Commissioner Of Income-Tax, Delhi vs Mahalaxmi Sugar Mills Co. Ltd on 15 July, 1986

Equivalent citations: 1986 AIR 2111, 1986 SCR (3) 150, AIR 1986 SUPREME COURT 2111, 1987 TAX. L. R. 452, (1986) 58 CURTAXREP 138, (1986) 27 TAXMAN 267, (1986) JT 228 (SC), 1986 SCC (TAX) 678, 1986 UPTC 1129, 1986 TAXATION 82 (2) 18, (1986) 160 ITR 920, 1986 (3) SCC 544, (1986) 3 SUPREME 369

Author: R.S. Pathak

Bench: R.S. Pathak, Sabyasachi Mukharji

PETITIONER:
COMMISSIONER OF INCOME-TAX, DELHI

Vs.

RESPONDENT:
MAHALAXMI SUGAR MILLS CO. LTD.

DATE OF JUDGMENT15/07/1986

BENCH:
PATHAK, R.S.
BENCH:
PATHAK, R.S.
MUKHARJI, SABYASACHI (J)

CITATION:
1986 AIR 2111 1986 SCR (3) 150
1986 SCC (3) 544 JT 1986 228
1986 SCALE (2)166

ACT:
Total world loss, computation of-Deduction of dividend received from the holding company in Pakistan from its business losses in India by an assessee, whether in order-Income Tax Act, 1922, section 24(1) read with Notification No. 28 dated 10.12. 47-Agreement for the Avoidance of Double Taxation of Income between India and Pakistan, scope and effect.

HEADNOTE:
The respondent assessee is a public limited company

carrying on the business of manufacturing and selling sugar. During the assessment years 1956-57 and 1957-58 the company also held shares in the Premier Sugar Mills and Distillery Co. Ltd., Mardan, West Pakistan. The Pakistan company also carried on the business of manufacturing and selling sugar. The assessee company earned dividend income of Rs.2,30,832 and Rs.3,30,868 from the holdings in the respective previous years relevant to the assessment years aforesaid, while it incurred a business loss of Rs.20,30,006 and Rs.9,11,728 respectively from its business in India. The assessee claimed that the entire loss sustained by it in India in each year should be carried forward and set off against its business profits in India in future years in as much as the dividend income derived by it from the Pakistan company was not liable to tax in India by virtue of the Agreement for the Avoidance of Double Taxation between India and Pakistan. The Income Tax Officer rejected the said contention and determined the total loss in the relevant assessment years by making certain adjustments. The appeals before the Appellate Assistant Commissioner and the Income Tax Appellate Tribunal failed. However, in the reference made at the instance of the assessee the Delhi High Court answered the questions relating to the Pakistan dividend in favour of the assessee and against the revenue. Hence the appeals by certificate.

Allowing the appeals, the Court,

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HELD: 1.1 The dividend income received from the Pakistan company is deductible in arriving at the total world loss of the assessee under sub-section (1) of section 24 of the Indian Income Tax Act, 1922. [160F-G]

1.2 Under sub-section (1) of section 24 of the Indian Income Tax Act, 1922 an assessee who has sustained a loss of profits or gains in any year under any of the heads mentioned in section 6 is entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year. The income, profits or gains against which the loss is set off must be such income, profits or gains as is assessable under the Indian Income Tax Act. The statute does not contemplate a setting off of loss against income which is not assessable at all under the Act. [157A-C]

1.3 For the purposes of the assessment under the Indian Income Tax Act, the income of the assessee must be determined in the ordinary way under the Indian law. Having regard to the relevant entry 8 of the Schedule to the Agreement for the Avoidance of Double Taxation between the two Dominions of India and Pakistan, the Dominion of India is not entitled to charge the dividend income at all. Article IV of the Agreement makes it clear that each Dominion is entitled to make assessments in the ordinary way under its own laws. The process of determining the

assessable income of the assessee is not affected by the Agreement. What the Agreement does is to give relief against double taxations. [156F-G; 157D-E]

Ramesh R. Saraiya v. Commissioner of Income Tax, Bombay City 1 [1965] 55 ITR 699 referred to.

