FULL BENCH.

Before Mr. Justice Sulaiman, Mr. Justice Banerji and Mr. Justice Ashworth.

IN THE MATTER OF MAKUND SARUP.*

1927 December, 2.

Act No. XI of 1922 *(Indian Income-Tax Act), sections* 2(1)(*a*), 3 *and* 4—*"Agricultural income"—Money-lender taking a usufructuary mortgage of agricultural land and immediately leasing it back to the mortgagor—Rent not liable to income-tax.*

If a person carrying on a money-lending business lends money in the course of such business on the security of lands of which he takes a usufructuary mortgage and if he immediately leases those lands back to the mortgagor with a stipulation for fixed annual payments which amount to a definite percentage on the sum advanced, *held*, that these annual payments should be excluded from the assessment of the profits and gains of his business, as being "agricultural income" within the meaning of section 2(1)(*a*) of the Indian Income-Tax Act, 1922. *Partington* v. *Attorney-General* (1), referred to.

THIS was a reference under section 66 of the Indian Income-tax Act of 1922. One Munshi Makund Sarup, in submitting his income-tax returns for the years 1925-26 and 1926-27, did not include the income derived by him from certain usufructuary mortgages in his favour. The income-tax officer on this discovery came to the conclusion that such income was derived from money-lending business and was not derived from landed property and was, therefore, liable to income-tax. The assessee appealed to the Assistant Commissioner, who, relying upon a Full Bench decision of the Madras High Court in the case of *Subramanya Sastrigal* (reported in Mr. P. R. Srinivasam's Reports of Income-tax cases, Volume II, part III, p. 152), dismissed the appeal. The assessee then

*Miscellaneous Case No. 605 of 1927.

(1) (1869) L.R., 4 E. and I. App., 100.

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requested the Commissioner to refer the question of law which arose in this case to the High Court. The Commissioner made the reference asked for and formulated the question for consideration in the following words :—

"If a person carrying on money-lending business lends money in the course of such business on the security of lands of which he takes a usufructuary mortgage and if he immediately leases those lands back to the mortgagor with a stipulation for fixed annual payments, which amount to a definite percentage ($8\frac{1}{2}$ in the case cited above) on the sum advanced, should those annual payments be excluded from the assessment of the profits and gains of his business, as being agricultural income within the meaning of section 2(1)(*a*) of the Indian Income-Tax Act, 1922"?

THE reference was laid before a Bench of three Judges for disposal.

Sir *Tej Bahadur Sapru*, Munshi *Narain Prasad Asthana* and Munshi *Shiva Prasad Sinha*, for the applicant.

Pandit *Uma Shankar Bajpai*, for the Crown.

THE judgement of SULAIMAN, J., after stating the facts as above, thus continued :—

The main question underlying this reference appears to be whether, if the case is not that of a pure usufructuary mortgage, but one where there is a simultaneous grant of a lease of the mortgaged property to the mortgagor, so that the net result is that the mortgagee obtains regular cash payments representing interest on his capital, the latter is exempted from liability to pay income-tax.

Section 3 of the Act, in the first place, makes all income, profits and gains liable to income-tax, but section 4 contains an exemption clause which, among other matters, provides that the Act shall not apply to "agricultural income." Now agricultural income is defined in section 2, sub-clause (1)(*a*) as being any rent or revenue derived from land which is used for agricultural

purposes and is either assessed to land revenue in British India or subject to a local rate assessed and collected by officers of the Government as such. And under clause (*b*) agricultural income is also income which is derived from such lands by agriculture. These two clauses undoubtedly indicate that the agricultural income can either be derived by a person who is actually carrying on agriculture or cultivation, or it may represent the rent received by him from land which is used for agricultural purposes, though the person who receives the rent may not himself be cultivating that land.

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It seems necessary to clear the ground by first considering the question whether a pure usufructuary mortgagee is liable to pay income-tax. The learned advocate for the Crown has laid great stress on the assumption in the reference that the present assessee is carrying on money-lending business and that it was in the course of such business that he has invested his capital, the return of which is his income from these lands. It is, therefore, his contention that his gains are gains of business and not rent. It may be conceded that the profits made by a usufructuary mortgagee, even though arising out of the land mortgaged to him, are gains of his business, if he has taken this mortgage in the course of his business as an investment. But this concession does not necessarily involve an admission that such gains of business are not rent within the meaning of section 2, so as to exempt him from liability to pay income-tax. The money which actually comes into the hands of a pure usufructuary mortgagee may be rent received direct from tenants or may be the profits from actual cultivation. It is, therefore, either rent derived from land which is used for agricultural purposes, or is income derived from land by agriculture. In either case it is agricultural income. It may also happen to be gains of his business, but that

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does not necessarily take him out of the exemption clause. I am, therefore, clearly of opinion that in the case of a pure usufructuary mortgagee there is no liability to pay income-tax. The position of such a mortgagee is very much analogous to that of a proprietor who is entitled to have his name recorded in the revenue papers and is for the purposes of revenue courts treated as a co-sharer. He is also entitled to sue for arrears of rent, eject tenants and to enter into possession and cultivate the land himself as the proprietor himself could have done. He is further liable to pay Government revenue, which a simple mortgagee is not. His position is analogous to that of a lessee who takes a lease of agricultural lands, say for a fixed period on payment of some *nazrana*. The latter class of transferees cannot be liable to the payment of income-tax. It is thus clear that the income received by a usufructuary mortgagee is really agricultural income, though it just happens to be also a return for the capital invested by him. To hold that he is liable to pay both Government revenue and income-tax would be imposing a double taxation, which is against the policy of the Act.

