Commissioner of Income-Tax, Bombay

Vs

Chugandas and Co., Bombay

Civil Appeals Nos. 685 & 686 of 1963

(K. Subha Rao, S. M. Sikri, J. C. Shah JJ)

29.07.1964

JUDGMENT

SHAH, J. –

M/s. Chugandas and Co. - a firm dealing in securities - received in the year 1946 Rs. 4,13,992/- as interest on securities held by it. In 1947 it received Rs. 1,01,229/- as interest from the same source. On June 30, 1947 the firm discontinued its business. In proceedings for assessment for 1947-48 and 1948-49 the firm, relying upon s. 25(3) of the Indian Income-tax Act, 1922, claimed exemption from payment of tax on income earned in the relevant previous year, on the plea that the firm was carrying on business before the Indian Income-tax Act, 1922, was enacted, and on that business, tax had been charged under the provisions of the Indian Income-tax Act 7 of 1918 in respect of the business done immediately before that Act was repealed. The firm also applied to substitute the income earned in the year 1947 for the income of the previous year. The Income-tax Officer held that the interest earned by the firm on securities being "liable to be assessed to tax" under s. 8 and not under s. 10 of the Income-tax Act, firm was not entitled to the benefit of the exemption claimed. The order of the Income-tax Officer was confirmed in appeal by the Appellate Assistant Commissioner. The Income-tax Appellate Tribunal, however, reversed the order and held that the firm was entitled to the benefit of the exemption in respect of the entire income of the business including income from securities in the year in which the business was discontinued.

At the instance of the Commissioner, the Tribunal referred under s. 66(1) of the Act a question, which when reframed by the High Court of Bombay read as follows :-

> "Whether the assessee is entitled to the benefit of s. 25(3) in respect of the interest on securities ?"

It is common ground that the principal business of the assessee was as a dealer in securities. Securities held by the assessee were its stock-in-trade and interest on those securities was received from time to time, and this interest had for computing the taxable income to be taken into account under s. 8 of the Indian Income-tax Act, 1922.

Section 25(3), on the true interpretation of which the respective contentions of the assessee and the Commissioner have to be adjusted, is in the following terms :

> "Where any business, profession or vocation on which tax was at any timecharged under the provisions of the Indian Income-tax Act, 1918 (VII of 1918), is discontinued, then, unless there has been a succession by virtue of which the

> provisions of sub-section (4) have been rendered applicable, no tax shall be payable in respect of the income, profits and gains of the period between the end of the previous year and the date of such discontinuance, and the assessee may further claim that the income, profits and gains of the previous year shall be deemed to have been the income, profits and gains of the said period. Where any such claim is made, an assessment shall be made on the basis of the income, profits and gains of the said period, and if an amount of tax has already been paid in respect of the income, profits and gains of the previous year exceeding the amount payable on the basis of such assessment, a refund shall be given of the difference."

Exemption from liability to pay tax in respect of the income, profits and gains under s. 25(3) may be claimed by an assessee if the business is one in respect of which tax was charged at any time under the Indian Income-tax Act, 1918 and the business is discontinued - there being no succession by virtue of which the provisions of sub-s. (4) of s. 25 have been rendered applicable. Section 25(3) however applies even if the person assessed under the Income-tax Act, 1918, was different from the person who claims relief under that section provided the former was the predecessor-in-interest of such person qua the business. The reason for enacting s. 25(3) was that under the Indian Income-tax Act 7 of 1918, income-tax was levied by virtue of s. 14(2) of Act 7 of 1918 on the income of the year of assessment. Tax was therefore levied in the financial year 1921-22 on the income of that year. By the Indian Income-tax Act 11 of 1922 the basis of taxation was altered and by s. 3 of that Act, charge for tax was imposed upon the income of the previous year. When Act 11 of 1922 was brought into force on April 1, 1922, two assessments in respect of the same income for the year 1921-22 had to be made. The income for 1921-22 was accordingly charged to tax twice; it was charged under Act 7 of 1918 and it was also charged to tax under s. 3 of Act 11 of 1922 read with the appropriate Finance Act, resulting in double taxation in respect of the income for that year.

