Russa H. Mehta trust, Bombay

Vs

Commissioner of Income-Tax, Bombay City I

Civil Appeal Nos. 589 to 590 of 1964

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

12.11.1965

JUDGMENT

SHAH, J. –

The appellant is a private trust, and was within the meaning of s. 4A and 4B of the Income tax Act, 1922 resident and ordinarily resident within British India in 1948. The appellant held 1,000 shares in an investment company styled Home Mehta and Sons Ltd. (hereinafter called 'the Company') which carried on the business of investing in shares in companies registered in British India and in the former Indian States. Dividends from the British Indian companies were received by the Company at its registered office at Bombay, and dividends from the Indian States' companies were received by the Company at its registered office at Billimora in the State of Baroda.

In the calendar years 1948 and 1949 the appellant received at Billimora Rs. 65,000 and Rs. 2,10,000 respectively as dividend in respect of share held by it in the Company. The 2nd Income tax Officer, A-I Ward, Bombay, upheld the claim of the appellant that its dividend income received from the Company at Billimora had accrued or arisen in the Baroda State and as the income was not brought into British India, it was exempt from liability to tax by virtue of s. 14(2)(c) of the Income-tax Act. The Commissioner of Income tax, Bombay held that the income accrued or arose to the appellant in Bombay where the dividend was declared, and was on that account liable to be assessed under the Income-tax Act, 1922. The Commissioner accordingly directed the Income tax Officer to pass orders imposing tax on the dividend income received by the appellant from the Company. On appeal, the Income-tax Appellate Tribunal held that the dividend income accrued or arose at Billimora and not at Bombay, but by reason of the definition of "taxable territories" the income which accrued at Baroda attracted liability to tax under the Income-tax Act and did not qualify for rebate under paragraph 6 of the Merged States (Taxation Concessions) Order, 1949.

The following questions were referred by the Tribunal under s. 66(1) of the Indian Income-tax Act, 1922, to the High Court of Bombay for its opinion :

> "(1) Whether, on the above facts and circumstances of the case the assessee is entitled to rebate equal to the difference between the British Indian rate and Baroda State rate in respect of the dividend income ?
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> (2) Whether on the facts and circumstances of the case the dividend income accrued or arose to the assessee at Bombay ?"

The High Court held, following it earlier judgment in Mrs. Kusumben D. Mahadevia, Bombay v.

The Commissioner of Income tax, Bombay City, Bombay (Income-tax Ref. No. 28 of 1955 decided on February 20, 1956 (unreported).) that the Merged States (Taxation Concessions) Order, 1949 did not apply to the income of a resident assessee and therefore the first question must be answered in the negative. The High Court declined to answer the second question. With special leave granted by this Court, the appellant has appealed to this Court.

Income received by the Company from its transactions in the Indian States was retained at its office in Billimora and dividend declared out of that income was paid to the appellant at the registered office in the State of Baroda. This dividend it is common ground was not brought into British India. To appreciate the claim that the income qualifies for rebate under paragraph 6 of the Merged States (Taxation Concessions) Order, 1949, the relevant statutory developments in tax laws to effectuate the merger of the former Indian States since August 15, 1947, may be briefly set out. Under s. 14(2)(c) of the Income-tax Act, added by Act 23 of 1941 and amended by Act 22 of 1947, it was enacted that :

> "The tax shall not be payable by an assessee . . . in respect of any income, profits or gains accruing or arising to him within an Indian State unless such income, profits or gains are received or deemed to be received in or are brought into British India in the previous year by or on behalf of the assessee, or are assessable under section 12B or Section 42."

By paragraph 3 of the States' Merger (Governors' Provinces) Order, 1949, it was provided that the States specified in Sch. II shall, as from August 1, 1949, be administered in all respects as if they formed part of the Provinces specified in the Schedule, and by paragraph 4 all the laws in force in the merged States or in any part thereof immediately before August 1, 1949, were to continue in force until repealed, modified or amended by a competent Legislature or other competent authority. The State of Baroda was one of the States specified in the Schedule and it was to be administered as if it formed part of the Province of Bombay. The Indian Income-tax Act was applied to the merged States by s. 3 of the Taxation Laws (Extension to Merged States and Amendment) Act, 67 of 1949 with retrospective effect from April 1, 1949, and by s. 7 corresponding laws relating to income-tax in the merged States were repealed. It was provided that if immediately before the 26th day of August, 1949, there was in force in any of the merged States any law relating to income-tax, super-tax or business profits tax, that law shall cease to have effect except for the purposes of the levy, assessment and collection of income-tax and super-tax in respect of any period not included in the previous year for the purposes of assessment under the Indian Income-tax Act, 1922, as extended to that State by s. 3, or, as the case may be, the levy, assessment and collection of business profits tax for any chargeable accounting period ending on or before the 31st day of March, 1948, and for any purposes connected with such levy, assessment or collection. By the application of Act 67 of 1949, and the repeal of law corresponding to those applied to the merged States by s. 3, residents in former British India and in the merged States were sought to be treated equally. But the result was a sudden imposition of high rates of taxation under the Indian Income-tax Act read with the appropriate Finance Acts upon the residents of the merged States. With a view to cushion the impact, the Central Government in exercise of the powers conferred by s. 60A of the Indian Income-tax Act granted certain exemptions from and reductions in the rates of tax and made certain other modifications in the tax structure in its application to the merged States. By paragraph 3(i) of the Merged States (Taxation Concessions) Order, 1949 the expression "Act" was defined as meaning the Taxation Laws (Extension to Merged States and Amendment) Act 67 of 1949. Paragraphs 4, 5, 6 and 6A of the Order as amended or added by the notification dated March 11, 1949, provided :

