltd., , wherein it is held that where a trader transfers his goods to another trader at a price less than the market price, and the transaction is a bona fide one, the taxing authority cannot take into account the market price of those goods, ignoring the real price fetched, to ascertain the profit from the transaction. In this case, reference was made to the decision of the Supreme Court in the case of Commissioner of Income Tax, Gujarat Vs. A.

Raman and Company, . In that case, Shah J., (as he then was), speaking for the court, stated the law, at page 17 of the report, thus :

"The plea raised by the Income Tax Officer is that income which could have been earned by the assessee was not earned, and a part of that income was earned by the Hindu undivided families. ...That, according to the Income Tax Officer, was brought about by "a subterfuge or contrivance", Counsel for the Commissioner contended that if by resorting to a "device or contrivance", income which would normally have been earned by the assessee is divided between the assessee and another person, the Income Tax Officer would be entitled to bring the entire income to tax as if it had been earned by him. But the law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands, income which he could have, but has not earned, is not made taxable as income accrued to him. By adopting a device, if it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous assessment a case for commencing a proceeding for reassessment u/s 147(b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income Tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented."

16. Lastly, Mr. Roy relies on the decision in the case of *Henriksen (H.M. Inspector of Taxes) v. Grafton Hotel Ltd.* [1942] 24 T.C. 453, and specially a portion of the judgment of Lord Green M.R., at page 460, which is being quoted here:

"A payment of this character appears to me to fall into the same class as the payment of a premium on the grant of a lease, which is admittedly not deductible. In the case of such a premium it is nothing to the point to say that the parties, if they had chosen, might have suppressed the premium and made a corresponding increase in the rent. No doubt they might have done so, but they did not do so in fact. The lessee purchases the term for the premium. There is no revenue quality in a payment made to acquire such an asset as a term of years. Another class of expenditure which is comparable to the payments now in question is expenditure on improvements to the property which Justices may require to be made as a condition of granting a licence. Such expenditure would clearly not be deductible in so far as at any rate as the work required went beyond mere repairs."

17. This paragraph Mr. Roy places before us to press his case that expenditure for an improvement of the property, which was embodied in the terms of the lease, was not of revenue quality.

18. Apart from the legal position, Mr. Roy makes a reference to the fact as stated

by the Tribunal, which found no camouflage in the agreement to divert income accrued to the assessee at its source to different channels. It was also the clear finding of the Tribunal that the sum of Rs. 70,000 per year was not the assessee's income directly or indirectly. These facts, according to Mr. Roy, have not been challenged.

19. Apart from the above findings of the Tribunal, there cannot be any denial of the principle that when an expenditure is made with a view to bringing into existence an asset or advantage for an enduring benefit to the trade, such expenditure might be treated as properly attributable not to revenue but to capital. So even if we agree with Mr. Sen that the advantage in this case be treated as an income of the assessee, in the absence of proof, there would be no reason to hold that such advantage or income was the assessee's revenue income. Thus, the Tribunal appears to be justified in coming to its conclusion.

20. In view of the above premises, we answer the question in the affirmative and in favour of the assessee.

21. We, however, propose to make no order as to costs.

Sabyasachi Mukharji, J.

22. I agree.