Joseph Kay Vs Commissioner of Income Tax, Bombay City, Bombay

Court: Bombay High Court

Date of Decision: Sept. 23, 1955

Acts Referred: Income Tax Act, 1922 â€" Section 16(2), 18, 18(4), 18(5), 4(1)

Citation: AIR 1956 Bom 577 : (1956) 58 BOMLR 126 : (1956) ILR (Bom) 165

Hon'ble Judges: Chagla, C.J; Tendolkar, J

Bench: Division Bench

Advocate: N.A. Palkhivala, for the Appellant; A.G., for the Respondent

Judgement

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 assesses Sir Joseph Kay is a resident of this country and he was assessed to tax in the assessment year 1852-53 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 Ã¯Â¿Â½500/- 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 Ã¯Â¿Â½500/- has been correctly included

in the total income of the assessee or the correct amount that should have been included is Ã¯Â¿Â½225/-.

2. In fact, the assessee actually received from these three insurance companies Ã¯Â¿Â½225/- and the contention of Mr. Palkhivala is that what is liable

to tax is the amount actually received by the assessee, viz., Ã¯Â¿Â½225/-, and not Ã¯Â¿Â½500/- which was the amount of annuity which the insurance

companies were liable to pay to the assessee. The-charging section is Section 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 Ã¯Â¿Â½500/- as contended by the Department or his

income was Ã¯Â¿Â½225/-?

The reason why these insurance companies in, the United Kingdom paid only Ã¯Â¿Â½225/- to the assessee and not Ã¯Â¿Â½500/- 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 Ã¯Â¿Â½500/-, which tax admittedly amounts to Ã¯Â¿Â½275/-by

reason of the method of taxation adopted by British Parliament the payer of the annuity is required to pay the sum of Ã¯Â¿Â½275/-, and the law also

provides that when the payer pays to the annuitant Ã¯Â¿Â½225/- instead of Ã¯Â¿Â½500/-, 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 Section 4(1)(b)(ii) was only Ã¯Â¿Â½225/- and not Ã¯Â¿Â½500/-.

3. The relevant provision with regard to tax on annuity payable out of profits is to be found in the General Rules applicable to Schs. A, B, C, D

and E which are annexed to the English Income Tax Act 1918, and Rule 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 Rule 19(1) is important:

The person to whom such payment is made shall allow such deduction upon the receipt of the rasidue 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.

4. 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 Ã¯Â¿Â½500/- but only

Ã¯Â¿Â½225/-. Attention is drawn to the provisions of Section 18 of our Act and it is pointed out that the scheme of deduction under the two Acts is

fundamentally different.

It is said that u/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, and it is made clear by Section 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 oat that u/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

Ã¯Â¿Â½225/- and not Ã¯Â¿Â½500/-, that when the insurance companies deducted Ã¯Â¿Â½275/- 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 Ã¯Â¿Â½275/- which was retained by the

insurance companies under the provisions of Rule 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 Ã¯Â¿Â½500/- is the income of Sir Joseph Kay and no part of it is the income of the insurance companies.

5. It is then urged that even though Ã¯Â¿Â½500/- 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 Lalbhai Dalpat Bhai Vs. Commissioner of Income Tax, Bombay North, Kutch and Saurashtra, Baroda,

between a debt accruing or arising and an income accruing or arising, and the debt does not become income till it comes in, or gut 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

Ã¯Â¿Â½500/-, Ã¯Â¿Â½275/- were extinguished by statute and only Ã¯Â¿Â½225/- was discharged by the insurance companies, and therefore the only amount

which became the income of Sir Joseph Kay was Ã¯Â¿Â½225/- and not Ã¯Â¿Â½500/-. 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, What the statute provides is that on the insurance companies paying Ã¯Â¿Â½225/- to Sir

Joseph Kay the full debt is discharged because the insurance companies have retained Ã¯Â¿Â½275/- which are to be paid as tax on Ã¯Â¿Â½500/-.

Therefore, this is not a case of extinguishment of part of the debt, viz. Ã¯Â¿Â½275/-, 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 Ã¯Â¿Â½225/- and not the whole of Ã¯Â¿Â½500/-. In substance the whole debt of

Ã¯Â¿Â½500/- has been paid to Sir Joseph Kay. The mode of payment is this Ã¯Â¿Â½ 225/- have been actually paid in cash to Sir Joseph Kay, and the

balance of Ã¯Â¿Â½275/- is retained by the insurance companies in order to pay the tax which is payable on the sum of Ã¯Â¿Â½500/-.

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 Ã¯Â¿Â½500/-

to Sir Joseph Kay and Sir Joseph Kay would have paid Ã¯Â¿Â½275/- to the Income Tax Authorities which he was liable to pay. Surely Mr. Palkhivala

then could not have contended that the full sum of Ã¯Â¿Â½500/- 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 Ã¯Â¿Â½500/- to Sir Joseph Kay and then collecting Ã¯Â¿Â½275/- from him, the taxing machinery set up in England provides that the Taxing Authorities will recover Ã¯Â¿Â½275/- from the insurance companies themselves and permit the

insurance companies only to pay Ã¯Â¿Â½225/- to Sir Joseph Kay. It may be that strictly according to the language of the law the insurance companies

are not paying Ã¯Â¿Â½275/- on behalf of Sir Joseph Kay, but you cannot get away from the salient fact that they are paying Ã¯Â¿Â½275/- on the income of

Sir Joseph Kay and not on their own income.

6. It is pointed out that in the absence of provision like Section 18(4) you cannot consider Ã¯Â¿Â½275/- 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 Section 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 Section 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 Ã¯Â¿Â½500/-

was the income of Sir Joseph Kay and no part of it was the income of the payer or of any one else.

7. 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 J. Kay was not liable to pay tax on this sum of Ã¯Â¿Â½500/- 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, Schedule V, Para 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 entitled 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.

8. Mr. Palkhivala has relied on a judgment of this Court in Commissioner of Income Tax, Bombay City Vs. Blundell Spence and Co. Ltd., . 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 toy 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 share-holder 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 income which is the profit made during the working of the company, and the share-holder 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 Section 16(2) and S, 18(5) by which the share-holder 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 or 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 Ã¯Â¿Â½500/-, 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.

9. The question therefore referred to us must be answered as follows: ""The sum of Ã¯Â¿Â½500/- fell to be included in the assessee''s total income for

the year ending 31st March 1952 for the purpose of assessment for the year 1952-53.

10. The assessee to pay the costs.

11. Answer accordingly.