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KEDAR NATH GOENKA v. RAM NARAIN LAL.

SIR JOHN WALLIS.

The 3rd defendant, Ram Narayan, preferred a separate appeal to the High Court claiming an independent title to some of the suit properties under a purchase at a sale for arrears of land cess on July 6th, 1914, subsequently to the Court sale. The High Court allowed the appeal on the ground that the suit was barred under Art. 12 of the Limitation Act, as the plaintiff had not sued to set aside the sale for arrears of road cess within the time prescribed. The bid-sheet A.A. shows what was sold was the property exclusively belonging to the judgment-debtor as detailed below, viz., Mahanth Mahabir Das. At the time of this sale the title to the property sold was not in that judgment-debtor but in the plaintiff, and their Lordships agree with the decision in India in *Jwala Sahai* v. *Masiat Khan*(1), that the sale was a nullity, and that the present suit is not barred under Art. 12 of the Limitation Act. For these reasons their Lordships will humbly advise His Majesty that the judgments of the High Court in these appeals to be reversed and the judgment of the Subordinate Judge restored. The appellant's costs in the High Court will be borne by the respondents, and the costs of the appeal to His Majesty in Council as to two-thirds by the 1st defendant and as to one-third by the 2nd defendant, who appeared to support the judgment of the High Court in the principal appeal.

*Solicitors for appellant*: Hy. S. L. Polak & Co.

*Solicitors for 2nd Respondent*: Douglas Grant & Dold.

## PRIVY COUNCIL.

COMMISSIONER OF INCOME-TAX, BIHAR AND ORISSA,

*v.*

MAHARAJADHIRAJ OF DARBHANGA.

*On Appeal from the High Court at Patna.*

* J. C. 1935.

*July* 2.

*Income-tax Act (XI of 1922), ss. 2(1)(a), 4(1) and (3), and 6(iv)—Agricultural Income—Loan by money-lender on*

* PRESENT: Lord Macmillan, Sir John Wallis and Sir Shadi Lal.

(1) (1904) I. L. R. 26 All. 346.

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*"Zarpeshgi lease and usufructuary mortgage"—Thika profits, whether assessable.*

A money-lender lent money on a "zarpeshgi lease and usufructuary mortgage" of agricultural lands under which he was put in possession with the general powers and obligations of an owner to manage the estate, collect rents, pay the Government revenue and taxes and to exercise all powers in relation to raiyats that an owner might exercise and upon terms that after deducting from a gross estimated rental the estimated costs of management and a sum (thika rent) which was to be credited towards discharge of the debt, he was to take the balance (thika profits). On the question whether the thika profits were agricultural income, not assessable under the Act or income from a money-lending business:

*Held*: that the thika profits were agricultural income, not assessable under the Act. Agricultural income is altogether excluded from the Act, howsoever and by whomsoever it may be received. The exemption is conferred indelibly on a particular kind of income and does not depend on the character of the recipient, thus contrasting with the exemption conferred on the "income of local authorities."

Judgment of the High Court affirmed.

Appeal (no. 94 of 1934) from a judgment of the High Court (December 21, 1933) on a Reference by the Commissioner of Income-tax, Bihar and Orissa.

The respondent's father who carried on a large money-lending business lent Rs. 18½ lakhs to the administratrix of an estate known as the Lachmipur estate on terms evidenced by two deeds dater February 3, 1929. By the first deed zamindari lands in the Bhagalpur district were conveyed by the administratrix as lessor-mortgagor to him as lessee-mortgagee "in zarpeshgi lease and by way of usufructuary mortgage with all rights and profits in respect of the properties demised which belong and accrue to the proprietor of the estate as zamindar and malik and administrator" for 15 years from September 19, 1929. The gross average rental was estimated at Rs. 1,59,813 and, under the terms of the lease the lessee-mortgagee was to be put in possession

and manage the properties, collecting rents, paying Government revenue and taxes and having all rights in relation to the raiyats that the lessor-mortgagor had. From the gross rental of Rs. 1,59,813, Rs. 37,530 was to be deducted for expenses and Rs. 31,000 for "thika rent" which was to be credited towards repayment of the zarpeshgi loan. The lessee-mortgagee was to take the balance of Rs. 91,283 as "thika profits". There was no mention of interest in the deed.

The second deed was a lease of zamindari lands in the Santal Parganas under the term of which, after deducting certain specified payments, the balance of the rent was to be credited towards the repayment of the zarpeshgi loan.

The respondent's father died on July 3, 1929, and the respondent succeeded to his properties and money-lending business and entered into possession of the estates conveyed by the said deeds.

