The Commissioner Of Income-Tax, Bombay ... vs The National Syndicate, Bombay on 1 November, 1960

Equivalent citations: 1961 AIR 398, 1961 SCR (2) 229, AIR 1961 SUPREME COURT 398

Author: M. Hidayatullah

Bench: M. Hidayatullah, S.K. Das, J.C. Shah

PETITIONER:
THE COMMISSIONER OF INCOME-TAX, BOMBAY CIRCLE II

Vs.

RESPONDENT:
THE NATIONAL SYNDICATE, BOMBAY.

DATE OF JUDGMENT:
01/11/1960

BENCH:
HIDAYATULLAH, M.
BENCH:
HIDAYATULLAH, M.
DAS, S.K.
SHAH, J.C.

CITATION:
1961 AIR 398 1961 SCR (2) 229
CITATOR INFO :
D 1965 SC 33 (6)
R 1971 SC2274 (7)

ACT:
Income-Tax--Business carried out for a part of the year--Computation--If must be for the whole year--Indian Income-Tax Act, 1922-(11 of 1922) s. 10(2)(Vii).

HEADNOTE:
The National Syndicate, a Bombay firm, acquired on January 11, 1945, a tailoring business as a going concern for Rs. 89,321 which included the consideration paid for sewing machines and a motor lorry. Soon after the purchase the respondent found it difficult to continue the business, therefore closed its business in August, 1945. Between

August 16, 1945, and February 14, 1946, sewing machines and the motor lorry were sold at a loss. The respondent closed its account books on February 28, 1946, showing the two losses and writing them off.

For the assessment year 1946-47, the. respondent claimed a deduction under s. 10(2)(Vii) of the Indian Income Tax Act. The Appellate Tribunal held that the sales of machines and the motor lorry were made in the course of the winding up of the assessee's business after the business had been stopped and that, therefore, the deduction could not be claimed under s. 10(2)(Vii). Respondent moved the High Court and obtained an order under s. 66(2) of the Income-Tax Act, and the following two questions were referred :-

" (1) Whether the Tribunal was justified in law in holding that the petitioner had carried on its business only till twenty eight day of August, One Thousand Nine Hundred and Forty Five ?

(2) Whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal was justified in law in not allowing the sum of Rs. 41,998 (Rupees forty-one thousand nine hundred and ninety eight) on sale of machines and Rs. 3,700 (Rupees three thousand and seven hundred) on the sale of lorry as a deduction from the total income of the applicant ?"

The High Court answered the first question in the affirmative, and the second question in the negative.

The Commissioner of Income-tax questioned the finding of the High Court and came up in appeal by special leave and contended that an allowance could only be claimed if sale of machines, etc. took place when the business was being continued and not if the business had come to a close. The respondent on the other hand submitted that s. 10(2)(Vii) would be applicable

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in a case where the business continued for a part of the account year, even though the sale of machinery, plant, etc. took place after the closure of the business during the course of the account year.

Held, that if the profits or gains of a business for a particular year are to be taxed, they must be computed for the whole year taking into account losses incurred during the same year, provided that the business had been " carried on by the assessee " ; the building, machinery or plant had been " used for the purpose of the business "; the sale etc. had taken place during the year of account, and the loss had been brought into the books of the assessee and written off. There is no other condition to be found expressly in the section or in the Act. It is nowhere stated that the business of the assessee should have been carried on for the whole year, or that the machinery or plant should have been used for the whole of the accounting period. There are no words which would show that, if the assessee worked only for a part of the year and then sold out, the loss that he

incurred was not a business loss, or that he must pay tax on the small profit that he might have made, and bear the loss in addition.
The Liquidators of Pursa Limited v. Commissioner of Income-Tax, Bihar, [1954] S.C.R. 767, Commissioner of Income-tax v. Express Newspapers Ltd. (1960) 40 I.T.R. 38, distinguished.
Indian Iron & Steel Co., Ltd. v. Commissioner of Incometax, Bengal, (1943) 11 I.T.R. 328, Commissioner of Income-tax v. Shaw Wallace & Co., Ltd., (1932) L.R. 59 I.A. 206, referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 280 of 1959. Appeal by special leave from the judgment and order dated the 22nd August, 1956, of the former Bombay High Court in Income-tax Reference No. 17 of 1956.

