

The Madurai District Central Co-Operative Bank Ltd.

Vs

The Third Income Tax Officer, Madurai

Civil Appeal No. 1795 of 1970

(Y. V. Chandrachud R. S. Sarkaria, A. C. Gupta JJ)

28.07.1975

JUDGMENT

CHANDRACHUD, J. –

1. The appellant filed a writ petition in the High Court of Madras under Article 226 of the Constitution to challenge an assessment order dated August 22, 1963 made by the respondent, levying additional surcharge on its residual income. The High Court dismissed the writ petition by its judgment dated October 15, 1968 but it has granted to the appellant a certificate to file an appeal to this Court under Articles 133(1) (a) and (c) of the Constitution.

2. The appellant is a co-operative society engaged in the business of banking. Its total income for the assessment year 1963-64 was computed by the respondent at Rs. 10,00,098. Out of this Rs. 9,48,335 was its business income while Rs. 51,763 was its income from other sources. Since, under Section 81(i)(a) of the Income-tax Act, 1961 a co-operative society engaged in the business of banking is not liable to pay income-tax on its business income, the tax amounting to Rs. 32,845.47 was charged on Rs. 51,763 only, though for the purposes of rate the income was taken at Rs. 9,48,335 in view of Section 110 of the Act. Applying the Finance Act, XIII of 1963, the respondent computed the residual income of the appellant at Rs. 5,39,386 and levied on it an additional surcharge of Rs. 52,828.60. Thus the total tax levied on the appellant came to Rs. 23,845.47 plus Rs. 52,828.60, i.e. Rs. 76,674.07.

3. The main grievance of the appellant before the High Court was that whereas its taxable income was only Rs. 51,763, a tax of Rs. 76,674.07 was imposed on it. The relevant provision of the Finance Act were accordingly said to be invalid as they could not subject to additional surcharge an income which was exempt from tax under the provisions of the Income-tax Act. The additional surcharge, it was contentions, was intended as an additional levy on the income-tax and had no independent existence apart from it. These contentions were rejected by the High Court and hence this appeal.

4. Section 81 of the Income-tax Act, 1961 was deleted by the Finance Act, XX of 1967, with effect from April 1, 1968 but its provisions were incorporated by the same Finance Act in Section 80P. Section 81(i) (a) read thus :

81. Income of co-operative societies, - Income-tax shall not be payable by a co-operative society -

(i) in respect of the profits and gains of business carried on by if it is -

(a) a society engaged in carrying on the business of banking or providing credit facilities to its members;

It is indisputable that by reason of this provision, the banking income of the appellant amounting to Rs. 9,48,335 is exempt from income-tax. It is equally clear that by reason of Section 99(1)(v) of the Act of 1961, the appellant is not liable to pay super-tax on its business income. That section provides that where the assessee is a co-operative society, super-tax shall not be payable by it on any income in respect whereof no income-tax is payable by it by virtue of the provisions of Section 81.

5. The dispute really centres round the provisions of Finance Act, XIII of 1963. The provisions of that Act which are relevant for our purpose are Sections 2(1)(a), 2(8), 3, paragraph a (ii) of Part I of the First Schedule, and clause (c) of that portion of Part I, called "Surcharges On Income Tax".

6. Section 2(1)(a) of the Finance Act, 1963 provides that :

2. Income-tax and super-tax. - (1) Subject to the provisions of sub-section (2), (3), (4) and (5), for the assessment year commencing on the 1st day of April, 1963, -

(a) income-tax shall be charged at the rates specified in Part I of the First Schedule and, -

(i) in the cases to which paragraphs A, B, C and E of that Part apply, shall be increased by a surcharge for purposes of the Union and, except in the cases to which the said paragraph E applies; a special surcharge, calculated in either case in the manner provided therein; and

(ii) in the cases to which paragraph A and C of the aforesaid Part apply, shall further be increased by an additional surcharge for purposes of the Union (hereinafter referred to as additional surcharge) calculated in the manner provided in the said Schedule;

7. Section 2(8) provides that :

For the purposes of paragraph A and C of part I of the First Schedule, the expression "residual income" means the amount of the total income as reduced by -

(a) the amount of the capital gains, if any, included therein; and

(b) the amount of tax (exclusive of additional surcharge) which would have been chargeable on such reduced total income if it had been the total income no part of which had been exempt from tax and on no portion of which deduction of tax had been admissible under any provisions of the Income-tax Act or this Act.

