in a commercial sense by transferring these shares to the newly formed limited company. In our opinion he did not make any profit or gain and therefore the mere fact that the shares which he transferred had a market value at the date of the transfer higher than the cost price of the shares did not make Sir Homi Mehta liable to pay tax on the difference.

We therefore answer the question submitted to us in the negative. The Commissioner to pay the costs.

Attorneys for Applicant: *N. K. Petigara.*

Attorneys for Respondent: *Kanga & Co.*

Answer accordingly.

P. M. P.

INCOME-TAX REFERENCE

Before Mr. M. C. Chagla, Chief Justice and Mr. Justice Tendolkar.

SIR JOSEPH KAY, APPLICANT *v.* THE COMMISSIONER OF INCOME-TAX, BOMBAY CITY, BOMBAY, RESPONDENT.*

1955 *Sept.* 23

Indian Income-tax Act, (XI of 1922), s. 4 (1) (b) (ii)—Assessee entitled to annuity of £ 500 from Insurance Companies in United Kingdom—£ 275 deducted by such companies for meaning British Income-tax liability on amount of such annuity and only £ 225 received by assessee—Income-tax Department including £ 500 in assessee's total income—Whether Department should have included only £ 225?

J. K., assessee, was entitled to receive £ 500 as annuity from insurance companies in United Kingdom but received only £ 225, £ 275 having been deducted by such companies for payment of British Income-tax on the amount of the annuity which according to the English Income-tax Act was deemed to be the income of such companies. The Income-tax Department included in the assessee's income arising or accruing outside taxable territories the amount of £ 500 which the assessee was entitled to receive. The assessee's contention that only £ 225 actually received by him should be so included was negatived by the Income-tax Appellate Tribunal. On reference,

Held, that the legal fiction making the amount of annuity the income of the companies liable to pay such annuity was only for the purpose of collection of income tax; it could not alter the fact that the annuity was the income of the annuitant. The Department was, therefore, justified in including £ 500 in assessee's total income.

Seth Lalbhai v. *The Commisioner of Income-tax*[1] and *Commissioner of Income-tax* v. *Blundell, Spence Co., Ltd.*,[2] referred to.

Facts appear in the Judgment.

At the instance of the assessee the Income-tax Appellate Tribunal referred the following question to the High Court of Judicature at Bombay.

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*Incame-tax Reference No. 20 of 1955.

1. [1952] 22 I. T. R. 13. 2. [1952] 21 I. T. R. 28.

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Chagla C. J

"Whether the sum of £ 500 or the sum of £ 225 fell to be included in the assessee's total income for the year ending 31-3-1952 for the purpose of assessment for the year 1952-53?"

N. A. Palkhivala, for the Applicant.

M. P. Amin, Advocate General for the Respondent.

Chagla C. J.—Although the question arising out of this reference has been elaborately and ingeniously argued, it is really a very simple one. The assessee Sir Joseph Kay is a resident of this country and he was assessed to tax in the assessment year 1952-53 and in his total income the income arising or accruing to him outside the taxable territories was also included and in this income was included a sum of £500 which the assessee was entitled to receive in the United Kingdom from three insurance companies under annuity policies which he had taken out with those insurance companies, and the only dispute which is the subject matter of this reference is whether the sum of £500 has been correctly included in the total income of the assessee or the correct amount that should have been included is £225.