Coming to the next question, whether, even if a usufructuary mortgagee is not liable to pay income-tax, a mortgagee, who at the same time leases back the mortgaged land to the mortgagor with a stipulation that there would be a fixed annual payment calculated on the basis of the rate of interest agreed upon between the parties, is in a worse position. It seems to me that to hold that such a person is liable to pay income-tax would amount to holding that the transaction is not that of a usufructuary mortgage but almost a simple mortgage. It is impossible to hold in this case that the transaction was not that of a usufructuary mortgage. No doubt the mortgage-deed and the lease were executed on one and the same date and the cross-references in the two documents

indicate that the whole transaction was settled at one time. Nevertheless there are certain distinguishing features which make the position of the present usufructuary mortgagee quite distinct from what it would have been if he had taken a purely simple mortgage. He has under the lease the right to recover rent through the revenue court, which, very often, is a speedy remedy. He has also the security of the fixed amounts being paid to him regularly year after year, with the option of entering into possession on the default of such payment. If he enters into possession after the ejectment of the mortgagor he is entitled to cultivate lands himself or to let the lands to tenants and receive profits from them. Under these circumstances it seems impossible to hold that the position of the assessee is that of a purely simple mortgagee who is liable to pay income-tax.

With regard to the Full Bench case of the Madras High Court relied upon by the Assistant Commissioner, I need only say that the judgement is very brief and contains no reasons in support of the view urged on behalf of the Crown. The learned Judges appeared to have assumed that the finding of fact arrived at by the Commissioner who had made the reference necessarily involved the result of the reference being answered in the negative. Perhaps they meant to assume that the finding of the Commissioner, that in that case the transaction was merely a device to evade the payment of the income-tax and was not in reality a transaction of usufructuary mortgage and the income was not derived from the land but from a business of the mortgagee, was a finding of fact which could not be disturbed. I am not saying that the remarks of the income-tax officer did in reality amount to a finding of fact. But the learned Judges appear to have treated it as such, and on that assumption held that the answer must be in the negative.

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I am, therefore, of opinion that the answer to the question should be in the affirmative, and the annual payments should be excluded from assessment.

BANERJI, J.—I agree. I am of opinion that upon the facts of the present case the income which is derived by the assessee is income which comes within the definition of agricultural income in section 2 (1) of the Income-tax Act. The mere fact that the usufructuary mortgagee has granted a lease to the mortgagor, in my opinion, does not alter what in law is the effect of the document executed by the mortgagor in favour of the mortgagee. It still remains a usufructuary mortgage and in the case of a usufructuary mortgage, although it would come within the definition of business, it is exempted from the operation of the Act by reason of the definition of agricultural income in section 4, which says that any income derived from any rent from land which is used for agricultural purposes is exempted from taxation. In my opinion, in no case can the profit which the usufructuary mortgagee receives be called anything but rent derived from land used for agricultural purposes.

ASHWORTH, J.—I concur. The owner of agricultural land who leases land is admittedly not liable to income-tax on the rent received. A usufructuary mortgagee is, for the time being, the owner of agricultural land, and, so long as the mortgage subsists, he is in the same position as an owner. The Government Advocate attempted to distinguish the rent paid to an absolute owner from that paid to a usufructuary mortgagee, by drawing a very subtle distinction. His argument was that a person purchasing agricultural land must pay the full market price, while a person taking a usufructuary mortgage of that land will never advance the whole market price. Consequently, by reason of the mortgage, he obtains higher profits on the money invested than a pur-

chaser would, and the difference should be regarded as a profit from the business of money-lending. But the price paid for the acquisition of land cannot affect the character of the land acquired. A usufructuary mortgagee is, like the owner of agricultural land, free from payment of income-tax, because the land is liable to land revenue. My researches into the history of land revenue have inclined me to believe that it is in reality a rent claimed by Government but collected under the procedure applicable to a tax. The exception in section 2 of the Income-tax Act, however, proceeds on a different assumption. It is clear that the exemption is made on the ground that the owner, temporary or otherwise, of agricultural land should not be liable to two forms of taxation, land revenue and income-tax.

Ashworth, J.

