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“LEGAL IMPLICATIONS OF INADEQUATELY STAMPED PROMISSORY NOTES”

AUTHORED BY - ALIND GUPTA

Abstract

The paper looks at the legal admissibility of a promissory note in cases where it is not duly stamped. This is looked at particularly in light of the 2006 amendment to the Stamp Act. Part 1 looks at the law dealing with promissory notes. It then touches upon stamping of promissory notes in light of Section 35 of the Indian Stamp Act 1899. Part 2 looks at the position of law before the 2006 amendment and the problems faced by people relying on inadequately stamped promissory notes. Part 3 highlights the change brought by the 2006 amendment in the context of promissory notes. It also mentions the relevant judicial decisions as well as the 178th report of the Law Commission of India which made certain recommendations with respect to stamping of promissory notes.

1. STAMPING OF PROMISSORY NOTE

Promissory note is defined under Section 4 of Negotiable Instruments Act, 1881 as ‘an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking to pay’.¹ No prescribed format is given for a document to be called a promissory note. It has to fulfil all the requirement given under Section 4 of the Negotiable Instruments Act, 1881. One of the most important aspects that has to be looked upon while determining the legal status of a document is the intention of the parties. In absence of intention to create a promissory note, a document technically falling under Section 4 would not be treated as a promissory note.²

Promissory note is used as a substitute of money due to its ability to be encashed at a prescribed time. These are debt instruments that can help a person in getting financing generally from an entity other than bank. Promissory note roughly lies between IOU and loan contract in terms of its legal ramifications. While IOUs merely acknowledge the debt, promissory note goes one step

¹ Negotiable Instruments Act 1881, s4.

² *Laxman Krishanji Mustilwar v Ramesh Amarchand Agrawal* (2002) 1 BC 406.

further towards loan contract to incorporate an unconditional undertaking to pay. Even though it closely resembles a loan contract, it lacks a specific enforcement mechanism e.g. foreclosure in the debtor defaults, which is characteristic feature in a loan contract.³The issues relating to legal enforcement of a promissory note are discussed in the next chapter.

One of the main reasons a promissory note is conceptualized as 'negotiable' is because of its relative flexibility in circulation. Its proximity to money makes it easily transferable and the condition embedded in Section 4 of Negotiable Instruments Act, 1881 ensure that promissory fulfils the essential requisite of certainty.⁴ In order that a promissory note may satisfy its purpose of a medium of exchange and may attract public confidence due to its safety and readiness, the certainty and the scope of contract in all material points and the whole lineage of title must appear on the face of the instrument, and there should be no necessity for the intrinsic enquiries on part of the potential receiver of the negotiable instrument.⁵

By printing currency, the Government earns a commission or profit called seigniorage in economic parlance.⁶ Higher the denomination, higher is the profit earned. Promissory notes are a close substitute of money and are widely used in various transactions. However, these are not issued by the Government or Reserve Bank of India (except promissory notes payable to bearer that are issued by Bank or Central Government by virtue of Section 31 of Reserve Bank of India Act⁷). Since the Government earns profit on printing on money (through the Reserve Bank of India), it is only logical that it earns some revenue on creation and usage of promissory notes, that are in essence a substitute to Government's currency.

Due to this practical consideration, Indian Stamp Act, 1899, provides that a promissory note needs to be stamped in order to be legally admissible in evidence. The purpose of this legislation was clearly elaborated in the Supreme Court decision titled *Chiranji Lal v. Hari Das*⁸ which states:

"The Stamp Act is a fiscal measure enacted with an object to secure revenue for the State on

³ Adam Barone, 'Promissory Note' (Investopedia) <<https://www.investopedia.com/terms/p/promissorynote.asp>> accessed 9 November 2019.

⁴ Bhasyam and Adiga, *The Negotiable Instruments Act* (19th edn, Bharat Law House 2014) 60.

⁵ *Corpus Juris Secundum* (vol 10, West Publishing Company) 519.

