Privy Council Appeal No. 33 *of* 1947

OUDH CONSOLIDATED APPEALS Nos. 19, 20, 21 & 22 OF 1944.

Raja Mustafa Ali Khan, through Special Manager, Court of Wards, Utraula, District Gonda – – *Appellant*

v.

The Commissioner of Income Tax, United Provinces, Ajmer and Ajmer Merwara – – – – – *Respondent*

The Commissioner of Income Tax, United Provinces, Ajmer and Ajmer Merwara – – – – – *Appellant*

v.

Raja Mustafa Ali Khan, through Special Manager, Court of Wards, Utraula, District Gonda – – *Respondent*

The Commissioner of Income Tax, United Provinces, Ajmer and Ajmer Merwara – – – – – *Appellant*

v.

Raja Mustafa Ali Khan, through Special Manager, Court of Wards, Utraula, District Gonda – – *Respondent*

Raja Mustafa Ali Khan, through Special Manager, Court of Wards, Utraula, District Gonda – – *Appellant*

v.

The Commissioner of Income Tax, United Provinces, Ajmer and Ajmer Merwara – – – – – *Respondent*

Consolidated Appeals

FROM

THE CHIEF COURT OF OUDH AT LUCKNOW

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 12TH JULY, 1948

Present at the Hearing:

LORD SIMONDS
LORD NORMAND
LORD OAKSEY
LORD MACDERMOTT
SIR MADHAVAN NAIR

[*Delivered by* LORD SIMONDS]

This consolidated appeal results from the consolidation of four appeals from the Chief Court of Oudh, all of which relate to assessments of income tax under the Indian Income Tax Act, 1922.

Two appeals relate to the income of Raja Mustafa Ali Khan of Utraula, who will be referred to as " the assessee ", for the year of assessment 1939-40 and two appeals to his income for the year of assessment 1940-41. In each case there is one appeal by the assessee and one by the Commissioner of Income Tax, United Provinces, who will be referred

to as "the Commissioner". The same questions are raised in regard to each year and it will be necessary to state and consider the facts in regard to one year only.

By an assessment order dated the 18th September, 1939, the Income Tax Officer, Gonda, made an assessment for the year 1939-40 on the assessee which included as income from "other sources" (as defined in section 12 of the Act) three separate items as follows:

1. Forest Rs.25,144.
2. Malikana Rs.6,967.
3. Annuity and interest Rs.1,07,000.

These items will be explained later, but it is convenient here to state that, the assessee having appealed against this assessment, the first item was reduced to Rs.21,040 by the Assistant Commissioner of Income Tax and was at this figure upheld by the Income Tax Appellate Tribunal and the Chief Court of Oudh, that the second item has throughout been upheld at the figure of Rs.6,967 less 10 per cent. for expenses, i.e., Rs.6,271, and that the third item was in the first place reduced by the Assistant Commissioner to Rs.61,797, that from his decision the assessee appealed, but the Commissioner did not, that the Appellate Tribunal allowed the assessee's appeal and that its decision was affirmed by the Chief Court. The appeals therefore to their Lordships' Board are by the assessee against assessments in respect of the first item at Rs.21,040 and the second item at Rs.6,271 and by the Commissioner against an order quashing an assessment in respect of the third item in the figure of Rs.61,797.

In the case of each item the question is whether the moneys received by the assessee were exempted from income tax as being "agricultural income" under section 4 (3) (viii) of the Act. With regard to the first item the assessee sought also to raise the question whether the moneys received under that head were not income at all but capital, but it did not appear to their Lordships that this point was open to him upon the present appeal.

The relevant provisions of the Act are as follows:—

"Section 2.—In this Act, unless there is anything repugnant in the subject or context,—

(1) "Agricultural income" means—

(*a*) 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 Crown as such;

(*b*) any income derived from such land by—

(*i*) agriculture, or

(*ii*) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market, or

(*iii*) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in sub-clause (*ii*);

* * * * *

Section 4.—(3) Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them:

(*i*) to (*vii*)

* * * * *

(*viii*) Agricultural income."

In regard to the first item the question referred to the Chief Court of Oudh under section 66 (1) of the Act was as follows:

"Whether income from the sale of forest trees growing on land naturally and without the intervention of human agency, even if the land is assessed to land revenue, is agricultural income within the

meaning of section 2 (1) (*a*) of the Income Tax Act and as such exempt from income tax under section 4 (3) (*viii*) of the Act."

