

(1989) 09 KAR CK 0009

In the Karnataka High Court

Case No : Writ Petition No's. 11507 and 11508 of 1981

E.M.V. Muthappan

APPELLANT

Vs

Agricultural Income Tax Officer and Another

RESPONDENT

Date of Decision : 01-09-1989

Acts Referred:

Karnataka Agricultural Income Tax Rules, 1957 — Rule 9 (c)
Mysore Agricultural Income Tax Act, 1957 — Section 26 (4), 3, 7

Citation : (1990) 88 CTR 169 : (1989) ILR (Kar) 3517 : (1990) 184 ITR 161

Hon'ble Judges : S. Rajendra Babu, J;M. Rama Jois, J

Bench : Division Bench

Advocate : G. Sarangan, for the Appellant; M.R. Achar, Government Advocate, for the Respondent

Judgement

S. Rajendra Babu, J.—The petitioner in these two petitions is an assessee under the Karnataka Agricultural Income Tax Act, 1957 ("the Act" for short). For the assessment years 1979-80 and 1980-81, the petitioner filed his returns accompanied by a letter which, inter alia, stated that he was, prior to the said letter, assessed to tax in his individual capacity, but on August 10, 1978, he having impressed his agricultural estate known as "Cotacadu and Jeynacadu Coffee Estates", with the character of joint family property, he was not liable to pay any tax. In these circumstances, he requested the authority to conclude the assessment holding the petitioner as not liable to pay tax.

2. The petitioner was the karta of his undivided Hindu joint family consisting of himself, his wife, Banumathi, minor son, Vishwanathan, and a minor daughter. On August 14, 1978, the petitioner affected a partial partition which was registered on August 17, 1978, in which no share was allotted to the wife or the daughter with the result that his status after the partition in question was that of a member of a joint Hindu family. He stated that the act of impressing the estate with the character of joint family property came about only on August 10, 1978, and the coffee points declared in respect of the coffee crop delivered by him

during 1977-78 coffee season and prior thereto were collected by him in the status of an individual. He contented that impressing the property with the character of joint family property and the subsequent partition would absolved him of the liability to pay tax in respect of the receipts which came to him in the form of coffee points, according to him, he no longer held the property as an individual, but held it only as an Hindu undivided family. During the previous year relevant to the assessment years in question, he had no income in his status as Hindu undivided family, and in his individual capacity or status he owned or held land only for a part of the accounting year between April 1, 1978 and August 9, 1978, and, therefore, he was not exigible to pay agricultural Income Tax as he had not held land during the entire assessment year u/s 3 of the Act. It was also contented that the income could not be subjected to tax once the source was not in existence.

3. The Agricultural Income Tax Officer overruled the contentions raised by the petitioner and assessed him to tax in the status of an individual till date of partition, bringing to tax the supplementary points declared for the coffee season referred to above and raised a demand accordingly. For the assessment year 1980-81, the petitioner filed returns on the supplementary coffee points received relating to the earlier season preceding the party, when his status was that of an individual. The total receipts for 1975-76 to 1977-78 seasons, on cash basis. Amounted to Rs. 79,644. The Agricultural Income Tax Officer, on a consideration of the matter and finding that the net income was taken to be at the same figure, held that there was no expenditure since the estate had been portioned between the father and his minor son, as for the contention of the assessee that the supplementary coffee points received in the year in question are not liable to tax as the same were not the income of the previous year, the assessing authority rejected the same and brought the said points also to tax.

4. Aggrieved by these two assessment orders, the petitioner has filed these petitions and has, inter alia, sought for the following reliefs

(i) Quash the assessment orders dated May 14, 1982, and May 16, 1981, for the assessment years 1979-80 and 1980-81 and the demand made thereon ACIX;

(ii) To strike down rule 9(c) of the Karnataka Agricultural Income Tax Rules, 1957 ("the Rules" for short), as being ultra vires sections 3 and 7 of the Act; and

(iii) To strike down section 26(4) of the Act holding the same unconstitutional and beyond the competence of the state legislature."

5. We have heard learned counsel for the parties. Besides, we also had the benefit of the arguments of those learned counsel who had filed similar writ petitions challenging the constitutional validity of section 26(4) of the Act and Rule 9(c) of the Rules more or less on the self-same contentions.

