(1929) 08 PAT CK 0031

In the Patna High Court

In Re: Raghunandan Prosad Singh and Another

Date of Decision : 07-08-1929

Acts Referred:
Income Tax Act, 1922 — Section 66(1), 66(2)
Income Tax Act, 1961 — Section 4

Citation : AIR 1929 Patna 476

Hon'ble Judges : Wort, J;Kulwant Sahay, J;Das, J

Bench : Full Bench

Judgement

Das, J.—The Income Tax officer assessed as Raga Rajhunandan Prosad Singh and Raja Deokinandan Prosad Singh, (who will be referred to as the assessees throughout this judgment), for Income Tax in respect of the year 1926-27 upon the sum of Rs. 17,02,321 of which Rs. 16,23,459, in the judgment of the Income Tax officer, represented the profits received by the assessees in the previous year as the result of certain mortgage transactions with the proprietors of the Srinagar Raj. On appeal, the Assistant Commissioner reduced the assessed income to Rs. 15,52,033. At the request of the assessees the Commissioner of Income Tax has stated a case to this Court u/s 66(2), Income Tax Act 1922 and he has also referred a question of law, on his own motion, for our decision u/s 66(1).

2. In to appreciate the arguments which have been advanced before us it is necessary to set out the facts as found by the learned Commissioner. Srinandan Singh the proprietor of the Srinagar Raj, had three sons, Nityanand Singh, Kamlanand Singh and Kalikanand Singh. Sometime in 1892 Nityanand Singh separated from his brothers. In 1894 he borrowed Rs. 20,000 from the predecessors in title of the assessees and executed a mortgage bond in his favour. In 1897 he borrowed Rs. 3,50,000 from the Baneli Raj on the security of the properties belonging to him. The Baneli Raj sued to enforce the mortgage and, on 11th March 1902, obtained a decree for Rs. 4,57,189 against Nityanand Singh. On 12th September 1903 Kamlanand Singh and Kalikanand Singh purchased from the Baneli Raj the decree obtained by it as against Nityanandfor the sum of Rs. 5,00,000, but, being unable to find the money, executed a

mortgage bond in favour of the Baneli Raj.

3. On 20th October 1903 Kamlanand and Kalikanand purchased from Nityanand his share in the properties constituting the Srinagar Raj and became liable to satisfy the claims of the predecessor in title of the assessees. The position on 18th July 1904 which is a very material late in these proceedings was as follows. Kamlanand and Kalikanand owed the assessees or their predecessor-in-title the sum of Rs. 4,33,135 on the transaction of 1894. They also owed the Baneli Raj Rs. 5,25,815 on the transaction of 12th September 1903. It appears that the Baneli Raj was pressing for repayment. On 18th July 1904 Kamlanand and Kalikanand paid Rs. 815 to the Baneli Raj. They borrowed another sum of Rs. 3,00,000 from the assessees and paid the whole of it to the Baneli Raj in reduction of their indebtedness to the latter. They were still liable to the Baneli Raj for Rs. 2,25,000 for which they executed a fresh bond in its favour. Having borrowed the sum of Rs. 3,00,000 from the assessees they executed a bond in their favour for Rs. 7,33,135 which included the sum of Rs. 4,33,135 which they owed the assessees at the date of this fresh transaction. On 7th November 1912 Kamlanand and Kalikanand borrowed another sum of Rs. 3,00,000 from the assessees and paid the whole of it to the Baneli Raj in reduction of their indebtedness to it. It will appear then that the assesseea or their predecessor-in-interest advanced to Kalikanand and Kamlanand or their predecessor-in-title the sum of Rs. 2,00,000 in 1894, Rs. 3,00,000 on 18th July 1904 and Rs. 3,00,000 on 7th November 1912.

4. The assessees instituted two suits or the two mortgages, one dated 18th July 1904 and the other dated 7th November 1912 and in due course obtained mortgage decrees as against the Srinagar Raj family. The mortgaged properties were-put up for sale on 19th November 1924 and the 31st January 1925 and they were purchased by the assessees themselves. They obtained sale certificate on 18th December 1925 and 21st December 1925 and it appears that they obtained delivery of possession on 30th September 1926. I may mention that the-claim of assessees at the date of the sale-on the mortgages to which I have already referred amounted to Rs. 27,13,379. The properties were however, sold for Rs. 25,65,100. The Assistant Commissioner took the view that the sum of Rs. 25,65,100 after deducting there out the cost charges and expenses incurred by the assessees up to the dates of the. execution sales the capital sums advanced represented the assessable income of the assessees on the Srinagar mortgage transactions. The question, which we have to consider is whether the view taken by the learned Assistant Commissioner is well founded.

5. It was contended by Mr. Jayaswal on behalf of the assessees that it is too late now to assess the interest on the Srinagar Raj mortgages to Income Tax and that such interest should have been, assessed if at all, as it accrued due. Section 4, Income Tax and which is the charging section provides that the Income Tax Act

shall apply to all income, profits or gains, as described or comprised in Section 6 from whatever source derived, accruing or arising or or received in Brtish India, or deemed under the provisions of this Act to accrue, or arise, or be received in British India.

6. Mr. Jayaswal contends that the interest on what have been described as the Srinagar Raj mortgages as "income, profits or gains" accrued to the assessees as they fell due from 1894 and that the claim of the Crown to assess that interest in the financial year 1926 1927 is wholly inadmissible. Now in dealing with this point we are conclusively bound by the finding of the commissioner that the assessees kept their accounts on the cash basis and that those accounts do not show actual realisation of interest at any time. I think the fallacy of the argument lies in confusing a debt due but not realised with income. It is one thing to say that a claim accrued to the assessees to recover the interest due to them by suit; it is another and a different thing to say that an income accrued to them.

