Madras Co-Operative Central Land ... vs Commissioner Of Income-Tax, Madras on 18 July, 1967

Equivalent citations: [1968]67ITR89(SC), [1968]1SCR30

Bench: J.C. Shah, S.M. Sikri, V. Ramaswami

JUDGMENT

Shah, J.

1. This is an appeal with special leave.

2. The appellant is a Society registered under the Co-operative Societies Act, 1912. The following table sets out the data relating to the earnings, investments, working capital, outgoings and expenditure of the Society for the year ending June 30, 1955, relevant to the assessment year 1956-57 :-

(i)	Interest from Government securities	Rs. 4,30,453.00
(ii)	Total gross earnings	Rs. 21,00,994.00
(iii)	Investments in Government securities	Rs. 130,60,653.00
(iv)	Total working capital	Rs. 473,42,603.00
(v)	Interest paid on debentures, deposits and other accounts	Rs. 15,09,490.00
(vi)	Total overhead expenses and establishment overhead charges	Rs. 3,01,102.00

3. In a proceeding for assessment of the total income of the Society to tax for the year 1956-57 it was claimed that under s. 14(3) of the Indian Income-tax Act, 1922 (as added by s. 10 of the Finance Act 1955, with effect from April 1, 1955) the income of the Society from business was exempt from payment of tax, and that in accordance with the instructions issued under s. 60 of the Act, out of the gross income from securities amounting to Rs. 4,30,053/- Rs. 4,16,475/- being income attributable to the assets utilized in the business, only the balance of Rs. 13,578/- was chargeable to tax. In support of its claim the Society relied upon the instructions published in the Income-tax Manual, 1946. In the view of the Income-tax Officer the Society could not claim the benefit of the Departmental Instructions, since in the relevant year of assessment those instructions had ceased to operate, and the Society's claim was governed by the Explanation to s. 8 of the Income-tax Act as incorporated by the Finance Act of 1956, with effect from April 1, 1956. He accordingly computed the taxable income under the head - "interest on securities" in the sum of Rs. 59,498/-. The Appellate Assistant Commissioner modified the order of the Income-tax Officer and reduced the taxable income under the head "interest on securities" to Rs. 13,578/- applying the Departmental

Instructions. He held that the Explanation to s. 8 of the Act applied to Banking Companies and not to Co-operative Societies.

4. In appeal by the Commissioner of Income-tax the Appellate Tribunal reversed the order of the Appellate Assistant Commissioner, and restored the order of the Income-tax Officer. In the view of the Tribunal, the Explanation to s. 8 of the Act cannot be invoked as the Society was not a Banking Company, but the principle of the Explanation may well be called in aid and that the relief granted by the Income-tax Officer was the only relief to which the Society was entitled.

5. The following question of law was submitted by the Tribunal to the High Court of Madras :

> "Whether the Tribunal is justified in law in holding that the taxable income of the assessee from interest on securities is Rs. 59,498/- ?"

6. The High Court reframed the question to read :

> "Whether the taxable income of the assessee from interest on securities is Rs. 13,578/- as contended by the assessee and as worked out on the basis of the Departmental instructions contained at pages 248 and 249 in Part III of the year 1946 ?", and answered it in favour of the Commissioner.

7. Counsel for the Society in the first instance, contended relying upon the judgment of this Court in Commissioner of Income-tax, Andhra Pradesh v. Cocanada Radhaswami Bank Ltd., contended that no part of the income of the Society, even if it be earned from Government securities, was liable to be taxed. It may be recalled that the Society had claimed before the Departmental authorities and the Tribunal that according to the instructions issued by the Central Government under s. 60 of the Income-tax Act only Rs. 13,578/- out of the income from Government securities were chargeable to tax. The Income-tax Officer and the Tribunal held that Rs. 59,498/- were chargeable to tax. The decision in Cocanada Radhaswami Bank's case (57 I.T.R. 306), relates to the right of a Bank to carry forward the net loss incurred by a Banking Company and to set it off in subsequent years against income from securities held as part of its trading assets. It is not a decision under s. 14(3) of the Act. Again it is not open to the Society in this reference to contend that the amount of Rs. 13,578/- itself is not taxable. Such a question was never raised before the Tribunal and cannot be permitted to be raised in this Court.

8. The Income-tax Act, 1922, as originally enacted, did not give to a Co-operative Society exemption from payment of tax in respect of income from its business activities. But by Departmental Instructions issued under s. 60 of the Act, certain exemptions were given by a notification issued on August 25, 1925 and modified by notifications dated June 25, 1927, October 20, 1934 and August 18, 1945. Among the classes of income exempt from liability to pay tax under the notification was :

> "(2) The profits of any co-operative society other than . . . or the dividends or other payments received by the members of any such society out of such profits.

Explanation - For this purpose the profits of a co-operative society shall not be deemed to include any income, profits or gains fro :-

> (1) investments in (a) securities of the nature referred to in section 8 of the Indian Income-tax Act, or (b) . . . (2) dividends, or (3) the 'other sources' referred to in section 12 of the Indian Income-tax Act".

