INCOME-TAX REFERENCE.

Before Sir Arthur Page, Kt., Chief Justice, Mr. Justice Mya Bu, and Mr. Justice Baguley.

IN RE THE COMMISSIONER OF INCOME-TAX, BURMA

1935
Jan. 7.

v.

V.S.A.R. FIRM.*

Income-tax—Method of accounting—Fresh promissory note for old debt—Inclusion of interest due in the fresh promissory note—Interest shown in books as paid—Interest assessed in the past as income—Liability for income-tax.

The assessees, who were a chettiar firm, had adopted for some years past the following method of accounting in transactions with non-chettiar customers. So long as the original promissory note or document was in force only cash receipts from the debtor were shown in the accounts; but when the promissory note or document was cancelled and a fresh one executed for the principal amount and the interest accrued on it the principal and interest were shown in the accounts as paid by the debtor. The creditor accepted the obligation of his debtor under the fresh promissory note in substitution for the old debt and the interest due thereon, and in past years the interest accruing in this manner was always charged with income-tax. The assessees now claimed that such capitalized interest was not liable to income-tax.

Held, that, having regard to the method of accounting adopted by the assessees, there was material to justify the conclusion that the assessees regarded the delivery of the fresh promissory note as amounting to a liquidation of the assessee's claim for interest. Such interest was shown in their books as interest received from the debtor, and was liable to income-tax.

In re The Commissioner of Income-tax, Burma v. *P.L.S.M. Firm*, I.L.R. 12 Ran. 488; *Gresham Life Assurance Society* v. *Bishop*, (1902) A.C. 287; *Mian Feroz Shah* v. *Commissioner of Income-tax, Punjab*, I.L.R. 14 Lah. 682—*referred to.*

Commissioner of Income-tax, Bihar and Orissa v. *Maharajadhiraj of Darbhanga*, I.L.R. 12 Pat. 318; *Raja Raghunandan Prasad Singh* v. *Commissioner of Income-tax, Bihar and Orissa*, I.L.R. 12 Pat. 305—*distinguished.*

A Eggar (Government Advocate) for the Crown.

The question at issue is, where interest is added to principal and a fresh promissory note is executed for the total amount, whether such interest is assessable to income-tax. The income-tax authorities have been in the habit of assessing such interest to tax

* Civil Reference No. 8 of 1934.

1935

In re THE COMMISSIONER OF INCOME-TAX, BURMA *v.* V.S.A.R. FIRM.

because it now ranks as principal, and brings in further interest, and also because assessees like those in the present reference enter such interest as having been received in their books of account.

The label attached to a particular system of accounting is not of much importance. The basis of accounting in the present case should more appropriately have been termed "cash basis", and not "mercantile", because a debt may be repaid in kind as well as in cash; and when the new promissory note is executed the interest due has been repaid in kind.

What the assessees apparently desire is to postpone the levy of tax until later and possibly better years; but they cannot claim the benefit of the decision in *Raja Raghunandan Prasad* v. *Commissioner of Income-tax, Bihar and Orissa* (1); unless their accounts are in suitable form. At present their method of accounting is suitable only to the view which has been taken by the Income-tax Officer, and it cannot be said that there was no material for his decision. *Mian Feroz Shah* v. *Commissioner of Income-tax, Punjab* (2); *The Commissioner of Income-tax, Madras* v. *A.T.K.P.P.L.S.P. Subramaniam* (3) referred to. The decision in *The Commissioner of Income-tax, Burma* v. *P.L.S.M. Firm* (4) does not really touch the subject-matter in issue.

K. C. Bose for the assessees. The system of accounting adopted in the present case is what may be termed the "receipt basis." In such a system of accounting there is no other method by which interest capitalized as in the present case can be entered. If this position is accepted there is no

(1) I.L.R. 12 Pat. 305.
(2) I.L.R. 14 Lah. 483.
(3) I.L.R. 50 Mad. 765.
(4) I.L.R. 12 Ran. 483.

difference between this case and the case of *Raja Raghunandan Prasad* v. *Commissioner of Income-tax, Bihar and Orissa*. Prior to that decision the assessees were under the impression that these amounts were taxable; but that decision points out that they are not assessable.

The Court should look at the substance of the matter, and not merely to the form of the balance sheet drawn up, in deciding whether a particular item is taxable. *The Commissioners of Inland Revenue* v. *The Sterling Trust* (1); *The Gloucester Railway Carriage & Wagon Co., Ltd.* v. *The Commissioners of Inland Revenue* (2).