1.4 The agreement for the Avoidance of Double Taxation functions in a different plane altogether. It enjoys no role in the application of the Indian law for the purpose of determining the total income of an assessee and the tax liability consequent upon such assessment. On the contrary, the provisions of the Agreement clearly envisage-that full effect must be given to the operation of the tax law of each Dominion. All that the Agreement does is to permit a Dominion to retain the tax recovered by it pursuant to an assessment under its law to the extent that an abatement is not allowed under the provisions of the Agreement. Article IV specifically provides that each Dominion shall make assessment in the ordinary way under its own laws. Such assessment includes the determination of the consequential tax liability. Thereafter, the Agreement takes over and the Dominion must allow an abatement in the degree mentioned in Article IV. Clause (b) of Article VI permits the
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Dominion to make a demand without allowing the abatement if the tax payable on the total income in the other Dominion is not known, but the collection of the tax has to be held in abeyance for a period of one year at least to the extent of the estimated abatement. If the assessee produces the certificate of assessment in the other Dominion within the period of one year or any longer period allowed by the Income Tax officer, the uncollected portion of the demand has to be adjusted against the abatement allowable under the Agreement. But if no such certificate is produced, the abatement ceases to be operative and the outstanding demand can be collected forthwith. Clause (a) of Article VII makes absolutely clear that nothing in the Agreement can be considered as modifying or incorporating in any manner the provisions of the relevant tax laws in force in either Dominion. Therefore, the Agreement cannot be construed as modifying or superseding in any manner the provisions of the Indian law in that regard. [158F-H;159A-D]

1.5 So long as it does not constitute the subject of exemption under any of the provisions (Sections 14 to 16) of the Indian Income Tax Act , the dividend income, in as much as it is taxable under the Indian Income Tax Act by virtue of sub-clause (ii) of clause (b) of sub-section I of section 4, must be brought into the net of income for assessment under the Indian law. [159G-H; 160A-]

1.6 Merely because the assessee fails to claim the benefit of a set off cannot relieve the Income-tax officer of his duty to apply section 24 in an appropriate case for the purpose of determining the true figure of the assessee's taxable income and the consequential tax liability. How ever

in the instant case a perusal of the assessment orders for two years shows clearly that the assessee did claim a set off of the Pakistan dividend against the losses of the Indian business. [160D-E]

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal Nos. 1350-51 (NT) of 1974 From the Judgment and order dated 19th October. 1973 of the Delhi High Court in Income Tax Reference Nos 46 and 52 of 1970 Dr. V. Gauri Shankar and Miss A. Subhashini for the Appellant.

Bishambar Lal, R.P. Gupta, S.K. Gupta and V.K. Jain for the Respondent.

The Judgment of the Court was delivered by PATHAK, J. These appeals by certificate granted by the Delhi High Court are directed against a common judgment of that High Court disposing of two income-tax references relating to the assessment years 1956-57 and 1957-58 on the question whether the assessee's dividend income from a Pakistan company was deductible against its business loss in India.

The assessee is a public limited company carrying on the business of manufacturing and selling sugar. During the relevant period it also held some shares in the Premier Sugar Mills & Distillery Co. Ltd Mardan, West Pakistan. The Pakistan company also carried on the business of manufacturing and selling sugar. In the previous year relevant to the assessment year 1956-57 the assessee earned a dividend income of Rs.2,30,832 from its holdings in the Pakistan company. It sustained a loss of Rs.20,30,006 from the business in India. Likewise, in the previous year relevant to the assessment year 1957-58 the asses- see received a dividend income of Rs.3,30,868 from the holdings in the Pakistan company, but sustained a loss of Rs.9,11,728 from the business in India. The assessee claimed that the entire loss sustained by it in India in each year should be carried forward and set off against its business profits in India in future years. It contended that the dividend income derived by it from the Pakistan company was not liable to tax in India as it was wholly taxed in Pakistan, and therefore, it could not be set off against the business loss in India. The Income-tax officer rejected the contention and deducted the dividend income received from the Pakistan company from the business loss in India disclosed by the assessee and after making certain other adjustments he determined the total loss of the assessee for the assessment year 1956-57 at p Rs.16,51,129 and for the assessment year 1957-58 at Rs.3,78,661.