B. Ganapathy Iyer and D. Gupta, for the Appellant. Sanat P. Mehta, S. N. Andley, J. B. Dadachanji, Rameshwar Nath and P. L. Vohra, for the Respondent.

1960. November 1. The Judgment of the Court' was delivered by HIDAYATULLAH J.-The Commissioner of Incometax, Bombay Circle II, has filed this appeal after obtaining special leave, against the judgment of the High Court of Bombay in an Income-tax reference under s. 66(2) of the Income-tax Act. The National Syndicate, Bombay (referred to in this judgment as the respondent) was a firm consisting of three partners. This firm acquired on January 11, 1945, a tailoring business as a going concern from one Chambal Singh for Rs. 89,321/-. Included in this amount was the consideration paid for sewing machines (Rs. 72,000) and a motor lorry (Rs. 8,000). The assessment concerns the year of account of the respondent, January 11, 1945 to February 28, 1946. The business of the respondent was to prepare garments for Government departments, and during the war years, this appears to have been a profitable business. Immediately after the respondent acquired this business, the last war came to an end, and the respondent found it difficult to continue the business. It, therefore, closed its business in August, 1945. Between August 16, 1945 and February 14, 1946, sewing machines were sold at a loss of Rs. 41,998. The motor lorry was also sold on February 14,1946, at a loss of Rs. 3,700. The respondent closed its account books on February 28, 1946, showing the two losses and writing them off.

For the assessment year, 1946.47, the respondent claimed a deduction of Rs. 45,698 under s. 10(2)(vii) of the Indian Income-tax Act. The Income-tax Officer disallowed this deduction, holding that the loss was of a capital nature, and that inasmuch as the business of the respondent was not carried on after August 1945 s. 10(2)(vii) was not applicable. This order of assessment was confirmed by the Appellate Assistant Commissioner, who also held that the loss represented capital loss, as the machines and the motor lorry were sold after the closure of the business. On appeal, the Appellate Tribunal, Bombay, also confirmed the order, holding that the sales of machines and the motor lorry were made in the course of the winding up of the assessee's business after the business had been stopped, and that, therefore, the deduction could not be claimed under s. 10(2Xvii).

The respondent asked the Tribunal to refer the questions of law arising from its order, but the request was refused. It then moved the High Court, and obtained an order under s. 66(2) of the Income-tax Act, and the following two questions were referred:

> " (1) Whether the Tribunal was justified in law in holding that the Petitioner had carried on its business only till twenty-eighth day of August one thousand nine hundred and forty-five ?
>
> (2) Whether on the facts and circumstances of the case, the Income-tax Appellate Tribunal was justified in law in not allowing the sum of Rs. 41,998 (Rupees forty-one thousand nine hundred and ninety eight) on sale of machines and Rs, 3,700 (Rupees three thousand and seven hundred) on the sale of lorry as a deduction from the total income of the applicant?"

The High Court answered the first question in the affirmative, holding that there was evidence on which the Tribunal could reach the conclusion that the business had, in fact, been continued only till August 28, 1945. On the second question, the High Court was of the opinion that the business having been carried on for at least a part of the account year, s. 10(2)(vii) was applicable, and that, therefore, this allowance had to be made under that clause. The High Court, therefore, answered the question in the negative. The High Court refused to grant a certificate to appeal to this Court, but the Commissioner of Income-tax applied for, and obtained special leave, and this appeal has been filed.