4. "The provisions of paragraphs 5, 6, 9, 10 and 11 of this Order shall apply to only so much of the income, profits and gains included in the total income of an assessee as would, had he been resident in British India, have been exempt under clause (c) of sub-section (2) of section 14 of the Indian Income-tax Act, 1922, if the Act had not been passed."

5. "(1) The income, profits and gains of any previous year ending after the 31st day of March, 1948, which is a previous year -

(i) for the merged State assessment year 1948-49, or

(ii) for the merged State assessment year 1949-50,

shall be assessed under the Indian Income-tax Act, 1922, if, and only if, such income, profits and gains have not, before the 1st day of August, 1949, been assessed under the State law.

(2) Where the income, profits and gains referred to in sub-paragraph (1) have not been assessed under the State law, they shall be assessed under the Indian Income-tax Act, 1922, and the tax payable thereon shall be determined as hereunder -

(i) the tax on the amount of such income, profits and gains included in the total income shall be computed at the Indian rate of tax;

"(ii) the amount of such income, profits and gains shall be computed under the State law and the tax thereon computed at the merged State rate of tax;

(iii) the amount, if any, by which the tax computed under clause (i) exceeds the tax computed under clause (ii) shall be allowed as rebate from the first mentioned tax, and the amount of the first mentioned tax as so reduced shall be the tax payable.

(3) For the purposes of this paragraph -

(a) the merged State assessment year 1948-49 means the assessment year which commences on any date between the 1st April, 1948, and the 31st December, 1948, both dates inclusive; and

(b) the merged State assessment year 1949-50 means the assessment year which commences on any date between the 2nd January, 1949, and the 31st July, 1949, both dates inclusive."

6. "(1) The income, profits and gains of any previous year ending after the 31st day of March, 1948, which does not fall within paragraph 5 of this Order or of any previous year commencing after the previous year referred to in the said paragraph shall be assessed under the Indian Income tax Act, 1922, but the tax payable on so much of the income as pertains to the period ending before the 1st day of August, 1949, shall be determined as hereunder -

(i) the tax on so much of such income included in the total income shall be computed (a) at the Indian rate of tax and (b) at the rates of tax in force in the merged State

immediately before the 1st day of August, 1949;

"(ii) the amount by which the tax computed under sub-clause (a) of clause (i) exceeds the tax computed under sub-clause (b) of clause (i) shall be allowed as rebate from the first mentioned tax, and the amount of the first mentioned tax as so reduced shall be the tax payable.

(2) Where any previous year falls partly before and partly on or after the 1st day of August, 1949, the income, profits and gains pertaining to the period falling before the said date shall, unless the Income tax Officer, having regard to any special circumstances, otherwise directs with the approval of the Inspecting Assistant Commissioner of Income-tax, be in the proportion which period before the said date bears to the whole previous year."

6A. "The income, profits and gains of any previous year, referred to in paragraph 5 or 6 of this Order, which accrue or arise without the taxable territories to a person who is resident but who would not be resident in the taxable territories if the Act had not been passed, shall be charged to tax in the same manner and to the same extent as specified in the said paragraph 5 or 6, as the case may be."

By the application of the Income tax Act, 1922, to the territories of the merged States, income received, accrued or arisen or deemed to be received, accrued or arisen to any person resident within the territory of the merged States became chargeable to tax under that Act. With a view to avoid hardship caused by the sudden application of high rates of taxation, the Central Government exercised its powers under s. 60A of the Indian Income-tax Act and modified the tax levy so as to give certain exemptions and benefits to residents in the areas of the former Indian States. By paragraph 6 of the Merged States (Taxation Concessions) Order, 1949, in respect of the income of any previous year ending with March 31, 1948, which accrued or arose to persons who were residents in the territories of the merged States, benefit of the same rate of income-tax to which it was subject in the merged State was granted by providing that the difference between tax computed at the Indian rate and the State rate shall be allowed as rebate. In respect of income of the residents in the merged States arising outside the taxable territories, a similar rebate was to be given (paragraph 6A). The result was that income of residents of the merged States became chargeable to tax under the Indian Income-tax Act, but it was to continue to get for a limited period benefit of the low rates of tax operative under the law in force in the State before merger. This concession or benefit was to apply by the express provisions contained in paragraph 4 only to so much of the income, profits and gains included in the total income of an assessee as would, had he been resident in the taxable territories, have been exempt under cl. (c) of sub-s. (2) of s. 14 of the Indian Income-tax Act, 1922, if the Act had not been passed.