⁶ 'All you wanted to know about seigniorage' (Hindu Business Line, September 2017) <<https://www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about-seigniorage/article9844554.ece>> accessed 9 November 2019.

⁷ Reserve Bank of India Act 1934, s31 < https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/RBIAM_230609.pdf> accessed 9 November 2019.

⁸(2005) 10 SCC 746.

certain classes of instruments. It is not enacted to arm a litigant with a weapon of technicality to meet the case of his opponent. The stringent provisions of the Act are conceived in the interest of the revenue.”

In order to enforce this object, Section 3 of the Indian Stamp Act, 1899 provides that ‘every instrument mentioned in that Schedule (I) shall be chargeable with (stamp) duty of the amount indicated in that Schedule’.⁹ Entry 49 of Schedule I covers promissory note as defined under Section 2(22) of the Indian Stamp Act, 1899. Section 2(22) of the Indian Stamp Act provides a wider definition of ‘promissory note’ as compared to the definition contained in Negotiable Instruments Act. The extended meaning only extends to a document:

- i. which includes the promise to pay the sum named out of the particular fund and such amount may or may not be available with the fund; or
- ii. where promise to pay a sum depends upon happening of a condition or a contingency which may or may not happen.¹⁰

This wider net aims to cover non-mercantile promissory notes i.e. those notes that do not contain mercantile incidence of promissory notes.¹¹

Since the requirement of stamp is not an intrinsic requirement of a promissory note but a prerequisite for the purposes of revenue creation, the promissory notes that are not stamped are legally inadmissible in evidence. Section 35 of Indian Stamp Act 1899 provides that *‘Instruments not duly stamped inadmissible in evidence, etc. — No instrument chargeable with duty shall be admitted in evidence for any purpose by any person having by law or consent of parties’ authority to receive evidence, or shall be acted upon, registered or authenticated by any such person or by any public officer, unless such instrument is duly stamped...’*¹²

This has to be read with Section 17 which states:

*‘all instruments chargeable with duty and executed by any person in India shall be stamped before or at the time of execution’.*¹³

By reading Section 35 with Section 17, we can logically conclude that a promissory note needs to be stamped before or at the time of execution in order to be legally admissible in a court of

⁹ Indian Stamp Act 1899, s3.

¹⁰ Khergamvala, *Negotiable Instruments Act* (21st edn, Lexis Nexis Butterworths 2013) 21.

¹¹ Adiga (n4) 93.

¹² Indian Stamp Act 1899, s35.

¹³ *ibid* s17.

law. A person cannot cure this defect by later stamping the instrument because of the clear wording of Section 17.

However, the inadmissibility of unstamped promissory notes has far reaching implications in the economic arena. This was aggravated due to the exception created in the proviso to Section 35 which provided that, unlike other documents, promissory notes and bills of exchanges cannot be admissible even after stamp duty is paid along with the penalty. The legal issues arising out this exception are discussed in the next Chapter.

2. BEFORE 2006 AMENDMENT - LEGAL ISSUES DUE TO INADMISSIBILITY OF INADEQUATELY STAMPED PROMISSORY NOTE

As discussed in the previous Chapter, promissory note is debt instrument which is a close substitute of currency. It can be used for buying goods or availing services on credit. The confidence of the public in such an instrument is contingent on the fact that it will be paid according to the terms mentioned on the face of the instrument. The purpose of law is also to ensure this confidence remains so as to ensure economic relations in the market are discharged smoothly. However, the fact remains that promissory note is not equivalent to currency, it is *merely* a substitute to it. This gap between currency and its substitute can be manipulated to the disadvantage of the creditor who relies on the apparent value of the promissory note.

This fact was brought out due to the exception created in Section 35 proviso (a) which, before the amendment in 2006, read as:

'any such instrument not being an instrument chargeable with a duty not exceeding ten naya paise only, or a bill of exchange or promissory note shall subject to all just exceptions, be admitted in evidence on payment of the duty with which the same is chargeable or, in the case of an instrument insufficiently stamped, of the amount required to make up such duty, together with a penalty of five rupees, or, when ten times the amount of the proper duty or deficient portion thereof exceeds five rupees, of a sum equal to ten times such duty or portion'¹⁴.