7. But in truth the question has been settled by an authoritative decision of the Judicial Committee in St. Lucia Usines and Estates Co. Ltd. v. Colonial Treasurer of St. Lucia [1924] A.C. 508. I take the facts of that case from the head notes, and they are these: In 1920 the appellants sold all their properties in St. Lucia and ceased to reside or carry on business there. In 1921 interest upon the unpaid part of the purchase price was payable to them, but it was not paid. The appellants were liable to pay Income Tax for the year 1921 under the Income Tax ordinance 1910, of St. Lucia only if the interest above mentioned was ''income arising or accruing'' to them in 1921. The question which their Lordships of the Judicial Committee had to try was whether the interest which was not paid in 1921 was nevertheless income arising or accruing in 1921; and their Lordships had no difficulty in answering the question in the negative. In so deciding Lord Wrenbury, who delivered the judgment of the Board said as follows:

The word arising or accruing occur repeatedly in the ordinance, e.g., in Section 4, Sub-Section 1(a)(b)(c)(d) and (e), coupled with the words, ''and derived from'' oft ''or derived from''. Sometimes the expression ''derived from'', is used alone, Section 5, Sub-section 1(a)(c)(g)(1) and (ii). The respondent contends that the above interest ''accrued'' to the company in the year 1921, because it was payable in that year and none the less because it was not paid in that year. Their Lordships do not agree. The words ''income arising or accruing, are not equivalent to the words ''debts arising or accruing.'' To give them that meaning is to ignore the word ''income.'' The words mean ''money arising or accruing by way of income.'' There must be a coming in to satisfy the word income. This is a sense which is assisted or confirmed by the word ''received, in the proviso at the end of Section 4 Sub-section 1.

8. The words in the Indian Statute are exactly the same as those which Lord Wrenbury was considering in the case just cited. It seems to me that these words must receive the same interpretation in India as they did in the Colonial case. In my view the argument advanced by Mr. Jayaswal must be overruled.

9. It was next contended that by the express agreement between the parties the

interest as it accrued due was added to the capital and that the agreement in fact effected--capitalization in the sense that no tax can be levied on it. All that we know from the case as stated by the Commissioner is that there were provisions as to compound interest in the bonds executed by the proprietors of Srinagar Raj. The question then resolves into this: Does the interest cease to be an income, profit, or gain, because at the end of certain specified periods it is added to the capital so that it may bear interest? I think not; and I am supported in my view by the decisions of the English Courts to the effect that an agreement as to compound interest does not effect capitalization. The question was debated in In re: Craven''s Mortgage Davies v. Craven [1907] 2 CH. 448.

10. The facts were these: By a mortgage of 1st June 1888, the mortgagor covenanted that on his death or on his son''s death, whichever event should first happen, he, his executors, administrators, or assigns, would pay to the mortgagee the principal sum secured, together with simple interest thereon at the rate of five per cent per annum reckoned from 10th August 1887, up to the time of such death; and if the aggregate amount of this sum and interest or any part thereof should not then be paid, would pay interest on the unpaid part by equal half yearly payments. The mortgagor predeceased his son and died in 1906. His executor paid to the mortgagee interest on the aggregate sum, consisting of principal and interest found due at the mortgagor''s death. He now proposed to pay off the aggregate amount due on the mortgage, and claimed the right, in doing so, to deduct Income Tax on so much of the aggregate sum as represented interest. It was argued that by the terms of the mortgage there was a contract that interest should be capital and that, therefore, the executor was not entitled to deduct Income Tax on so much bf the aggregate sum as represented interest as Income Tax was not payable on it. The argument was negatived by Warrington, J., (as he then was) in these words:

Then there is one word I have to say on the question of capitalization. It was argued that even if the interest before the death of W. G, Craven was within Section 40, it then ceased to be so, and became capital and itself liable to pay interest, in other words, that there was a contract that it should be capital. I do not think so. I find nothing in that deed to capitalize the interest or to change the character of the interest and make it something which it was not before. In order to recover this interest the executors of the mortgagee would have to sue the mortgagor''s executor on the covenant for payment of interest. The effect of the last clause of the covenant is only that if the principal and interest is not paid at the right time, the unpaid interest is itself to bear interest, There is no capitalization.

11. The decision in this case was followed in In re: Morris-Mayhew v. Halton [1921] 1 Ch. 172, which was affirmed by the Court of appeal in Mayhew v. Halton [1922] 1 Ch. 126. It was pointed out by P.C. Lawrence, J., that the decision in In re Craven''s Mortgage [1907] 2 CH. 448 has stood unchallenged for more than. 13 years, and has in all probability bean acted upon in numerous

cases.

12. In these circumstances the learned Judge thought that he was relieved from having to form any conclusion of his own as his clear duty was to follow that decision which he accordingly did. In the Court of appeal, however, there was an elaborate discussion; but the Court in the end, came to the unhesitating conclusion that an agreement as to compound interest does not effect capitalization. In my judgment the view taken by the learned Commissioner is right; and I have no hesitation whatever in endorsing it.

13. It was then contended that the interest which accrued on the bond of 1894 is no longer assessable since that bond was extinguished so far back as 18th July 1904. I have already mentioned that the proprietors of the Srinagar Raj owed the assessees Rs. 4,33,135 on the transaction of 1894. They took a further loan of Rs. 3,00,000 from the assessees on 18th July 1904 and executed a bond in favour of the assessees for Rs. 7,33,135. It is claimed that the transaction of 18th July 1904 must be looked as if the mortgage bond of 1894 was completely paid off and that a fresh advance of Rs. 7,33,135 was made on 18th July 1904. Mr. Jayaswal contends that the assessees should have been taxed on the sum of Rs. 2,33,135 which represented the accumulated interest on the bond of 1894 as the income of the year 1904-1905; and that it is too late now for the Crown to claim Income Tax on that sum since it must be regarded as having been actually received by the assessees in 1904. The answer to the argument is that, as the Commissioner has found, the assessess keep their accounts on the cash basis and that, as the commissioner has also found,

this sum of Rs. 2,33,000 and odd is not shown separetly as interest realized in the assessee''s books of account of that year either in the interest account or in the personal account of the debtor.

14. The inference is irresistable that the bond of 1894 was not extinguished from the point of view of the Income Tax administration since nothing was received by the assessees as income, profit or gain in that year. The view taken by the learned Commissioner is obviously right and must be affirmed.