Their Lordships would observe that, inasmuch as (as is stated in the Order passed by the Appellate Tribunal under section 33 of the Act) the Income Tax Officer and the Assistant Commissioner " have devoted considerable parts of their orders to a consideration of the question whether the land is assessed to land revenue or not and have both found it is not so assessed ", and from this finding there has been no dissent, there appears to be little justification for raising the hypothesis in the question referred to the Court. The Chief Court has, however, been content to entertain a question thus referred and their Lordships, since they concur in the conclusion reached by the Court, will take the same course.

As appears from the form of the question, the income under the first head was derived from the sale of trees described as " forest trees growing on land naturally " and the case has throughout proceeded upon the footing that there was nothing to show that the assessee was carrying on any regular operations in forestry and that the jungle from which trees had been cut and sold was a spontaneous growth. Upon these facts the question is whether such income is (within section 2 (1) (*a*) of the Act) rent or revenue derived from land which satisfies two conditions, (*a*) that it is used for agricultural purposes, and (*b*) that it is " either assessed to land revenue or etc.", or alternatively (as, notwithstanding the form of the question, counsel for the assessee was allowed to argue), whether such income was, within section 2 (1) (*b*), income derived from *such* land by agriculture.

It appears to their Lordships that, whether exemption is sought under section 2 (1) (*a*) or section 2 (1) (*b*), the primary condition must be satisfied that the land in question is used for agricultural purposes: the expression " such land " in (*b*) refers back to the land mentioned in (*a*) and must have the same quality. It is not then necessary to consider any other difficulty which may stand in the way of the assessee. His case fails if he does not prove that the land is " used for agricultural purposes ". Upon this point their Lordships concur in the views which have been expressed not only in the Chief Court of Oudh but in the High Court of Madras (see I.L.R. 1946 Madras 745) and the High Court of Allahabad (see 15 I T.R. 98) and elsewhere in India. The question seems not yet to have been decided whether land can be said to be used for agricultural purposes within the section, if it has been planted with trees and cultivated in the regular course of arboriculture, and upon this question their Lordships express no opinion. It is sufficient for the purpose of the present appeal to say (1) that in their opinion no assistance is to be got from the meaning ascribed to the word " agriculture " in other statutes and (2) that, though it must always be difficult to draw the line, yet, unless there is some measure of cultivation of the land, some expenditure of skill and labour upon it, it cannot be said to be used for agricultural purposes within the meaning of the Income Tax Act. In the present case their Lordships agree with the High Court in thinking that there is no evidence which would justify the conclusion that this condition is satisfied.

The second item " malikana " is the subject of the second question referred to the Chief Court which is as follows:

" Whether having regard to the nature and incidents of the tenure in this case, the income of Rs.6,271 realised by the assessee as Malikana in the year of account is agricultural income etc.".

It is necessary then to examine the facts of the case, which can conveniently be taken from the Order passed by the Appellate Tribunal which repeated almost in terms and adopted the finding of fact by the Appellate Assistant Commissioner as to the source and true nature of this sum. In its Order the Tribunal said:

" 7. This due is stated by the Appellate Assistant Commissioner to be peculiar to the Utraula (the Assessee's) Estate, and distinguishable from the (haq) malikhana due which is payable by the under-proprietors to the superior proprietors. The nature of this due is

thus described in the revenue papers (meaning the Appellate Order of the Appellate Assistant Commissioner made on the Assessee's appeal):

> ' During the days of the Nawabs of Oudh the Raja of Utraula was recognised as the Pargana lord and as such retained the right to a small feudal tribute and to manorial dues. From the beginning of the 19th century till the annexation, the Rajas of Utraula could not manage their estate properly on account of the continued warfare between the neighbouring estates. During this period they transferred, made grants of or sold a large number of villages to certain persons for monetary consideration. In doing so they surrendered all their Zamindari and proprietary rights and lost all their title to real property in respect of those villages. They, however, retained the right of a small annual cash payment by virtue of their position as the old " pargana lord." This cash allowance came to be called the " Malikana." The villages otherwise became quite independent and the exclusive property of the purchasers, grantees or transferees.
>
> ' 8. The amount of the malikana was fixed by a settlement decree and is not variable. It is payable whether the land on which it is supposed to be a charge is used for agricultural purposes or not or whether it yields any profits or not. It is admitted that suits for the recovery of this due are cognizable by Civil Courts and not by Revenue Courts. This being so it is impossible to describe this due as rent or as agricultural income. There is no relation of landlord and tenant between the appellant and the proprietors who are liable to pay this amount. . . .' "

Upon these facts their Lordships agree with the Chief Court in holding that this malikana is not agricultural income. It may be conceded that it would never have become payable to the ancestors of the assessee had they not been feudal proprietors of the land. But that does not mean that it is now rent or revenue derived from the land: on the contrary it is paid just because the original proprietors relinquished their claims to the land and it represents the consideration for that relinquishment. The land is in no real sense its source; and even if it is to be regarded as secured by a charge on the land that is no more decisive of the question in the present case than it was in *Maharaja Kumar Gopal Saran Narain Singh* v. *Commissioner of Income Tax, Bihar and Orissa,* 62 I.A. 207.