9. By the notification, profits of a Co-operative Society were exempt from tax, but those profits were not to include any income, profits or gains from securities of the nature referred to in s. 8 of the Indian Income-tax Act. The Legislature by s. 10 of the Finance Act of 1955 added sub-section (3) to s. 14, whereby it was enacted, inter alia, that :-

> "The tax shall not be payable by a co-operative society, including a co-operative society carrying on the business of banking -
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> (i) in respect of profits and gains of business carried on by it;
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> (ii) in respect of interest an dividends derived from its investments with any other co-operative society;
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> . . . . ."
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> 10. A co-operative society since the enactment of the Finance Act, 1955, with effect from April 1, 1955, was therefore not liable, by the express provisions in the Act, to pay tax in respect of the profits and gains of business carried on by it. Under s. 8 of the Income-tax Act 1922, tax is payable by an assessee under the head "Interest on securities" in respect of the interest receivable by him on any security of the Central Government or of a State Government, or on debentures or other securities for money issued by or on behalf of a local authority or a company, subject to exemption, inter alia, in respect of any sum deducted from such interest by way of commission by a banker realizing such interest on behalf of the assessee, or in respect of any interest payable on money borrowed for the purpose of investment in the securities by the assessee. The Parliament by the Finance Act, 1956 amended the first proviso, and added and Explanation to s. 8 providing for the computation of the sum reasonably spent for the purpose of realising interest and of interest paid on sums borrowed for the purpose of investment by a Banking Company. The Explanation provide :
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> "Explanation - In the case of a banking company, -
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> (a) the amount which bears to the aggregate of its expenses as are admissible under sub-section (2) of section 10, other than clauses (iii), (vi), (vi-a), (vi-b), (vii), (viii), (xi), (xii), (xiii) and (xiv) thereof, the same proportion as the gross receipts from interest on securities inclusive of tax deducted at source chargeable to tax under this section bears to the gross receipts from all sources which are included in the profit

> and loss account of the company, shall be deemed to be the sum reasonably expended by it for the purpose of realising such interest; and the amount for which allowance is admissible under sub-section (2) of section 10 shall be reduced correspondingly; and
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> (b) money borrowed shall include moneys received by way of deposits; and that amount which bears to the amount of interest payable on moneys borrowed the same proportion as the gross receipts from interest on securities (inclusive of tax deducted at source) chargeable to tax under this section bears to the gross receipts from all sources which are included in the profit and loss account of the company, shall be deemed to be interest payable on money borrowed for the purpose of investment in the securities by the assessee, and the amount of such interest for which allowance is due under sub-section (2) of section 10 shall be reduced correspondingly."

11. Broadly stated, under clause (a) the sum reasonably spent is computed as that proportion of the aggregate of the expenses admissible under the various clauses of sub-s. (2) of s. 10 mentioned therein which the gross receipts from interest on securities bear to the gross receipts from all sources included in the profit and loss account of the banking company. Similarly under clause (6) interest payable on money borrowed for the purpose of investment in Government securities is that proportion of the total interest paid on borrowings which gross receipts from securities bear to gross receipts from all sources.

12. Income of the Society from its trading activity being exempt from tax, its income from Government securities had, it was common ground, to be apportioned between income earned from investment for trading purposes and for non-trading purposes. The Income-tax Officer applied the first proviso read with the Explanation to s. 8 of the Income-tax Act. The Income-tax Appellate Tribunal held that in terms, the Explanation to s. 8 did not apply because the Society was not a banking company, but the principal of the Explanation furnished, after the Departmental Instructions had been withdrawn, a reasonable basis for apportionment. In the view of the Tribunal, the principle embodied in the Explanation was an "improvement on the instructions", since it co-related the income chargeable under the head with the expenditure and also provided for proportionate allocation of overhead charges. The High Court held that the benefit of the departmental notification was not available to the Society in the year of assessment, because it must be deemed to be withdrawn and the Explanation to s. 8 did not in term apply to the Society.

13. It was common ground between the parties in this Court and the High Court that Explanation to s. 8 has no application to a co-operative society which does not carry on the business of a banking company. There is also no dispute that the departmental notification relied upon by the company was withdrawn before the relevant assessment year. There is, therefore, no statutory rule, and nor there are departmental instructions, governing the apportionment of income from Government securities between business and non-business sources of income. It was never urged, and it cannot be urged, that in the absence of a specific rule for apportionment, the entire income from Government securities should be brought to tax. Any attempt to bring the entire income from Government securities would infringe s. 14(3) of the Act. A rule of apportionment consistent with commercial accounting must be evolved for determining the income from Government securities

attributable to business activity of the Society. The rule contained in clause (a) of the Explanation to s. 8 has specially been evolved for determining the appropriate outgoings for the purpose of realizing interest from securities held by a Banking Company in computing income chargeable to tax; it seeks to exempt, on the footing that it is deemed to be the sum reasonable expended for the purpose of realizing interest, a part there for which is equal to the proportion which the gross receipts from interest on securities chargeable to tax, bear to the gross receipts from all sources. The rule is an artificial rue for allocating business expenditure between different sources of income of Banking Companies. It is not a rule for apportionment for the purpose of taxation of composite income which is partly taxable and partly not. Clause (b) provides for allocation of outgoings in respect of "money borrowed", which expression includes money deposited with the Bank. Interest payable on borrowings is directed to be allocated in proportion in which income is received from investments from securities and from other sources. This clause also deals with the proportion in which the outgoings are allocable. The problem arising under s. 14(3) is of apportionment of income under heads taxable and non-taxable : it not a problem relating to allocation of outgoings to determine taxable income.

14. In our judgment, a rule of apportionment which dismembers income in proportion to the business and non-business components of the single source from which it arises would be more consistent with principles of commercial accounting. The proportion of income from securities which is exempt from taxation under s. 14 (3) of the Act will be that proportion which the capital of the Society used for the purpose of the business bears to the total working capital.

15. It is admitted that Rs. 13,578/- is the gross income from securities which is, according to that rule, liable to tax. No question was raised in the High Court about any deduction to be made in respect of expenses for collection of that amount, and admissibility of deduction on that score does not fall to be considered.

16. The appeal is allowed. Answer to the question as reframed by the High Court is that Rs. 13,578/- are taxable as income of the Society received from Government securities under s. 8 of the Income-tax Act. The Commissioner will pay the costs of the Society in this Court.

17. Appeal allowed.