In fact, the assessee actually received from these three insurance companies £225 and the contention of Mr. Palkhivala is that what is liable to tax is the amount actually received by the assessee, viz. £225, and not £500 which was the amount of annuity which the insurance companies were liable to pay to the assessee. The charging section is s. 4 (*1*) (*b*) (*ii*). The total income includes the income accruing or arising to the assessee without the taxable territories during the relevant year, and the very short question that we have to decide is—what was the income of the assessee in the accounting year in respect of these annuity policies? Was his income £500 as contended by the Department or his income was £225? The reason why these insurance companies in the United Kingdom paid only £225 to the assessee and not £500 is this. By reason of the provisions of the law, to which we shall presently refer, when an annuity is payable out of profits, the English law requires that the payer should pay to the annuitant the amount due to him in respect of the annuity less the income tax payable on the annuity, and the law also provides that the amount of the annuity payable by the payer shall be considered to be the income of the payer and the payer will pay tax on that annuity. In other words, the substance of the matter is that instead of the annuitant paying tax on £500, which tax admittedly amounts to £275, by reason of the method of taxation adopted by British Parliament the payer of the annuity is required to pay the sum of £275, and the law also provides that when the payer pays to the annuitant £225 instead of £500, the annuitant must give a full discharge to the payer of the annuity. It is on these provisions of the English law that the contention is put forward by Mr. Palkhivala that

Sir Joseph Kay's income which accrued to him within the meaning of s. 4 (*1*) (*b*) (*ii*) was only £225 and not £500.

The relevant provision with regard to tax on annuity payable out of profits is to be found in the General Rules applicable to Schedule A, B, C, D and E which are annexed to the English Income Tax Act, 1918, and r. 19 is the material rule. That rule provides that where any annuity is payable wholly out of profits or gains brought into charge to tax, no assessment shall be made upon the person entitled to such annuity, but the whole of the profits or gains shall be assessed and charged with tax on the person liable to the annuity, without distinguishing the same, and the person liable to make such payment, whether out of the profits or gains charged with tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled, on making such payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the rate or rates of tax in force during the period through which the said payment was accruing due. Therefore the rule clearly provides that there shall be no assessment with regard to this annuity upon the person receiving the annuity. It equally clearly provides that the annuity shall be deemed to be the income of the payer of the annuity and that the payer shall pay tax on that annuity and he is entitled to deduct from the annuity the amount of the tax which he is liable to pay. Then the second paragraph of r. 19 (*1*) is important:

> "The person to whom such payment is made shall allow such deduction upon the receipt of the residue of the same, and the person making such deduction shall be acquitted and discharged of so much money as is represented by the deduction, as if that sum had been actually paid."

Therefore the payer receives a complete discharge as far as his debt to the annuitant is concerned when he pays not the full amount of the annuity but the amount of the annuity less the tax payable on that amount.

What is urged by Mr. Palkhivala is that under this rule there is no liability upon Sir Joseph Kay to pay the tax. It is not his liability to pay the tax that is being discharged by the insurance companies. He says that the law imposes a liability upon the payer himself and it is that liability, a substantive liability, which is being discharged when the payer pays tax to the revenue in England. The contention therefore is put forward that what Sir Joseph Kay is entitled to in view of this provision of the law is not £500 but only £225. Attention is drawn to the provisions of s. 18 of our Act and it is pointed out that the scheme of deduction under the two Acts is fundamentaly different. It is said that under s. 18, although an obligation is cast upon the payer of salaries etc., to deduct the tax at the source, the person who is entitled to the salary still remains liable to pay the tax if the tax has not been deducted,

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and it is made clear by s. 18 that the person deducting the tax at the source is deducting it on behalf of the person entitled to the salary. It is also pointed out that under s. 18 (*4*) it is expressly provided:

"All sums deducted in accordance with the provisions of this section shall, for the purpose of computing the income of an assessee, be deemed to be income received."

It is said that in the absence of these provisions under the English law the only part of the annuity which became the income of Sir Joseph Kay is £225 and not £500, that when the insurance companies deducted £275 they were not deducting the sum on behalf of Sir Joseph Kay in order that they should pay the tax on behalf of Sir Joseph Kay, but they were deducting it because the English statute cast an obligation upon the insurance companies to retain this sum, and it was by reason of this statutory obligation that this sum was being paid. What we must really look at is the substance of the legal provisions to which reference has been made and on which reliance has been placed, and we must look at the substance of the matter from only one simple point of view. Whose income was this £275 which was retained by the insurance companies under the provisions of r. 19? It is clear that the tax was payable on the annuity due to Sir Joseph Kay and it was by a legal fiction that the income of Sir Joseph Kay was deemed to be the income of the insurance companies. That legal fiction was imported by the English law in order to collect the tax from the payer of the annuity rather than from the annuitant himself. But the legal fiction cannot possibly change the patent fact that the annuity is that of Sir Joseph Kay and the whole of £500 is the income of Sir Joseph Kay and no part of it is the income of the insurance companies.

