Commissioner of Income-Tax, Gujarat

Vs

Kantilal Nathuchand Sami

Civil Appeal No. 676 of 1965

(J. C, Shah, V. Ramaswami-I, V. Bharagava JJ)

11.10.1966

JUDGMENT

BHARGAVA, J.

The respondent is a firm which, for purposes of assessment under the Income-tax Act (hereinafter referred to as "the Act"), was registered under section 26A of the Act during the assessment years 1958-59, 1959-60, and 1960-61. The respondent was earning income from property, ready business in kappas, and also from speculation business carried on an extensive scale. During the assessment year 1958-59, the income from property was assessed at Rs. 1,369/- and from ready business at Rs. 28,449/-. There was a loss of Rs. 6,26,606/- in the speculation business. The Income-tax Officer, in making the assessment for that year, charged tax on the total of the income from property and ready business which amounted to Rs. 29,818/-. The loss of Rs. 6,26,606/- was not set off against this profit in view of the provisions of the first proviso to s. 24(1) of the Act. This loss was, however, apportioned between the partners by the Income-tax Officer, purporting to act under the second proviso to the said sub-section. Similarly, in the next assessment year 1959-60, where there was income from property and loss in ready business as well as speculation business, no tax was imposed, as the loss in ready business exceeded the income from property. The net loss of Rs. 1,239/-, worked out on the basis of loss in ready business reduced by the income from property, was apportioned between the partners. Further, the speculation loss of Rs. 5,416 was also apportioned between the partners on the same basis as was done in the preceding assessment year 1958-59. In the assessment year 1960-61, there was an income of Rs. 1,014/- from property, and a loss of Rs. 21,197/- from ready business. In addition, there was a profit of Rs. 6,19,784/- in the speculation business. Since this year there was a profit in speculation business, the first proviso to s. 24(1) did not apply, and the net income of the respondent was worked out by taking all the three figures into account. The respondent claimed that in the assessment of the respondent's income in this year, the respondent was entitled to set off the speculation losses of the two preceding assessment years 1958-59 and 1959-60 against the profits earned from speculation business in this year, urging that the Income-tax Officer in the two earlier years was wrong in apportioning the loss between the partners. The plea was that under the second proviso to s. 24(1), this loss in speculation business could not be apportioned between the partners, and consequently, under s. 24(2), the respondent was entitled to carry forward this loss and to have it set off against the profit from speculation business under clause (i) of s. 24(2). This plea was rejected by the Income-tax Officer whose order was upheld by the Appellate Assistant Commissioner. On further appeal, the Income-tax Appellate Tribunal, however, accepted the plea of the respondent and held that the speculation losses sustained by the respondent in the two preceding assessment years must be adjusted against the profit earned in the account year in question in speculation business. Thereupon, at the request of the Commissioner of Income-tax, the following question of law was referred by the Tribunal for opinion to the High

Court of Gujarat :

> "Whether on the facts and in the circumstances of the case and on a true interpretation of the various provisions of the Indian Income-tax Act, 1922, the Tribunal was correct in holding that speculation losses of the Respondent firm (assessee firm) for the assessment years 1958-59 and 1959-60 should be set off against its speculation profit of Rs. 6,19,784/- in its assessment for the assessment year 1960-61."

The High Court upheld the view of the Tribunal and answered the question in favour of the respondent. This appeal has now been brought up to this Court by the Commissioner of Income-tax on certificate granted by the High Court under s. 66A(2) of the Act.

The answer to the question referred to the High Court obviously depends on the interpretation of the second proviso to s. 24(1) of the Act. In interpreting this provision, the purpose of s. 24(1) and (2) has to be kept in view. Under the Act, the Income-tax Officer has to determine the total income of an assessee under section 23(1), (3) or (4) of the Act. In determining this total income, income under all the various heads enumerated in s. 6 has to be taken into account. Sections 7 to 10 & 12 lay down the principles on which the income under these various heads is to be computed. In the case of income from business, profession or vocation, the income has to be computed under s. 10(1) of the Act. Section 10(2) of the Act lays down certain deductions which have to be made in computing the profits and gains from business, profession or vocation. It is during this computation to be made by the Income-tax Officer under s. 23 of the income from business, profession or vocation in accordance with s. 10(1) of the Act that the Income-tax Officer is further required to apply the provisions of s. 24. Section 24 is, thus, a provision laying down the manner of computation of total income. The principal clause of s. 24(1) lays down that if there be a loss of profits or gains in any year under any of the heads mentioned in section 6, that loss has to be set off against the income, profits or gains of the assessee under any other head in that year. If this provision had stood by itself without any provisos, the result would have been that all losses incurred by an assessee under any of the heads mentioned in s. 6 would be adjusted against profits under all other heads, and then the total income of the assessee would be worked out on that basis. The first proviso to this sub-section, however, lays down an exception to this general rule contained in the principal clause. The exception relates to income from business consisting of speculative transactions, and places the limitation that losses sustained in speculative transactions are not to be taken into account in computing the profits and gains chargeable under the head "Profits and gains of business, profession or vocation", except to the extent that they will be set off against profits and gains in any other business which itself consists of speculative transactions. The effect of the proviso is that if there are profits in speculative business, those profits are added to income under other heads mentioned in s. 6 for purposes of computing the total income of the assessee in order to determine the tax under s. 23 of the Act. On the other hand, losses in speculative business are not to be taken into account when computing the total income, except to the extent to which they can be set off against profits from other speculative business. The first proviso, thus clearly limits the applicability of the principal clause of s. 24(1); and, when applied, it governs the manner in which the total income of the assessee is to be computed. In the case before us, the Income-tax Officer was clearly right in the assessment years 1958-59 and 1959-60 in not setting off the losses in the speculative business against the income earned in those years either from property or from ready business in Kappas.