15. The next question argued is formulated as follows in the case as stated by the Commissioner:

When a property is purchased in execution of a mortgage decree by the mortgagee subject to deposit of security sufficient to safeguard the interest of a party claiming a one-eighth share in the property to be unaffected by the decree, can the value of the whole property be taken into account for the purpose of computing profits, or, on the other hand, can the amount deposited in the Court as security in these circumstances be claimed as deductible expenditure in computing profits?

16. The point arises in this way: In 1923 Kumar Ghananand Singh, one of the sons of Kalikanand Singh, filed a suit in the Court of the Subordinate Judge of

Bhagalpur claiming 1/8th share in the mortgaged property and praying that the sale be not confirmed in respect of his 1/8th share. It appears that in the mortgage suits which the assessees instituted against the proprietors of Srinagar Raj, Kumar Ghananand Singh was by a mistake left out; and it was this circumstance which encouraged Kumar Ghananand Singh to claim that the sale had not the effect of passing his 1/8th share in the mortgaged properties. As the suit was still pending when the assessees applied for confirmation of sale, it was directed by the High Court that the assessees should deposit security to the value of Rs. 3,20,633, being 1/8th of the purchase price of the property under the mortgage decrees; and it appears that the assessees did furnish security for that amount. It is now contended that the profits or gains in this case should have been computed after: making allowance of Rs. 3,20,633 as

an expenditure (not being in the nature of I capital expenditure) incurred solely for the; purpose of earning such profits or gains.

17. In my opinion it is impossible to give effect to the contention. It is sufficient to say that the assessees have not incurred any expenditure at all though they have given security for a definite I sum and that if they incurred any expenditure it was not incurred solely or otherwise for the purpose of earning such profits or gains. It may be that if Kumar Ghananand Singh ultimately succeeds in his action, the assessees will incur a loss; but the Income Tax department will no doubt take such loss into consideration if and when it takes, place land set it off against the income, profits or gains under any other head u/s 24(l), Income Tax Act. The question in my view does not arise in the present proceedings; and I must accept the view which has been taken by the learned Commissioner on this point.

18. The next point arises with reference to a decree which Baneli Raj has obtained against the assessees. In enumerating the mortgage transaction of ''the Srinagar Raj I have omitted to mention that on 29th April 1916 the proprietors of that Raj executed a mortgage bond in favour of the Baneli Raj to secure an advance of Rs. 7,00,000. The Baneli Raj brought a suit in 1923 to enforce the mortgage bond of 29th April 1916 and in the course of that suit a question of priority arose between the Baneli Raj and the assessees. On 18th September 1926 the Court decided against the assessees, and gave a decree to the Baneli Raj, the effect of which is that that Raj is entitled to recover Rs. 1,50,000 from the properties which have been purchased by the assessees. In these circumstances the assessees claim as admissible deduction from their income the amount of the decree obtained against them by the Baneli Raj. The answer to the argument is that no expenditure has yet been incurred by the assessees and it cannot be allowed at the present moment. It appears that the decision of the learned Subordinate Judge was pronounced'' on 18th September 1926, i.e., in the year subsequent to the year on the income on which tax is being charged. It is obvious then that that sum cannot be an admissible deduction from the income of the year on which tax is now being assessed under any of the sub-

sections of Section 10 of the Act. It may be capital loss of the subsequent year or it may be an admissible deduction from the income of the subsequent year in which the amount was actually paid by the assessees to the Baneli Raj.

19. It was next contended that the law does not contemplate taxation of notional receipts of income and profits arising from the purchase by the assessees of the mortgaged properties and that the transaction in respect of which tax has been assessed by the Crown was in fact a capital transaction and was therefore outside the provisions of the income taxi Act. I am unable to agree with the contention. The assessees were entitled to recover from the Srinagar Raj money or money''s worth. The properties which they have now purchased represent the money originally advanced to the Srinagar Raj together with the accumulated profits on the advances. It is in fact the money originally advanced with the accrued profits in another form.

20. So the matter stands on principle; but it is also concluded by the decisions in Scottish and Canadian General Investment Co. Ltd. v. Easson 8 Tax Cas 265. and Californian Copper Syndicate v. Hurris 5 Tax Cas. 159. In the former of the cases, the question arose in this way. The appellant held bonds of a company unable to meet the coupons for the interest thereon for the half year from 1st July 1915. A reorganization involving the formation of a new company took place, and the appellant surrendered the bonds, with the unpaid coupons, and received in exchange five per cent bonds of the new company of equivalent face value, bearing interest from 1st July 1917, together with an issue of debentures of the new company equal in face value to 10 per cent of the face value of the surrendered bonds, such debentures being thus equivalent in face value to the coupons for the two years'' interest from 1st July 1915 to 1st July 1917. It will be noticed that the interest was paid in kind, not in cash; and, in computing the profits of the appellant, a sum equal to 75 per cent of the face value of these debentures, as representing their actual value at the time of receipt, was included as income received. This method of computation was contested by the assessee; but it was held that, there being before the Commissioners evidence sufficient to enable them to determine that the debentures represented the two years'' interest on coupons surrendered, the value of the debentures had been properly included in the computation of the company''s profits, and that there was no material on which to question the Commissioners'' finding that 75 per cent of the face value of the debentures represented the profit.

21. In the latter of the eases, a company formed for the purpose, inter alia, of acquiring and reselling mining property, first acquired and worked various mines, and then it resold the whole to a second company receiving payment, not in cash, but in fully paid shares of the latter company. The Income Tax Department took the view that the difference between the purchase price and the value of the shares was a profit assessable to Income Tax. It was contended on behalf of the company that the case was one of substitution of one kind of capital for another and that, in any case, no tax should be levied until the value of the

shares had been realized in money. The Court negatived the contention and held that the view taken by the Income Tax Department was correct. In delivering the judgment of the Court, Lord Trayner said as follows:

But it was said the profit wag not realized profit, and therefore not taxable, I think the profit was realized.... No doubt here the price took the form of fully paid up shares in another company, but if there can be no realised profit except when that is paid in cash, the shares were realizable and could have been turned into cash.