PAGE, C.J.—This case raises an interesting question; but when the facts are understood, in my opinion, it presents no difficulty.

The question propounded is:

"Whether there was material on which the Income-tax Officer could conclude that the assessees' method of accounting was the mercantile or accrued method in respect of the sum of Rs. 23,373, interest from non-chettyar debtors shown in the assessees' accounts as received, and taxed in the assessment."

Now, in *Mian Feroz Shah* v. *Commissioner of Income-tax, Punjab* (3) Lord Blanesburgh, delivering the judgment of the Judicial Committee, observed:

"Too much emphasis has, they think, throughout the case been attached to the use by the Income-tax Officer and the Assistant Commissioner of the term 'mercantile system.' The finding of both, in its essential substance, was that the appellant's system of accounting, by whatever name called, required the inclusion in his accounts of 1926-27 of the Rs. 90,618 referred to, and the only question open to judicial determination is whether there was any evidence before these officers upon which they might so find."

(1) 12 Tax Cas. 868, 882. (2) 12 Tax Cas. 720, 740.
(3) (1933) I.L.R. 14 Lah. 682 at p. 692.

1935

In re THE COMMISSIONER OF INCOME-TAX, BURMA *v.* V.S.A.R. FIRM.

PAGE, C.J.

These observations apply with equal force to the present case, and the real question that falls for determination is,

"whether there were materials before the Income-tax Officer upon which he could find that the sum of Rs 23,373 was interest upon loans that had accrued to the assessees in the accounting year, and as such was assessable to income-tax for the year 1933-34."

The material facts are set out in the revised case stated by the Commissioner of Income-tax as follows :

"The assessees' actual method of accounting for transactions with non-Chettyars is as follows :—So long as the original pro note or document is in force, only cash receipts from the debtor are shown in the accounts ; but when this pro-note or document is cancelled and a fresh one executed for the amount of the principal of the loan and the interest accrued on it, the principal and the interest are shown in the accounts as paid by the debtor. And it is only logical that the interest should be shown as paid by him since it now ranks as principal earning interest, whereas the original pro-note only bore simple not compound interest. In respect, therefore, of loans to non-Chettyars, for which fresh pro-notes or documents are taken, the assessees abandon the cash method and follow the mercantile method of accounting.

For many years all Chettyars have been assessed without question on these sums of interest included in fresh pro-notes or documents, and shown in their accounts as received. This practice was according to the provisions of section 13 as understood by this Department. Accordingly when the Income-tax Officer came to make the assessees' assessment for 1933-34, and found that they had omitted to include in their return Rs. 23,373, which represented interest for which fresh pro-notes had been taken from non-Chettyar debtors and which was shown in their accounts as received, he included the amount in the assessment. His order was upheld on appeal."

The Income-tax Officer in his assessment order stated :

"In the present case, however, the assessee, according to the custom of the Chettyar community to which he belongs, has

always been treating interest included in the fresh pro-note or mortgage bond taken in a settlement of account to cover outstanding principal and interest as realized, and there has been no objection thereto for the last so many years. Further, the amount is shown in the assessee's books as interest realized both in the interest account and in the accounts of the debtors. This method of accounting has been regularly employed by the assessee as well as other members of his community, and under section 13 I am bound to compute income, profits and gains in accordance with the method of accounting regularly employed by the assessee, and to allow the assessee to exclude the sum of Rs. 23,373-9-0 would be allowing him to change the method of accounting hitherto adopted and thereby not properly deduce the income, profits and gains therefrom. It is also to be noted that the debtors in giving fresh pro-notes for the principal and interest already due have capitalized the amount due to the assessee, and thereby undertaken to pay interest on the capitalized amounts, and that a fresh contract has been entered in place of the old."

The case for the Crown is that the assessees, in order to postpone payment of income-tax until a reduction is made in the rate at which the tax is levied, are wrongfully claiming that this sum of Rs. 23,373 is not income that accrued during the accounting year, but represents unpaid interest due to them for the repayment of which they have received fresh promissory notes from their debtors as security.

Now, it is well settled that a debt may be repaid in kind as well as in bullion. *Gresham Life Assurance Society* v. *Bishop* (1); *Raja Raghunandan Prasad Singh* v. *Commissioner of Income-tax, Bihar and Orissa* (2); and *Commissioner of Income-tax, Bihar and Orissa* v. *Maharajadhiraj of Darbhanga* (3).

In *Gresham Life Assurance Society* v. *Bishop* (1) Lord Lindley observed :

" My Lords, I agree with the Court of Appeal that a sum of money may be received in more ways than one, *e.g.*, by the

(1) (1902) A.C. 287. (2) (1933) I.L.R. 12 Pat. 305.
(3) (1933) I.L.R. 12 Pat. 318.