6. In attacking the validity of the second proviso to rule 9(c), the petitioner has raised the following contentions : That, in the absence of specific provisions in

the Act, the supplementary points received by the petitioner which relate to crops of earlier years, not being the crops of the previous year, cannot be charged to tax. According to learned counsel, the coffee-picking season commences in the month of November and terminates about the end of March of next year after the picking is completed. The growers supply coffee to curers under the directions of the Coffee Board and even at the point of picking, there is statutory sale of the coffee grown pursuant to the directions of the Coffee Board and the Coffee Board thereafter allots points to the growers and declares certain value per point, and it is submitted that, depending upon the price realised on sale in auctions, there were subsequent declaration of dividends, thus, in a year, a grower may receive dividends in respect of the crops raised in any of the earlier crop season. It is submitted that there is no provision in the Act to bring to tax the dividends received by a grower in respect of coffee grown and surrendered to the curers in earlier years and. In view of such absence, there cannot tax in respect of the supplementary points received for earlier years. Learned counsel brought to our notice section 7 of the Act which provides for the method of accounting. It is submitted that the manner in which the income is to be computed from specified sources is not regulated by section 7 of the Act and the proviso to section 7 cannot modify or enlarge the ambit of the substantive part of the section, it is contended that the first proviso authorises the Agricultural Income Tax Officer to reject the method of accounting adopted by an assessee if no regular method of accounting has been adopted or the method of accounting adopted is such that the agricultural income cannot be deducted therefrom. The second proviso merely states that income from a coffee crop may be computed on the basis of valuation of coffee points declared by the Coffee Board. Neither section 7 nor the provisos thereto contemplate the framing of a rule. But rule 9(c) has been framed pursuant to the power u/s 63 of the Act and, in particular, the second proviso to the said rule states that the accounts in relation to any receipt in respect of earlier crop seasons received during the accounting period in excess of the amount already taken into consideration in the assessments of preceding years shall be considered as the income of the previous year. The contention is that when the Act did not make any provision for bringing to tax sums of money received in respect of earlier coffee seasons, rule 9(c) of the Rules which make a specific provision is ultra vires the act and there is no warrant for taxing the receipt in the year of receipt itself disregarding the method of accounting adopted by the assessee.

7. Although, arguments have been advanced on a very wide compass, the question that really arises for consideration is : Whether any receipt of

income of earlier season coffee crop (in excess of amounts already taken into consideration in the assessments for previous years) cannot be considered as income of previous year and brought to tax. In resolving this question, the petitioner attacked rule 9(c) of the Rules.

8. The power of State to levy tax on "agricultural income" is traced to entry 46 of

List II in the Seventh Schedule to the Constitution. Entry 82 of List I of the Seventh Schedule to the Constitution empowers the Union to levy tax in income other than agricultural income. Article 366(1) of the Constitution having defined "agricultural income" as having the meaning attributed to it for the purpose of enactments relating to Income Tax, to ascertain the meaning of the expression "agricultural income". We have to look to enactments under the Income Tax Act. The Act incorporates the very definition and the concepts enumerated in the Income Tax Act, 1962, to the expression "agricultural income" as provided in section 2(1)(a) thereof.

9. 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 and is assessed to land revenue and also any income derived from such land by agriculture, or by subjecting an agricultural crop grown thereon to process to render such produce fit to be taken to market or sale of such crop or user thereof. "Person" is defined as any individual or association of individuals wing or holding property for himself or for any other, or partly for his own benefit and partly for another as owner, trustee, receiver, common manager and includes an undivided Hindu Mitakshara family, a firm, company, etc. "Previous year" is defined to mean the twelve months ending on the 31st day of March preceding the year for which the assessment is to be made, or, if the accounts of the assessee have been made up to a date within the said twelve months in respect of a year ending on any date other than the said 31st day of March, then at the option of the assessee the year ending on he day to which his accounts have been so made up. Section 3 is the charging section which provides for levy of tax at such rate or rates as specified in the Act to be charged for each financial year on the total agricultural income of the previous year of every person.