22. These cases appear to me to be relevant, and I must accept the conclusion reached by the Commissioner on this point.

23. The next point argued raised the question whether the Income Tax Department employed a correct method of computation. What fell to be decided was what was the profit made by the assessees on the Srinagar mortgages. At the date of the sale there was due to the assessees Rs. 27,13,379 on the mortgages in question. They purchased the properties at the Court sale for Rs. 25,65,100. The assessees contended that the real value of the properties was not Rs. 25,65,100, the price paid by them, but Rs. 17,13,701 as valued by the civil Court Commissioner. Now if Rs. 17,13,701 be regarded as the value of these properties, then it must follow that considerably less profit was made by the assesses. I am not prepared to attach any importance to the valuation: as made by the civil Court Commissioner; but it is sufficient for me to say that the; Income Tax Department did not err, in point of law, in taking the view that the: price pail by the assessees represented the true value of the properties and that there is no material in the record which would enable us to say that its conclusion, in point of fact, is not a correct one.

24. The next question argued is one of considerable difficulty, and it is necessary for me to proceed with care. The question is formulated as follows in the case stated by the Commissioner:

If the profits or gains arising to the assessees from the buying in of mortgaged property are taxable, what is the date on which the profits are to be deemed to have arisen? Is it the date of decree, the date of sale, the date of confirmation of sale, or the date of delivery of possession?

25. The importance of the question lies in the circumstance that, in order to enable the Crown to claim Income Tax in the case, it must be shown that the profits accrued, arose or were received, by the assessees in "the previous year," that is to say, in the year ending with 31st March 1926.

26. The mortgage decrees were pronounced on 22nd December 1917, so that, if that date be taken as the material date, it must follow that the Crown has lost its right to recover Income Tax in respect of the profits made by the assessees on the Srinagar mortgages. The argument that that date must be taken to be the material date was not seriously: pressed before us, and it is not necessary for

me to say more than this that the obtaining of decrees is not equivalent to realization of profits. An elaborate argument was, however, advanced to us in support of the view of the assesses that the profits must have been received by them on 19th November 1924 and 31st January 1925, the dates of the Court sales. If this argument be well-founded then it must again follow that the present assessment must go, though the Crown has the right to proceed against the assessees u/s 34 in respect of the income which escaped assessment. We are informed that the Income Tax Officer has served notice on the assessees u/s 34; so that it must follow that the question argued before us is of no practical importance so far as this case is concerned. But the Question is of general importance and it is necessary that we should decide it.

27. If I have understood Mr. Jayaswal''s argument, it is this it is quite an error to suppose (so he contends) that the immovable properties purchased by the assessees represent the actual advances made by them together with the profits thereon. The true position according to him is that which has been put so clearly by the Commissioner in the case stated by him. When a decree-holder buys in mortgaged properties, so says the Commissioner in para. 17 of the case:

though the transaction is nominally a single transaction, it is in reality of a dual nature and what really happens is that the amount for which he buys in the property has been notionally received by him and with that notional receipt he purchases the property,

28. Mr. Jayaswal contends that what must be regarded is, not the purchase of the properties by the assessees but the notional withdrawal of the purchase money by them. A third party might have purchased the properties and the assessees would have been entitled to withdraw the purchase money from Court in satisfaction of their claim as against the Srinagar Raj. The position is not different, according to the argument advanced before us, because the assessees who are the decree-holders have themselves bought in the properties. Mr. Jayaswal relies upon Order 21 Rule 72 of the Code which provides that where a decree-holder purchases with the express permission of the Court, the purchase money and the amount due on the decree may be set off against one another and the Court executing the decree shall enter up satisfaction of the decree in whole or in part accordingly. Mr. Jayaswal contends that though the assessees have not in fact paid the purchase money into Court and have therefore not withdrawn the purchase money r the transaction must be regarded as if they paid the purchase money and with-drew that purchase money, so that it must follow that the profits accrued to them at the dates of the sales.

29. As I have said the argument is a. weighty one but at the same time if this argument is to succeed, it must-follow that the material dates are not the dates of the sales but the date, on-which the Court entered up satisfaction of the decree. Now there are no materials in the record to enable us to decide when the Court in fact entered up satisfaction of the decree; and, this being the position, we are not at liberty to question the Commissioner''s finding on this point.

30. But in truth the question is of a more complicated nature. When a third party purchases properties at Court sales, he is required to bring the money into Court at once for the protection of the decree-holder. But where the decree-holder himself purchases the property he is not in need of the protection; and so the Code provides that the purchase-money and the amount due on the decree may be set off against one another. But does it follow that, because the set off is allowed under the provisions of the Code, the profits are actually received when the Court enters up satisfaction of the decree? The solution of the question requires a consideration of some of the more important sections in the Code relating to Court sales.

31. It is abundantly clear from Section 65 of the Code that the property does not vest in the auction purchaser until the sale has become absolute. I do not overlook the actual words of Section 65 which provides that the property shall be deemed to have vested in the-purchaser from the time when the property is sold and not from the time when the sale becomes absolute. Section 65 creates a statutory fiction, but as that section) makes it quite clear, the fiction comes into play when the sale has become absolute and not a moment sooner. The reason is obvious. A period of at least thirty days must expire from the date of sale before the sale can become absolute. During; that period the sale is liable to be set aside at the instance of the judgment-debtor on the ground of irregularity in publishing or conducting the sale under Order 21, Rule 90 of the Code or on deposit by him in Court of the amount specified in the sale proclamation together with a percentage on the purchase money by way of compensation to the purchaser tinder Order 21, Rule 89. It is also liable to be set aside under Order 21, Rule 91 at the instance of the auction purchaser on the ground that the judgment-debtor had no saleable interest in the property sold. A judicial sale is therefore liable to be set aside; and it is for this reason that the Code provides in Rule 92 that where no application is made under Rule 89, Rule. 90 or Rule 91 or where such application is made and disallowed the Court shall make an order confirming the sale and thereupon the sale shall become absolute. Now let me turn to Section 65 which provides that where immovable property is sold in execution of a decree and such sale has become absolute the property shall be deemed to have vested in the purchaser from the time when the property is sold and not from the time when the sale becomes absolute. This section has a long history behind it; but it is not necessary for me to deal with it except to point out that the emphasis is on the words "and such sale has become absolute." It is obvious therefore that the statutory fiction created by Section 65 comes into play only when the sale has become absolute.