The assessee appealed to the Appellate Assistant Commissioner of Income-tax in respect of each assessment year, but the appeals failed, except that in the case for the assessment year 1957-58 the Appellate Assistant Commissioner determined the dividend income from the Pakistan company at Rs.2,27,472 and reduced the net loss accordingly. In second appeal the Income-tax Appellate Tribunal confirmed the orders of the Appellate Assistant Commissioner. Thereafter, at the instance of the assessee the Appellate Tribunal referred the following questions in the two cases to the Delhi High Court for its opinion:

"1. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the net dividend income of Rs.2,30,832 received from a Pakistan Company and the capital gains of Rs.5,120 were not deductible in arriving at the total world loss under section 24(1)?"

2. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the net dividend income of Rs.2,27,472 received from a Pakistan company and the capital gains of Rs.50,829 were not deductible in arriving at the total world loss under section 24(1)?"

The High Court answered the questions relating to the Pakistan dividend in favour of the assessee and against the revenue.

So far as the question in each case refers to the deduction of capital gains against the total world loss for the year, learned counsel for the parties jointly state that it is not subject matter of these appeals.

It is necessary to mention at the outset that the Dominion of India and the Dominion of Pakistan concluded an Agreement for the Avoidance of Double Taxation of Income chargeable in the two Dominions in accordance with their respective laws, and in exercise of the powers conferred by s. 49AA of the Indian Income-tax Act 1922 and the corresponding provisions of the Excess Profits Tax Act, 1940 and the Business Profits Act, 1947 the Government of India directed by Notification No. 28 dated December 10, 1947 that the provisions of the Agreement would be given effect to in the Dominion of India. As the scope and effect of the Agreement is intimately involved in the resolution of the controversy between the parties, the material provisions may be set forth immediately:

"Article IV-Each Dominion shall make assessment in the ordinary way under its own laws; and, where either Dominion under the operation of its laws charges any income from the sources or categories of transaction specified in column I of the Schedule of this Agreement (hereinafter referred to as the Schedule) in excess of the amount calculated according to the percentage specified in columns 2 and 3 thereof, that Dominion shall allow an abatement equal to the lower amount of tax payable on such excess in their Dominion as provided for in Article VI.

Article V-Where any income accruing or arising without the territories of the Dominions is chargeable to tax in both the Dominions, each Dominion shall allow an abatement equal to one- half of the lower amount of tax payable in either Dominion on such doubly taxed income. Article VI(a) For the purposes of the abatement to be allowed under Article IV or V, the tax payable in each Dominion on the excess or the doubly taxed income, as the case may be, shall be such proportion of the tax payable in each Dominion as the excess or the doubly taxed income bears to the total income of the assessee in each Dominion.

(b) Where at the time of assessment in one Dominion, the n tax payable on the total income in the other Dominion is not known, the first Dominion shall make a demand without allowing the abatement, but shall hold in abeyance for a period of one year (or such longer period as may be allowed by the Income-tax officer in his descretion) the collection of a portion of the demand equal to the estimated abatement. If the assessee produces a certificate of assessment in the other Dominion within the period of one year or any longer period allowed by the Income-tax officer, the uncollected portion of the demand will be adjusted against the abatement allowable under this Agreement; if no such certificate is produced the abatement shall cease to be operative and the outstanding demand shall be collected forthwith.

Article VII(a) Nothing in this Agreement shall be construed as modifying or interpreting in any manner the provisions of relevant taxation laws in force in either Dominion

(b) If any question arises as to whether any income falls within any one of the items specified in the Schedule and if so under which item, the question shall be decided without any reference to the treatment of such income in assessment made by the other Dominion.

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The Schedule

(See Article IV)

_____ Source of Income Percentage of Remarks or nature of Income which each transaction from Dominion is en-

which income is titled to charge derived. under the Agreement.