10. When the income derived is in the previous year and its character is agricultural income, it cannot escape the net of taxation although the crop from which such income was grown was harvested during earlier years. The sale proceeds of agricultural produce constitutes income derived from a plantation. The use of the expression "derived" by itself does not postulate that the income must have been derived in the previous year in question. The agricultural produce gathered towards the end of the year of account may be sold and the sale proceeds realised early next year. The sale proceeds will nevertheless be liable to be included in the total agricultural income though the amount was not received in the year in which this produce was gathered, since the amount was not received in the year in which this produce was gathered, it does not cease to be agricultural income derived from a plantation merely on the ground that the receipt of income is in a year subsequent to the year in which the produce was raised and gathered for sale. This view was clearly expounded in the case of PUTHUTOTAM ESTATES (1943) LTD. Vs. AGRICUTURAL Income Tax OFFICER., . That view stood approved by the Supreme Court that agricultural Income Tax was payable no matter even if the produce was of an earlier year and the sale took place in a later year. Though a distinction is made on the basis of the

system of accounting, the Supreme Court held that this view of the High Court was right and stated that the reasoning in the said case was the same as in the judgment of the Supreme Court. In *S. S. Rajalinga Raja v. State of Madras* [1966] 63 ITR 617, the Supreme Court again considered this question and stated that merely because the produce of the plantation was received in earlier years, income derived by the assessee from the sale proceeds of that produce in the year of accounts is not exempt from tax under the Act in that year.

11. In that case, the court was concerned with section 3 of the Madras Plantations Agricultural Income Tax Act, 1955. It has been explained that (headnote) "income" in its normal connotations does not mean mere production or receipt of a commodity which may be converted into money. Income arise when the commodity is disposed of by sale, consumption or use in the manufacture or other processes carried on by the assessee quo that commodity. There is no reason to think that the expression "income" has any other connotation in that Act. A tax on income whether agricultural or non-agricultural is, unless the statute otherwise provides, a tax on monetary return-actual or notional. Merely because the produce of his plantation was received in the earlier years, income derived by the assessee from the sale of that produce in the year of accounting is not exempt from tax under the Act in that year.

12. This position has been reiterated in the case of *Tara Chand Hoti Lal Babu Ram Vs. Income Tax Officer, and Sheveroy Estates Ltd. Vs. Government of Madras*, . However, learned council for the petitioner contended that the decision in *S.S. Rajalinga Raja Vs. State of Madras*, , must be confined to the facts of that case and sought to rely upon the decision of the Supreme Court in the case of *State of Kerala and Others Vs. Bhavani Tea Produce Co. Ltd.*, to contend that coffee delivered to the coffee Board becomes the property of the Board no sooner it is delivered and, therefore, the sale was completed when the coffee was delivered to the Coffee Board. Learned counsel relied upon the observations of Chief Justice Rajamannar in *PUTHUTOTAM ESTATES (1943) LTD. Vs. AGRICUTURAL Income Tax OFFICER.*, to contend that if the sale took place during the financial year, tax was payable no matter whether the produce is of the earlier year and if the sale took place earlier, namely, prior to the financial year, tax would not be payable even if the price was realised later. In view of the clear enunciation of law by the Supreme Court in *State of Kerala and Others Vs. Bhavani Tea Produce Co. Ltd.*, , there is no warrant for such a contention. Even if the sale takes place in a later year after the crop is gathered, income is computed depending upon the system of accounting adopted or according to the statute or rules thereunder. In view of this settled position of law, the view expressed by this court in *M. L. Narasimhiah Setty v. Agrl. ITO* [1965] 55 ITR 55 616 to the contrary and disagreeing with the view expressed in *PUTHUTOTAM ESTATES (1943) LTD. Vs. AGRICUTURAL Income Tax OFFICER.*, therefore, must be held to be no longer good law.

13. With this background. Let us look at the contention raised on behalf of the

petitioner based on section 7 of the Act and the attack on the second proviso to rule 9(c) of the Rules. Section 7 of the Act provides for computation of income in accordance with the method of accounting regularly employed by the assessee. If the method of accounting is defective or no method is regularly employed, the Assessing Officer can assess on any other reasonable basis provided in the case of a coffee crop. The assessing Officer may compute on the basis of valuation of points declared by the Coffee Board in respect of such crop. Rule 9 (c) of the Rules reads as follows :

"(c) in a case of the coffee crop of the previous year. The cash amount received within the accounting period in respect of the crop grown and consigned by the assessee to the Coffee Board or the estimated value of such crop shall be taken into account as the income of the year according to the method of accounting regularly employed by the assessee.