32. Now if this position be accepted, then it must follow that the entering up of satisfaction of the decree by Court under Order 21, Rule 72 of the Code does not decide the question as to the point of time at which profits must be said to have accrued to the assessees. Rule 72 does not say when the Court shall enter up satisfaction of the decree if it allows the purchase money to be set off against the amount due on the decree. I apprehend that if the Court executing the decree

knows its duty it will not enter up satisfaction of the decree until the sale has become absolute. I may turn to the provision of Order 21, Rule 93 of the Code on which reliance was placed by Mr. Jayaswal. That rule provides that where a sale of immovable property is set aside under Rule 92, the purchaser shall be entitled to an order for repayment of his purchase money, with or without interest, as the Court may direct, against any person to whom it has been paid. Mr. Jayaswal contends that this rule clearly contemplates that the decree-holder may be entitled to withdraw the purchase money from Court if the property is purchased by a third person, and he argues that if in this case a third party had purchased the properties and the decree-holder had withdrawn the money from Court it could not be urged that the profits did not accrue to the decree-holder at the date of such withdrawal. But Rule 93 itself provides that if the sale is set aside the purchaser shall be entitled to an order for repayment of his purchase money. A case of this nature is not before us, for the properties have been purchased by the decree-holders and not by a third party. But I apprehend that the decree-holder would hardly deal with the money so withdrawn as his profit, so long as the sale was liable to be set aside. The question has been debated in England as to when a profit is actually earned In Commissioner of Taxes v. Molborne Trust Ltd. [1914] A.C. 1001 their Lordships of the Judicial Committee said that a profit; can be said to be earned when it is dealt with as a profit. They agreed that in ordinary cases this synchronises with the realisation of the sums that swell the assets of the person or company; but they pointed out that a person or a company is entitled to hold a part of their realisations in suspense so that such realisations can hardly be said to be profits so long as they are held in suspense.

33. Assuming that in this case a third party had purchased the properties, and assuming that the assessees were allowed to withdraw the purchase money subject to the statutory liability to bring the money into Court if the sale was set aside under Rule 92 of the Code, could it be said as a matter of law that the purchase money so withdrawn was a profit in the hands of the assessees? I apprehend that the answer must be that it would be regarded as a profit if in fact it was dealt as such by the assessees; but that it would not be a profit if it was held in suspense by the assessees. It would, in my judgment, be open to the assessees to hold the money in suspense and to say to the Income Tax Officer, if any attempt was made to tax it.

We do not know our position with respect to this money until the sale has become absolute, for there is a statutory obligation on us to bring it into Court, should the sale be set aside under Order 21, Rule 92 of the Code. Please call when the sale has become absolute; for until then we do not propose to deal with the money as in any way belonging to us.

34. In my judgment such an answer would be conclusive to any attempt on the part of the income tax-Officer to tax the money before confirmation of sale.

35. But as I have said we are not concerned with the question as to what the

position would have been, had the properties been purchased by a third party. The only question before us is whether, the decree-holders having purchased the properties, it can be said that the profits accrued when the Court entered up satisfaction of the decree. In my opinion the answer must be in the negative for the reason that such entering up of satisfaction of the decree is liable to be recalled if the sale is ultimately set aside. We were invited to consider the case of two merchants having claims against each other and we were asked whether it could not be said that incomes actually accrued to them, though nothing was in fact received by either of them, if they set off their claims against each other. In my judgment such a case is not parallel to this. In the case of merchants, the set off is final, absolute and decisive; but, in a case of this nature, it is conditional on the sale becoming absolute; and, as have said, no Court knowing its duty would enter up satisfaction of the decree before the sale has become absolute.

36. But in truth I regard the transaction as something entirely different. The Srinagar Raj might have sold the properties to the assessee in satisfaction of their liability to the latter. They did not voluntarily sell the property; but in my judgment the involuntary sale stands exactly on the same footing as a voluntary sale. If this be so, then, the statutory fiction notwithstanding, it is impossible to say for the purpose of the Income Tax Act that the profits were realized by the assessees at any time before the sale became absolute. I will apply one simple test. Could the assessees apply for delivery of the properties to them before the sale became absolute? Order 21, Rule 95 is clear on this point. That rule provides that

where the immovable property sold is in the occupancy of the judgment-debtor or of some person on his behalf or of some person claiming under a title created by the judgment-debtor subsequently to the attachment of such property and a certificate in respect thereof has been granted under Rule 94, the Court shall, on the application of the purchaser, order delivery to be made by putting, such purchaser or any person whom he may appoint to receive delivery on his behalf in possession of the property, and, if need be, by-removing any person who refuses to vacate the same.

37. It is obvious that an application under Rule 95 cannot be made until a sale certificate has been granted to the decree-holder under Rule 94. How can it then be said that the profits accrued to the decree-holder at the date of the sale when they were not entitled to an order for delivery of possession of the properties to them? In my opinion the view taken on this point by the Commissioner is right and. it ought to be affirmed.

38. I need not discuss the other question, namely, whether the critical date is the date of delivery of possession which was effected on 30th September 1926. It was not seriously contended that that is the material date to be regarded by us. In my view the profit was a realizable profit at the date when the sale became absolute.

39. The last question argued before us, namely, whether the assessees are entitled to deduct from the profits expenses which are always entailed in taking delivery of possession and effecting mutation, in the collectorate registers must be answered in favour of the view taken by the Commissioner. If I am right in taking the view that the profits must be said to have accrued to the assessees at the date when the sales became absolute, then it must follow that the expenses incurred by the assessees subsequent to that date must be entirely ignored.