But with a view to make the number of assessments equal to the number of years during which the business was carried on the Legislature enacted the exemption prescribed by s. 25(3). This benefit was however restricted only to the income, profits and gains of business, profession or vocation on which tax had been charged under the provisions of the Indian Income-tax Act, 1918. By enacting s. 25(3) the legislature intended to exempt the income, profits and gains resulting from the activity styled business, profession or vocation from tax when the business, profession or vocation is discontinued if tax was charged in respect thereof under the Act of 1918. That much is clear. But that is not the whole problem. What is to be regarded as income, profits and gains of business, profession or vocation within the meaning of s. 25(3) for which exemption may be obtained on discontinuance raises a problem on which there was a difference of opinion in the High Court. In the judgment under appeal, Tendolkar J. was of the view that by this expression only income, profits and gains of business chargeable to tax under the head "profits and gains of business, profession or vocation" under s. 10 read with s. 6(iv) stood exempt from liability under s. 25(3). S. T. Desai J., held that s. 25(3) exempted from liability to tax all income, profits and gains earned by conducting a business, profession or vocation irrespective of whether they were chargeable to tax under the head "profits and gains of business, profession or vocation", and with this view K. T. Desai, J., to whom the case was referred for opinion, agreed.

To appreciate the point in dispute, it is necessary to bear in mind the scheme of the Act for computing the taxable income. Under the Act, income-tax is a single tax on the aggregate of income received from diverse heads mentioned in s. 6 : s. 6 is not a charging section, and income computed under each distinct head is not separately chargeable to tax. But income which is chargeable under a specific head, cannot be brought to tax under another head either in lieu of or in addition to that

head. As observed by this Court in The United Commercial Bank Ltd., Calcutta v. The Commissioner of Income-tax, West Bengal [[1958] S.C.R. 79] "the scheme of the Indian Income-tax Act, 1922, is that the various heads of income, profits and gains enumerated in s. 6 are mutually exclusive, each head being specific to cover the item arising from a particular source and, consequently, "interest on securities" which is specifically made chargeable to tax under s. 8 as a distinct head, falls under that section and cannot be brought under s. 10 Whether the securities are held as trading assets or capital assets." In The United Commercial Bank' case [1958] S.C.R. 79] the Income Tax Officer split up the income of a Banking Company was in the course of assessment, into two heads - "interest on securities" and "business income", and set off the business loss against the income from securities in the year of assessment, but did not allow the business loss of a previous year to be set off under s. 24(2) against that income. This view was approved by the High Court of Calcutta. The High Court held that the several heads under s. 6 of the Income-tax Act are mutually exclusive, and an item falling under an exclusive head cannot be charged under another head. This view was affirmed by this Court, and it was held that "interest on securities" being specifically charged under s. 8, which is a distinct head, it could not be brought under s. 10, whether the securities were trading assets or capital assets.

It must therefore be held that even if an item of income is earned in the course of carrying on a business, it will not necessarily fall within the head "profits and gains of business" within the meaning of s. 10 read with s. 6(iv). If securities constitute stock-in-trade of the business of an assessee, interest received from those securities will for the purpose of determining the taxable income be shown under the head "interest on securities" under s. 8 read with s. 6(ii) of the Act. Similarly dividends from shares will be shown under s. 12(1A) and not under s. 10. If an assessee carries on business of purchasing and selling buildings, the profits and gains earned by transactions in buildings will be shown under s. 10, but income received from the buildings so long as they are owned by the assessee will be shown under s. 9 read with s. 6(iii). Income earned by an assessee carrying on business will in each case be broken up, and taxable income under the head profits and gains of business will be that amount alone which is earned in the business, and does not all under any other specific head.