8. Section 3 provides that :

Notwithstanding anything contained in the provisions of Chapter VII or Chapter VIII-A or Section 110 of the Income-tax Act or sub-section (5) of Section 2 of this Act, in calculating any relief, rebate or deduction in respect of income-tax payable on the total income of an assessee which includes any income on which no income-tax is

payable or in respect of which a deduction of income-tax is admissible under any of the aforesaid provisions, no account shall be taken of the additional surcharge.

9. The First Schedule of the Finance Act, 1963 consists of three parts out of which we are only concerned with Part I. Part I which is called "Income-tax and surcharges on income-tax" consists of paragraphs A, B, C, D and E out of which we are concerned with paragraph A prescribes rates of income-tax for incomes accruing, inter alia, to "association of persons". Since a co-operative society is an association of persons, paragraph A of Part I would apply to the case of the appellant for the purposes of Section 2(1) (a) (ii) of the Finance Act of 1963, though not for the purpose of bringing its exempted business income to income-tax.

10. That portion of Part I, paragraph A, called "Surcharges on Income Tax" provides :

The amount of income-tax computed at the rates hereinbefore specified shall be increased by the aggregate of the surcharge calculated as under :

Clause (a) provides for a surcharge for the purpose of the Union at the rates mentioned in sub-clauses (i), (ii) and (iii). Clause (b) provides for the levy of a special surcharge. Clause (c) with which we are concerned provides for the levy of "an additional surcharge for the purposes of the Union calculated on the amount of the residual income" at the rates mentioned therein.

11. The grievance of the appellant, which appears to have been pressed before the High Court with some earnestness, that the tax levied upon it exceeds its taxable income can afford no true guide to the construction of the relevant provisions of the Income-tax Act or the Finance Act. Harshness of a taxing statute, apart from a possible challenge to it under Article 13 of the Constitution, cannot be an invalidating circumstance. But the grievance on this score is basically misconceived. It assumes, what has to be examined, that no part of the income exempted from income-tax and super-tax under the Income-tax Act can be brought to tax by a Finance Act. The total income of the appellant was computed at Rs. 10,00,098. By reason of Section 81(i)(a) and 99(1) (v) of the Income-tax Act, 1961 the appellant enjoys an exemption from income-tax and super-tax in respect of its business income which amount to Rs. 9,48,335. The balance, viz. Rs. 51,763 which was the appellant's income from other sources was alone taxable under the Act of 1961 and a tax of Rs. 23,845.47 was imposed on that income. The Finance Act of 1963 subject 'residual income' to certain charges and such income was computed, admittedly correctly, at Rs. 5,39,386. An additional surcharge of Rs. 52,828.60 was levied on the residual income. Thus on the assumption that the Finance Act, validly and on a true interpretation, imposes the additional surcharge on residual income, the tax imposed on the appellant is Rs. 23,845.47 plus Rs. 52,828.60. The total taxable income arrived at by the addition of its non-business income and the residual income. That leads to the inquiry first as regards the scope of a Finance Act and then as regards the interpretation of the Finance Act of 1963.

12. Learned Counsel for the appellant, during the course of his arguments, gave up the challenge to the power of the Parliament to impose a new charge by a Finance Act. This concession was properly made. By Article 246(1) of the Constitution, Parliament has the exclusive power to make laws with respect to any of the matters in List I of the Seventh Schedule. Entry 82 in List I relates to "taxes on income other than agricultural income". The Income-tax Act, 1961 and the annual Finance Act are enacted by the Parliament in exercise of the power conferred by Article 24(1) read with Entry 82 of List I. Once the Parliament has the legislative competence to enact a law with respect to a certain subject-matter, the limits of that competence cannot be judge further by the form or manner in

which in which that power is exercised. Accordingly, though it would be unconventional for the Parliament to amend a taxing statute by incorporating the amending provision in an Act of a different pith and substance, such a course would not be unconstitutional.

