

**(1977) 03 BOM CK 0043**

**Bombay High Court**

**Case No:** Income-tax Reference No. 70 of 1967

Commissioner of Income Tax,  
Bombay City-II, Bombay

APPELLANT

Vs

Narandas and Sons

RESPONDENT

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**Date of Decision:** March 6, 1977

**Acts Referred:**

- Income Tax Act, 1922 - Section 10, 15A, 16(1), 23(6)
- Income Tax Act, 1961 - Section 67, 67(2)

**Citation:** (1978) 115 ITR 587

**Hon'ble Judges:** V.D. Tulzapurkar, J; R.M. Kantawala, J

**Bench:** Division Bench

**Advocate:** R.J. Joshi, for the Appellant; I.M. Munim, for the Respondent

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### **Judgement**

1. Three questions have been referred to this court by the I.T. Tribunal at the instance of the CIT, Bombay City-II, under s. 66(1) of the Indian I.T. Act, 1922, and these questions run as follows :

"(1) Whether, on the facts and in the circumstances of the case, the interest received by a dealer in Government securities, in respect of Government securities held by it as its stock-in-trade, is business income assessable under s. 10 or interest income assessable under s. 8 of the Indian I.T. Act, 1922 ?

(2) whether for the purposes of the assessment of the share income in the hands of the partner, apportionment under s. 23(6) read with 16(1) of the Indian I.T. Act, 1922, of the total income of the firm determined in the firm's assessment under two heads, viz., business income and interest income in the same manner and under those very heads, is legal and valid ?

(3) Whether, on the facts and in the circumstances of the case, the share income of an active partner from a firm which deals in Government securities and earns

interest on them is business income assessable under s. 10 and consequently is the partner entitled to earned income relief in respect thereof under s. 15A of the Indian I.T. Act, 1922 ?" At the outset it may be stated that so far as question No. (1) is concerned, it was not disputed before us either by Mr. Joshi appearing for the revenue or by Mr. Munim appearing for the assessee that the answer thereto is self-evident and obvious and the question was really concluded by the decision of the Supreme Court in case of [United Commercial Bank Ltd. Vs. Commissioner of Income Tax, West Bengal](#), and the answer to the question will be to the effect that the interest referred to in the question will have to be regarded as interest income assessable under s. 8 of the 1922 Act. It may be stated that in the case the Supreme Court has expressed the view that the income of an assessee is one and ss. 7 to 12 of the Act directs the modes in which Income Tax is to be levied, that none of these sections can be treated to be general or specific for the purpose of any one particular source of income, and they are all specific and deal with various heads in which an item of income, profits and gains of an assessee falls. It has further expressed the view that these sections are mutually exclusive and where an item of income falls specifically under one head it has to be charged under that head and no other, and that income from "interest on securities" falls under s. 8 of the Act and not under s. 10 and, therefore, it cannot be brought under a different head of income, viz., "profits and gains of the business" under s. 10, even though the securities are held by a banker as part of his trading assets in course of business. In view of this categorical pronouncement of the Supreme Court which, according to counsel to either side, lays down the position of law correctly, the question referred to us will have to be answered and we do answer it to the effect that the interest referred to in that question will have to be treated as interest income assessable under s. 8 of the Act.

2. So far as question Nos. (2) and (3) are concerned, the relevant facts in regard thereto will have to be stated. The question related to assessment years 1949-50 to 1953-54, in the case of the firm of Messers. Narandas & Sons, and assessment years 1949-50 to 1953-54, 1957-58 to 1959-60 and 1961-62, in the case of individual partners, N. R. Cantol and V. N. Cantol. The firm of Messers. Narandas & Sons consisting of two partners, N. R. Cantol and V. N. Cantol, was registered under s. 26A of the I.T. Act, 1922, for the purpose of assessment to Income Tax. The firm was a dealer in Government securities and it also received interest on Government securities, which formed its stock-in-trade, for the aforesaid assessment years. It appears that the income of the firm was determined by the ITO for assessment purposes under two heads, viz., (i) Business, and (ii) Interest on securities. Since the firm was registered under s. 26A of the Act, the ITO did raise a demand on the firm but apportioned the firm's total required by s. 23(6) of the Act among its partners in the same manner and under the same heads as it was assessed in the assessment of the firm, i.e., interest on securities and business income. In the individual assessments of the partners of the aforesaid assessment years 1949-50 to 1953-54,