Tendolkar J., in the judgment under appeal was of the opinion that income of the business to be computed under s. 10 alone could be admitted to the exemption : the majority of the Court held that all income earned by carrying on business qualified for the exemption. Now cl. (3) of s. 25 expressly provides that income of a business, profession or vocation which was charged at any time under Act 7 of 1918 to tax is, on discontinuance of that business, profession or vocation, exempt from liability to tax under Act 11 of 1922 for the period between the end of the previous year and the date of such discontinuance. Tax is charged under the Income-tax Acts on specific units, such as, individuals, Hindu Undivided Families, Companies Local Authorities, Firms and Association of persons or partners of firms and members of associations individually, and business, profession or vocation is not a unit of assessment. When, therefore, s. 25(3) enacts that tax was charged at any time on any business, it is intended that the tax was at any time charged on the owner of any business. If that condition be fulfilled in respect of the income of the business under the Act of 1918, the owner or his successor-in-interest qua the business, will be entitled to get the benefit of the exemption under it if the business, is discontinued. The section in terms refers to tax charged on any business, i.e., tax charged on any person in respect of income earned by carrying on the business. Undoubtedly it is not all income earned by a person who conducted any business, which is exempt under sub-s. (3) of s. 25 : non-business income will certainly not qualify for the privilege. But there is no reason to restrict the condition of the applicability of the exemption only to income on which the tax was payable under the head "profits and gains of business, profession or vocation".

The Legislature has made no such express reservation, and there is no warrant for reading into sub-s. (3) such a restricted meaning. Sub-section (3) it may be noticed does not refer to chargeability of income to tax under a particular head as a condition of obtaining the benefit of the exemption.

Diverse other provisions of the Act lend strong support to that view. Where the Legislature intended to refer to a specific head of taxation under s. 6 of the Act as a condition for imposing an obligation or claiming a right, the Legislature has in terms referred to such a head. For instance, by s. 18(2) liability is imposed upon any person responsible for paying any income chargeable under the head "salaries" to deduct income-tax and super-tax on the amount payable. Similarly under s. 18(3) persons responsible for paying income-tax under the head "interest on securities" are liable to deduct income-tax and super-tax at the prescribed rates on the amount of interest payable. Section 24 enables set-off in respect of loss sustained under any of the heads mentioned in s. 6 against income, profits and gains from any other head in that year. These are some of the provisions in which reference is made to specific heads of taxation. But the exemption under s. 25(3) is general : it is not restricted to income chargeable under s. 10 of the Act. Some indication is also furnished by the scheme of sub-ss. (1) and (2) of s. 25. Under sub-s. (1) the Income-tax Officer is given power to make what is called an "accelerated assessment" when a business, profession or vocation is discontinued in any year. The reason of the rule contained in s. 25(1) is to prevent loss of revenue by the assessee discontinuing the business, profession or vocation and frittering away or secreting the assets and income or disappearing from the scene of his activity. But such an assessment would in the normal course have to be in respect of the entire income that business, profession or vocation. If the contention of the Department that income of the business, profession or vocation for the purpose of an accelerated assessment is to be limited only to income on which tax is payable under s. 10 be correct, the assessment under s. 25(1) would serve little useful purpose, because income received from securities, from dividends, from house-property, etc. would remain still to be determined and brought to tax after the end of the year and in the relevant year of assessment. Again an assessee discontinuing his business, profession or vocation is entitled by s. 24 to set off losses in one business against profits in another, and this right may turn out to be illusory if in the assessment of the income of a business which is discontinued, profits and gains which fall within s. 10 only are taken into account. The Revenue authorities, it is true, may get a complete picture of the liability of the assessee to taxation only on final assessment. This is not to say that a mere possibility of two assessments is decisive of the intention of the Legislature, for if that be the test, every person who has income received from business, profession or vocation and income from other source would still have to be subject, after an accelerated assessment under s. 25(1), to final assessment in respect of the non-business income to determine his overall liability. But the possibility of two assessments in respect of the same business for the same year, one of which serves no useful purpose, must be taken into account in ascertaining the meaning to be attributed to the expression "income, profits and gains of business, profession or vocation" which is discontinued. The phraseology of s. 25(2) also supports the view that the income, profits and gains of business are not restricted to profits and gains chargeable under s. 10. For failure to give notice of discontinuance of business, penalty for an amount not exceeding the tax assessed in respect of any income, profits or gains of the business may be imposed. There is no logical reason for restricting the penalty to the amount of tax assessed on profits and gains determined for the purpose of s. 10.