13. Much more so can the Parliament introduce a charging provision in a Finance Act. True, as said in *Kesoram Industries and Cotton Mills Ltd. v. Commissioner or Wealth Tax, (Central) Calcutta* ((1966) 2 SCR 688, 704 : AIR 1966 SC 1370 : (1966) 59 ITR 767), that the Income-tax Act is a permanent Act while the Finance Act are passed every year and their primary purpose is to prescribe the rates at which the income-tax will be charged under the Income-tax Act. But that does not mean that a new and distinct charge cannot be introduced under the Finance Act. Exigencies of the financial year determine the scope and nature of its provisions. If the Parliament has the legislative competence to introduce a new charge of tax, it may exercise that power either by incorporating that charge in the Income-tax Act or by introducing it in the Finance Act or for the matter of that in any other statute. The alternative in this regard is generally determined by the consideration whether the new charge is intended to be more or less of a permanent nature or whether its introduction is dictated by the financial exigencies of the particular year. Therefore, what is not 'income' under the Income-tax Act can be made 'income' by a Finance Act, an exemption granted by the Income-tax Act can be withdrawn by the Finance Act or the efficacy of that exemption may be reduced by the imposition of a new charge. Subject to constitutional limitations, additional tax - revenue may be collected either by enhancing the rate or by the levy of a fresh charge. The Parliament, through the medium of a Finance Act, may as much do the one as the other. In *McGregor and Balfour Ltd. Calcutta v. C. I. T. West Bengal* ((1955) 27 ITR 389 (Call)), which was affirmed by this Court in 36 ITR 65 (*Mc Gregor and Balfour Ltd. v. C. I. T., West Bengal, 1959 Supp 2 SCR 355 : AIR 1959 SC 771*), Chakravarti, C.J. delivering the judgment of a Division Bench observed that the Finance Acts though annual Acts are not necessary temporary Acts for they may and often do contain provisions of a general character which are of a permanent operation.

14. In *Hari Krishna Bhargav v. Union of India* ((1966) 2 SCR 22 : AIR 1966 SC 619 : (1966) 59 ITR 243) an assessee challenged the scheme of annuity deposits on the ground that the Parliament had no competence to incorporate in the Income-tax Act a provision which was substantially one relating to borrowings by the Central Government from a class of tax-payers. That scheme was introduced by Finance Act 5 of 1964 which incorporated Chapter XXII-A containing Section 280-A to Section 280-X in the income-tax Act, 1961. The challenge was repelled by this Court on the ground that if the Parliament had the legislative competence to pass an Act for collecting annuity deposits from tax-payers, nothing contained in the Constitution desentitled it "as a matter of legislative arrangement to incorporate the provisions relating to borrowing from tax-payers in the Income-tax Act or any other statute".

15. This discussion became necessary in spite of the appellant's concession on the Parliament's legislative competence because for a proper understanding of the provision of the Finance Act, 1963, it is essential to appreciate that a Finance Act may not only. Prescribe rates but also introduce a new charge.

16. We will now proceed to consider the provisions of the Finance Act, 1963 under which the respondent has levied additional surcharge on the appellant's residual income. The question for consideration is whether clause (c) of the portion "Surcharges on Income Tax" occurring in Paragraph A of part I introduces a new charge in the shape of additional surcharge so that the said charge be levied even on a part of the appellant's income which is exempt from income-tax and super-tax under Section 81(1)(a) and 99(i)(v) of the Act of 1961.

17. The history of Indian income-tax, according to appellant's Counsel, shows that surcharge by way of increase in the amount of income-tax are nothing but income-tax and therefore the expression "income-tax" occurring in Section and 81 of the Act of 1961 and in Section 2 and the First Schedule of the Finance Act, 1963 includes surcharges. To put it differently, the argument is that the exemption granted by Section 81(i)(a) extends to surcharges also as a result whereof a co-operative society engaged in the business of banking is neither liable to pay income-tax nor any of the surcharges on its business income.