(1) (2) (3) (4)

_____ xxxx xxxx xxxx xxxx S. Dividends By each (As in Relief in respect of Dominion preceding any excess income-tax in pro- column) deemed to be paid by portion to the shareholder shall the profits be allowed by each of the Dominion in proportion company to the profits of the chargeable company chargeable by by each each under this Dominion Agreement.

under this Agreement.

xxx xxxx xxx xxx"

_____ It is apparent that in the case of dividend income the percentage of income which each Dominion is entitled to charge under Agreement is in proportion to the profits of the company chargeable by each Dominion under that Agreement. The relevant entry in the Schedule indicates that as the factory is situated in Pakistan the Dominion of Pakistan is entitled to charge 100 per cent of the income and that the Dominion of India is not entitled to charge any percentage of the Income. Therefore, the dividend income derived from the Pakistan Company by the assessee is, by virtue of the Agreement,

liable to charge wholly by the Dominion of Pakistan, and the Dominion of India is not entitled to charge the dividend income at all. But this, it must be noted, is the position obtaining pursuant to the Agreement. If regard be had to the provisions of the Indian Income-tax Act, without reference to the Agreement, the dividend income, even though accruing or arising abroad, is liable to tax under the Indian law.

The High Court held that because of the operation of the aforesaid Agreement dividend income derived by the assessee in Pakistan was not assessable under the Income-tax Act in India and, therefore, could not be set off under sub- s. (1) of s. 24 of the Indian Income-tax Act 1922 against the business loss suffered by the assessee. Now there can be no doubt that under sub-s. (1) of s. 24 an assessee who has sustained a loss of profits or gains in any year under any of the heads mentioned in s. 6 is entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year, and that the income, profits or gains against which the loss is set off must be such income, profits or gains as is assessable under the Indian Income-tax Act. The statute does not contemplate a setting off of loss against income which is not assessable at all under the Act. But in order to determine whether the income in question is assessable under the Act regard must be had to the provisions of the Act itself. The High Court erred in taking into consideration the circumstance that the Agreement between the two Dominions prohibited the Dominion of India from charging income-tax on dividend income earned in Pakistan and treating it as exempt from the process of assessment to tax under the Act. It will be apparent from Article IV of the Agreement that each Dominion is entitled to make assessments in the ordinary way under its own laws. The process of determining the assessable income of the assessee is not effected by the Agreement. What the Agreement does is to give relief against double taxation, and as is clear, from Article lV, V and VI it is the charge levied by a Dominion on the income of an assessee that is involved in the relief. For Article IV goes on to say that where either Dominion under the operation of its laws charges any income from the sources or categories of transactions specified in column 1 of the Schedule to the Agreement in excess of the amount calculated according to the percentage specified in columns 2 and 3 thereof, that Dominion shall allow an abatement equal to the lower amount of tax payable on such excess in the Dominion as provided for in Article VI. The Agreement was considered by this Court in Ramesh R. Saraiya v. Commissioner of Income-tax Bombay City-I, [1965] 55 lTR 699 and the position was summed up clearly as follows.

> "It seems to us that the opening sentence of Article IV of the Agreement that each Dominion is entitled to make assessment in the ordinary way under its own laws clearly shows that each Dominion can make an assessment regardless of the Agreement. But a restriction is imposed on each Dominion and the restriction is not on the power of assessment but on the liberty to retain the tax assessed Article IV directs each Dominion to allow abatement on the amount in excess of the amount mentioned in the Schedule. The scheme of the Schedule is to apportion income from various sources among the two Dominions In the case of dividends each Dominion is entitled to charge "in proportion to the profits of the company charge able by each Dominion under this agreement." This refers us back to the other items For instance, in respect of goods manufactured by the assessee partly in one Dominion and partly in the other, each Dominion is entitled to charge on 50% of the profits But the

> Schedule does not limit the power of each Dominion to assesss in the normal way all the income that is liable to taxation under its laws. The Schedule has been inserted only for the purpose of calculating the abatement to be allowed Article VI also leads to the same conclusion For if no assessment could be made on the amount on which abatement is to be allowed, there could be no question of making a demand without allowing the abatement and holding in abeyance for a period the collection of a portion of the demand equal to the estimated abatement."