In 1931 the Income-tax Officer, in assessing the respondent's income, included the sum of Rs. 91,283 (thika profits) derived from the properties mortgaged under the first deed on the footing of its being interest from money-lending, and, in an appeal by the respondent to the Assistant Commissioner, the decision of the Income-tax Officer was upheld. On a petition by the respondent under s. 66 of the Act, the Commissioner referred to the High Court the questions:

(*a*) Is the Lachmipur bond a simple mortgage or a usufructuary mortgage?

(*b*) Is the income from the Lachmipur property taxable?

The High Court answered the second question in the negative and found it unnecessary to answer the first. From this decision the Commissioner appealed.

*Dunne K. C.* and *Sir Thomas Strangman*, for the appellant. The thika profits, if collected

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by the mortgagor would be agricultural income. In the hands of the respondent it was a source of income from his money-lending business. It was not to go towards the discharge of the debt. Sections 2 and 4 read.

LORD MACMILLAN: Under the Indian Act is it the income that is taxed or the person in respect of his income as in England?

DUNNE: It seems to be the income.

Section 9 was referred to.

In this case the assessee is a money-lender and he has been taxed as such. The profits are the profits of his money-lending business. The transaction was one in the course of the business. The profits are taxable under s. 6(*iv*) as gains from "business" or s. 6(*vi*) "other sources". The money was being collected by the respondent for the mortgagor for the purpose of paying himself the profits. The money was received in his money-lending business and entered in the accounts of the business. The learned Chief Justice, in his judgment found "The source of the income must be considered in its proximate rather than its ultimate significance". That is not the proper test. The respondent did not collect the Rs. 91,000 as rent or revenue. He collected a gross sum and out of that appropriated Rs. 91,000 as interest or profit. When appropriated it is not rent. This is not an investment, but a money-lending transaction.

*Latter K. C.*, *Jayaswal* and *Colombos*, for the respondent. It is the character of the income and not that of the assessee that is to be considered. *John Smith and Son* v. *Moore*(1) referred to. The respondent gets rents and enters them in the zamindari accounts. It is not correct to say he was merely a

(1) (1921) 2 A. C. 13, 39.

manager for the mortgagor. He is a landlord. He takes the risk of profits in rents. He is a rent-receiver and his profits arise solely from land: *Fry* v. *Salisbury House Estate, Ltd.*(1) and *Hoare and Co., Ltd.*, v. *Collyer*(2). There is no personal covenant to pay him interest. He takes the risk of a landlord's position and is either taxed in a particular way or escapes taxation. *Partap Bahadur Singh* v. *Gajadhar Baksh Singh*(3) and *Feroz Shah* v. *Sobhat Khan*(4), referred to. The legal position is defined in the documents. The Act is careful in saving exemptions. Sec. 4(*i*) " save as hereinafter provided ", and s. 6 " save as otherwise provided " clearly save exemptions. Exemptions are based on the character of either (*a*) the property, or (*b*) the person. Agricultural income is exempted under s. 2. Agriculture may be combined with business. If the intention of the Act was that the exemption should be lost if combined with business, it would not have separated the two in s. 4(*2*) and (*3*). *Back* v. *Daniels*(5). One cannot get out of an exemption by saying it is included in something else. Exemption in s. 8 apply to securities. It could not be suggested that, if a person had a business, he would have to pay tax or tax free securities. Agricultural income which is exempted cannot be brought in under s. 12 as " other sources :" *Commissioner of Income-tax, Madras* v. *Subramanya Sastrigal*(6) was overruled by *Ibrahimsa* v. *Commissioner of Income-tax, Madras*(7). *In re Makund Sarup*(8). It is enough for me to show I am enjoying the fruits of land. Salaries in India may be by grant of land. In such cases they would not fall within s. 6(*5*). They would be exempted. The character of

(1) (1930) A. C. 432.
(2) (1932) A. C. 407.
(3) (1902) I. L. R. 24 All. 521, 531.
(4) (1933) I. L. R. 14 Lah. 466; L. R. 60 I. A. 273.
(5) (1925) 1 K. B. 526.
(6) (1925) 2 Ind. Tax Cas. 152.
(7) (1928) I. L. R. 51 Mad. 455.
(8) (1927) I. L. R. 50 All. 495; 2 Ind. Tax Cas. 495.

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income for tax purposes is determined at the moment of receipt and is not affected by subsequent appropriation: *Sundar Das* v. *Collector of Gujrat*(1). Reference was made to the Advocate-General's opinion in the Income-tax Manual. The Legislature intended the meaning given by the Advocate-General or it would have amended the Act.

*Commissioners for Special Purposes of Income-tax* v. *Pemsel*(2) and *Muhammad Yaqub Khan* v. *Commissioner of Income-tax*(3) were referred to.