This exception disabled the promissory note from being subsequently admissible in evidence even after payment of stamp duty along with the penalty. The normal rule which cured the defect

¹⁴ Indian Stamp Act 1899, s35.

of inadmissibility after payment of stamp duty and penalty was not applied to the case of promissory note. This was ostensibly done to put a higher burden on instruments seeking to be a substitute of money. However, besides leading to a lot of practical problems, it created an inconsistency that just within the statute but also across the statutes which lead to various conflicting judicial decisions.¹⁵

This was primarily because of one reason. Promissory note is created for the discharge of debt. The debt is what gives rise to the promissory note. The *presumption* is that the promissory note is conditional payment of the debt which is discharged only when the promissory note is paid according to terms mentioned in the note. The cause of action on original consideration is merely suspended till the time the promissory note is active. However, if the promissory note is dishonoured or is rendered unenforceable due to any reason, the creditor/payee can fall back on the original cause of action to seek legal remedy.¹⁶

The above mentioned presumption is rebuttable and in specifically these cases the law became extremely hazy. When the promissory note is issued contemporaneously i.e. at the time of creation of debt, and it contains all the terms of contract that give rise to the creation of debt, the debt *merges* with the instrument itself. This had serious consequences when it came to exception created in Section 35 proviso (a) of the pre-2006 Indian Stamp Act. It was because, legally speaking, after the debt has merged with the instrument itself, there was no other cause of action to claim the debt.¹⁷ The instrument was the cause of action and when it became inadmissible by virtue of Section 35(a) proviso (pre-2006), the creditor/payee was left helpless due to Section 91 of the Indian Evidence Act, 1872.

Section 91 of Indian Evidence Act, 1872 bars the production of oral evidence for documents in which terms of contract are contained. It reads as:

“91. Evidence of terms of contracts, grants and other dispositions of property reduced to form of document. — When the terms of a contract, or of a grant, or of any other disposition of property,

¹⁵ YS Rao, ‘Promissory Notes in India’ (Legal Service India) < <http://www.legalservicesindia.com/article/1590/Promissory-Note-in-India.html>> accessed 9 November 2019.

¹⁶ *Maung Chit v Roshan N.M.A. Kareem Oomer* 1934 Rang 389 < <http://document.manupatra.com/Other%20Courts/Rangoon/Pre1950/1930-1939/R340144.htm>> accessed 9 November 2019.

¹⁷ Law Commission of India, *Recommendation for amending various enactments, both criminal and civil* (178th report, December 2001) < <http://10.21.88.204/lawcommissionofindia/reports/178rpt1.pdf>> accessed 9 November 2019

have been reduced to the form of a document, and in all cases in which any matter is required by law to be reduced to the form of a document, no evidence shall be given in proof of the terms of such contract, grant or other disposition of property, or of such matter, except the document itself, or secondary evidence of its contents in cases in which secondary evidence is admissible under the provisions hereinbefore contained.

Exception 1. —When a public officer is required by law to be appointed in writing, and when it is shown that any particular person has acted as such officer, the writing by which he is appointed need not be proved.

Exception 2. — Wills 3 [admitted to probate in 4 [India]] may be proved by the probate.

Explanation 1. —This section applies equally to cases in which the contracts, grants or dispositions of property referred to are contained in one document and to cases in which they are contained in more documents than one.

Explanation 2. — Where there are more originals than one, one original only need be proved.

Explanation 3. — The statement, in any document whatever, of a fact other than the facts referred to in this section, shall not preclude the admission of oral evidence as to the same fact.”¹⁸

Further to make it clear, illustration (b) exemplifies:

“(b) If a contract is contained in a bill of exchange, the bill of exchange must be proved.”

