

BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

Industrial Investment Trust Co

(Kotwal, C.J. V Desai, J.)

11.09.1967

JUDGMENT

V.S. Desai, J.

1. This is a reference under section 66 (1) of the Indian Income-tax Act referring to this court a question of law, which arises in the assessment orders made on the assessee for the assessment of eight years, viz., the assessment years 1951-52 to 1958-59.

2. The assessee is a company incorporated under the Indian companies Act having for its principal business, acquisition and holding of investments in stocks and shares, etc. It has extensive holdings and derives income from dividends and interest on securities. In all the assessment years, which are involved in this reference, the nature of the business of the company and its earning was the same. It is, therefore, necessary to give the figures of income only for the first year as the said figures are typical with regard to the subsequent years also. In the assessment years also. In the assessment year 1951-52 the company derived income from dividends to the extent of Rs. 7,61,407. Out of this amount, a sum of Rs. 5,86,873 represented the dividends paid by other companies which had paid or would pay super tax in respect of the profits out of which such dividends were paid. The balance of Rs. 1,74,534 represented income from other than such dividends. Now, the assessee-company satisfied all the conditions set out in the explanation to the Notification No. 47 of the Governor-General-in-Council dated 9th December, 1933, and was, therefore, entitled to the exemption from payment of super-tax in respect of the income specified in the said notification. In the assessment year the sum of Rs. 5,86,873 represented such income and the assessee accordingly claimed exemption in terms of the notification in respect of the entire amount. The loss of the business being the expenses for the year of assessment was Rs. 92,619 and allowing this amount the computed total income of the assessee came to Rs. 6,68,788. The Income-tax Officer took the view that the business loss or expenses had to be spread over the entire income and, consequently, the assessee will be entitled to exemption in terms of the notification not in respect of the entire amount of Rs. 5,86,873 but

only in respect of that part of the computed income, which was referable to the said amount of Rs. 5,86,873. In other words, the exemption could be allowed only in respect of a sum arrived at by deducting from Rs. 5,86,873 the proportionate expenses attributable to the said figure. In that view of the matter, he apportioned the expenses between the two figures of Rs. 5,86,873 and Rs. 1,74,534 which represented, respectively, the income which was entitled to exemption under the notification and the income which was not so exempted, and, ultimately, arrived at the conclusion that the income of the assessee which was liable to pay super-tax was Rs. 1,74,534 less the proportionate business loss of Rs. 22,544. The assessee appealed to the Appellate Assistant Commissioner, who agreed with the view taken by the Income-tax Officer. In the further appeal to the Tribunal, it accepted the assessee's contention that, on a proper construction of the notification, the assessee was entitled to an exemption in respect of the entire amount of Rs. 5,86,873. On an application made by the department under section 66 (1) of the Income-tax Act, it has referred the following question arising out of its order to this court :

"Whether, on the facts and on a proper construction of the Notification No. 47 dated December 9, 1933, the assessee was entitled to exemption from super-tax on the whole of the dividend income derived from any other company which has paid or will pay super-tax in respect of the profits out of which such dividends were paid without deduction of any loss or other expenses that the company has incurred ?"

3. The notification in question is as follows :

"The Governor-General-in-Council is pleased to exempt from super-tax -

(i) so much of the income of any investment trust company as is derived from dividends paid by any other company which has paid or will pay super-tax in respect of the profits out of which such dividends are paid."

4. There is an Explanation appended to this notification, which defines the companies which come within its scope. Since there is no dispute that the assessee-company fulfills all the requirements of the Explanation to the notification, it is not necessary to set it out. On the construction of the notification the main question is what is the meaning of the expression "income" used in the said notification.

5. Mr. Joshi, the learned counsel for the department, argues that the word "income" as used in the notification means the computed income or the total income and not the gross income. His argument is that the notification provides for exemption from tax and, therefore, postulates the taxability of the income. Now, taxable income under the Income-tax Act is the total income, because under the charging section it is the total income that is subjected to tax. Total income under the Income-tax Act is the income of the categories referred to in sub-section (1) of section