1935

In re THE COMMISSIONER OF INCOME-TAX, BURMA *v.* V.S.A.R. FIRM.

PAGE, C.J.

transfer of a coin or a negotiable instrument or other document which represents and produces coin, and is treated as such by business men. Even a settlement in account may be equivalent to a receipt of a sum of money, although no money may pass; and I am not myself prepared to say that what amongst business men is equivalent to a receipt of a sum of money is not a receipt within the meaning of the statute which your Lordships have to interpret. But to constitute a receipt of anything there must be a person to receive and a person from whom he receives, and something received by the former from the latter, and in this case that something must be a sum of money. A mere entry in an account which does not represent such a transaction does not prove any receipt, whatever else it may be worth."

And in *In re The Commissioner of Income-tax, Burma* v. *P.L.S.M. Firm* (1) I had occasion to refer to the following observations of Lord Macmillan when delivering the judgment of the Board in *Commissioner of Income-tax, Bihar and Orissa* v. *Maharajadhiraj of Darbhanga* (2) :

"What the officer is directed to compute is not the assessee's receipts but the assessee's income, and *in dubio* what the assessee himself chooses to treat as income may well be taken to be income and to arise when he so chooses to treat it."

and I added

"although book entries purporting to relate to the receipt of income are not necessarily conclusive as to the *quantum* of the income to which they purport to refer, for the real income, profits, and gains that have accrued during each accounting year are in every case to be determined by the Income-tax Officer as a matter of fact."

In the present case the assessees have elected to treat the interest due under the original loans as having been received and paid on the execution and delivery of the fresh promissory notes by the debtors, and the interest is entered as having been received both in the interest account and in the

(1) (1934) I.L.R. 12 Ran. 488. (2) (1933) I.L.R. 12 Pat. 318.

personal accounts of the respective debtors; the creditors accepting the obligations of the debtors under the fresh promissory notes in substitution for the old debts and the interest due thereon, and in past years being content that the interest accruing in this manner should be assessed to income-tax. In these circumstances I am unable to hold that there were no materials before the Income-tax Officer which would justify him in concluding that these sums, amounting in all to Rs. 23,373, represented interest liable to assessment in the year 1933-34.

The assessees rely upon two judgments recently delivered by the Judicial Committee in *Raja Raghunandan Prasad Singh* v. *Commissioner of Income-tax, Bihar and Orissa* (1) and *Commissioner of Income-tax, Bihar and Orissa* v. *Maharajadhiraj of Darbhanga* (2); but, in my opinion, both these cases are clearly distinguishable, and afford no assistance to the assessees. In *Raja Raghunandan Prasad Singh* v. *Commissioner of Income-tax, Bihar and Orissa* (1) the assessees kept their accounts on a cash basis, and did not regard the interest under the old mortgage as having been liquidated by the execution and delivery to them of the new mortgage, and further, in their books of account the assessees in that case did not treat the interest under the old loan as having been received or paid. In *Commissioner of Income-tax, Bihar and Orissa* v. *Maharajadhiraj of Darbhanga* (2) "there was an arrangement affecting the whole indebtedness whereby certain assets were accepted in part satisfaction and promissory notes were taken for the balance;" there was no continuous or open account, and in that case the general rule therefore prevailed that the giving of

(1) (1933) I.L.R. 12 Pat. 305. (2) (1933) I.L.R. 12 Pat. 318.

1935

In re THE COMMISSIONER OF INCOME-TAX, BURMA *v.* V.S.A.R. FIRM.

PAGE, C.J.

the promissory notes did not amount to payment, the promissory notes being merely conditional payment of the debts. In the present case, however, in my opinion, there is material to justify the conclusion that the assessees regarded the delivery of the fresh promissory notes as amounting to a liquidation of the assessees' claim for interest, and the sum of Rs. 23,373 was treated by the assessees both in the interest account book and the books relating to the accounts of the respective debtors as being interest that had been received by the assessees from their debtors. The remedy for the difficulty in which the assessees find themselves in the present case lies with the assessees themselves; for I see no reason why in the future they should not so adjust their accounts as to make it clear that the acceptance of a fresh promissory note is not taken as effecting payment of the interest due under the old loan.

In the circumstances obtaining in the present case, however, I would answer the question as amended in the affirmative. The assessees will pay the costs of the Commissioner, advocate's fee ten gold mohurs.

MYA BU, J.—I concur.

BAGULEY, J.—I agree also.