*Dunne K. C.* replied.

*July 2.* The judgment of their Lordships was delivered by—

LORD MACMILLAN.—The present appeal arises from an assessment to income tax made upon the respondent for the year 1929-30 and the only question before their Lordships relates to an item of Rs. 91,283 included in the assessment. The appellant maintains that this item, the receipt of which is admitted, forms part of the taxable profits or gains of the business of money-lending carried on by the respondent; the respondent maintains, and the High Court has held, that it is "agricultural income" within the meaning of the Indian Income-tax Act and consequently exempt from income-tax.

In order to determine which of these contentions is right, it is necessary to describe briefly the transaction out of which this item of receipt arose. It appears that in 1929 the respondent's father, who carried on an extensive money-lending business, made a loan of 18½ lacs of rupees, with the sanction of the High Court at Patna, to Thakurain Kusum Kumari, widow and administratrix of the late proprietor of the estate of Lachmipur. The transaction was

(1) (1922) I. L. R. 3 Lah. 349.
(2) (1891) A. C. 531, 590.
(3) (1928) 3 Ind. Tax Cas. 308.

embodied in two indentures both dated February 3, 1929. The respondent's father died on July 3, 1929, and the respondent has succeeded to him as his eldest son and heir and as his successor in business.

The first of the indentures is described as a "zarpeshgi lease with usufructuary mortgage" and is granted by Thakurain Kusum Kumari as "lessor mortgagor" in favour of the respondent's father as "lessee mortgagee" in consideration of the loan of 18½ lakhs. The lessor mortgagor thereby grants, demises and conveys in zarpeshgi lease and by way of usufructuary mortgage certain lands in the district of Bhagalpur, forming part of the Lachmipur zamindary, to the lessee mortgagee, to have and to hold the same for fifteen years. After stating that the lessor mortgagor has put the lessee mortgagee in possession, the indenture proceeds to state that the parties have agreed that the lessee mortgagee shall advance the sum of 18½ lacs and that, for repayment of the loan, the lessor mortgagor has given, and the lessee mortgagee has taken, the zarpeshgi lease and usufructuary mortgage. The rent reserved to the mortgagor lessor, and described as the "thika rent", is fixed at Rs. 31,000 arrived at by taking the gross average rental of the properties at Rs. 1,59,813 and then deducting management and other expenses amounting to Rs. 37,530 and "thika profits" Rs. 91,283, leaving Rs. 31,000. This sum of Rs. 91,283, designated "thika profits", is the sum now sought to be assessed. The indenture further provided that the thika rent should form part of the yearly payments which the lessor mortgagor thereby undertook to make in reduction of the loan and should be increased as the amount of the loan diminished by 6 per cent. on the sums repaid with a corresponding reduction in the "thika profits". Other articles of the indenture provided that the lessee mortgagee should maintain the irrigation works, look after boundaries and collect all rents and income of every kind from the properties thereby leased and mortgaged and should peacefully hold and enjoy the same. The leased

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properties were mortgaged and hypothecated as security for payment of the zarpeshgi loan and the lessee mortgagee was given the right to hold over and retain possession of the properties until satisfaction of the entire debt.

The second indenture dealt with certain properties in the Santhal Parganas also forming part of the Lachmipur estate, which could not legally be mortgaged. It is described as an indenture of lease and demised these properties to the respondent's father by way of the lease for fifteen years at a thika rent of Rs. 30,000, the lessee being bound also to pay the Government Revenue charges in respect of the properties comprised in both indentures. Part of the rent was appropriated to certain payments and the balance was to be credited by the lessee " towards the liquidation of the zarpeshgi loan and the usufructuary mortgage in respect of the properties in the district of Bhagalpur in possession of the lessee " under the other indenture. The lessee was entitled peacefully to hold and enjoy the leased properties and to collect all rents, profits and income of every kind therefrom.

The legal position occupied by the respondent's father and now by the respondent in relation to the Lachmipur properties, as the result of the transaction embodied in the two indentures, is thus stated by the learned Chief Justice (Courtney Terrell):—

" The mortgagee lessee was to be in possession of both properties, and, in his relation to the cultivators of the soil he stood in the position of landlord, dealing directly with them and collecting the rents. He had moreover to pay the Government revenue, cesses and taxes and his name was registered in the Land Registration Department. He alone was able to sue for rent whether current or arrears, to sue for enhancement or for ejectment and was able to settle lands with raiyats and tenants in all the properties, in fact he was in a position to take all proceedings which the mortgagor would have been able to take in the ordinary course if the lands leased and mortgaged had remained in her khas possession."