1957-58 to 1959-60 and 1961-61, the ITO apportioned the firm's income in their hands under both the above heads, and refused to allow earned income relief under s. 15A of the Act to the partners in respect of interest income on securities because in his opinion it was not business income.

3. The firm as well as the individual partners appealed against those assessments to the AAC and in those appeals relying upon a decision of this court in [Commissioner of Income Tax, Bombay City Vs. Ahmuty and Co. Ltd.](#), it was contended that the interest on securities received by the partners from the firm as their share income from the firm was business income and that the partners were entitled to the earned income relief thereon. The AAC distinguished the ruling in [Commissioner of Income Tax, Bombay City Vs. Ahmuty and Co. Ltd.](#), on which reliance was placed on behalf of the partners and took the view that the ratio of the case in [H.C. Kothari and Others Vs. The Commissioner of Income Tax, Madras](#), was applicable. He, therefore, rejected the contention of the partners and upheld the ITO's action in refusing earned income relief to them on interest on securities.

4. Aggrieved by the orders passed by the AAC, the firm as well as the individual partners preferred appeals to the Appellate Tribunal. On behalf of the individual partners three separate and independent contentions were urged on the basis of which earned income relief was claimed. Since, however, out of the three contentions two were not accepted by the Tribunal, we need refer only to the third contention which was accepted by the Tribunal on the basis of which the relief sought was granted. It was urged on behalf of the individual partners that irrespective of the head under which interest on securities was assessed in the assessments of the firm, what the partner received from the firm was his share of the profit from the firm and the share was assessable in his hands as business income. It was further urged that the ITO had wrongly apportioned the income and assessed it in the hands of the partner under different heads, and the correct procedure according to s. 16(1)(b) should have been considered in the hands of the partners as their respective share of income from the firm assessable under s. 10. This contention was accepted by the Tribunal who observed that whatever be the source of income of the firm, all the income which were assessed under different heads merged into one category and would be the total income of the firm and when it was apportioned under s. 23(6) read with s. 16(1)(b), what was apportioned to the partners was only their share income from the firm. The Tribunal found that instead of apportioning income as required by s. 16(1)(b) of the 1922 Act which governed the assessment for the concerned years, the ITO had wrongly apportioned the income under two heads, viz., (i) Business income, and (ii) Interest on securities, and according to the Tribunal this was done by the ITO, in view of the provisions of s. 67(2) of the 1961 Act, which was inapplicable to the instant case. Accordingly, the Tribunal held that the share income of the individual partners from the firm was only assessable under s. 10 and in that view of the matter it further held that the individual partners were entitled to earned income relief under s. 15A even in

respect of a portion of share income which interest on securities. The decision of this court in the case of [Arvind N. Mafatlal Vs. Income Tax Officer, North Satara,](#) was relied upon in support of this view. At the instance of the CIT questions Nos. (2) and (3) set out at the commencement of this judgment have been referred to us for our determination.

5. The material provisions with which we are concerned in this case are the provisions which are to be found in s. 23(5) and (6) and s. 16(1)(b). s. 23(5) runs thus :

"23. (5) Notwithstanding anything contained in the foregoing sub-sections, when the assessee is a firm and the total income of the firm has been assessed under sub-s. (1), sub-s. (3) or sub-s. (4), as the case may be, -

(a) in the case of registered firm,

(i) the Income Tax payable by the firm itself shall be determined; and

(ii) the total income of each partner of the firm, including therein his share of its income, profits and gains of the previous year, shall be assessed and the sum payable by him on the basis of such assessment shall be determined :

Provided that if such share of any partner is a loss it shall be set off against his other income or carried forward and set off in accordance with the provisions of section 24....." s. 23(6) runs thus :

"(6) Whenever the ITO makes a determination in accordance with the provisions of sub-section (5), he shall notify to the firm by an order in writing the amount of the total income on which the determination has been based and the apportionment thereof between the several partners." s. 16(1)(b) which is very material runs thus :

"16. (1) In computing the total income of an assessee -....