Before we deal with the question whether s. 10(2) (vii) of the Indian Income-tax Act is applicable to the facts of this case, we may mention that during the course of the argument Mr. S. P. Mehta, counsel for the respondent, sought to re- open the first question. According to him, there was no evidence on which the Tribunal or the High Court could reach the conclusion that the business of the respondent had come to a close in August 1945. We, however, did not permit him to raise this contention, partly because, in our opinion, such a contention could not be allowed to be raised at this stage in an appeal by the Department and partly because, in our opinion, there were adequate materials for the High Court to have based its conclusion. Inasmuch as we were in agreement with the High Court on the question of the applicability of s. 10(2)(vii), we also felt that no useful purpose would be served in examining the matter to find out whether the business had, in fact, closed on August 28, 1945 or had continued till the end of the account year. We are really concerned in this appeal with the interpretation of s. 10(2)(vii) and its applicability to the facts of the case. It may be assumed for the purposes of this case that the business did, in fact, close down on August 28,1945, even though some in comings and outgoings were taking place for the rest of the year and the books of account were not finally closed till February 28, 1946. The Commissioner contends that an allowance could only be claimed if the sale of machines etc., took place when the business was being continued and not if the business had come to a close. The respondent, on the other hand, submits that s. 10(2)(vii) would be applicable in a case where the business continued for a part of the account year, even though the sale of the machinery, plant etc., took place after the closure of the business during the course of the account year.

Section 10(2)(vii) reads as follows:

" 10(2). Such profits or gains shall be computed after making the following allowances, namely:-

(vii) in respect of any such building, machinery or plant which has been sold or discarded or demolished or destroyed, the amount by which the written down value thereof exceeds the amount for which the building, machinery or plant, as the case may be, is actually sold or its scrap value:

Provided that such amount is actually written off in the books of the assessee:".

The Commissioner emphasises the word " such " in the clause, and states that this takes us back to cl. (iv) where the words " used for the purposes of the business occur. It is, therefore, contended that if the business itself comes to an end before the sale takes place, the sale is not during the continuance of the business but is during the course of the winding up ,of the business, and the condition precedent to the application of s. 10 is that the business must be is carried on " by the person claiming the benefit of sub-s. (2). Reference in this context is made to the first sub-section of s. 10, where it is provided that the tax 'shall be payable by an assessee under the head " Pro. fits and gains of business..... in respect of the profits or gains of any business, etc., ' carried on by him'." The Department relies upon a decision of this Court reported in The Liquidators of Pursa Limited v. Commissioner of Income-tax, Bihar (1). The respondent also relies upon the same ruling, and contends that it supports the case set up by it. The respondent also relies on a recent decision of the Madras High Court in Commissioner of Income-tax v. Express Newspapers Ltd. (2). These two cases were decided under the second proviso to s. 10(2)(vii) before its amendment in 1949. The second proviso reads:

" Provided further that where the amount for which any such building, machinery or plant is sold whether during the continuance of the business or after the cessation thereof, exceeds the written down value, so much of the excess as does not exceed the difference between the original cost and the written down value shall be deemed to be profits of the previous year in which the sale took place."

The words underlined above were inserted by s. 11 of the Taxation Laws (Extension to Merged States and Amendment) Act, 1949.

In both the cases, the business had admittedly closed down before the sales took place, and it was held, applying the proviso as it was before the amendment of 1949, that such receipts were not taxable. The amendment now renders these cases obsolete. Reliance is, however, placed on certain observations in these oases, and it is contended that the same reasoning must be applied to a case of loss as to a case of profits. We shall, therefore, refer briefly to them.

In The Liquidators of Pursa Limited v. Commissioner of Income-tax, Bihar (1), the year of, assessment was 1945-46, which corresponded to the accounting year, October 1, 1943 to September

30, 1944. Pursa Limited were manufacturers of sugar, and sold the business on August 9, 1943, including buildings, machinery and plant but excluding manufactured sugar worth about Rs. 6,00,000. This sugar was sold till June, 1944; but throughout the accounting period, the machinery, plant or buildings were not used. Pursa Limited went into voluntary liquidation on June 20, 1945. In the sale of the buildings, machinery and plant there was an excess, such as is described in the second proviso, and that amount of excess was sought to be taxed. This was negatived by this Court on two grounds. They were (a): " If the machinery and plant have not at all been used at any time during the accounting year no allowance can be claimed under clause (vii) in respect of them and the second proviso also does not come into operation "; and (b) " that the intention of the company was to discontinue its business and the sale of the machinery and plant was a step in the process of winding up of its business. The sale of the machinery and plant was not an operation in furtherance of the business carried on by the Company but was a realisation of its assets in the process of gradual winding up of its business which eventually culminated in the voluntary liquidation of the Company".

