The Commissioner of Income-tax Vs. Janab Hajee Muhammad Sadak Khoyee Sahib (Assessee)

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Court : Chennai

Decided On : Dec-13-1934

Reported in : (1936)70MLJ24

Appellant : The Commissioner of Income-tax

Respondent : Janab Hajee Muhammad Sadak Khoyee Sahib (Assessee)

Judgement :

Ramesam, J.

1. This matter comes on before us on a reference by the Commissioner of Income-tax under Section 66(2) of the Indian Income-tax Act. The facts of the case are these. The assessee Janab Hajee Mohammad Sadak Khoyee Sahib, carries on money-lending business in Viziana-garam within the jurisdiction of the Income-tax Officer, Vizagapatam circle. In the course of his money-lending business he advanced a sum of Rs. 1,50,000 to the Zamindar of Salur in the Vizagapatam District and obtained a mortgage-deed which is Ex. A dated the 8th November, 1928. The document directs the amount of consideration to be paid to various creditors of the mortgagor. It provides for payment of interest at one per cent, per mensem at the end of the year. If the interest is not fully discharged at the end of the year, overdue interest will be added to the principal and will carry compound interest. The principal amount was to be paid within ten years. At the end of ten years if the amount is not paid the mortgagee may file a suit for sale. Possession of 10 out of 21 jeroyati villages in Schedule A attached to the document was delivered to the mortgagee. The other eleven villages were then in the possession of the Maharajah of Vizianagaram who was one of the creditors intended to be paid off from the consideration of this mortgage. The mortgagee himself is to pay off the debt and to take possession of those eleven villages. Certain other villages and in am lands were also mortgaged but without possession. So that the document is a mixture of a usufructuary mortgage and a simple mortgage. It is also provided that the mortgagee may take five per cent, of the gross receipts for establishment charges. After meeting the expenses necessary repairs and after payment of peishkush due to Government the balance is to be credited towards the interest on the bond. If there is any surplus it should be credited towards the principal. No objection is to be raised to the accounts kept by the mortgagee. The peishkush to be paid by the mortgagee is to be the proportionate peishkush. The mortgagor reserves to himself the right of leasing out waste lands and unauthorised cultivations and also resumption of subsequent inams. But the mortgagee is to have the benefit of the additional income so realised. Mining leases may also be issued by the mortgagor but the royalty should go to the mortgagee, and both should have the right of scrutinising the accounts of the mining leases. The mortgagor is to be allowed once a year inspection of the D.C.B., irrigation, etc.

accounts, the muchilikas and other records that may be maintained by the mortgagee and if the mortgagor requires a copy of any of those documents, it should be given. The mortgagor undertakes to deliver all records such as muchilikas, D.C.B., accounts and other records that are with the Maharajah of Vizianagaram. Whenever the debt is paid off the villages are to be put back in the possession of the mortgagor. Under this document the mortgagee has entered into possession. He has also been recognised as the limited proprietor of the estate under the Limited Proprietor's Act, IV of 1911. In the year of account the assessee received Rs. 17,393 slightly less than one year's interest.

2. On these facts the Commissioner of Income-tax wanted to assess the income on the ground that it is not agricultural income. The assessee claimed exemption under Section 4(3)(viii) of the Act. In Ibrahimsa Rowther v. Commissioner of Income-tax, Madras (1928) 3 I.T.C. 33 : I.L.R. 51 Mad. 455 : 54 M.L.J. 524 a Full Bench of five Judges of this Court held that the profit derived from land under the usufructuary mortgage in that case was exempt from income-tax on the ground that it is agricultural income. In that case the profit of the land was to be enjoyed by the mortgagee in lieu of interest, no particular rate of interest being specified. Except this fact there is no other difference between that case and this case. However it is argued before us that that case is distinguishable from this.