Then comes the second proviso, and it is clear from the language of this proviso that it does not deal

with the computation of the income of the assessee for purposes of determining the total income. This second proviso was incorporated in order to indicate the personality of the assessee for the purpose of applying the principal clause of s. 24(1) taken together with the first proviso. No difficulty could arise in applying the principal clause and the first proviso together in the case of individuals, companies, Hindu undivided families, etc.; but a provision was needed for cases where the assessee happened to be a firm. This necessity arose because of the special manner laid down in s. 23 itself for assessing the income of a firm. That section lays down different rules for assessment of unregistered firms and registered firms. In the case of an unregistered firm, the total income computed by the Income-tax Officer for determining the tax can be assessed by apportioning that income between the partners, and determining the tax payable by each partner on the basis of such assessment, including his income from other sources, as laid down in s. 23(5)(b) of the Act. In the alternative, the Income-tax Officer may choose to assess an unregistered firm as a unit by itself, and in that case, the tax is determined as payable by the firm as a unit, so that the provisions of s. 23(5)(b) are not applied. The second proviso to s. 24(1) lays down that in such a case where an unregistered firm is not assessed under the provisions of clause (b) of sub-section (5) of s. 23, "any such loss shall be set off only against the income, profits and gains of the firm and not against the income, profits and gains of any of the partners of the firm." It is clear that the expression "any such loss" in this part of the second proviso can only refer to the loss computed for purposes of applying the principal clause of s. 24(1) taken together with the first proviso. That will, therefore, be the loss suffered by the unregistered firm in businesses other than speculative business. The loss incurred in the speculative business by the unregistered firm is, thus, to be ignored. If this part of the second proviso were to be interpreted as laying down that the loss mentioned therein includes the loss from speculative business, the effect would be that the provision contained in the first proviso would be completely nullified. The effect of the first proviso is that when setting off the loss of profits and gains under one head against income, profits and gains under any other head in accordance with the principal clause, the loss suffered in speculative business is not to be taken into account and is to be kept apart. If the word "loss" in the first part of the second proviso were to be interpreted as including the loss in speculative business also, the result would be that the loss excluded under the first proviso would be included in the assessment of total income under the second proviso. In the circumstances, the only interpretation that can be placed on the words "any such loss" in this part of the second proviso is that this expression refers to the loss as determined for purposes of the principal clause of s. 24(1) read with the first proviso, and, thus, does not comprise within it loss incurred in speculative business referred to in the first proviso.

Then comes the second part of the second proviso which prescribes the personality of the assessee to which the provisions of s. 24 are to be applied in cases where the assessee is a registered firm. Under this part, the loss, which cannot be set off against other income, profits and gains of the registered firm, is to be apportioned between the partners of the firm and they alone are entitled to have the amount of the loss set off under this section. Clearly, in this part also, the words "any loss" must refer to the loss computed for purposes of the principal clause taken together with the first proviso, and will, therefore, not comprise in it the loss in speculative business which is not to be taken into account under the first proviso. The aspect of this provision, which is of importance, is that under it, the Income-Tax Officer is required to take two steps. The first is that the loss, which cannot be set off against other income, profits and gains of the registered firm, has to be apportioned between the partners of the firm, and then he has to give effect to the right of the partners to have the amounts of the loss set off under this section. Once again, if this part of the second proviso were interpreted to include within it the loss in speculative business which is not to be taken into account under the first proviso, the effect of giving a wider meaning to the words "any loss" in it would be

that the same loss in speculative business would, after apportionment, be set off against income, profits and gains under other heads in computing the total income of the partners. The result would be that the effect of the first proviso would again be nullified by this part of the second proviso. Consequently, the correct interpretation must be that the words "any loss" in this part of the second proviso also refer to the loss computed for the purposes of the principal clause of s. 24(1) taken together with the first proviso, so that it must also exclude the loss in speculative business which is not to be taken into account when computing the total income of the assessee. The language used in the second proviso, thus, itself leads to the conclusion that the decision arrived at by the High Court was correct, even though on a different reasoning.

