SPECIAL BENCH.

Before Sir Murray Coutts Trotter, Kt., *Chief Justice*, *Mr. Justice Wallace and Mr. Justice Beasley.*

THE COMMISSIONER OF INCOME-TAX, MADRAS, REFERRING OFFICER,

1927, May 4.

v.

A. T. K. P. L. S. P. SUBRAMANIAM CHETTIYAR, RESPONDENT.*

Income-tax Act (XI of 1922), ss. 4 (1), (2), 10 and 13—Loan or advance made, by a person owning a business at Rangoon, to his partnership business in Penang—Interest on advance credited in Rangoon accounts, though no cash was received from Penang—Mercantile basis of accountancy adopted in the Rangoon accounts—Income, whether accrued without or within British India—Liability to income-tax, whether under sec. 4 (1) or sec. 4 (2).

An assessee, who had a business of his own in Rangoon and a partnership business at Penang, advanced a sum of money from the Rangoon funds to the Penang business; it appeared that interest on that advance was credited in the accounts of the Rangoon business, though no amount was actually received from Penang; the assessee had chosen to adopt the mercantile basis in his accounts. On his being assessed to income-tax in respect of such interest, the assessee contended that he was not liable, as it was not income which accrued, arose or was received in British India;

Held, that the interest in question was not profit or gain arising without British India, but was income which properly accrued or arose in British India within section 4 (1) of the Indian Income-tax Act (XI of 1922).

The assessee, having chosen to adopt the mercantile basis of accountancy in keeping his accounts, it is upon that basis, and upon that basis alone, that he was to be assessed to income-tax, under sections 10 and 13 of the Act.

CASE stated under section 66 (3) of the Income-tax Act (XI of 1922) in pursuance of the order of the High Court

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in O.S.A. No. 89 of 1924, calling on the Commissioner of Income-tax to refer the question of law in the case.

The material facts appear from the judgment. The questions referred are stated in the beginning of the judgment.

K. S. Krishnaswami Ayyangar for the assessee.—The advance was not a loan. A person cannot lend to a firm or partnership comprising of himself and others as partners—see *Kashinath Kedari* v. *Ganesh*(1), *Lakshmanan Chetty* v. *Nagappa Chetty*(2), *Commissioner of Income-tax* v. *Arunachalam Chettiar*(3); Lindley on Partnership, pages 150 and 151, as also pages 490 and 491. Legally a partner cannot be a creditor or debtor of a firm of which he is also a partner: See *Ellis* v. *Kerr*(4).

The interest in question was not received by the Rangoon firm. Book entries are not receipts of income. Book entries are not bases for assessment, as they are not receipts of income. See *Standard Life Assurance Co.* v. *Allan*(5), *Gresham Life Assurance Society, Ltd.* v. *Bishop*(6), *Aurangabad Mills, Ltd., In re*(7). Section 13 of the Indian Income-tax Act cannot enlarge the area of taxation laid down in section 4.

M. Patanjali Sastri for the Referring officer.—Section 4 (1) refers to income derived in British India. This income accrued or arose in British India. Receipt in British India need not be shown: See *Re Rogers Pyatt Shellac & Co.* v. *Secretary of State for India*(8), *Commissioners of Taxation* v. *Kirk*(9), Lindley on Partnership, page 686.

The JUDGMENT of the Court was delivered by

BEASLEY, J.

BEASLEY, J.—Two questions are referred to us for decision: (1) In the circumstances of this case can the interest on the loans or advances made by the assessee to the partnership firm at Penang be said to be income accruing or arising in British India within the meaning of section 4, clause (i) of the Indian Income-tax Act, and (2) if

(1) (1902) I.L.R., 26 Bom., 739.
(2) (1918) 34 M.L.J., 408.
(3) (1924) I.L.R., 47 Mad., 660 at 665.
(4) [1910] 1 Ch., 529.
(5) (1901) 4 Tax Cases, 446 (455).
(6) [1902] A.C., 287 (294).
(7) (1921) I.L.R., 45 Bom., 1286.
(8) (1925) I.L.R., 53 Calc., 1 (34).
(9) [1900] A.C., 588.

the answer to the above question is in the negative and if the income is one accruing or arising without British India to a person resident in British India, is the income one received in British India so as to make it taxable under section 4 read with sections 6, 10 and 13 of the Act?