It has also to be noticed that prior to the insertion of sub-s. (1A) of s. 12 by s. 9 of the Finance Act, 1955, with effect from April 1, 1955, income from dividends was chargeable under s. 12 but under s. 10, if the shares from which such income was received were the stock-in-trade of the assessee. The result of the insertion of s. 12(1A) is that in respect of a business in shares dividends received from the shares were till March 31, 1955, regarded as profits and gains of business assessable to tax

under s. 10. After the enactment of the Finance Act of 1955, dividends became chargeable under s. 12(1A) under the head "income derived from other sources". Could it have been the intention of the Legislature that dividend income of a business in respect of which tax was charged under the head "Income from shares" under Act 7 of 1918 would not, after March 31, 1955, be entitled to the benefit of the exemption under s. 25(3) merely because the head under which it was charged prior to the Finance Act of 1955 is now the head "other sources" ?

Section 2(4) of the Indian Income-tax Act, 1922 defines "business" as including any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. Business is therefore an activity of a commercial nature. By s. 25(3) indisputably exemption from payment of tax was intended to be given where there had been in respect of the same activity double taxation when Act 11 of 1922 was enacted. If the right arises on discontinuance of the activity styled business, as s. 25(3) expressly provides, tax in connection with that activity would prima facie be tax payable on the income, profits and gains derived from that business activity. The heads described in s. 6 and further elaborated for the purpose of computation of income in ss. 7 to 10, and 12, 12A, 12AA and 12B are intended merely to indicate the classes of income : the heads do not exhaustively delimit sources from which income arises. This is made clear in the judgment of this Court in the United Commercial Bank Ltd.'s case [[1958] S.C.R. 79] that business income is broken up under different heads only for the purpose of computation of the total income : by that break-up the income does not cease to be the income of the business, the different heads of income being only the classification prescribed by the Indian Income-tax Act for computation of income. It cannot be gainsaid that there was on the part of the Legislature a desire by enacting s. 25(3) to give relief to two classes of income subjected to double taxation for the income of the year 1921-22. That this benefit was restricted to income paid by assessees who paid tax on income derived from business and professional earnings under the earlier Act and was not available in respect of other income, will not, in our judgment, be a ground for giving a restricted meaning to the expression "income, profits and gains of business, profession or vocation" occurring in sub-s. (3) of s. 25. An intention to grant a partial exemption to income, profits and gains of a business, profession or vocation may not be lightly attributed to the Legislature.

There is no force in the contention raised by counsel for the Commissioner that for the year 1921-22 interest on securities could not be charged to tax twice over. Under the Income-tax Act, 7 of 1918, by s. 14(2) tax was levied in respect of the year beginning from April 1, 1918 in respect of each subsequent year, upon every assessee on his taxable income in that year at the rate specified in Sch. I. Section 5 of that Act classified the income chargeable to income tax, and "Interest on securities" was charged under s. 7 read with s. 5(ii). In respect of interest on securities by s. 14(1) the aggregate amount of the assessee's income chargeable under each of the heads mentioned in ss. 6 to 11 became taxable in the year in which it was received. Act 7 of 1918 undoubtedly made a provision in s. 19 for adjustment of liability to tax when the actual income was ascertained. Our attention has not been invited to any provision in the Income-tax Act 7 of 1918 which excluded from liability to tax, interest on securities for the year in which that income had accrued. By s. 3 of Act 11 of 1922 interest on securities earned in the year 1921-22 became chargeable and under s. 68 of that Act which was a provision transitory as well as repealing, machinery provided by the Income-tax Act of 1918 was expressly kept alive for the purpose of assessment and making adjustments under s. 19 of the Income-tax Act, 1918. Interest on securities earned in 1921-22 was therefore chargeable to tax under Act 7 of 1918, and it was also chargeable to tax under Act 11 of 1922. We are therefore unable to agree with counsel for the Commissioner that interest on securities not being exposed to double taxation for the year 1921-22, benefit of s. 25(3) was not admissible to that class of income.