4 and computed in the manner laid down in the Act. The different heads of the income referred to in section 4 or given in section 6 of the Act and the manner and the method of computing the income arising under the said heads is given in the following sections from 7 to 12 of the Act. Mr. Joshi says that it is when the process of the computation as given in the Act is applied to the income of the assessee that the computed total total income emerges, which is thereafter subjected to tax at the prescribed rates Mr. Joshi therefore, argues that when a notification says that income will be exempted from the payment of tax, the reference is to the taxable or total or computed income and not to the gross income Mr. Joshi has, therefore, argued that the Income-tax Officer and the Appellate Assistant Commissioner were right in allowing exemption not on the gross amount of Rs. 5,86,873 but on that amount which resulted after the process of computation was applied to the said gross income Since the total computed income arrived at by the Income-tax Officer was Rs. 6,68,788, which was after deduction of the business expenses or loss being allowed out of the entire income, the part of this total income, which would be referable to the amount of Rs. 5,86,873, would be the said amount of Rs. 5,186,873 less the proportionate expenses attributable to the said amount. The result then would be that a taxable income which would be liable to pay super-tax would be that part of the computed income of Rs. 6,68,788 which was referable to the amount of Rs. 1,74,534 and would, therefore, be the said amount of Rs. 1,74,534 minus the proportionate expenses attributable to the said amount of Rs. 1,74,534 minus the proportionate expenses attributable to be said amount.

6. In our opinion, the argument advanced by the learned counsel would not be available in view of the Supreme Court decision in Commissioner of Income-tax v. South Indian Bank. In that case the Supreme Court was considering another notification under section 60A providing for exemption from payment of Income-tax. The relevant part of that part of that notification was in these terms :

"No income-tax shall be payable by an assessee on the interest receivable on the following income-tax free loans issued by the former Government of Travancore or by the former Government of Cochin, provided that such interest is received within the territories of the State of Travancore-Cochin and is not brought into any other part of the taxable territories to which the said Act applies. Such interest shall, however, be included in the total income of the assessee for the purpose of section 16 of the Indian Income-tax Act, 1922..."

7. The assessee in that case had received a sum of Rs. 44,720 towards interest to respect of tax-free securities to which the notification applied. In his assessment he had claimed exemption from tax in respect of the entire amount of Rs. 44,720. The Income-tax Officer, however, had deducted from the said sum of Rs. 44,720 a reasonable sum expended by the assessee in realising the interest and interest payable on the money borrowed for the purpose of investing in those

securities, with the result that he had allowed him exemption only in respect of Rs. 7,276. The argument advanced by the department was similar to the argument advanced by the learned counsel before us, viz., that the exemption could be allowed not in respect of the gross income but in respect of the computed income under the Act. It was contended that, since the interest on securities was required to be computed under the provisions of section 8 of the Act, the income in respect of which exemption could be granted would be the income which would emerge as computed income after the process of computation of income under section 8 was applied to it. The Supreme Court negated the said contention and held that the notification was a self-contained one giving a total exemption from income-tax, and there was, therefore, no scope for controlling the provisions of the notification with reference to section 8 of the Income-tax Act. "Interest receivable" was an unambiguous expression and it could only mean the amount of interest calculated in accordance with the terms of the securities and it could not mean interest receivable minus the amount spent in receiving the same. In the notification before us the expression used is "income derived by the assessee from dividends" of the specified kind. The income arrived from dividends of the kind specified in the notification would mean the amount received by the assessee-company as dividends of the specified kind. The object of the notification, it would appear, was to allow exemption in respect of super-tax on the dividends, which, before they had been received by the assessee, had been subjected to the payment of super-tax in the hands of the paying company. That being so, the dividend income which was exempted under the notification would be the dividend income received by the assessee and not the said income less any further amounts. As has been held by the Supreme Court in the said case, the notification must be regarded as a self-contained one and not controlled by any other provisions of the Act. There is, therefore, no warrant to construe the word "income" in the notification as total income nor to qualify the dividend income nor to qualify the dividend income specified in the said notification as the dividend income computed under section 12 of the Act. In our opinion, therefore, on a proper construction of the notification the assessee would be entitled to exemption from super-tax on the whole of the dividend income of Rs. 5,86,873 without deducting therefrom the proportionate expenses attributable to the same.

8. Mr. Joshi has then argued that, even though on this construction of the notification the entire amount of Rs. 5,86,873 is exempted from the payment of super-tax, the amount of income of the assessee chargeable to super-tax would still be as found by the Income-tax Officer, viz., the sum of Rs. 1,74,534 less proportionate business loss of Rs. 22,544 attributable to the said amount. Mr. Joshi has argued that the effect of the notification would be to give the assessee an exemption only in respect of the income of the dividend of the kind specified in the notification received by it and nothing more. The assessee's business was carried on for the purpose of obtaining income, which was exempt from super-tax, and income which was not so exempt. Expenditure incurred in the business was incurred for the purpose of earning both kinds of income. The part of the