(b) when the assessee is a partner of a firm, then, whether the firm has made a profit or a loss, his share (whether a net profit or a net loss) shall be taken to be any salary, interest, commission or other remuneration payable to him by the firm in respect of the previous year increased or decreased respectively by his share in the balance of the profit or loss of the firm after the deduction of any interest, salary, commission or other firm remuneration payable to any partner in respect of the previous year :

Provided that if his share so computed is a loss, such loss may be set off or carried forward and set off in accordance with the provision of s. 24."

6. It is obvious that while apportioning the income of the firm among the partners in the relevant assessment years in question the ITO had not followed the procedure as indicated in s. 16(1)(b) of the Act, but instead had made the apportionment under two different heads, viz., Business income, and Interest income in the same manner and under those very heads as he had done while assessing the firm and after

effecting the apportionment in the aforesaid manner had denied the earned income relief to the individual partners in so far as income under the head "Interest on securities" was concerned, on the footing that such income did not fall within the meaning of the expression "earned income" as defined in s. 2(6AA) of the Act. That is why the principal question that has arisen for our consideration is whether the share income of the individual partners from the firm is business income assessable under s. 10 or is the part of such share income which represents the interest on securities as interest - income assessable under s. 8 of the Act, for, it cannot be disputed that if the entries share income of the individual partners from the firm is to be regarded as business income assessable under s. 10, the individual partners would be entitled to earned income relief under s. 15A of the Act.

7. The question, in our view is covered by the decisions of this court and Supreme Court. In the case of [Arvind N. Mafatlal Vs. Income Tax Officer, North Satara](#) , certain shares were held by the assessee, but merely as a nominal holder, and in reality the shares belonged to the firm in which the whether when the assessee was merely a nominal holder of the shares, the grossing up in respect of the dividend income under s. 16(2) read with s. 18(5) of the Act could be done, and this court negatived the claim on the ground that the dividend received by a nominal holder of shares and paid to the real owner could not be regarded as dividend income of the latter within the meaning of s. 16 (2) of the Act and such income was not liable to be processed in terms of ss. 16(2) and 18(5). This court also held that where the assessee, who was a partner in a firm, held shares in a company, and the ITO did not assess the assessee as a shareholder but distributed the dividend income among the partners on the ground that he was only a nominee of the firm, on such distribution the amount deemed to have been received by the assessee as a partner of the firm could not be regarded as dividend income in his hands, but could only be his share of the profits in the firm. At page 357 of the report this court has made the following eloquent observations :

"But the ITO did not assess the assessee as a shareholder; he accepted the contention of the assessee that he was a nominee of the firm of Mafatlal Gagalbhai & Sons and on that footing the dividend income was distributed the amount deemed to have been received by the assessee in that income as partner of the firm could not be regarded as dividend income in his hands. In the hands of the firm it was evidently dividend income, but in his hands of the assessee it could only be his share of the profits of the firm." The aforesaid observations clearly lay down the proposition that after apportionment is made what the individual partner receives from the firm in his share in profits in the business of that firm. The Supreme Court decision in [Commissioner of Income Tax, Bihar Vs. Ramniklal Kothari](#), and this court's decision in [Shantikumar Narottam Morarji Vs. Commissioner of Income Tax, Bombay City](#), also clearly lay down that share income received by a partner from the firm is liable to be assessed as business income under s. 10 of the Act.