Provided that if the estimated value declared by the assessee is less than the average of the rates declared by the Coffee Board for three immediate previous years, the Agricultural Income Tax Officer or the Assistant Agricultural Income Tax Officer shall take into consideration the average rates for the purpose of assessment :

Provided further that any receipt in respect of the earlier season's coffee crop received during the accounting period in excess of the amount already taken into consideration in the assessments of preceding years shall be considered as the income of the previous year."

14. These provisions prescribed the manner of computation of income. The question at what point of time it is chargeable is answered by the method of accounting adopted by the assessee either when it is received by him or when it accrues or arises to him during the previous year. Taxability is attracted even when income has accrued and it is clear that receipt of income is not the sole test of taxability under the Act. Whether it is on receipt basis or on accrual basis, it is the real income and not a hypothetical or theoretical income that has to be subjected to tax under the Act. In *The Commissioner of Income Tax, Madras Vs. A. Krishnaswami Mudaliar and Others*,¹ after noticing the distinction between the cash and the mercantile systems of accounting, it was held that both methods are somewhat rough and may have been made in the said decision, it can be safely said that the provision such as section 7 and the rule 9(c) which deal with computation of income do not purport to and cannot enlarge or restrict the nature, scope or content of taxable income. The method of accounting is relevant only for the purpose of computation of income, but it cannot restrict or enlarge the range or character or content of the taxable income, a regular method of accounting determines the mode of computing the taxable income or ambit of taxation. Therefore, section 7 or rule 9 cannot control the charging section. Section 3 brings the total agricultural income of the previous year of every person to tax. The question whether such income is derived from the irrelevant as long as the income is relatable to agricultural operations and is derived during

the previous year. If, in the previous year, any income is derived and such income, although it may relate to the crops harvested in earlier years. Is also taxable under the Act. Therefore, the argument developed on the basis of the provisions relating to assessment and computation have no relevance in understanding the nature, scope, ambit or content or character of the income which is subjected to tax under the Act.

15. Several other decisions have been referred to by learned counsel for the petitioners which explained the scope and applicability of section 7 of the act and rule 9(c) of the Rules in relation to income from plantations depending upon the nature of the method of accounting adopted and the circumstances available. If it is borne in mind that both section 7 and rule 9(c) merely provide for a method of computation of income without affecting the extent or scope or content of section 3 of the Act as to charge ability of agricultural income, it becomes clear that the rule 9(c) is framed to carry out the purposes of the Act. Since the method of accounting by itself will not determine the nature or ambit of tax, the Act itself can provide for a mode, apart from the cash system or mercantile system to bring to tax an income which is really intended to be subjected to tax. Considering the nature and complexity of the matter involved in respect of the income from coffee estate, as the coffee is supplied to the coffee Board, and such supply takes place in pursuance of the statute which holds it to be a sale, the sale proceeds. Therefore, constitute income. Such income will fall u/s 2(1)(a) as it is income derived from land in the State by the sale by the cultivator of the produce raised by him. The price is tentatively fixed at the time of sale but is liable to adjustment subsequently. Often, that process takes time before entire sale price is paid, if we bear these aspects in mind, demonstrating the complexity of the nature of transaction, it cannot be said that the Legislature cannot provide for any other mode of ascertaining income for purposes of taxation apart from cash or mercantile system. Hence, it is certainly permissible for the Legislature to provide for taxing all income derived from agricultural produce harvested and sold in a year preceding the previous year, but the income during the previous year can be brought to tax only in a particular manner. Even if it modifies the system of accounting, no fault can be found with it. Indeed, a careful perusal of the provisions thereto will reveal that even if the income was computed on accrual basis, what is now sought to be added is income in excess of that, and, therefore, no exception can be taken to the same. In a given case, in what manner the provisions will operate is altogether a difference question, but that does not effect the validity of the provisions.