Counsel also contended, relying upon the judgment of this Court in Commissioner of Income-tax, Bihar and Orissa v. Ramkrishna Deo [[1959] Supp. 1, S.C.R. 176], that it is for the respondent to prove that the income sought to be taxed is exempt from taxation, and unless he discharges that burden, the claim of the respondent must fail. Undoubtedly where a doubt arises on the facts placed before the taxing authority, whether the tax-payer is entitled to exemption from taxation under a certain statutory provision, the burden lies upon him to establish that exemption. But, here we are concerned not with any question of burden of proof, but with a question of interpretation whether the exemption which is admittedly given by s. 25(3) operates in respect of the entirety of the business income for the year in question in the course of which the business is discontinued or whether it applies only to that class of income which is taxable under the head "profits and gains of business" carried on by the assessee in that year.

Section 26 on which reliance was placed by counsel for the Commissioner also may be noticed in this connection. That section provides for a scheme of assessment when there is change in the constitution of a firm or succession to a business. The section applies not to discontinuance of business, but to changes in the constitution of the assessee firm and to succession to business. Under sub-s. (1) if at the time of making an assessment it be found by the Income-tax Officer that a change has occurred in the constitution of a firm or that a firm has been newly constituted, the firm as constituted at the time of making the assessment has to be assessed. But the income, profits and gains for the previous year for the purpose of inclusion in the total income of the partners must be apportioned between the partners who in such previous year were entitled to receive the same. If the tax assessed upon a partner cannot be recovered from him it may be recovered from the firm as constituted at the time of making the assessment. This provision deals with the machinery of assessment and not with computation of income, nor with exemption from liability to tax. Sub-section (2) of s. 26 deals with deals with cases of succession to any person carrying on any business, profession or vocation by another person carrying on business, profession or vocation in such capacity, and provides that the person succeeding is, subject to the provisions of sub-s. (4) of s. 25, liable to be assessed in respect of his actual share of the income, profits and gains of the previous year. But the proviso enacts that if the person succeeded in the business, profession or vocation cannot be found, the assessment of the profits of the year in which succession took place up to the date of succession, and for the previous year, shall be made on the person succeeding in like manner and in the same amount as it would have been made on the person succeeded or when the tax in respect of the assessment made for either of such years assessed on the person succeeded cannot be recovered from him, it shall be payable by and recoverable from the person succeeding. This clause also deals with liability to assessment and payment of tax and not with the computation of income and whatever interpretation may be placed on s. 26 as to the extent of liability incurred by a successor to a business, profession or vocation, it is not indicative of the extent or of the field of the right to claim exemption under s. 25(3). Section 26 provides for apportionment of liability to tax in case of change in the constitution of firms and succession to persons carrying on business : it directs apportionment of tax liability in respect of the actual share of the successor and the person succeeded. The fact that under sub-s. (2) of s. 26 liability is imposed upon the successor to pay tax on behalf of his predecessor or to be assessed in respect of the income of the person succeeded for the previous year, will not, in out judgment, be sufficient to hold that the exemption which has been granted in consequence of double taxation under the Acts of 1918 and 1922 also must be restricted to income which is taxable under s. 10.