It is then urged that even though £500 may be due as a debt by the insurance companies to Sir Joseph Kay, the fact that a debt had accrued to Sir Joseph Kay did not result in law in an income accruing to Sir Joseph Kay. That proposition of law is perfectly sound. A distinction has been drawn (see *Seth Lalbhai* v. *Commissioner of Income-tax*,[3]) between a debt accruing or arising and an income accruing or arising, and the debt does not become income till it comes in, or put in a different language, the debt does not become income till it has been discharged. What Mr. Palkhivala argues is that although the debt might have been £500, £275 were extinguished by statute and only £225 was discharged by the insurance companies, and therefore the only amount which became the income of Sir Joseph Kay was £225 and not £500. That is completely misreading both the position in law and the actual facts that emerge in this reference. There is no extinguishment of the debt or part of it by statute.

3. [1952] 22 I. T. 13.

What the statute provides is that on the insurance companies paying £225 to Sir Joseph Kay the full debt is discharged because the insurance companies have retained £275 which are to be paid as tax on £500. Therefore, this is not a case of extinguishment of part of the debt, viz. £275, but a discharge of the debt in the manner provided by law. Nor is Mr. Palkhivala right when he contends that the debt is only partly paid and not fully paid. He says that even if there is no extinguishment, only part of the debt in fact has been paid to Sir Joseph Kay and that part is £225 and not the whole of £500. In substance the whole debt of £500 has been paid to Sir Joseph Kay. The mode of payment is this : £225 have been actually paid in cash to Sir Joseph Kay, and the balance of £275 is retained by the insurance companies in order to pay the tax which is payable on the sum of £500. It is difficult to understand how the position is different from what it would have been if the insurance companies had paid the full sum of £500 to Sir Joseph Kay and Sir Joseph Kay would have paid £275 to the Income Tax Authorities which he was liable to pay. Surely Mr. Palkhivala then could not have contended that the full sum of £500 has not been paid to him or that the debt has not been discharged. Instead of permitting the insurance companies to pay the full sum of £500 to Sir Joseph Kay and then collecting £275 from him, the taxing machinery set up in England provides that the Taxing Authorities will recover £275 from the insurance companies themselves and permit the insurance companies only to pay £225 to Sir Joseph Kay. It may be that strictly according to the language of the law the insurance companies are not paying £275 on behalf of Sir Joseph Kay, but you cannot get away from the salient fact that they are paying £275 on the income of Sir Joseph Kay and not on their own income.

It is pointed out that in the absence of a provision like s. 18 (4) you cannot consider £275 as the income of Sir Joseph Kay. Section 18 (4) does not make something, which is not the income of the person to whom the salary is due, his income. The legal fiction introduced by s. 18 (4) is that the person, part of whose salary has been deducted at the source, shall be deemed to have received that part of the income for the purpose of tax. But what he is deemed to have received was his income and to repeat, there is no fiction introduced in s. 18 (4) which makes something the income of the person which was not in fact his income. But the fiction that has been introduced in the English law is that the income of Sir Joseph Kay is to be considered the income of the payer of the annuity. But what we are concerned with is not the fiction but the fact and the fact remains and no argument can undermine that fact that £500 was the income of Sir Joseph Kay and no part of it was the income of the payer or of anyone else.