18. In *C. I. T. Kerala v. K. Shinivasan* ((1972) 83 ITR 346 : (1972) 4 SCC 526 : 1974 SCC (Tax) 360 on which the appellant relies, this Court has traced the history of the concept of 'surcharge' in the tax laws of our country. After considering the report of the Committee on Indian Constitution Reforms, the provisions of the Government of India Act, 1935, the provisions of Articles 269, 270 and 271 of the Constitution and the various Finance Act, this Court held, differing from the High Court, that the word "income-tax" in Section 2(2) of the Finance Act, 1964 includes surcharges and the additional surcharge.

19. This case does not touch the point before us. In that case, the assessee's income for the accounting year ending March 30, 1964 consisted mainly of his salary. Section 2(2)(a) of the Finance Act, 1964 did not by itself refer to any surcharge but it provided that in making the assessment for the assessment year commencing on April 1, 1964 the "income-tax" payable by the assessee on his salary-income shall be an amount bearing to the total amount of "income-tax" payable according to the rates application under the operation of the Finance Act 1963 on his total income, the same proportion as the salary-income bears to the total income. The question which arose for consideration was whether the words "income-tax payable according to the rates application under the operation of the Finance Act, 1963" included surcharges which were leviable under the Act of 1963. The question was answered by this Court in the affirmative. As the judgment shows, "the essential point for determination" was "whether surcharge is an additional mode or rate for charging income-tax" (p. 351). The Court held that it was. The question before us is whether, even if the surcharge is but an additional mode or rate for charging income-tax, Finance Act of 1963 authorises by its terms the levy of additional surcharge on income which is exempt from income-tax under the Income-tax Act, 1961. In *K. Shinivasan's* case (*supra*) the Court declined to express any opinion on the distinction made by the High Court that surcharge levied under the Revenue that a surcharge partakes of the essential characteristics of income-tax and is an increase in income-tax. What we have to determine is whether the Act of 1963 provides for the levy of additional surcharge.

20. Granting that the word "income-tax" includes surcharge, it may be arguable that the exemption from the payment of income-tax under Section 81(i)(a) of the 1961 Act would extend to surcharges. But the matter does not rest with what Section 81(i) (a) says. Even if that section were to grant an express exemption from surcharge on business-income, the Parliament could take away that exemption or curtail the benefit available under it by making an appropriate provision in the Finance Act. If while legislating on the a matter within its competence the Parliament can grant an exemption it is surely competent to it to withdraw that exemption in exercise of the self-same power.

21. The Finance Act, 1963, like its annual counterparts, contains provisions not only prescribing rates of taxation but making extensive and important modifications in the Income-tax Act itself. By Section 4 to 20 of the Act of 1963, various provisions of the Income-tax Act have been amended. By these amendments, some of which are given retrospective effect, old provisions are deleted, new ones are added and indeed new concepts of taxation altogether are introduced. Such innovations fall within the legitimate scope of Finance Acts. Section 11(14) of the Indian Finance Act, 1946, made

the amount of excess profits tax repaid under Section 28 of the U.K. Finance Act, 1941, "income" for the purpose of the Indian Income-tax Act and further provided that "income" shall be "treated" for purposes of assessment to income-tax and super-tax as the income of the previous year. It was held by this Court in *McGregor and Balfour Ltd. v. C. I. T., West Bengal* ((1959) 36 ITR 65 : 1959 Supp 2 SCR 355 : AIR 1959 SC 771), that Section 11(14) charged the amount with a liability to tax by its own force. It was further held that the particular provision, framed as it was, applied to subsequent assessment years just as it applied to the assessment year 1946-47.

22. Having seen the nature and scope of Finance Act, the specific question which we have to consider is whether, as contended by the appellant, Section 2 read with paragraph A, Part I of the First Schedule of the Finance Act, 1963 merely lays down a method of computation in cases where income-tax is in fact payable or whether, as contended by the Revenue, the Finance Act provisions for the levy of a new and independent charge. According to the appellant, these provisions of the Finance Act do not, directly or indirectly, bring about any amendment to Section 81(i) (a) of the Income-tax Act but merely prescribe that in cases where the income-tax is payable, "the amount of income-tax ... shall be increased by the aggregate of the surcharges". The heading "Surcharges On Income Tax" under which provision is made in the Finance Act for the calculation of a surcharge, a special surcharge and an additional surcharge is also to bear out the contention that the levy of additional surcharge on the residual income cannot be dissociated from the main charge of income-tax.