In this connection, learned counsel appearing for the Commissioner drew our attention to the first proviso to s. 23(5)(a) of the Act, under which the share of a partner in a loss is required to be set off against his other income, or carried forward and set off in accordance with the provisions of s. 24. We do not think that this proviso refers to the loss incurred by a registered firm in speculative business which is not to be taken into account when computing the total income of the registered firm under s. 23(1), (3) and (4) of the Act. Section 23(5)(a) clearly applies only to the total income of the firm which has been assessed under sub-s. (1), sub-s. (3) or sub-s. (4) of s. 23, and does not apply to any other income or loss. If speculative business of a firm has resulted in profit, that profit, as we have indicated earlier, would be taken into account when determining the total income of that firm. But if there be a net loss in all speculative businesses taken together, that loss is not to be taken into account when computing the total income, and consequently, that loss would be outside the scope of s. 23(5)(a) also. The first proviso to s. 23(5)(a) cannot be, therefore, held to be applicable to loss in speculative business kept apart under the first proviso to s. 24(1).

Coming to sub-section (2) of s. 24 on which reliance was placed by learned counsel for the Commissioner, we find that, instead of supporting the interpretation sought to be put on behalf of the Commissioner on the second proviso to s. 24(1), it supports the view which we have arrived at on interpretation of the language of s. 24(1) and its provisos. Clause (1) of s. 24(2) lays down that where the loss was sustained by an assessee in a business consisting of speculative transactions, it shall be set off only against the profits and gains, if any, of any business in speculative transactions carried on by him in that year. This is a general provision which is applicable to loss in speculative business suffered by any assessee, including a firm, and the limitation that it places is that speculative loss, kept apart under s. 24(1) and not set off against the income, profits and gains of that earlier year, is only to be set off in a subsequent year, if there are profits in speculative transactions of the same business. This provision is also, however, governed by some provisos, including proviso (c) which lays down that : "nothing herein contained shall entitle any assessee, being a registered firm, to have carried forward and set off any loss which has been apportioned between the partners, under the proviso to sub-s. (1), or entitle any assessee, being a partner in an unregistered firm which has not been assessed under the provisions of clause (b) of sub-s. (5) of s. 23 to have carried forward and set off against his own income any loss sustained by the firm." This proviso is again divisible into two parts. One part relates to the case of an unregistered firm and lays down an absolute prohibition against setting off of loss carried forward in the assessment of a partner of an unregistered firm, which has been assessed as a separate unit, by omitting to apply the provisions of cl. (b) of sub-s. (5) of s. 23. This part, thus, does not envisage that, in the case of such an unregistered firm, there would be any loss which could be apportioned between the partners. In the case of a registered firm, however, the provision made is in different language. It lays down that "nothing herein contained shall entitle any assessee, being a registered firm, to have carried forward and set off any loss which has been apportioned between the partners, under the proviso to sub-section (1)." Thus, it prohibits a claim being made by a registered firm as such to set off loss in the

future year against profits in that year, which loss has been apportioned between the partners under the proviso to s. 24(1). That loss would be the loss taken into account in computing the total income under s. 23 in view of the principal clause of s. 24(1) read with the first proviso to it and will, thus, exclude the speculative loss which is not taken into account. The language of this part of the proviso clearly envisages that there could be loss which has not been apportioned between the partners of a registered firm, so that the registered firm can claim to have it carried forward and set off in future years. Clearly, that can only be the loss in speculative business of the registered firm which is not taken into account, when computing the total income of the firm under s. 23, in view of s. 24(1). No question could have arisen of the Legislature recognising the possibility of a firm claiming set off of any loss incurred in an earlier year if, as contended on behalf of the Commissioner, even the loss in speculative business were to be apportioned between the partners under the second proviso to s. 24(1). On the interpretation sought to be placed on behalf of the Commissioner, loss, other than loss in speculative business, has to be set off against the income, profits and gains under any head of the assessee in view of s. 24(1) read with its first proviso, while loss in speculative business would also have to be apportioned under the second proviso leaving no loss unapportioned between the partners. The fact that proviso (c) to s. 24(2) envisages the existence of loss which has not been apportioned between the partners clearly strengthens our view that the second proviso to s. 24(1) does not cover loss in speculative business, and consequently, does not permit that loss to be apportioned between the partners. Thus, s. 24(2) also leads to the same conclusion which we have arrived at above on the interpretation of the language of s. 24(1).

In view of the reasons given by us above, we are unable to agree with the reasoning adopted by the Bombay High Court in Commissioner of Income-tax, Bombay City I, v. Chimanlal J. Dalal and Co. (57 I.T.R. 285.), and cannot accept the view of that Court that the decision given in the present case by the Gujarat High Court was incorrect.

The appeal, therefore, fails and is dismissed with costs.

G.C.

Appeal dismissed.

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