16. It is contended that. In view of the second proviso to section 7 of the Act, there is no option left to the Assessing Officer except to compute the income on the basis of valuation of points declared by the Coffee Board of such crop by placing reliance on the decision in B.V. Veerathradhya Vs. Commissioner of Agricultural Income Tax, Bangalore, We do not think that that decision lays down any proposition that, in the case of income arising in the previous year from a crop of earlier years, the second proviso to section 7 determines the point at

which tax has to be computed. That decision lays down that the second proviso to section 7 provides that when account of the assessee are not accepted as correctly disclosing the income, the Assessing Officer shall evaluate the quantum of income on the basis of points and determine the year in which such income has to be brought to tax. Hence, neither that decision nor that provision can have any bearing upon the question that arises for consideration in this case.

17. To sum up the discussion, section 7 and rule 9(c) provide for several modes of computation of income. Any one of them can be adopted in any given case subject to the conditions thereof. Each one of those methods of computation of income is within the scope of the Act. Those provisions have been the subject-matter of interpretation by this court without touching upon their validity. Therefore, we hold that rule 9(c) including the second proviso thereto is not ultra vires the Act.

18. We now propose to deal with the contention of the petitioner with regard to section 26(4) of the Act. It was contended on behalf of the petitioner that sub-section (4) of section 26 of the Act is unconstitutional as the same was beyond the competence of the State Legislature, and, therefore, the same should be declared as invalid by this court.

19. Section 26 of the Act came to be substituted by the Karnataka Act 10 of 1987, sub-section (4) of section 26 provides that receipts after discontinuance of the business or profession can be treated as agricultural income in the year of receipt in the hands of the recipients. The petitioner's contention is that this provision is applicable only to cases in respect of a company, firm or association of individuals discontinuing the business yielding agricultural income and is not attracted to a case of the nature on hand. According to learned counsel for the petitioner, since the State has no power to bring within the net of taxation an item which does not bear the character of agricultural income, sub-section (4) is legislated beyond the purview of article 366(1) of the Constitution and, therefore, it is liable to be struck down, supplementary receipts received by the petitioner were at a point of time when he ceased to have an interest in the agricultural land and there being no nexus between the agricultural operation and the income, those receipts cannot be treated as agricultural income and the State cannot bring to tax an item which is shorn of the character of agricultural income. It was submitted that the concept of agricultural income cannot be different from the one contained in article 366(1) of the Constitution which states that agricultural income means such income as defined for the purpose of Income Tax enactments. It is, therefore, contended that since the State, by the impugned legislation, has brought to tax receipts which do not bear the characteristics of agricultural income and goes far beyond the mandate of article 366(1) of the Constitution, the same is unconstitutional.

20. While section 26(1) and (3) of the Act clearly refers to a company, firm or association of persons, section 26(4) of the Act does not make any such reference. When section 26(4) does not, in terms, refer to any company, firm or

association of persons while other sub-sections refer to such expressions, it is obvious that the Legislature did not intend to confine the provisions of section 26(4) to a company, firm or association of persons. Hence, the contention of the petitioner that section 26(4) is applicable only to a company. Firm or association of persons is untenable and is rejected.

21. Section 26(4) of the Act is to the effect that where any business through which agricultural income is received is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and liable to tax accordingly in the year of such receipt if such sum could have been included in the total income of the person who carried on the business had such sum been received before such discontinuance. The provisions of section 26 were brought into effect by the validation clause found in section 13 of the amendment Act so as to have effect from April 1, 1975, validating the assessments made thereunder on that basis. The question that emerges for consideration is whether the State Legislature had no competence to enact such a provision, the basis of the contention is that the source of income earned has ceased to be income in the hands of the assessee and after the cessation of agricultural operations, any income received cannot be treated as agricultural income so as to make it liable to tax. Elaborating this submission, it was contended that agricultural income can be brought to tax as provided in entry 46, List II of the Seventh Schedule read with entry 82 of List I. It was submitted that the concept of income would include only such income as agricultural income as defined in the Income Tax Act.