If we concede that a usufructuary mortgagee is not liable for income-tax in respect of the mortgaged land, provided that the land is agricultural, then the question referred to us amounts to this. Does it make any difference when by means of a lease, forming a single transaction along with the mortgage, the mortgagee restores possession to the mortgagor, and himself, in the form of rent, receives a sum equal to the land revenue plus interest at a definite rate? The answer to this depends on whether the result of the two deeds could have been effected *in toto* by a simple mortgage-deed. My learned brother has shown that this was not the case. The result of the execution of the two deeds is fraught with consequences that would not attach to the execution of a simple mortgage-deed. One transaction differs from the other not merely in form but in substance.

The Commissioner of Income-tax has not suggested in his reference to this Court that the transaction of a usufructuary mortgage and a lease was fraudulent, or colourable, or that the legal consequence of the execution

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of both deeds can be avoided on this ground; but he has referred to a decision of the Madras High Court in which this point is raised.

There can be no doubt that the decision by the Madras High Court was reasonably invoked by the Income-tax Commissioner. It appears, therefore, desirable to examine that decision, both to see how far it is on all fours with the present case, and, if so, on what grounds dissent from it should be expressed. The main distinction to my mind between the reference to the Madras High Court and this reference is that there was undoubtedly forwarded to the Madras High Court an expression of opinion, treated by the Madras High Court as a finding of fact, which is wanting in the reference to this Court. In that reference the Income-tax Commissioner had stated :—

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"The income received or receivable by the capitalist is not income derived from land but income derived from the business of money-lending. It appears to me that taxing authorities and courts in such a case as this must look to the substance of the transaction. The source of the petitioner's income is his money-lending business, and the mortgage and lease back are merely devices adopted partly to protect his capital and partly to secure his business from liability to income-tax. It is evident from the drafting of sub-section 2(1) of the Income-tax Act (XI of 1922), that the object of exemption of agricultural income is to avoid subjecting the income from land to double taxation, once in the form of land revenue and once in the form of income-tax."

On this reference the judgement of the Madras High Court was as follows :—

"The finding of fact in this case necessarily involves that the question propounded in the reference should be answered in the negative."

Now the question of fact found by the Madras High Court was presumably that the income assessed was not derived from land. If this finding had been stated with-

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out reasons, it would clearly have been a simple finding of fact and would have precluded the interference of the High Court. It appears that the Madras High Court treated the reference as containing such a finding of fact, and so it did not discuss the question of law referred to us. In the present reference, on the contrary, all questions that can be raised are left open.

Ashworth, J.

It appears, however, to me desirable to state that if the terms of the reference and the decision of the Madras High Court are rightly reproduced in the publication placed before this Court, what was submitted to the Madras High Court was not merely a finding of fact but a finding of fact based upon an interpretation of the Income-tax Act and on a certain proposition of law, from both of which it is necessary to express dissent. The Act does not make the distinction drawn in that reference between income derived from business and income derived from land. The business of money-lending may bring in an income which is exempt from income-tax on the ground that it is derived from agricultural land. Nor again can the taxing authorities avoid an implication arising from the form of a transaction on the ground that, except for a desire to escape income-tax, the transaction would have taken a different form, which is what is meant in that reference by "looking at the substance of the transaction." It is not unlawful to avoid, by any means not forbidden by law, rendering oneself liable to the payment of income-tax, though it is an offence by false return or by concealment to evade payment of income-tax. In this connection I would quote the remarks of Lord CAIRNS on the interpretation of a Taxing Statute :—

"If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring

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the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any Statute, what is called an equitable construction, certainly such a construction is not admissible in a Taxing Statute, where you can simply adhere to the words of the Statute:" *Partington* v. *Attorney-General* (1).

For the above reasons I would concur in answering the question propounded in the affirmative.

BY THE COURT.—The order of the Court is that the annual payments made to the mortgagee in the circumstances mentioned in the reference are excluded from the assessment of the profits and gains of his business, as being agricultural income. It would appear that this case had three hearings. We fix Rs. 100 per day as fee for both sides. The assessee will have his costs from the Crown.

Reference answered in the affirmative.

Before Mr. Justice Sulaiman, Mr. Justice Banerji and Mr. Justice Ashworth.

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December, 2.

IN THE MATTER OF SHIAM SUNDAR LAL, SHANKAR LAL.*

Act No. II of 1899 *(Indian Stamp Act), section* 57(1), *sub-clause* (b)—*Stamp—Agreement—Document containing an agreement to pay interest, but also containing items constituting a two-sided account.*

The first portion of a document, called a *sarkhat*, contained an agreement to pay interest, and was signed by two persons. Below their signatures was an entry of Rs. 500 as having been advanced to these persons on the same date, and then followed entries of a number of items on the credit and debit sides respectively, which were neither totalled nor signed. *Held*, on a reference by the Board of Revenue, that the document did not constitute more than one agreement and was properly stamped with a stamp of the value of eight annas.

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*Miscellaneous Case No. 845 of 1927.

(1) (1869) L.R., 4 E. and I. App., 100.