Counsel for the appellants claims that paragraph 4 applies to income of all assessees resident within British India as defined in s. 2(3A) at the relevant time, and not merely to residents in the territories of the merged States. It is contended that by paragraph 4 it was intended not only to give the benefit of the State rate of taxation to residents of the former Indian State which were merged with the provinces under the States Merger (Governors' Provinces) Order, 1949, but also to preserve the

benefit which was conferred by section 14(2)(c) of the Income-tax Act to residents of the territories of British India before August 15, 1947, in respect of income arising or accruing to them within the territory of the merged States. It is said that by the application of Act 67 of 1949 all residents in the taxable territory became liable to pay tax at Indian rates, but with a view to maintain the status quo ante, it was intended by the Taxation Concessions Order, 1949, to restore the State rates of taxation to residents in the former Indian States, and also to continue the exemption in respect of the income of the former British Indian residents arising or accruing in the territory of the merged States within the limits prescribed by s. 14(2)(c). But paragraph 4 of the Taxation Concessions Order, 1949, is not susceptible of any such interpretation. Paragraph 4 of the Order, and ss. 3, 4, 4A, 4B and s. 14(2)(c) of the Income-tax Act must be read together. The Indian States specified in the Schedule to the States Merger Order, on their merger with the provinces of British India, ceased to be separate entities and became part of British India, and by the application of Act 67 of 1949 the Indian Income-tax Act was applied to the territories comprised within British India. Section 14(2)(c) undoubtedly remained in force even after the merger of the Indian States effected by the States Merger Order, but its operation was restricted. After the merger of the States, income arising or accruing within the territory of such merged State, could not be deemed to be income arising or accruing within an Indian State, for the State had ceased to exist, and the income was for the purpose of s. 4 of the Income-tax Act income arising or accruing to person resident within the taxable territories. There is nothing in paragraph 4 of the Concessions Order which seeks to grant exemption from liability to tax in respect of income which prior to the merger of the States was not liable to tax by virtue of s. 14(2)(c), but has since the application of the Income-tax Act become so liable.

The claim that paragraph 4 applies to income of residents of former British India which was exempt from taxation under section 14(2)(c) is belied by the plain words of the Order. Paragraph 4 does not substantively grant any exemption : it merely designates income to which the provisions of the Order granting exemption will apply. It applies to income which would, if Act 67 of 1949 had not been passed, have been regarded as accruing or arising in an Indian State, and the assessee would, in respect of that income, had he been a resident of the taxable territory before merger, have been exempt under s. 4(2)(c). The use of the expression "had he been a resident" implies that the benefit is not to enure to persons who were before the merger entitled to the exemption under s. 14(2)(c).

The Order provides that paragraphs 5, 6, 9, 10 and 11 apply to a slice of income and not to the entire income of the an assessee, and by the express terms, it is that slice of the income, as would, had the assessee been resident, the taxable territories, have been exempt under cl. (c) of sub-s. (2) of s. 14 of the Indian Income-tax Act, if the Taxation Laws Act, 1949, had not been passed. In terms the concession is not given to residents of the territories of British India, and the context does not warrant an implication to the contrary.

It is true that by this interpretation of paragraph 4, British Indian residents are defined the benefit of the exemption under s. 14(2)(c) in respect of income arising or accruing in the territories of the former merged States. But that denial is the result of merger of the State into British India. The operation of s. 14(2)(c) had become

> restricted by the modification of the definition of British India. Since that amendment, income accruing or arising after the merger in Indian States outside British India alone would be exempt under s. 14(2)(c). There is nothing in the Concessions Order which suggests that it was intended to ensure continuance of the exemption under s. 14(2)(c) to residents of British India as it was before merger, as if the merger had not taken place. The use of the expression "had he been resident in the taxable territories" introduces a fiction : it grants the benefit of s. 14(2)(c), though on the express terms it is not available, to a person who was not before the merger covered thereby, and in respect of income which would have been, if the Merger Act had not been passed, exempt from taxation in his hands, if he had been resident in British India. In our view, Chagla, C.J., was right in observing in Mrs. Kusumben D. Mahadevia's case (Income-tax Ref. No. 28 of 1955 decided on February 20, 1956 (unreported).) that :
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> "A person resident in a Merged State, whose income accrued to him there, could not possibly claim exemption under section 14(2)(c). Such an exemption could "only be claimed by a person resident in the taxable territories. In order to give this particular concession to a resident in a merged State this paragraph was enacted, and the particular language which we find in this paragraph was used."

In the view we have taken on the first question, it is unnecessary to record an answer on the second question.

The appeals therefore fail and are dismissed with costs.

Appeals dismissed.

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