22. The Act incorporates the very definition given in the Income Tax Act in respect of agricultural income. What is really contended in this case is that the income derived being not from agricultural land and being merely a receipt from the Coffee Board, such income has no connection or nexus to the agricultural activities and, therefore, the same is invalid. It is clear that the income is derived as a result of supply of coffee to the Coffee Board. The Coffee Board was enjoined with the duty to make payments for coffee received and the assessee is entitled to receive payment though not concerned any more with the coffee supplied by him. Since the sale precedes received is income relating to agricultural activity carried on during the earlier years, it must be deemed to be the income of the recipient, as the original assessee is no longer continuing the business and, therefore, is liable to tax in the year of receipt in the hands of the recipient, thus, it is clear that the income derived from the Coffee Board is agricultural income arising out of sale which is realised in a year other than the one in which it was produced. There exists a clear nexus between the amount received and the coffee supplied. Therefore, there is absolutely no substance in the contention raised on behalf of the petitioner that the State Legislature had no competence to bring to tax by creating a fiction u/s 26(4) of the Act. Thus, we hold that section 26(4) is valid piece of legislation.

23. It was, however, contended by learned counsel for the petitioner, relying on

the decision in *Nalnikant Ambalal Mody Vs. Commissioner of Income Tax, Bombay*, that, in the case of discontinued business, when the income earning asset was no longer in the hands of the assessee in question, it was not open to bring to tax income earned after ceasing to hold the agriculture land though such income is relatable to such assets and therefor. Was not within the scope of change ability of section 3 of the Act. To obviate the difficulty caused by the said section 25 of the Indian Income Tax act, 1922 section 176(4) of the Income Tax act, 1961, was enacted. Identical with those provision, section 26 has been introduce into the Act. If section 26 is valid, there could be no argument available on the basis of *Nalnikant Ambalal Mody Vs. Commissioner of Income Tax, Bombay*, to the petitioner. We have already held section 26(4) to be valid and hence this contention has no force.

24. One other contention advanced on behalf of the petitioner is that the agriculture income should have been derived in the previous year and the previous year as defined in section 2(1)(s) of the Act can only mean a full period of twelve months and those not contemplated a broken period therefore. Learned counsel in this context relied upon a decision in the case of *Agri. AGRICULTURAL Income Tax COMMISSIONER Vs. JETHMAL GIRDHARILAL.*, Elaborating this contusion learned casual submitted that, during the period between April 1, 1978, and March 31, 1979, the petitioner had thrown his self acquired property into the Hindu undivided family hotchpot and, therefore after, partitioned the properties which resulted in interruption in the period of 12 month. Thus, for the assessment year 1978-80, there was no previous year at all and the charge to tax is not justified as section 3 and section 2(1)(s) contemplated only a full previous year.

25. What is brought to tax u/s 3 of the Act is agricultural income during the previous year. If the income earned by the petitioner is agricultural income, whether it is for a broken period or for a full period dose not matter at all, because, in agricultural operation, the income is not earned throughout the year, but mostly seasonal; and, therefore, the contusion raised on behalf of the petitioner has no basis at all.

26. Now what remains for consideration is the challenge to the impinged assessment orders. We have un helped the constitutional validity of section 26(4) of the Act. Section 13 of Act 10 of 1987 (hereinafter referred to as "the Amending Act"), has made the same retrospectively applicable from April 1, 1975, and the assessments made which fulfill the condition thereto are validated. These petitions have been filed in the year 1981. It is doubtful if the action of the respondent impugned herein could be sustained without recourse of the amended provision. Moreover, section 13(1) of the Amending Act proscribes several condition for retrospective applicability of section 26(4) of the Act. These provision were not and could not have been before the Assessing Officer and, obviously, he has not applied his mind to these aspect of the matter while passing the impinged orders. Thus, the matter needs to re-examined in the light

of the amended provisions.

27. In the result, we make the following order :

- (i) These petitions are partly allowed;
- (ii) The petitions are dismissed in so far as they relate to the challenge to validity of section 26(4) of the Act and rule 9(c) of the Rules;
- (iii) The petitions are allowed in so far as they relate to inclusion of the income received from earlier season's crop and quash the impugned assessments and remit these matters to the concerned assessing authority to redo the assessment in the light of this order and in accordance with law;
- (iv) Except to the extent indicated above, the impugned assessment orders shall remain undisturbed.