Counsel differ as to the ratio of the case. The Commissioner contends that the ratio is that no sale, whether at a loss, or at a profit can be said to fall within, respectively, cl. (vii) or the second proviso, if it takes place after the closure of business and during the process of winding up, while the respondent contends that the real ratio was that during the account year the machinery and plant were not at all used. No doubt, this Court did give two reasons for its decision, but the primary consideration was the second ratio quoted above. This is clear from the following passage towards the end of the judgment:

> " Even if the sale of the stock of sugar be regarded as carrying on of business by the Company and not a realisation of its assets with a view to winding up, the machinery or plant not being used during the accounting period at all and in any event not having had any connection with the carrying on of that limited business during the accounting year, section 10(2)(vii) can have no application to the sale of any machinery or plant."

Learned Counsel for the respondent relies upon the passage last quoted, and urges that where the buildings, machinery or plant have been used for a part of the accounting period, the ruling cannot apply, and draws attention to the words "

> at all " used twice in the judgment. He argues that if the machinery or plant had been used for a part of the accounting year, the result would have been different. It is not possible to say how the case would have been decided in the changed circumstances, but it is obvious that the case is distinguishable on more than one ground. The proviso is in a language different from cl. (vii), as a fiction is introduced and such ' profits' are taxed to take back what had been given away for depreciation which did not really take place. But more of it later.
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> Express Newspapers Ltd. case (1) is also distinguishable. In that case, the Free Press of India (Madras) Ltd. resolved on August 31, 1946, to transfer the right of printing

and publishing its daily newspapers to Express Newspapers Ltd. They rented out their machinery, etc., to the new Company, which took possession on September 1, 1946. The year of account ended on December 31, 1946. The Free Press went into voluntary liquidation on October 31, 1946 and on November 1, 1946, its building, machinery and plant were sold to the new Company at a price which exceeded the written down value by Rs. 6,08,666 made up of Rs. 2,14,090 being the excess of the original cost price over the written down value, and Rs. 3,94,576 being the excess over the original cost price. One question, among others, was whether the second proviso to s. 10 (2)(vii). applied. The Madras High Court ob. served :

(1) (1960) 40 I.T.R. 38.

"..... in the present case the sale of the machinery took place during the year of account, and it was used by Free Press Company for at least a part of the year. This would be sufficient to attract liability.. The learned counsel for the assessee is on a firmer ground when he contended that the sale being made in the process of winding up of the company section 10(2)(vii) will not apply. The second proviso to section 10(2)(vii) would be invoked only where the sale was one made in the course of business carried on by the predecessor. Where the sale is a closing down sale, that profit could not be brought to tax. In Liquidators of Pursa Ltd. V. Commissioner of Income-tax (1), the Supreme Court held that where in a case the sale of machinery and plant was a step in the process of winding up of its business, the intention of the company having been to discontinue the business, such sale was not an operation in furtherance of the business carried on by the company, but was only a realisation of its assets in the process of gradual winding up of its business which eventually terminated in the voluntary liquidation of the company, and provision of section 10(2)(vii) would not apply. In the present case, the formation of the new company was to take over the business of the old company. The lease of the machinery, the transfer of the right to carry on the business of publishing newspapers, and the ultimate sale of the machinery were part of the same scheme for winding up the Free Press Company. The sale of machinery was undoubtedly a closing down sale and the profit earned therein could not come in for assessment under section 10(2)(vii)."

These two cases deal with the second proviso to s. 10(2Xvii). Clause (vii) deals with loss and the second proviso, with profits; but the proviso is not an exact counterpart of the clause. The proviso enacts a fiction which the main clause does not enact. The reason for the introduction of the fiction in the proviso appears to be this: Loss in business may take place in various ways. If the business requires more to run it than it produces, there is loss. Loss in (1) [1954] S.C.R. 767.