40. The learned Commissioner has submitted a question for our consideration u/s 66(1), Income Tax Act. The facts as stated by the learned Commissioner are. These: The total of the decrees passed in favour of the assessees including principal, interest and costs up to the date of the sale was Rs. 27,13,379 and the assessees bought in the mortgaged property for Rs. 25,65,100. The Income Tax Officer was of opinion that the realizations. should first be appropriated to interest and not principal; and he made the assessment accordingly; but the Assistant Commissioner held that the assessees by making a declaration declaring what portion of the amount realised was interest and what portion was principal have made an appropriation in this casa and he accordingly reduced the amount of tax assessed by the sum of Rs. 1,48,279. The question which the Commissioner submits for our consideration is:

When a creditor executes a mortgage decree against a debtor and puts to gala the mortgaged property in satisfaction of the decree if the total sum realised by the sale is less than the total of principal, interest and cost due, is the amount realised to be taken for Income Tax purposes, as credited after satisfaction of costs, first towards the payment of interest, up to the amount of interest due and the balance only credited towards the satisfaction of principal, or, on the other hand, should the profit for Income Tax purposes be taken as what is left over after satisfaction of principal and costs?

41. The view taken by the Commissioner is that the Income Tax Officer was right in holding that realisations should first be appropriated to interest up to the amount of interest due. In stating his own opinion he has relied upon the law of appropriation as propounded by their Lordships of the Judicial Committee in Venkatadri Appa Rao v. Parthasarathi Appa Rao AIR 1922 P.C. 233 and on certain passages in Sir Rash Behari Ghosh''s Law of mortgages. In my opinion it is not necessary to get entangled in the law of appropriation since the position here is perfectly clear. The assessees advanced a sum of money to the Srinagar Raj. They have realised a certain sum of money from them. It is obvious that the profit which has accrued to the assesseos is the sum of money realised by them less the capital sums advanced by them. The learned Advocate-General appearing on behalf of the Crown supports the view of the learned Commissioner. He contends that there is still a sum due to the assessees from the Srinagar Raj; and it may be that they will proceed to realise what is still due to them in subsequent years. Now the question put to us by the learned Commissioner arises on the facts as stated by him. We do not know whether it is possible for

the assessees to recover anything more from the Srinagar Raj. We were not told whether the assessees have taken out execution against the Srinagar Raj to realise what is still due to them. In these circumstances and as there is no material in the record to enable us to decide the point. I am unable to say that the view taken by the Assistant Commissioner is erroneous

42. As all the points raised on behalf of the assessees have failed, they must pay the costs of this reference: hearing fee Rs. 500.

Kulwant Sahay, J.

43. I entirely agree with Das, J. and I have nothing further to add.

Wort, J.

44. This is a case stated by the Commissioner of Income Tax on some nine questions of law. The facts have already been set out in the judgment of my learned brother and it is therefore unnecessary for me to state them. Taking the questions in the order in which they have been put to this Court by the Commissioner, the first is whether notional interest on the first bond can be said to arise in years subsequent to the execution of the second bond and can it be charged to Income Tax subsequently. The argument in this connection on behalf of the assessees sufficiently indicates the meaning of the first question and it is this, that the interest on the bond of 1894 arose or accrued yearly and that had the Income Tax Officer been so minded he could have charged the assessee Income Tax on that interest from year to year whether in fact it was paid by the mortgagor to the mortgagee or not. As that has not been done the interest which had accrued from year to year was capitalized in the bond of 1904 and the right, of the Income Tax authorities to levy Income Tax on that sum has been lost for ever. As we know the interest on 190, bond and the interest on the 1912 bond was received by the assessee as a result of the decree which was obtained in the year 1917: in other words all the loans with interest thereon were ultimately obtained in a lump "sum. Substantially the question is whether the income represented by this interest arose or accrued at such a date as to be assessable in the Income Tax year for which the Income Tax is sought to be charged in respect thereof, that is to say, the Income Tax year of 1926 and 1927. This as we shall see, raises another question. The proceeds of the decree were obtained in the year 1924-25 or 1925-26 according to what view is taken of the point of law which arises in connection therewith. But that, as I have stated, raises another question which will be dealt with in a moment. The section which is under consideration in this connection is Section 4 which provided that:

save as hereinafter provided, this Act shall apply to all income, profits, or gains, (as described or comprised in Section 6) from whatever source derived, accruing or arising, or received in British India, or deemed under the provisions of this Act to accrue, or arise or to be received in British India,

46. It is said that this income from these mortgagors accrued or arose in the

years in which the mortgagor became liable to pay interest and it is pointed out that the section to which I have made reference uses the words "to accrue, or accruing or arising or received" and it is said therefore that it is clear that the Legislature used the expression "accruing" not in the sense of the actual receipt of the income; this is to be gathered from the expression used in the section "or received." Quite apart from the construction of this section, it seems to me to be a very bold proposition to assert that a person might be charged for Income Tax when he may have no income, and the learned Counsel on behalf of the assessee admits that he is driven back to the position in which he must agree that a person may be so charged although he has not received the sums which in fact go to make up his income. This question is not without authority.

47. It is true that the decision which has been quoted, and which I refer to, is not binding on this Court, but it is, if I may be allowed to say so with great respect, a very weighty decision on the very subject which is debated before us. It is a case of St. Lucia Usines and Estates Co. Ltd. v. Colonial Treasurer of St. Lucia [1924] A.C. 508. In that case a Company ceased to carry on their business and sold their assets in the year 1920. A part of the purchase price was left unpaid and was secured by, what is known locally, as "vendor''s privilege" with a covenant to pay on the following year 30th November that sum so left together with interest at 6 per cent, from 19th November 1920. Interest was not paid and the Company obtained & judgment and was subsequently paid. The Company was held liable to pay Income Tax on the proceeds of the judgment or a part thereof. Lord Wrenbury delivering the opinion of the Board stated that the Income Tax was an annual tax on income derived from any source and is due and payable in respect of the year in which it is assessed, and that the section under the Income Tax Ordinance then under consideration was Section 3 which enacts that every person receiving income or to whom income shall accrue shall in respect of such income pay an annual Income Tax at certain defined rates. He points out that for the purpose of the local Income Tax law it is necessary either to show that the person sought to be charged was a person residing in the colony or a person not residing in the colony but having income derived from a source in the colony, and he points out that the question for determination was whether in the year 1921 the Company had income derived from a source in the colony: it should be remembered that they were held not to be residents in a colony in "that year. It is pointed out that the respondent, that is the Colonial Treasurer of St. Lucia argued that the interest on the unpaid sum had accrued in the year 1921 and therefore the Company could be made liable. It is pointed out by Lord Wrenbury that the words "income arising or accruing" were not equivalent to the expression "debts arising or accruing" and there must be a "coming in" to satisfy the word "income." As a result it was held that the Company were not liable to be assessed in the year 1921. The mutter under consideration in this case is, both so far as the word itself is concerned and the general proposition underlying the statute and the ordinance, the same. To repeat the words of Lard Wernbury in order that this income by way of interest should have accrued, there must be

something to satisfy the word income,'' that is to say, there must be some ''coming in'' to come within the provision of the Income Tax law. In my judgment it cannot be said that this income by way of interest not being paid accrued from year to year up to the year 1904.