23. We are unable to accept this contention. Article 269(1) of the Constitution provides that the duties and taxes mentioned therein shall be levied and collected by the Government of India but shall be assigned to the States in the manner provided in clause (2). Article 270(1) provides that taxes on income other than agricultural income shall be levied and collected by the Government of India and distributed between the Union and the States in the manner provided in clause (2). By Article 271, notwithstanding anything in Articles 269 and 270, Parliament may increase any of the duties or taxes referred to in these Articles by a surcharge for purposes of the Union. Surcharges leviable under Section 2(1) of the Finance Act, 1963 are relatable to Article 271 of the constitution.

24. Section 2(1)(a)(ii) of that Act provides, in so far as relevant, that for the assessment year commencing on April 1, 1963 income-tax shall be charge at the rates specified in Part I of First Schedule and in cases to which Paragraph A of Part I applied, the applies, the income-tax shall further be increased by an additional surcharge for purpose of the Union calculated in the manner provided in the First Schedule. Clause (c) of paragraph A prescribes the manner in which the additional surcharge for purposes is to be calculated. It provides that additional surcharge for purposes of the Union shall be calculated "on the amount of the residual income" at the rates mentioned in that clause. Thus, both the purpose and concept of the additional surcharge is leviable exclusively for purposes of the Union so that the entire proceeds of such surcharge may, under Article 271 of the Constitution, from part of the Consolidated Fund of India. Taxes and duties mentioned in Article 269(1), though levied and collected by the Government, have to be assigned to the States in the manner provided in clause (2) of that Article. Then again, the additional surcharge levied for purposes of the Union is to be calculated not on total income like the income-tax but it is to be calculated on the residual income. Section 2(8) of the Act of 1963 defines residual income as total income reduced by (a) capital gains, if any, included in that total income, and (b) the amount of tax (exclusive of additional surcharge) which would have been chargeable on such reduced total income if it had been the total income no part of which had been exempt from tax and on no portion of which deduction of tax had been admissible. In order that the exemption granted to co-operative banks by Section 81(i) (a) may not lose its meaning and content, Section 2(8) of the Finance Act

introduces the concept of residual income on which alone the additional surcharge is payable. The residual income is not the same as the business income of a co-operative bank, which is exempt under Section 81(i)(a) from income-tax. For ascertaining the residual income, the total income is reduced by the amount of capital gains and further by the amount of tax (other than additional surcharge) which would have been charged on such reduced total income in the assumption that the whole of it was liable to be brought to tax.

25. Thus, in the instant case the additional surcharge is not levied on the appellant's business income of Rs. 9,48,335 which is exempt from income-tax and super-tax. It is levied on the residual income of Rs. 5,39,386 which is arrived at after deducting gross taxes (exclusive of additional surcharge) amounting to Rs. 4,60,712 from the assessee's gross income of Rs. 10,00,098. By Section 3 of the Finance Act of 1963 no account can be taken of the additional surcharge in calculating any relief, rebate or deduction in respect of income-tax payable on the total income of an assessee which includes any income on which no income-tax is payable or in respect of which a deduction of income-tax is admissible. Section 3, by its terms, has precedence over anything contained in Chapter VII-A or in Section 110 of the Income-tax Act in Section 2(5) of the Finance Act itself. Additional surcharge is treated in this way as falling in a separate category.

26. Thus, additional surcharge is a distinct charge, not dependent for its leviability on the assessee's liability to pay income-tax or super-tax. Such a qualification cannot be read into Section 2(1)(a)(ii) of the Act of 1963 as argued by the appellant. That section uses the language that "income-tax . . . shall further be increased by an additional surcharge", not for making the assessability to surcharge dependent upon assessability to income-tax but for the simple reason that if an assessee's total income includes income on which no tax is payable, tax has all the same to be computed for purposes of rate. Section 110 of the income-tax with which he is chargeable on his total income, of an amount equal to the income-tax calculated at the average rate of income-tax on the amount on which no income-tax is payable. The income-tax computed at a certain rate is by Section 2(1)(a)(ii) to be further increased by an additional surcharge for purposes of the Union. This becomes clearer still from the language of paragraph A, under the heading "Surcharges On Income Tax". It says : "The amount of income-tax computed at the rate hereinbefore specified shall be increased by the aggregate of the surcharges". If the intention was to limit the liability to pay additional surcharge to income which can be brought to income-tax, appropriate language could have been used to convey that simple sense.