business may also take place if the equipment with which business is done is lost, destroyed, or depreciates or suffers in value. The law takes note of the loss, and, provided it has been computed and brought into the books of the business and written off, it can be claimed as a deduction. Profit in business, on the other hand, primarily, means profit earned in the business. But if an allowance had been claimed as depreciation and had been allowed, and if the sale of the building, machinery or

plant on which depreciation allowance was claimed in the past, shows that there was, in fact, no depreciation but an accretion in value, the law deems that a profit has been made. The fiction thus converts that which may not be strictly profit of the business in a narrow sense, into a profit for purposes of assessment. Formerly, it was a matter of doubt whether even this accretion could be deemed a profit when the business had closed down; but now, the legislature has amended the law by saying that this fictional profit must be brought to tax irrespective of the fact that the sale took place " during the continuance of the business or after the cessation thereof" But it is to be noticed that no such amendment was made in cl. (vii) to exclude loss over buildings, machinery or plant after the clospre of the business. It is thus clear that the principles which govern the proviso cannot be used to govern the main clause, because profit or loss arise in different ways in business. The two rulings do not, therefore, apply to the facts here.

We must thus restrict ourselves to the scheme of the Indian Income-tax Act and the clause in question. The scheme of the Income-tax Act, as was pointed out by Lord Porter in Indian Iron & Steel Co. Ltd. v. Commissioner of Income-tax, Bengal (1), is that income. tax is assessed and paid in the next succeeding year upon the results of the year before. It is the income of the previous year which is brought to tax in the succeeding year, which is called the year of assessment. For the purpose of assessment, the Indian Income Tax Act divides the sources of income, profits (1) [1943] 11 I.T.R. 328, 336.

and gains into six heads in s. 6. The fourth head is "

> Profits and gains of business, profession or vocation ".

Sections 7, 8, 9, 10, 12, 12A and 12B lay down' the rules of computation under the different heads. Profits and gains of business are dealt with in s. 10. The first subjection of that section provides:

> " The tax shall be payable by an assessee under,, the head I Profits and gains of business....' in respect of the profit or gains of any business..... carried on by him."

In Commissioner of Income-tax v. Shaw Wallace & Co., Ltd. (1), it was pointed out by the Judicial Committee that the words " carried on by him " were " an essential constituent of that which is to produce the taxable income; it is to be the profit earned by a process of production ". It was further pointed out that " business " had been defined in the Income-tax Act to " include any trade, commerce or manufacture, or any adventure or concern in the nature of trade, commerce or manufacture ", and that it involved " a fundamental idea of the continuous exercise of an activity." It was, however, pointed out that the source was not necessarily one which was expected to be continuously productive, but one whose object was the production of a definite return, excluding anything in the nature of a mere windfall, and that 'capital' in most cases was hardly more than an element in the process of production. We agree with this analysis of the Income-tax Act, and indeed, these observations were also applied in the Pursa Limited case (2), to which we have already referred. It thus follows that capital may, in the process of production, depreciate, get used up or lost. The Income-tax Act, while taxing income, profits or gains, takes note of, and makes allowance for such eventualities.

If the profits or gains of a business for a particular year are to be taxed, they must be computed for the whole year taking into account losses incurred during the same year. Now, the first condition precedent appears to be that the business must have been (1) (1932) L.R. 59 I.A. 206.

(2) [1954] S.C.R. 767.

> " carried on by the assessee ". This is to be found in the first sub-section of s. 10. The second condition is that the building, machinery or plant must have been " used for the purposes of the business ". This is to be found in of.
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> (iv) of the second sub-section of s. 10. The third condition is that the sale etc., should have taken place during the year of account. This follows from the nature of the tax which is assessed and levied on the profits of the working of the previous year. The fourth condition is that the loss should have been brought into the books of the assessee and written off. This is provided by the first proviso. There is no other condition to be found expressly in the section or in the Act. It is nowhere stated that the business of the assessee should have been carried on for the whole year, or that the machinery or plant should have been used for the whole of the accounting period. There are no words which would show that, if the assessee works only for a part of the year and then sells out, the loss that he incurs is not a business loss, or that he must pay tax on the small profit that he might have made, and bear the lose in addition. We have shown above that the case of profit referred to in the second proviso stands on a different footing altogether, since profit and loss arise in different ways. The law has thus treated the two subjects differently, and the legislature has amended the proviso but not the clause.

In view of what we have said above, we are of opinion that the judgment of the High Court was correct in all the circumstances of this case, and this appeal must be dismissed with costs.

Appeal dismissed.