It was not indeed disputed that the rents payable in respect of both properties were rents " 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 Government as such ". The rents thus come within the definition of " agricultural income " in s. 2(1)(*a*) of the Income-tax Act, and the " thika profits " or profit rental of Rs. 91,283, forming part of the rents, are therefore " agricultural income " within the statutory meaning. That being so, the respondent relies on s. 4(*3*) of the Income-tax Act which in terms provides that " This Act shall not apply to the following classes of income.....(*viii*) agricultural income ".

In answer to this *prima facie* conclusive ground for excluding the sum in question from the respondent's assessment the appellant concedes that if the respondent were not a money-lender and if the transaction in virtue of which he receives the rents had not been a transaction entered into in the course of his money-lending business, he would have been entitled to invoke the statutory exemption of agricultural income; but the appellant submits that the fact that the respondent carries on a money-lending business and receives the rents as the result of a transaction entered into in the course of that business makes all the difference. He refers to s. 4(*1*) which prescribes that " this Act shall apply to all income, profits or gains as described or comprised in s. 6 ", which section in turn provides that " the following heads of income, profits and gains shall be chargeable to income-tax..... (*iv*) Business ", and he contends that the item of income in question, while it may be " agricultural income ", nevertheless having been received by the respondent not as an ordinary proprietor or landlord but as part of the income, profits and gains of his money-lending business, it loses the benefit of the statutory exemption of " agricultural income " and becomes assessable as business profits. This is the view which was taken by the Income-tax Officer and by the Assistant Commissioner. It was also the opinion expressed by the Commissioner in referring to the High Court, at the respondent's request, the two

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questions: "(*a*) Is the Lachmipur bond a simple mortgage or a usufructuary mortgage? (*b*) Is the income from the Lachmipur property taxable?".

Their Lordships find themselves in agreement with the learned Judges of the High Court in rejecting the appellant's contention. Sect. 4(*1*) in declaring that "this Act shall apply to all income, profits or gains as described or comprised in s. 6" is prefaced with the words "save as hereinafter provided", and thereinafter in the third sub-section it is expressly provided that "this Act shall not apply to..... agricultural income". Similarly s. 6, which includes "business" among the "heads of income, profits and gains..... chargeable to income tax", opens with the words "save as otherwise provided by this Act". The result, in their Lordships' opinion, is to exclude "agricultural income" altogether from the scope of the Act, howsoever or by whomsoever it may be received. As Ashworth, J. puts it in *In re Makund Sarup*(1), "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." The exemption is conferred, and conferred indelibly, on a particular kind of income and does not depend on the character of the recipient, contrasting thus with the exemption conferred by the same sub-section on the "income of local authorities".

There are no doubt cases where the question whether a particular item of receipt is taxable or not depends upon the nature of the recipient's business. Thus the profit made on the realisation of an investment is taxable income receipt in the hands of an investment company which engages in the business of buying and selling investments but is a non-taxable capital receipt in the hands of an ordinary investor who is not engaged in that business. But in the case just put the question is whether the item is income at all; if it is income it is plainly taxable. In the

(1) (1927) I. L. R. 50 All. 495, 503; 2 Ind. Tax Cas. 495, 501.

present case the item of receipt is admittedly income but it is income which the Act expressly excludes from taxation.

Their Lordships, being of opinion that the High Court has rightly answered question (*b*) in the negative, find it unnecessary, as did also the High Court, to deal with question (*a*). The sum originally assessed appears to have been Rs. 97,283; this is an error and the figure which their Lordships find to be exempt from taxation is Rs. 91,283.

Their Lordships will accordingly humbly advise His Majesty that the appeal be dismissed and the judgment of the High Court affirmed. The respondent will have his costs of the appeal.

*Solicitor for appellant*: Solicitor, India Office.

*Solicitors for Respondent*: Hy. S. L. Polak & Co.

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## APPELLATE CIVIL.

*Before Wort, J.*

1935.

*Feb.* 19.

DISTRICT BOARD OF DARBHANGA

*v.*

SURUJ NARAIN SINHA.*

*Res Judicata—previous decision on a question of jurisdiction only—matter, whether res judicata—Code of Civil Procedure,* 1908 (*Act V of* 1908), *section* 11—*suit brought in the name of Manager, Court of Wards—action, whether maintainable—Court of Wards Act,* 1879 (*Beng. Act IX of* 1879),

* Appeal from Appellate Decree no. 829 of 1932, from a decision of Babu Dwarika Prasad, Subordinate Judge of Darbhanga, dated the 19th of March, 1932, confirming a decision of Babu Kapildeva Sahay, Munsif of Samastipur, dated the 14th of July, 1930.