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Any doubt that there might be with regard to the true position is completely set at rest by the provisions to which our attention has been drawn with regard to the refund of income tax. If Sir Joseph Kay was not liable to pay tax on this sum of £500, which tax has been paid by the insurance companies by reason of his total income, he would be entitled to get either a refund of the full amount or a proportionate refund. It is impossible to contend that Sir Joseph Kay should obtain a refund with regard to payment of tax in respect of something which is not his income. The answer given by Mr. Palkhivala is that the Income Tax Act of 1918, V Schedule, paragraph 17 statutorily makes the deduction which has been made by the payer of the annuity part of the total income of the annuitant, and it is because of this that the annuitant becomes entitled to claim the refund. But the very reason why the annuitant is allowed to include in his total income the deduction made by the payer is that the payer is paying tax out of the income of the annuitant and when the annuitant prepares a statement of his total income he is enitled to include in it what has been deducted out of his income for the purpose of payment of tax. Therefore, looking to the whole scheme both of deduction and of provisions with regard to refund, it is clear that the English law does not overlook or ignore the fact that the annuity payable is the income of the annuitant—indeed it would be extraordinary if the British Parliament overlooked the obvious fact,—and that the annuity being the income of the annuitant the easier and the more convenient way of recovering tax would be to recover it from the payer of the annuity rather than from the annuitant himself. But having made that provision it proceeds to make it clear that the annuitant has received the full amount of the annuity, that the payer receives a proper discharge, and that in proper cases the annuitant is entitled to refund of tax if he was not liable to pay tax which the payer of the annuity has paid.

Mr. Palkhivala has relied on a judgment of this Court in *Commissioner of Income-tax* v. *Blundell Spence & Co. Ltd.*[4] What we held there was that the assessee, a non-resident company registered in the United Kingdom with its head office in London, received dividend in respect of some shares held by it in a company which was assessed to income-tax both in the United Kingdom and in India. We held that in grossing up the dividends received by the assessee the income-tax authorities were not entitled to take into consideration the tax paid by the company in the United Kingdom. In our opinion the two cases are not in *pari materia*. The only income of a shareholder is the dividend that he receives on the shares which he holds. The tax which the company pays on its profits is a tax not paid on behalf of the shareholder. The company pays tax on its own

4. (1952) 21 I. T. R. 28.

income which is the profit made during the working of the company, and the shareholder pays tax on his income which is the dividend. But in order that relief should be given to the shareholder and in order that the same income should not be taxed twice, a machinery is introduced into the Income Tax Act by s. 16 (2) and s. 18 (5) by which the shareholder is allowed to gross up the dividend received by him and then to deduct the tax paid by the company which by legal fiction is deemed to have been paid on his behalf. But in the case which we are dealing with there is no legal fiction with regard to the income of the annuitant. The annuity that he receives stands on the same footing as the dividend received by a shareholder, and we are not permitting the income-tax authorities to tax Sir Joseph Kay with the help of some legal fiction introduced into our Income Tax Act for the purpose of dealing with shareholders who have received dividends from Companies here. We are upholding the action of the income-tax authorities in taxing Sir Joseph Kay on the simple finding that in substance and in fact the income of Sir Joseph Kay is £500, that it accrued to him outside the taxable territories and that as he is a resident he is liable to pay tax on that amount.

The question therefore referred to us must be answered as follows :

"The sum of £ 500 fell to be included in the assessee's total income for the year ending March 31, 1952, for the purpose of assessment for the year 1952-53."

The assessee to pay the costs.

Attorneys for Applicant: *Daphtary Farreira & Diwan.*

Attorneys for Respondent: *N. K. Petigara.*

Answer accordingly.

P. M. P.

APPELLATE CIVIL

Before Mr. Justice Gajendragadkar.

MANGILAL KAJODIMAL, PETITIONER (ORIGINAL OPPONENT No. 1) *v.* SHANKAR SHRAVAN NIKAM, OPPONENT (ORIGINAL APPLICANT).*

1955 *Sept.* 27

Civil Procedure Code (Act V of 1908), ss. 2 (2), 96, 144 and 151—Restitution—Whether appeal lies against an order of restitution passed under s. 151.

No appeal lies from an order of restitution passed under s. 151 of the Code of Civil Procedure and not falling within the purview of s. 144 inasmuch as such an order is not a 'decree' as defined under s. 2 (2).

*Civil Revision Application No. 86 of 1954.