We may briefly refer to the decision of this Court in The Commissioner of Income-tax, Madras v. The Express Newspapers Limited, Madras [[1964] 8 S.C.R. 189]. In that case Free Press Limited - a Private Company - transferred its business on August 31, 1946 to the assessee the Express

Newspapers Ltd., and thereafter resolved to wind up its business voluntarily. An Amount of Rs. 2,14,000/- was assessed in the relevant year of assessment as business profit of the transferor company taxable under s. 10(2)(vii) and Rs. 3,94,576/- taxable as capital gains. The business profit was held to be not taxable because it accrued in a winding up sale and not in a trading venture. Liability of the second amount to tax as capital gains was not canvassed, but it was contended by the Express Newspapers Ltd. that as successor to the Free Press Ltd., it was not liable to be assessed under s. 26(2). In examining the scheme of section 12B it was observed :-

"Under that section the tax shall be payable by the assessee under the head capital gains in respect of any profits or gains arising from the sale of a capital asset effected during the prescribed period. It says further that such profits or gains shall be deemed to be income of the previous year in which the sale, etc. took place. This deeming clause does not lift the capital gains from the 6th head in s. 6 and place it under the 4th head. It only introduces a limited fiction, namely, that capital gains accrued will be deemed to be income of the previous year in which the sale was effected. The fiction does not make them the profit or gains of the business. It is well settled that a legal fiction is limited to the purpose for which it is created and should not be extended beyond its legitimate field. Sub-sections (2A) and (2B) of s. 24 provide for the setting off of the loss falling under the head "capital gains" against any capital gains falling under the same head. Such loss cannot be set off against an income falling under any different head. These three sections indicate beyond any doubt that the capital gains are separately computed in accordance with the said provisions and they are not treated as the profits from the business. The profits and gains of business and capital gains are two distinct concepts in the Income-tax Act : the former arises from the activity which is called business and the latter accrues because capital assets are disposed of at a value higher than what they cost to the assessee. They are placed under "different heads; they are derived from different sources; and the income is computed under different methods. The facts that the capital gains are connected with the capital assets of the business cannot make them the profit of the business. They are only deemed to be income of the previous year and not the profit or gains arising from the business during the year."

Dealing with s. 26(2) it was observed :-

"The expression "profits" in the proviso makes it clear that the income, profits and gains in sub-s. (2) of s. 26 only refer to the profits under the 4th head in s. 6. On the other hand, if the interpretation sought to be put upon the expression "income" in sub-s. (2) of s. 26 by the Revenue is accepted, then the absence of that word in the proviso destroys the argument. But the more reasonable view is that both the sub-section and the proviso deal only with the profits under the 4th head mentioned in s. 6 and, so construed, it excludes capital gains. The argument that sub-s. (2) of s. 26 read with the proviso thereto indicates that the total income of the person succeeded is the criterion for separate assessment under sub-s. (2) and for assessment and realisation under the proviso is on the assumption that sub-s. (2) and the proviso deal with all the heads mentioned in s. 6 of the Act. But if, as we have held, the scope of sub-s. (2) of s. 26 is only limited to the income from the business, the share under sub-s. (2) and the assessment and realisation under the proviso can only relate to the income from the business. The argument is really begging the question itself."

It is obvious that the Court in that case held having regard to the special nature of "capital gains" which are not in truth income, but are deemed income for the purpose of taxation and the phraseology used, that the liability of the successor under the proviso to s. 26(2) is only in respect of tax on income, profits and gains of the business strictly so-called, to be computed under s. 10 read with s. 6(iv) and not in respect of all receipts which may be regarded as income of the business. The

schemes of s. 25(3) and s. 26(2), proviso are different. The first grants an exemption because there has been a double levy of tax, and an intention to exempt all income, profits and gains of business from taxation may be attributed to the Legislature. Section 26(2) fastens liability of the predecessor, if he cannot be found, upon the successor and must be strictly construed. The Legislature has imposed by s. 26(2) liability upon the successor to be assessed for profits earned in a business carried on by his predecessor, and unless there is a clear intention expressed in the statute to include in that expression what in reality is not income, but is deemed income, the liability to assessment would justifiably be limited to profits of the business which is computable under s. 10.

The appeals therefore fail and are dismissed with costs. One hearing fee.

Appeals dismissed.

</html