In conclusion their Lordships would emphasise that in affirming the decision of the Chief Court upon this point they deal solely with malikana which, to use the words of the formal question, has "the nature and incidents of the tenure in this case ".

The third item of " annuity and interest thereon " amounting to Rs.1,07,000 reduced to Rs.61,797 was the subject of the two following questions:

> (*a*) " Whether in the circumstances of the case the sum of Rs.1,07,000 received by the Utraula Estate from the Nanpara Estate during the previous year represents agricultural income, etc.", and
>
> (*b*) " Whether the interest portion of the above receipt represents damages or compensation for wrongful withholding of the annuity money and is as such not assessable to income tax.".

But, as was pointed out by the Chief Court and is admitted by the Commissioner, the first of these questions ignores the fact that the assessment under this head was reduced by the Appellate Assistant Commissioner to Rs.61,797 and no appeal was preferred against this reduction. As has been already stated, the Chief Court has held that this sum is agricultural income and exempt from tax accordingly and against its decision the Commissioner has preferred this appeal.

The facts in regard to the " annuity and interest " now to be considered which are somewhat complex are set out at length in the Statement of Case referred to the Chief Court. Their Lordships think it unnecessary to repeat what is there stated. For the question now to be determined depends

not on the historical origin of the payment but upon its present quality and incidents. It is sufficient then to say that the present payment, which is made under and by virtue of two documents to be presently stated, represents a compromise of a long-standing dispute between the Nanpara Estate and the Utraula Estate. It had been agreed between the parties that as at the 30th June, 1937, there was due from the former Estate to the latter no less a sum than Rs.12.13,079, and a scheme for the liquidation of this sum was made. Shortly stated, it provided that this total sum should be funded and liquidated over a period of 10 years, bearing interest at 3½ per cent. per annum on the unpaid part of the principal amount in the meantime, and should be liquidated by equal annual instalments of Rs.1,45,862 to cover both principal and interest.

At the same time, and as part of the liquidation scheme, a deed of mortgage of certain Nanpara Estate property, dated the 4th September, 1937, and described as a "usufructuary mortgage deed", was executed by the Raja of Nanpara as mortgagor in favour of the Court of Wards, acting on behalf of the assessee the Raja of Utraula, as mortgagee. Simultaneously, and also as part of the scheme, the Court of Wards acting on behalf of the assessee leased back to the Raja of Nanpara by a lease of the same date the whole of the mortgaged property at an annual rent equivalent to the annual instalment payable under the mortgage, namely Rs.1,45,862.

The relevant provisions of this mortgage and lease can now be stated, but it must first be observed that they are genuine documents which are to be taken at their face value, creating in law the relations which they purport to create.

By the mortgage the mortgagor covenanted to pay the mortgagee the sum of Rs.12,13,079 with interest thereon at 3½ per cent. per annum from the 31st July, 1937, to 30th June, 1947, and thereby granted and transferred the property comprised in the mortgage to the mortgagee by way of usufructuary mortgage from the 1st July, 1937, " to the intent that the said premises shall remain in possession of the mortgagee and be charged by way of usufructuary mortgage as security for the payment to the mortgagee of the said principal sum interest thereon and costs till the entire satisfaction of such amount . . . " and he thereby covenanted that he would cause the name of the mortgagee to be entered in the revenue records as mortgagee in possession. And the mortgagee covenanted that if he entered into possession he would (i) collect the rent and other moneys accruing due and payable upon the premises, (ii) out of such rents and moneys pay the Government revenue and cesses and defray the cost of collection and management and the costs incurred in any suit relating to the premises, and (iii) apply the balance, first to the liquidation of all sums payable as interest under the mortgage and the remainder in satisfaction of the principal money secured by the mortgage.

By the Lease the lessor as mortgagee in possession demised by way of " Theka " the mortgaged property for a term of 10 years from the 1st July, 1937, at a yearly rent of Rs.1,45,862 payable annually on the 31st May, the first payment to be made on the 31st May, 1938, and it was thereby provided that the lessee should pay all Government revenue and cesses assessed or imposed on the demised premises and he undertook not to assign or sublet without the lessor's consent.

Thus the assessee went into possession of the property and as mortgagee in possession leased it to the mortgagor. He did not thereby cease to be a mortgagee in possession.