This section precluded the creditor from bringing any oral evidence to prove the existence of debt when the debt merged with the instrument itself. This bar of oral evidence was made clear by the Supreme Court in these words:

*‘if the parties choose to reduce the contract to writing, the implication is excluded by their express bargain, and the document will be the sole evidence of its terms’.*¹⁹

In order to save the creditors from getting duped of their money, the courts started employing different statutory constructions in order to ensure the debt remains alive. One of the most prominent approach was that of ‘money had and received’ or Section 70 of the Indian Contract Act, 1872. The courts interpreted that if the contract cannot be proved, the plaintiff can fall back on the principle of implied promise to claim the debt.²⁰ However, this approach essentially negated the effects of Section 91 of the Indian Evidence Act, 1872 and pre-2006 Section 35 proviso (a).²¹

¹⁸ Indian Evidence Act 1872, s 91.

¹⁹ *Rachpal Maharaj v Bhagwandas* 1950 AIR 272.

²⁰ *Kundan Lal v Sahu Bhikhari Das* AIR 1929 All 254.

²¹ *Lothamasu Rao v Balakotiah* AIR 1973 AP 342.

What also complicated the matters further was the investigation into the nature of promissory note. The fact whether the debt merged with the promissory note was highly contested. This was because the question of absolute or conditional satisfaction of debt was not a question of law but of facts which required looking at the intention of the parties.²²

The legal complexities around the above-mentioned issue were extensively dealt by 7 judge bench of Andhra Pradesh High Court in the case of *Lothamasu Rao v Balakotiah* AIR 1973 AP 342. In this case, the court had to adjudicate upon the legal consequences of inadmissibility of a promissory note which contained the terms of the contract and was issued contemporaneously. The court, after dealing with multitude of case laws, held that when unstamped promissory note is not the basis of debt, the plaintiff can rely upon the original consideration to claim the money and Section 91 of the Indian Evidence Act would not operate as a bar. However, when the debt is claimed on the foot of an unstamped promissory note, there is no recourse for the plaintiff as then Section 91 of the Indian Evidence Act would prevent the plaintiff from producing any oral evidence in regard to the debt.²³

3. CHANGE IN LAW- 2006 AMENDMENT

The previous Chapter highlighted the difficulties faced by the judiciary in establishing the rights and liabilities of parties in cases involving an inadequately stamped promissory note. In order to save the creditors from the rigors of law, the judiciary had to rely on different approaches like ‘money had and received’²⁴, original consideration/oral evidence²⁵, etc. in order to reconstruct his claim to debt. By doing so, it created a lot of inconsistencies and uncertainty with respect to the scope of rights and liabilities of parties dealing in an inadequately stamped promissory note. All this was solely because of the exception created in favour of promissory notes in proviso (a) of Section 35 of Indian Stamp Act, 1899.²⁶ This was echoed by various judgements and reports. The court in *Lothamasu Rao v Balakotiah* (AIR 1973 AP 342), after going through a plethora of cases remarked on the need to amend Section 35 of the Indian Stamp Act, 1899. It stated:

“Before parting with this case, we would like to observe that, if any provision in any enactment

²² *Halsbury’s Laws* (3rd edn) vol 8, 212.

²³ *ibid.*

²⁴ *Kundan Lal v Sahu Bikhari Das* AIR 1929 All 254.

²⁵ *Lothamasu Rao v Balakotiah* AIR 1973 AP 342.

²⁶ YS Rao, ‘Promissory Notes in India’ (Legal Service India) <<http://www.legalservicesindia.com/article/1590/Promissory-Note-in-India.html>> accessed 9 November 2019.

requires an amendment, there cannot be a better one than the provisions of Section 35 of the Stamp Act so as to incorporate a proviso to make an insufficiently stamped promissory note, admissible in evidence by directing the person relying upon it to make the deficit stamp duty and subjecting him to such penalty as the Legislature may deem fit to impose. Such an amendment in our view, would not only bring about uniformity in the law in the various States, but also avoid unnecessary litigation and save quite a lot of judicial time."