The assessee has a business of his own in Rangoon carried on by an agent, and is interested with another or others in a money-lending business in Penang in which he is the chief partner. From the Rangoon business under his orders a sum of Rs. 78,768-7-3 was transferred in cash to the Penang business. In the books of the Rangoon business a sum of Rs. 12,174 is entered as interest on that money from Penang and the assessee has in respect of that interest been assessed under section 4, sub-section (1) of the Indian Income-tax Act as income accruing, arising or received in British India. The assessee contends that interest so credited in the Rangoon books is interest earned outside British India, that is foreign income and that the crediting of interest in the Rangoon books is merely a book entry and that there has in fact been no actual receipt of the money in Rangoon and that therefore it is not income arising under section 4, sub-section (1) of the Indian Income-tax Act and is not income arising under section 4, sub-section (2) of the same Act because it has never been received in British India. The short answer to that contention in our view is that this interest is not a profit or gain arising without British India. The Income-tax Commissioner does not seek to tax anything that the Rs. 78,768 may have earned in Penang. What he has done is to assess the profits of the Rangoon business under section 10 of the Indian Income-tax Act computed in the manner directed by section 13 of the same Act. Section 13 was no doubt introduced to obviate

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many difficulties. It is a great advantage to both traders and Income-tax officers. It is open to a trader to adopt either the mercantile basis of accounting or the cash basis. He is not forced to adopt one in preference to the other but he cannot adopt both. The assessee in common with most of the business firms in India has chosen to adopt the mercantile basis of accountancy and not the cash basis. He cannot for the purpose of more conveniently carrying on his own business adopt the mercantile basis and then for the purpose of income-tax assessment adopt the cash basis. What is done in accordance with the mercantile basis is that the debit entries made on account of interest due by the assessee to his creditors in foreign places are treated as payments of interest though interest has not actually been paid and such debits are allowed as an expenditure in computing the profits of the assessee's business in British India. Similarly credit entries made on account of interest due by debtors in foreign places to the assessee are treated as payments though that interest has not actually been paid, and admittedly in this case this basis has been adopted and no question as to whether or not interest has actually been received or has actually been paid can under this basis possibly arise. What the assessee seeks to do is, whilst adopting the mercantile basis in regard to all the other entries of interest in his accounts, to adopt an entirely different basis, i.e., cash basis for the purpose of this one entry and to argue that interest has never been received in British India, although it is entered as a profit in exactly the same way as all the other credits of interest are, all the other entries being treated on the mercantile basis as money actually received. The assessee has chosen to adopt the mercantile basis. His own accounts are dead against him and in our view preclude him from arguing here, as

he does, that this interest is income arising outside British India, and not received in British India because in law the transfer, called in the assessee's books an advance to the Penang firm, cannot be a loan. In our view once an assessee has adopted the mercantile basis of accountancy it is upon that basis and upon that basis alone that he is to be assessed. It would be an impossible position if an assessee after having adopted the mercantile basis were to call upon the Income-tax Officers to make a long and difficult inquiry with regard to the various items entered as profits in the accounts of the assessee in order to prove that those sums were actually received in British India. The interest is treated like all the other interest in the assessee's books as a receipt of profit. The money transferred is treated as an advance. The interest is treated as interest on that advance in just the same way as all other interest is treated as interest on loans made to others. Not only that, interest chittas were actually sent to Penang in respect of this interest. The case of *the Gresham Life Assurance Society, Ltd.* v. *Bishop*(1) was referred to by the assessee as a case in support of his contention. But that case has no application to this case, as that was a case of a foreign income whereas in this case on the facts, that is to say the mercantile basis of accountancy voluntarily adopted by the assessee, the interest is income which properly arises under section 4, subsection (1) of the Indian Income-tax Act. Our answer to the first question referred to us is in the affirmative and in view of this answer the second question does not arise. The assessee will pay the costs of this reference Rs. 250 to the Commissioner of Income-tax.

K.R.

(1) [1902] A.C., 287.