In respect of the annual rent of Rs.1,45,862 payable on the 1st May, 1938 (which date fell within the " previous year " for the purposes of the 1939-40 income-tax assessment), the mortgagor paid various sums amounting in all to Rs.1,07,000. It is the sum of Rs.61,797, part of this sum, which is the subject of the appeal by the Commissioner, and the question simply stated is whether this sum, which was paid as rent

in respect of lands admitted to be used for agricultural purposes and to be assessed to land revenue, was in the hands of the assessee " agricultural income " and as such exempt from tax. Despite the elaborate arguments which have been urged on behalf of the Commissioner, their Lordships entertain no doubt that the Chief Court has correctly answered this question in the affirmative and they think it is immaterial whether any part of this sum in any account as between mortgagor and mortgagee is or ought to be appropriated to the payment of principal or of interest or to any other purpose. They therefore do not propose to analyse the payment nor to consider whether, in so far as any part of it was in respect of a principal sum, that principal sum was itself an aggregate of a principal sum and interest. The salient and decisive fact is that the assessee being in possession of the mortgaged property was entitled to receive and received the rents thereof. It was conceded that if the assessee was truly a usufructuary mortgagee within the meaning of section 57 (*d*) of the Transfer of Property Act, 1882, and in that capacity received the rent in question, it would be in his hands agricultural income and exempt from tax. But it was contended that, if the assessee was not such a usufructuary mortgagee, then, notwithstanding that he went into possession and received the rent, it was not agricultural income. For this reason learned counsel for the Commissioner was at pains to show that the mortgage in question was not a usufructuary mortgage within section 57 (*d*) of the Act. But in their Lordships' opinion it is unnecessary to pursue this question. For the rent of agricultural land received by a usufructuary mortgagee is agricultural income not because he is a usufructuary mortgagee but because, being a usufructuary mortgagee, he has gone into possession and received the rent. So also the assessee, being a mortgagee, usufructuary or other, has gone into possession and the rent that he receives is agricultural income. The law is correctly and succinctly stated by Sir Vepa Ramesam, J., in *Khoyee Sahib* v. *The Commissioner of Income Tax*, 8 I.T.C. 138, in these words: " If the mortgagor receives it [the rent] from the tenants, it is agricultural income in his hands and, when it passes from his hands, it is not. Similarly if the mortgagee collects it from the tenants, it is agricultural income in his hands." The view of the law thus expressed receives confirmation from the decision of the Board in the *Commissioner of Income Tax* v. *The Maharajah of Darbhanga*, 62 I.A. 215. That was a case of usufructuary mortgage: but the language used by Lord Macmillan in delivering the judgment of the Board is equally applicable to the present case. " The exemption ", he said, " is conferred and conferred indelibly, on a particular kind of income and does not depend on the character of the recipient." And again " the result in their Lordships' opinion is to exclude ' agricultural income ' from the scope of the Act howsoever or by whomsoever it may be received." Enough has been said to show that the distinction sought to be made between rent received by a mortgagee " in lieu of interest " and rent received by him but applicable by him, inter alia, in satisfaction of interest cannot be maintained. It is, however, proper to refer to a case much relied on by the Commissioner. In *C.I.R.* v. *Paterson*, 9 Tax Cases 163, a case arising under the English Income Tax Act, it was decided that, where a taxpayer borrowed money from an insurance company and gave certain shares and a policy of assurance to the company as security for the loan, the dividends on the shares being receivable by the company and applicable, inter alia, in payment of the interest on the loan, such dividends were income of the taxpayer for the purposes of supertax. Assuming that this case was correctly decided, and that it has any relevance to the case of a mortgagee in possession of agricultural land in India, matters upon which it is unnecessary to express any opinion, it appears to their Lordships to give no assistance to the Commissioner. For the only result of its application to the present case must be that the rent received by the mortgagee is to be regarded as the income of the mortgagor and this affords no possible ground for saying that it loses its quality of agricultural income.

Their Lordships are therefore of opinion that the whole of the sums mentioned in the third and fourth questions are without distinction to be regarded as agricultural income within the meaning of the Act.

As has been already stated the same considerations apply to the assessment for the years 1940 to 1941 and the same results follow.

Their Lordships are of opinion that the two appeals of the assessee and the two appeals of the Commissioner must be dismissed and they will humbly advise His Majesty accordingly. The assessee and the Commissioner will pay their own costs of the several appeals.

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In the Privy Council

RAJA MUSTAFA ALI KHAN, THROUGH SPECIAL MANAGER, COURT OF WARDS, UTRAULA, DISTRICT GONDA

v.

THE COMMISSIONER OF INCOME TAX, UNITED PROVINCES, AJMER AND AJMER MERWARA

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DELIVERED BY LORD SIMONDS

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