On the basis of Agreement the High Court came to the conclusion that the dividend income was not liable to charge by the Dominion of India The High Court omitted to note that the Agreement functions on a different plane altogether. It enjoys no role in the application of the Indian law for the purpose of determining the total income of an assessee and the tax liability consequent upon such assessment. On the contrary, the provisions of the Agreement clearly envisage that full effect must be given to the operation of the tax law of each Dominion All that the Agreement does is to permit a Dominion to retain the tax recovered by it pursuant to an assessment under its law to the extent that an abatement is not allowed under the provisions of the Agreement Article IV, it may be reiterated, specifically provides that each Dominion shall make assessment in the ordinary way under its own laws. Such assessment includes the determination of the consequential tax liability. Thereafter, the Agreement takes over the Dominion must allow an abatement in the degree mentioned in Article IV. It will also be noticed that clause (b) of Article VI permits the Dominion to make a demand without allowing the abatement if the tax payable on the total income in the other Dominion is not known, but the collection of the tax has to be held in abeyance for a period of one year at least to the extent of the estimated abatement. If the assessee produces the certificate of assessment in the other Dominion within the period of one year or any longer period allowed by the Income-tax officer, the uncollected portion of the demand has to be adjusted against the abatement allowable under the Agreement. But if no such certificate is produced, the abatement ceases to be operative and the outstanding demand can be collected forthwith. Clause (a) of Article VII makes absolutely clear that nothing in the Agreement can be considered as modifying or incorporating in any manner the provisions of the relevant tax laws in force in either Dominion. Therefore, having regard to what is expressly stated in Article IV of the Agreement, and re-emphasised in cl. (a) of Article VII, there can be no escape from the conclusion that for the purposes of the assessment under the Indian Income-tax Act, the income of the assessee must be determined in the ordinary way under the Indian law, and in no way can the Agreement be construed as modifying or superseding in any manner the provisions of the Indian law in that regard.

The High Court has proceeded on the basis that for the purpose of giving abatement of tax in India the dividend income from the Pakistan Company can be excluded from the taxable income of the assessee. It has reasoned that by requiring the dividend profits accruing or arising in Pakistan to be set off against the business loss of the assessee in India there is, in the result, a taxing of the dividend income from the Pakistan company. The High Court has fallen into the fallacy of treating the setting off of the dividend income against the business loss as an infringement of the Agreement. It has lost sight of the provisions of the Agreement itself which provide that the Indian Income-tax Act must be applied without regard to the Agreement for the purpose of determining the total income and the consequential tax liability of the assessee.

Once it is accepted that the Agreement preserves the right of each Dominion to determine the assessable income in accordance with the operation of its own laws and it is concerned only with the question of the degree of retention of the tax charged by it consequent upon such assessment, it becomes abundantly clear that the dividend income, inasmuch as it is taxable under the Indian Income-tax Act, by virtue of sub cl. (ii) of d. (b) of sub. s. (1) of s. 4, must be brought into the net of income for assessment under the Indian law. It has not been shown to us by learned counsel for the assessee that it constitutes the subject of exemption under any provision of the Indian Income-tax Act Subs. (3) of s. 4 sets forth the cases in which income is not includible in the total income of the person receiving it. And ss. 14 to 16 detail the cases where the statute grants exemption from tax. No provision in the Act has been pointed out from which we may infer that the dividend income in question is not liable to inclusion in determining the total income of the assessee.

Learned counsel for the assessee has placed a number of cases before us which deal with the application of the Indian Income-tax Act, and where it has been held that for the purpose of sub-s. (t) of s. 24 of that Act income which does not fall within the purview of the Act at all cannot be set off against a loss arising under the Act. These are cases which are wholly inapposite, and have no bearing, at all upon the role played by the Agreement. It is also urged that it is open to the assessee to claim or not to claim the benefit of s. 24 of the Act, and that if he does not do so no question arises of applying s. 24. In the first place, a perusal of the assessment orders for the two years shows clearly that the assessee did claim a set off of the Pakistan dividend against the losses of the Indian business. In the second place there is a duty cast on the Income-tax officer to apply the relevant provisions of the Indian Income-tax Act for the purpose of determining the true figure of the assessee's taxable income and the consequential tax liability. Merely because the assessee fails to claim the benefit of a set off cannot relieve the Income-tax officer of his duty to apply s. 24 in an appropriate case.

In the result the appeals are allowed, the judgment of the High Court is set aside and the questions referred by the Income-tax Appellate Tribunal to the High Court are answered in favour of the Revenue and against the assessee in so far that we hold that the dividend income received from the Pakistan company is deductible in arriving at the total world loss of the assessee under sub-s (1) of s. 24 of the Indian Income-tax Act, 1922. The Revenue is entitled to its costs.

S.R. Appeals allowed.