Similar concerns were by the Law Commission of India in its 178th report. The Law Commission lamented the fact that due to the rigid procedure applied exclusively to bills of exchange and promissory notes, many debtors were allowed to escape liability unjustly. It continued to remark the failure of the Indian courts to provide justice in cases involving an inadequately stamped bill of exchange or promissory note. This was especially facilitated by Section 91 of the Indian Evidence Act, 1872 which precluded oral evidence and left plaintiff remediless. The disoriented approach employed by the courts only led to unending litigation and unnecessary costs.²⁷ In light of these facts, the Law Commission of India suggested to amend Section 35 of the Indian Stamp Act, 1899 in order to ensure that inadequately stamped promissory notes and bills are admissible in evidence after paying stamp duty and penalty.

Besides the legal difficulties as elaborated above, the proviso (a) of Section 35 of the Indian Stamp Act, 1899 also went against the object of the legislation. Indian Stamp Act was enacted to increase the revenue of the government (*Chiranjil Lal v. Hari Das*²⁸) and not to create technicalities that could potentially defeat the rights and liabilities of parties. The said Section precluded the government from getting additional revenue through the subsequent payment of stamp duty and penalty on promissory notes and bills of exchange. Instead, it increased the burden on government exchequer by leading to unending litigation.

Therefore, in light of the abovementioned reasons the Indian Stamp Act was amended in 2006 to incorporate the suggestions of the 178th report of the Law Commission of India. Now, inadequately stamped promissory notes and bills of exchange can be admitted into evidence if stamp duty is paid along with the prescribed penalty.

²⁷ Law Commission of India, *Recommendation for amending various enactments, both criminal and civil* (178th report, December 2001) < <http://10.21.88.204/lawcommissionofindia/reports/178rpt1.pdf> > accessed 9 November 2019.

²⁸(2005) 10 SCC 746.

CONCLUSION

The legal implications of an unstamped promissory notes have gone paradigm shift after the 2006 amendment to the Indian Stamp Act, 1899. The change was facilitated by many case laws that pointed to the unwanted consequences of the provision, specifically *Lothamasu Rao v Balakotiah* AIR 1973 AP 342.²⁹ The judgement tried to provide clarity to the legal conundrum by dealing with cases across various jurisdictions and differentiating between the legal value of unstamped promissory notes in which the debt had merged and those notes which were merely conditional payment of the debt. The issues revolving around Section 70 of the Indian Contract Act, 1872 and Section 91 of the Indian Evidence Act 1872 were also given much need attention. Despite going through multitude of case laws, commentaries and foreign sources the court expressed its inability to protect the creditor's rights due to bar imposed on oral evidence by Section 91 of the Indian Evidence Act, 1872. This prompted the court to highlight the need to amend Section 35 of the Indian Stamp Act, 1899.

The Law Commission of India also, in its 178th report, stressed on the need to amend Section 35 of the Indian Stamp Act, 1899.³⁰ It placed emphasis on the inconsistent approaches adopted by the courts while dealing with inadequately stamped promissory notes. This, according to the Law Commission, gave rise to uncertainty and helped escape many debtors from their liability. The Government of India responded to the cue from Law Commission by amending Section 35 in 2006.

What is striking in this ordeal is the laxity shown by the law makers in responding to the much needed change. The Andhra Pradesh High Court in 1973 presented an accurate picture of the legal inconsistencies due to Section 35. The repercussions on rights of parties were clearly evident from the judgment. Still, it took the Law Commission of India around 27 years to take cognizance of this fact and the Legislature another 4-5 years to effectuate a change during the course of which many creditors lost their money and the Government too lost on an important source of revenue. This presents us with a lesson to be vigilant about rights and liabilities of parties because change in order to be meaningful has to be prompt.

²⁹ YS Rao, 'Promissory Notes in India' (Legal Service India) < <http://www.legalservicesindia.com/article/1590/Promissory-Note-in-India.html>> accessed 9 November 2019.

³⁰ Law Commission of India, *Recommendation for amending various enactments, both criminal and civil* (178th report, December 2001) < <http://10.21.88.204/lawcommissionofindia/reports/178rpt1.pdf>> accessed 9 November 2019.

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