48. Now the other aspect of this question which has been argued is this. First, so far as the bond of 1894 is concerned there was a provision for rests of four month but as regards the bonds of 1904 and 1912 there were rests six monthly. It is argued as an alternative to the argument which I have dealt with in regard to the bond of 1894, interest not having been paid it was capitalized for four months that is, every four months interest then accrued due became capital and interest was to be paid thereon. It is said as a result of this that the payment received by the assessee from these three bonds is a capital accretion and not income within the meaning of the Act at all.

49. I am not certain that this question in this argument really arises on the case stated by the Commissioner. But it does arise, I think, in another form with regard to the bond of 1904. This point has been dealt with by English authorities. I propose to follow them. The first case is the case of Craven''s Mort gage: Davies v. Craven [1907] 2 Ch. 448. The mortgagor in that case covenanted that on his death or on the death of his son, whichever event should first happen, a certain sum of money would be paid to the mortgagee, his executors, administrators or assigns, together with interest at the rate of five per cent per annum and up to the time of such death and if, the aggregate amount of such sum and interest or any part thereof should not then be paid, then and in such case, ascertaining the aggregate, the part so remained unpaid would be paid to the mortgagees, etc., etc., with interest on the aggregate sum or for the unpaid part thereof at the rate of five per cent per annum by equal or half year payments. The interest at the date of his death was unpaid. The executor of the mortgagor then proposed to pay the mortgagee or his executors the principal and interest deducting Income Tax therefrom. The argument on behalf of the mortgagees was that they were not entitled to deduct Income Tax u/s 40, Income Tax Act 1853, because at the time when it was sought to deduct the Income Tax, the amount had become capital sum and not income or to put it in the words of the argument, it was capital and could not be treated as "yearly rate of interest." It is true that the case rests on the construction of an English Act of Parliament; but the same question which we have to determine arose in that case. The major portion of the judgment, however, does not refer to this matter; it is the later paragraph only in which Warrington, J., as he then? was, refers to this question stating that it was argued that this interest became'' capitalized and that there being a contract to capitalize, it ceased to be interest and therefore Income Tax was not deductable. He came to the conclusion that there was no capitalization and there was no agreement to that effect-He states:

I find nothing from that deed to capitalize the interest or to change the character of the interest and make it something which it was not before and that in order to recover this interst the executor of the mortgagee would have to sue the mortgagor''s executor on the covenant for payment of interest.

50. He then refers to the last part of the covenant under consideration to the effect that if the interest is not paid at the right time the unpaid interest is itself to bear interest.

51. The next case is In re Morris Mayhew & Halton [1922] 1 Ch. 126. That was a covenant where a mortgagee was to pay compound interest at the rate of 4 per cent, per annum with annual rests and the same questions which were decided before Warring-ton, J., came to be considered in this case Lord Sterndale in delivering his judgment stated that the expression "yearly rests" added nothing to the matter; the contention in that case being that all that could be deducted was tax on the interest of the last year. It was contended that the words "compound interest" when rests are taken, turns the interest overdue into capital. Therefore when there is a payment to the mortgagee it was a repayment of capital. It was contended! that the word "capitalization" as used in many of the books in this connexion was fallacious and Lord Sterndale points out that:

when these sums of interest came to be paid at the end of the time when payment is made, although interest had been charged on them, and although as a matter of bookkeeping, they had from time to time been added to the capital, they did not cease to be interest.

52. No further statement need be mad? with regard to the matter than what is stated in the judgment to which I have referred. In other words interest was interest whatever you may call it. If it was interest in its inception it remains interest whether you charge interest upon it or not. Now as to the question whether the fact that the consideration for the bond of 1904 was first of all the interest overdue on the bond of 1894 plus a cash payment then made and that the interest was to be charged thereon, had the result of capitalizing the interest on the bond of 1894. This part of the argument more specifically deals with the matter which is put in the first question by the Commissioner, as I have already stated. He puts it in the form of question whether the interest on the bond of 1904 can be said to arise after the year 1904 under these circumstances. It seems to me that making the overdue interest on the bond of 1904 a part of the consideration for the bond of 1904 is nothing more than the condition relating to the bond of 1894 or 1904, that is, that interest being unpaid interest, interest should be charged thereon.

53. It is argued of course that here is a definite contract to capitalize the sum and that the view which was expressed by Warrington, J. in the case of Craven''s mortgage was to the effect that if there had been a contract to capitalize the sum, the question will be decided differently. Here we have all the. essentials of actually turning this interest into capital and therefore the sum of Rs. 2,33,000 cannot be the amount upon which the Income Tax authorities should charge Income Tax. I do not agree with the argument advanced. The most that can be

said with Warrigton, J. judgment in this respect is that he definitely stated in that case that there was no contract to capitalize the interest. I cannot see myself that the transaction which was entered into in 1904 in any way alters the character of the sum of Rs. 2,33,000 which formed one of the liabilities of the mortgagor and was in the first place, at any rate, interest. In my judgment interest remains interest to the last and therefore the first question put to the Court by the Commissioner shall be answered in favour of the Crown. The next question is that when the purchase by the mortgagee in execution of a mortgage decree subject to deposit of security is sufficient to safeguard the interest of a party claiming one-eighth share in the property to be unaffected by the decree, can the sum be deducted as expenditure. I fail to see in any way that the asaessee can have this privilege. As is pointed out in the case, a judgment adverse to the assessee was given in September 1927, that is in a year subsequent to the year on the income of which they are being assessed. I agree with the view expressed by the Commissioner that it may be an expense for the year 1927; but as the matter is not finally disposed of it seems to be open to the Commissioner to decide that it is an expenditure which can be taken into account in a later assessment year.