3. It will be convenient first to discuss the matter from first principles. Omitting the case where a cultivator is also the owner of the land which he cultivates and therefore enjoys the produce which is an obvious e, the simplest case for consideration is where a perse enjoys the land through his tenants and the tenants pay rent to him either in cash or in kind. In such a case the rent received by the landlord is undoubtedly agricultural income within the meaning pf the Act. Though he himself does not cultivate and may get the rent in money, still it is agricultural produce of his land which he receives in one shape or other. Though the point does not arise, I may add that the existence of an intermediary between the landlord and tenant makes no difference. For instance if a Zamindar gives a farming lease of several of his villages to a farmer of revenue the farmer collects rent from the various tenants and after deducting some percentage for his profits pays the balance to the Zamindar. In such a case not only the receipts by the farmer from the tenants but also the receipts by the landlord from the farmer would be agricultural income. The contrary cannot be suggested. In some of the districts in this Presidency, especially, Ganjam such farming leases usually called Ijara or Mustagari are very common and in some of the Zamindaris that is the only mode according to which a Zamindar enjoys the income of the Zamindari. So far there is no question of mortgage. But now suppose the owner of the land executes a mortgage of his land to a creditor. If the mortgage is simple, the mortgagor himself collects the income from the land and if he then pays it to the mortgagee, even if he pays in kind, in the mortgagee's hands it is not agricultural income but only interest. Having been once received by the owner of the land as agricultural income, further payments by him would not be in the character of agricultural income. But suppose in such a case instead of of the mortgage being a simple mortgage it is a usufructuary mortgage i.e. possession of the land is transferred to the mortgagee. Thereafter the mortgagee collects the rent from the tenants. In such a case it is held in Ibrahimsa Rowther v. Commissioner of Income-tax, Madras I.L.R. (1928)Mad. 455 : 54 M.L.J. 524 : 3 I.T.C. 33 (S.B.) and also in In the matter of, Makund Sarup I.L.R. (1927) All. 495 at 498 (F.B.) (first part of the judgment pp. 497 and 498) and in Commissioner of Income-tax, B. & O. v. Kameshwar Singh (1933) I.T.C. 13 Pat. 336 that the income received by the mortgagee from the

tenants is agricultural income and is exempt from tax, the reason for this being apparently that the mortgagee directly collects it from the tenants just as in the case of a simple mortgage the mortgagor collects it from the tenants. In such a case it might be reasonably argued for the Crown that though the mortgagee collects the rent from the tenants directly, the reason for it is that it is strictly the mortgagor's money but the mortgagor authorises him to collect and take it towards his interest and therefore though it may be agricultural income of the mortgagor when the mortgagee takes it in payment of his own interest it is not agricultural income but merely income from money lending. Though this argument was accepted in the decision reported in Commissioner of Income-tax, Madras v. Subrahmanya 2 I.T.C. 152 which was overed in Ibrahimsa Rowther v. Commissioner of Income-tax, Madras I.L.R. (1928) Mad. 455 : 54 M.L.J. 524 : 3 I.T.C. 33 (S.B.) it was not accepted in the latter case as well as in In the matter of, Makund Sarup I.L.R. (1927) All. 495 and in Commissioner of Income Tax B. & O. v. Kameshwar Singh I.L.R. (1933) Pat. 336 The only reason for this can be that what one has to look to is who receives the rent from the tenants. If the mortgagor receives it 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. What use he puts it to is immaterial. I am not now discussing the question whether this is sound or not. Obviously this is the ratio decidendi of the three cases mentioned. If so such ratio decidendi applies to all cases of usufructuary mortgage.

