PETITIONER:
THE COMMISSIONER OF INCOME TAX,MADRAS

Vs.

RESPONDENT:
THE LAKSHMI VILAS BANK LTD.,KARUR

DATE OF JUDGMENT: 08/05/1996

BENCH:
SEN, S.C. (J)
BENCH:
SEN, S.C. (J)
JEEVAN REDDY, B.P. (J)

CITATION:
1996 AIR 2060 JT 1996 (5) 141
1996 SCALE (4)275

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T

Lakshmi Vilas Bank, Karur, respondent herein in course of its usual business of banking, purchases and sells securities for and on behalf of its constituents in consideration of agreed commission/brokerage. During the accounting periods relevant for the assessment years 1964-65 and 1965-66, the Bank purchased certain securities, namely, Madras State Electricity Board Bonds and Madras State Loan Bonds on behalf of its constituents. The usual practice of the Bank in purchasing the securities on behalf Sf the constituents was to require a certain percentage of the face value of the securities to be paid by the constituents in advance-: 2 receipt of the said margin money, the Bank purchased securities at their face value in its own name. Each one of the constituents gave a letter to the Bank undertaking to pay the balance amount on or about the specified date and also undertaking that if they did not pay the balance amount within the stipulated time, the securities would belong to the Bank and the margin money deposited by them would stand forfeited to the Bank. This was in addition to the commission and service charges to which the Bank was entitled.

During the relevant accounting period, the Bank purchased bonds for its constituents at face value of the bonds. The Bank had received margin money from its constituents in respect of these purchases. The constituents failed to pay the balance amount by the stipulated date. The Bank forfeited the margin money and adjusted the same against the purchase price which the Bank had paid for purchasing the securities and showed the balance of the price as the cost of purchasing the bonds. In the income-tax assessments for the assessment years 1964-65 and 1965-66, the Income Tax Officer treated the margin money forfeited by the Bank as income of the year in which the margin money was forfeited and brought the forfeited amount to tax. The

Income Tax Officer was of the opinion that the Bank had no right to adjust the margin money to reduce the purchase price of the bonds. The view taken by him was affirmed by the Appellate Assistant Commissioner. The Tribunal, however, upheld the contention of the Bank that they were entitled to adjust the margin money forfeited by them against the cost of the bonds for arriving at the cost of the securities.

At the instance of the Commissioner of Income Tax, the following question of law was referred to the High Court:

> "Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the sum of Rs.1,69,966/- and Rs.62,563/- in assessment years 1964-65 and 1965-66 respectively received as deposits in the first instance and forfeited at a later stage was not the income of the assessee liable to tax, but that the assessee was entitled to take them into account in arriving at the cost of securities acquired by the assessee when these sums were forfeited?"

The High Court held that when the Bank purchases the securities in their own name, it was really purchasing them for the benefit and on behalf of the constituents. The constituents defaulted in making payment of the balance amount. The High Court was of the view that three things happened simultaneously:

(a} Failure on the part of the constituents to pay the balance of the price agreed to be paid on the bonds.

(b) On such failure, the margin money deposited by the constituents became money of the Bank, and

(c) At the same time, the bonds also became the property of the Bank.

There was nothing in law to prevent the Sank from adjusting the margin money forfeited by it and which had become its own just at that point of time against the cost of the securities. It was, however, held that the profits and gains of the Bank would arise only when the Bank sold the securities or redeem them at the time of maturity if it had become the owner of the securities. Since the Bank became the owner of the securities at the same time when it became the owner of the margin amount also, there was nothing unnatural or illegal for the Bank taking into account this margin amount which had become its money at that time, in arriving at its cost of the securities. For these reasons, the High Court answered the question referred to it in affirmative and against the Department. The Department has now come up in appeal before this Court.

The facts of this case clearly go to show that when the Bank forfeited the margin money deposited by the customers with it, the Bank was doing something which was in course of its usual banking business. After the deposits made by the constituents were forfeited by the Bank, the forfeited amount became Bank’s money. There is no reason why this amount should not be treated as income of the Bank earned in course of carrying on its business. The Bank undertook to buy the securities on behalf of its constituents, served two purposes. In the event of the constituent paying the balance amount, the deposits were to be treated as part payment of the price of the securities. But in the interval between the deposits and the due date of payment of the balance amount, the deposit was to be treated as earnest money liable to be

forfeited. In this case, the Bank bought the securities on behalf of its constituents in course of its business and for the purpose of taking profit. If the contract was duly executed, the Bank would have been entitled to charge brokerage. The entire transaction was a part of the profit making process of the Bank. This is not a case of pre-deposit of money for acquisition of licence or business contract which had to be kept deposited with the principal for the entire duration of the period of contract. Each deposit was made for a specific transaction. The Bank undertook to purchase the securities for and on behalf of its constituents. The Bank's practice was to take a deposit before purchasing the security, which was liable to be forfeited in case of default. The money was received and forfeited incidentally and in the course of day to day banking business. After the forfeiture, the money became Bank's own money. The Income Tax Officer was right in treating this forfeited money as income of the assessee earned in usual course of banking business. The securities purchased by the Bank in its own name became the sold, any profit made would be profit earned by the Bank. The cost of acquisition of the security will be the price actually paid for it. In the instant case, the finding of fact is that the Bank had purchased them at face value. There is no justification in law for reducing the price actually paid by the Bank by reducing it by the amount of margin money forfeited by the Bank. This is a straight-forward case. The Bank has purchased the securities at face value. Its cost cannot be anything less than the price which was actually paid by the Bank. The Bank would have handed over the securities to the constituent if he had not defaulted. In that case, the Bank would have been entitled only to the brokerage. Since the constituent defaulted, the deposit amount was forfeited and the end result of the transaction was that the Bank became full owner of the securities and the amount lying in deposit with it became its own money. The forfeited amount was Bank's income made in course of its banking business and had to be assessed accordingly in the year in which it became the Bank's money. The accrual of income cannot be deferred by adjusting the deposit amount against the cost of the securities. It may have utilised the depcsits although there is no finding of fact to that effect, as part payment of the price of the securities. But after its forfeiture, the deposit amount became the property of the Bank. The money that was utilised for the of reduction of costs of the securities by adjustment of the deposit amount can arise in the facts of this case.

In that view of the matter, we allow the appeal and set aside the judgment of the High Court. The question referred is answered in the negative and in favour of the Revenue. There will be no order as to costs.