27. The weakness of the appellant's contention becomes manifest when it is realised that were the contention right, the appellant would not be liable to pay additional surcharge even in that portion of its non-business income which is contained in the residual income. By the definition in Section 2(8) of the Act of 1963, residual income means the total income as reduced and therefore, the non-business income which is chargeable to income-tax must form a component of the residual income. Concededly, the appellant is liable to pay additional surcharge on its non-business income. This is so, not because additional surcharge is payable by law on non-business income but because it is payable on residual income and residual income, by definition, includes non-business income as reduced. In fact, it consists of the amount of total income as reduced by the amounts mentioned in clauses (a) and (b) of Section 2(8).

28. Relying on *United Commercial Bank Ltd. v. C. I. T., West Bengal* ((1957) 32 ITR 688 : 1958 SCR 79 : AIR 1957 SC 918), *East India Housing and Land Development Trust Ltd. v. C. I. T., West Bengal* ((1961) 42 ITR 49 (SC)), and *K. V. Al. M. Ramanathan Chettiar v. C. I. T., Madras* ((1973) 88 ITR 169, 191 : (1973) 3 SCC 351, 364 (Para 16) : 1973 SCC (Tax) 229, 242), the appellant's

Counsel urged that income-tax is a single levy, that it is one tax and not so many taxes separately levied on several heads of income. This partly is the same argument in a different disguise that an assessee who is not liable to pay income-tax cannot be made liable to pay additional surcharge under the Finance Act, 1963. We have rejected that contention. Partly, the argument is designed to establish co-relation with Section 146 of the Income-tax Act, 1961 by which, when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, the Income-tax Officer has to serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable. This provision presents no difficulty for, if an assessee is liable to pay additional surcharge but no income-tax or super-tax, the notice of demand will mention the particular amount payable as tax due. The appellant being liable to pay tax on its non-business income and additional surcharge on its residual income, the demand notice will call for payment of the total amount due from the appellant by way of tax.

29. The interpretation put by us on the Finance Act, 1963 does no violence to Section 4 of the Income-tax Act, 1961 under which income-tax at the rate prescribed by the Finance Act is to be charged "in accordance with, and subject to the provisions of", the Income-tax Act. The Income-Tax Act exempts the assessee's business income from income-tax and super-tax. The Finance Act brings to tax its residual income.

30. The decision of the Allahabad High Court in Allahabad District Co-operative Bank Ltd. v. Union of India ((1972) 83 ITR (All)) is directly in favour of the appellant and naturally, learned Counsel for the appellant relies on it very strongly. But that case, in our opinion, is incorrectly decided. The learned Judges were in error in holding that Section 2 of the Finance Act, 1963 "does not provide for the levy of a tax other than income-tax" and that therefore, additional surcharge is not payable to the extent of the income which is exempt under Section 81 of the Income-tax Act. One of the difficulties which the learned Judges felt in accepting the Revenue's contention was that if the additional surcharge mentioned in the Finance Act of 1963 does not partake of the nature of income-tax it will not be possible to demand and realise it under the provision of the Income-tax Act, and the notice of demand and recovery proceedings would be vitiated on that account.

The very assumption of this observation is fallacious because additional surcharge indubitably partakes of the nature and essential characteristics of income-tax. It is a tax on residual income and by reason of the definition contained in Section 2(8) of the Act of 1963, "residual income" would include non-business income which under the Income-tax Act is chargeable to income-tax. Thus, the additional surcharge, though levied by the Finance Act, 1963 independently of the Income-tax Act, is but a mode of levying tax on a portion of the assessee's income computed in accordance with the definition in Section 2(8) of the Act of 1963. Therefore, the notice of demand under Section 156 of the Income-tax Act can lawfully call for the payment of amount due from an assessee by way of additional surcharge.

31. For these reasons, we confirm the judgment of the High Court but in the circumstance there will be no order as to costs.

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