4. I am unable to distinguish the case before us from those cases on the ground that in this case there is the provision for a deduction of five per cent from the gross profits, or that the mortgagor may ask for inspection of the documents once a year So far as the deduction of five per cent from the gross income is concerned that is the usual expenditure which all landlords have got to incur in collecting the rent, and the mortgagee also, has necessarily to incur such expenditure. But instead of deducting the amount of the actual expenditure the parties fixed it at a certain figure namely, five per cent of the gross collections. I do not see how this can make a difference for the purpose of argument. In both cases it is either really the money of the mortgagor taken by the mortgagee towards his interest and therefore liable to assessment or income directly collected from the tenants by the mortgagee and hence agricultural income not liable to be assessed. The truth is that it has both these characteristics. But the question is which of these we have to look to. According to the three cases mentioned we have to look more to the fact that the collection is made directly by the mortgagee from the tenants and not to the fact that he afterwards credits it for his interest. Similarly the clause relating to inspection can have no bearing on the matter. I can understand that if there is a clause that at the time of the collection a representative of the mortgagor must always follow the officer of the mortgagee keeping an eye on the collections and preventing any possibility of collusion such a clause makes a good deal of difference. For in such a case the collection is all made under the mortgagor's supervision though he is not allowed to take it and only the mortgagee takes it. But in this case it is not even that. It seems to me that the fact that in Ibrahimsa Rowther v. Commissioner of Income Tax (1928)Mad. 455 : 54 M.L.J. 524 : 3 I.T.C. 33 no particular rate of interest is mentioned is also immaterial. Undoubtedly the profits are taken towards interest. If one is curious enough to know at what rate it works one can easily take the average income and make the arithmetic as to how much it comes to as interest. It is possible that the profits may be slightly varying; the interest too may be slightly varying but on the average there is no difficulty in describing that the interest works at such and such a rate, and the profits are obviously taken by the mortgagee towards his interest though without mentioning

the rate at which it works. I do not see therefore how such a thing can make any difference. If in this case we are to hold that the income is not agricultural income but has only the character of interest, it seems to me that we will be doing so in the face of the three cases cited above. It is not possible to hold in that way without dissenting from them.

5. At this stage it may perhaps be mentioned that for all practical purposes the mortgagee is the landholder. He is recognised as proprietor. He pays the peishkush to Government. He undergoes all the trouble of going to the tenants and collecting the rents. It is he who has to exchange muchilikas and Pattas under the Estates Land Act. If a ryot refuses to exchange muchilika or to pay rent it is the landholder that has to undertake legal proceedings for those purposes, and not the mortgagor. It will certainly be anomalous to say that he is not a landholder and the income he collects is not agricultural income though on the other hand it is also true that he is doing all this because interest is due to him on a debt.

6. In my opinion we ought to follow the decision in Ibrahimsa Rowther v. Commissioner of Income Tax, Madras I.L.R.(1928)Mad. 455 : 54 M.L.J. 524 : 3 I.T.C. 33 and leave the Commissioner of income-tax to appeal to the Privy Council if he chooses.

7. There is one point in In the matter of, Makund Sarup I.L.R. (1927) All. 495 which does not arise in the present case. There is a lease back to the mortgagor and the mortgagee takes from the mortgagor ostensibly as rent but really the interest due to him. Sometimes the two may be different. The rent may be much higher than the interest due but the mortgagee takes only the interest due to him. Still it was held in that case that it is agricultural income. (Vide pp. 498 onwards). Here again the only reason for this can be that the mortgagor pays as lessee to the mortgagee. There is a double relationship of landlord and tenant first between the mortgagor and his tenants and secondly between the mortgagee and the mortgagor. As was pointed out in the earlier part of the judgment that ought not to make a difference. But where under the guise of a lease what is taken is really interest which is different from the rent on the land, one may argue that in such a case the lease is merely a mask and the mortgagee merely gets interest. But this argument did not recommend itself to the learned Judges who decided In the matter of Makund Sarup (1927) I.L.R. 50 All. 495 This point does not arise in the present case but I only point out that even in a case beyond the facts of this case it was held that it was agricultural income. In the present case there is no such difficulty. It is not the mortgagor that collects but it is the mortgagee himself that directly collects it from the tenants, and there is no lease back to the mortgagor. So this is an a fortiori case looked at from the point of view of In the matter of, Makund Sarup.2 My answer is that the income is not assessable. Costs to the assessee Rs. 250. Refund ordered of his deposit of Rs. 100.

The Chief Justice:

8. I agree.

King, J.

9. I agree.