expenses enter the computation of the income, which was liable to tax, because that income being free from tax, there was no question of considering the expenses incurred for earning that income and there was also no question of allowing the assessee the said expenses. In the present case, a larger portion of the income earned by the assessee was of the kind, which was exempted from payment of super-tax. A large part of the expenses incurred by the assessee, therefore, must also have been spent for the earning of that income. What the assessee wants by allowing an exemption in respect of the entire amount is not only to get an advantage in respect of the tax in respect of the dividend amount but also in respect of a further sum representing the expenses attributable to the earning of the said income, because he wants to set off that sum of expenses also against the taxable income, viz., Rs. 1,74,534 and bring it to a reduced figure. It may be, says Mr. Joshi, that the assessee may get the exemption of the entire amount of the dividend income obtained by him but there is no reason why he should get a further exemption in respect of the other items, which are liable to pay tax, by deducting an additional amount by way of expenses which it has not spent in earning that income, but in earning the other kind of income. Mr. Joshi has, therefore, argued that even if the notification is construed as giving exemption in respect of the entire amount of the dividend income of the kind specified in the notification, the assessment order passed by the Income-tax Officer would still be a correct order.

9. Mr. Mehta, the learned counsel appearing for the assessee, has contended in the first place that the contention urged by Mr. Joshi does not arise on the question which has been referred to this court by the Tribunal. He argues that the only question that was argued before the Tribunal was whether the assessee was entitled to exemption in respect of the entire amount of Rs. 5,86,873 or in respect of a sum arrived at after deducting therefrom a proportionate portion of the expenses. It depended entirely on the construction of the notification. There was no argument advanced before the Tribunal, says Mr. Mehta, that in any event the income of the assessee liable to the payment of super-tax could be only Rs. 1,74,534 minus proportionate expenses attributable to the earning of the said income, because the said income could not be further reduced by taking therefrom expenses which were not incurred for the earning of the said income. The question now posed by the learned counsel for the department, says Mr. Mehta, is an entirely different question which is whether, when the business of the assessee earns income, a part of which is free from tax, the expenses of business which are allowable to the assessee under section 10 of the Act, are the whole of such expenses or only a proportionate part thereof, which could be allocated as for the earning of the taxable income. This question, he says, is a new question not argued before the Tribunal and, therefore, does not arise out of its order and cannot be permitted to be argued in the present reference.

10. It is no doubt true that the argument before the Tribunal proceeded mainly on the basis whether the whole or part of the income of Rs. 5,86,873 was entitled to exemption. It cannot,

however, be said that the contention, which is now made out by Mr. Joshi, was not involved as an aspect of the question raised and debated before the Tribunal. It would appear from the order of the Tribunal that the departmental representative had submitted before it that, by allocating the whole of the loss or expenses to the income which was outside the scope of the notification, the assessee would be getting, what may be called a double advantage, i.e., getting exemption under the notification once and getting deduction for the entire loss or expenses out of the income which does not come within the notification. It may be, as Mr. Mehta says, that this submission was urged in the context of the construction of the notification and for urging that, on a proper construction of the notification, the expression "income" used in the notification must be construed to mean computed income and not the gross income and it may be that the Tribunal might have considered it in that context only. In cannot, however, be said that this aspect of the controversy between the parties was not even referred to before the Tribunal. Moreover, it may be pointed out that the Income-tax Officer or Rs. 1,74,534 minus Rs. 92,619 as contended by the assessee, because the assessee's claim for exemption of the whole of the amount of expenses towards the other part of the income. We do not, therefore, agree with Mr. Mehta that the contention urged by the learned counsel for the department relates to an entirely new question not arising from the order of the Tribunal.

11. Mr. Mehta has been then said that the question, which has been referred by the Tribunal to this court does not involve this aspect and the department has not asked for any question to be framed so as to cover this aspect, nor has it taken out a notice of motion for any such question. The function of this court on a reference under section 66 (1) being merely to answer the question, which is referred to this court, and since the question as is referred to this court does not take in this aspect, we should not consider and answer the same.

12. Now, it is well-settled that although this court, on a reference under section 66 (1), cannot frame new or additional question not referred to by the Tribunal so as to bring out the real controversy between the parties if the question as framed fails to do so. As we have already pointed out earlier, the contention urged by the learned counsel for the department was an aspect of the controversy between the parties before the income-tax authorities as well as before the Tribunal and if the difficulty in considering that aspect here were to arise because of the wording of the question framed by the Tribunal, we would have reframed the question so as to bring in the said aspect. We find, however, that the question as framed is wide enough to take in that aspect also, because what it requires to be determined is whether, on the facts of the case, that is, the case of an assessee-company whose business yields income, part of which qualifies for exemption under the notification, the benefit to which it is entitled, on a proper construction of the notification, would cover the whole of the income without deduction of any loss or other expenses that the company has incurred. In other words, what is required to be considered is not

only a construction of the notification but the effect thereof on the assessment of the assessee in the present case. We will, therefore, hold in favour of Mr. Joshi that the second contention urged by him is permissible to be raised on the question framed in the present reference.