54. The next question is whether a deduction can be made with regard to a sum of Rs. 1,50,000, which the Courts held to be the value of the encumbrance held by the Baneli Raj being a prior encumbrance. The judgment in this case was given on 18th September 1926, and the same answer which was given to the second question, it seems to me, applies to this.

55. The fourth question is answered by this judgment on the first and should be answered in favour of the Income Tax authorities.

56. The fifth question is whether the transaction in which the mortgagee purchased the mortgaged property is a capital transaction or whether from that transaction it can be said that the mortgagee has recovered the income to which he was entitled by reason of the obligation of the mortgagee to pay him interest In one sense of the word, of course, the transaction is a capital transaction but the question is, can the mortgagee escape from paying the Income Tax on sums of money which have been held to be interest and income therefrom and not capital by real son of the fact that he purchased, when the debt became due by the mortgagor to the mortgagee, the mortgaged property. The real question in this case is whether assuming that part of the debt which represents interest and upon which income-: tax is assessable can, in any sense of the word, be said to have been recovered by the assessee. It appears to me that if the answer is in the affirmative it can not be said that the income received ceased to be income, because he entered into capital transaction a part of the consideration for which was the income so received. That question, in my judgment should also be answered in favour of the Income Tax authorities.

57. The next question in substance is at what date can it be said that the assessee received the income by way of interest assessable in this case. It

shoald be remembered, as I have indicated la discussing the earlier matters, that the mortgaged property was" put up for sale in execution and that the mortgagee himself with the consent of the Court purchased it. He did not receive the money in cash in satisfaction of his judgment debt as he would have done had a third party purchased it. It is contended first of all by the counsel on behalf of the assessee that the sum received in this manner was received on the date of the sale which was in December 1925. The contention on behalf of the Crown, however, is that the sums so received were not received on that date but it was received notionally on the date on which the sale was confirmed. The reason for raising this question appears to be this, that if this was received on the date of the sale then it was received a year before the year, that is to say April 1925 to April 1926, which is to be taken for the purpose of assessing the income for the assessment in question, that is to say the Income Tax year 1926-27. If, however, it was received notionally on the date of the confirmation of the sale it will bring it within, what I may call, the computing year 1925-26.

58. This point was argued as a question of law but I have the gravest doubt whether it was a question of law at all. Mr Jayaswal on behalf of the assessee, as I have already indisated, argues that in fact that which was chargeable to Income Tax in this case was received notionally when the sale took place in December, that is to say, took the form of the judgment-creditor being allowed to exchange his decree or part thereof for the mortgaged property. The reason why I do not think it was a question of law is this: we are not considering when the assessee as purchaser became, if I might use the expression, "absolutely" entitled to the property or when, to repeat myself in other language, the assessee was allowed to use his decree as if it represented cash and in payments for the mortgaged property. It is uncertain whether satisfaction was entered on the date of the sale or shortly after or not or was paid on the date on which the sale was confirmed. In my judgment, however, these are irrelevant matters. It was pointed out in this connexion by the Crown that the transaction was not complete in two ways; first, it had not been confirmed and secondly as a result thereof the whole transaction might hereafter be set aside. However, I do not see any difference in this case from the case of an ordinary commercial transaction which is not represented by the passing of cash or its equivalent but which on a bookkeeping entry shows a profit. As I have said, this appears to me to be not a question of law but essentially a practical one, in other words, it was open to the Income Tax authorities to say to the assessee:

you have entered into a transaction which shows a profit: that profit in your case is income and is therefore taxable; if subsequently it is shown that it is a bad debt you will be entitled to an allowance for it hereafter.

59. What the Crown has done in this case, however, is to say (it is true for their own convenience and interest) that we will not treat this as a complete transaction but until it is complete in the sense of there being no possibility of its being set aside. From the point of view of Income Tax payers generally this was a

concession and it makes no difference for the purposes of this case that it was for the benefit of the Crown that this course was followed in this particular instance. I am firmly of the opinion that this is purely a matter of practice of the Income Tax authorities depending upon the method of accounting of the assessee. It was contended that according to the case stated, so far as the assessee''s accounts are concerned the profits were earned at a later date. As I have said it is a matter of practice and that the Income Tax authorities are entitled to do this and a question of law does not in my opinion arise and the course which they adopted is consistent with the assessee''s book entries. But so far as it is necessary for to decide the matter, the Income Tax Commissioner was within his right and the question must be answered, therefore, in favour of the Crown.

60. The next question is whether the assessee is entitled to deduct the expenses and costs which would entail in taking delivery of possession. In my judgment I think the Commissioner is right that this was an expense subsequent to the accruing of the profit and therefore cannot be said to have been incurred in earning it.

61. The last question is what was the correct method of computing the value of the property acquired by the assessee in this case: whether the prices paid by the assessee or whether the valuation placed upon it by the civil Court commissioners before the sale. I think the answer to this question is that generally and this case seems to be no exception to it, the valuation of a property is that sum which the purchaser thinks it worth while to pay.

62. The last question is one submitted by the Commissioner and it arises in this way: the total amount of interest and costs amounts to Rs. 27,13,379; the purchase price of the property was Rs. 25,65,100. As there was a difference of nearly Rs. 1,50,000 between these two figures, the Income tax Officer sought to appropriate the amount of the purchase price first to interest and then to principal. I have had the advantage of reading the judgment just delivered by my learned brother and I agree with him that the profit which has accrued and upon which the Income Tax in assessable is the difference between the sum realized and the amount of the capital sum advanced.

63. This would, therefore, result; in the amount of purchase price which remained after the deduction of the principal advance being the profit earned on this particular transaction. If at a later date further sums are recovered it would necessarily result in their being treated as interest. This question, I think, should be against the Crown.