13. We find, however, that the said contention cannot succeed in view of the Supreme Court decision in *Commissioner of Income-tax v. Indian Bank Ltd.* In that case the assessee, which was a banking company, had, in the course of its business, invested a large sum in securities including securities, the interest on which was exempt from tax. Profits and losses on the purchase and sale of such securities were duly taken into account in computing the business income of the assessee. The Income-tax Officer, however, did not allow the entire amount of interest paid by the respondent on moneys borrowed from its various depositors under section 10 (2) (iii) of the Indian Income-tax Act, on the ground that part of the moneys borrowed had been utilised for the purpose of investing in securities, the interest on which was exempt from tax, and, consequently, the said part of the interest could not be allowed under section 10 (2) (iii). He, accordingly, disallowed a proportionate part of the interest referable to moneys borrowed from depositors for purchase of securities whose interest was tax free. The Supreme Court held that the entire interest was allowable under section 10 (2) (iii). It was argued before the Supreme Court that no expenditure could be allowed as a deduction from the profits of a business unless the part of the business to which the expenditure is attributable is capable of producing income or profits liable to be taxed under the Act, and, consequently, if a part of the profits of the business was not taxable, no expenditure incurred for the purpose of earning that income could be allowed as a deduction. The argument was negated by the Supreme Court. It was observed deductions and allowances allowed under the Act must be construed on the language of the provision allowing the deductions and exclusions.

14. Proceeding to consider section 10 of the Act, it observed :

"Let us then look at the language employed. Sub-section (1) directs that an assessee be taxed in respect of the profits and gains of business carried on by him. What is the business of the assessee must first be looked at. Does he carry on one business or two businesses or along with the business carried on by him some activity which is not a business ? If he is carrying on an activity which is not business, we must leave out of account the receipts of that activity. That is the first step. Secondly, we must look at section 10 (2) and deduct all the allowances permissible to him. In allowing a deduction which is permissible the question arises : Do we look behind the expenditure and see whether it has the quality of directly or indirectly producing taxable income ? The answer must be in the negative for two reasons : First, Parliament has not directed us to undertake this enquiry. There are no words in section 10 (2) to that effect. On the other hand, indications are to the contrary. In section 10 (2) (xv), what Parliament requires to be

ascertained is whether the expenditure has been laid out or expended wholly and exclusively for the purpose of the business. The legislature stops short at directing that it be ascertained what was the purpose of the expenditure. If the answer is that it is for the purpose of the business, Parliament is not concerned to find out whether the expenditure has produced or will produce taxable income. Secondly, the reason may well be that Parliament assumes that most types of expenditure which are laid out wholly and exclusively for the purpose of business would directly or indirectly produce taxable income, and it is not worth the administrative effort involved to go further and trace the expenditure to some taxable income."

15. In view of this decision, it would be clear that, if the expenses are allowable as business expenses, they will be allowed to be deducted from the income of the business, which is liable to tax. The circumstance that the business activity has produced income, a part of which is liable to tax and a part of which is free from tax, will not permit the allocation of the expenses between these two parts of the income and allow only that part which is attributable to the earning of the taxable income. In the present case before us, it is not disputed that the business activity of the assessee was a single activity and it had not two distinct or different businesses: one yielding a tax-free profit and the other a profit, which was subject to tax. The expenses were incurred for the carrying on of a single business, which produced income partly of one kind and partly of another. In such a case, as observed by the Supreme Court, where the expenses were allowable under the Act as expenses of business, no further enquiry was required as to whether the expenses had directly or indirectly the quality of producing income, which was liable to tax. The whole amount of the allowable expenses under the provisions of the Act was, therefore, required to be deducted from the part of the income of the assessee which was liable to pay super-tax and the decision of the Tribunal, therefore, that the income of the assessee, which was liable to pay tax, was Rs. 1,74,534 minus the entire business loss or expenses of Rs. 92,619 was correct.

16. In the result, therefore, the answer to the question referred to us by the Tribunal is that the assessee is entitled to exemption from super-tax on the whole of the dividend income derived from any other company which had paid or would pay the super-tax in respect of the profits out of which such dividends were paid, and the Income-tax Officer was not entitled to deduct any loss or other expenses that the company had incurred, from the said amount.

17. The Commissioner to pay costs of the assessee.