8. Mr. Joshi appearing for the revenue has invited our attention to the provision of s. 67(2) of the I.T. Act, 1961, which runs thus :

"67. (2) The share of a partner in the income or loss of the firm, as computed under sub-s. (1) shall, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which the income or loss of the firm has been determined under each head of income." He pointed out that when this new provision was introduced in the 1961 Act, it was intended to be a clarificatory provision and according to him what was implicit under the 1922 Act, was made explicit or express under s. 67(2) of the 1961 Act. He, therefore, urged that since the principle was implicit in the scheme of the 1922 Act, the manner in which the ITO has apportioned the firm's income among the partners under two different heads should be regarded as correct and the individual partners would not be entitled to claim earned income relief under s. 15A at least in regard to that portion of the income which represented interest on securities. Strong reliance was placed by him upon the decision of the Gujarat High Court in [P.M. Bharucha and Co. Vs. G.S. Venkatesan Income Tax Officer, Circle I Ward A, Bhavnagar](#) . In particular, he relied upon the observations which appear at page 525 of the report. The Gujarat High Court posed a question in these terms : "Would the share of the income, profits and gains received by the partner be assessable as income, profits and gains of business under s. 10 irrespective of the heads of income under which the income, profits and gains of the firm fall, or would it liable to be apportioned under the various heads of income according as the income, profits and gains of the firm are determined under each head of income ?" and the court has then proceeded to observe as follows (page 525) :

"Now, it is no doubt true that unlike s. 67(2) of the new Act, there is no provision in the old Act which provides for apportionment of the partner's share of income, profits and gains of the firm under the different heads of income according to the determination made in respect of the income, profits and gains of the firm but when the share of the partner is sought to be assessed in his individual assessment, it is implicit in the very scheme of the Act that it must be determined under what head of income it falls. When the total income of the partner is computed, the head of income under which each item of income falls has to be determined, for there are different rules of computation appropriate to each head of income. The ITO computing the total income of the partner would, therefore, have to ask himself the question as to what is the head of income under which the share of the partner in the income, profits and gains of the firm falls. Now, in order that any profits or gains should fall within the head of income, profits and gains of business under s. 10, it is necessary that they should be profits or gains of some business carried on by the assessee. The share in the income, profits and gains of the firm would, therefore, be assessable under the head "profits and gains of business, profession or vocation" only if it can be predicated of it that it represents profits or gains of any business carried on by the partner. We must, therefore, ask ourselves the question whether

the share of each partner in the amount representing capital gain of the firm could be said to be profits or gains derived from any business carried on by the partner."

9. Relying on the aforesaid observation Mr. Joshi contended before us that the principle to be deducted from s. 67(2) must be regarded as implicit in the scheme of the old Act of 1922 and, therefore, the ITO's apportionment of the individual partner's share income under two different heads must be regarded as proper and valid and the individual partners must be held to have been rightly denied the earned income relief under s. 15A of the Act. It is not possible to accept Mr. Joshi's contention for more than one reason. In the first place, no retrospective effect of the provisions contained in s. 67(2) of the 1961 Act could be given so as to make the principle enunciated therein applicable to a case under the 1922 Act. Mr. Joshi urged that clause (2) of s. 67, though a new clause introduced in the 1961 Act, was merely clarificatory and in that behalf he relied on the notes to clauses in the statement of objects and reasons to the Bill; that is true, but if by clarificatory is meant that the clause is "declaratory of the law" we do not agree. Ordinarily a "declaratory" provision is regarded as having retrospective operation. Giving retrospective operation to this new provision by calling it clarificatory would result in unsettling the settled legal position that share income received by a partner on apportionment of the firm's income has always been regarded as business income in his hands. The new clause will be clarificatory for future cases arising under the 1961 Act. Secondly, though it has been stated by the Gujarat High Court in [P.M. Bharucha and Co. Vs. G.S. Venkatesan Income Tax Officer, Circle I Ward A, Bhavnagar](#), that the principle of apportionment under different heads as now incorporated in s. 67 of the 1961 Act must be regarded as appear to be any warrant for the said view and in fact the provisions of s. 16(1)(b) and particularly the proviso thereto and the manner in which the said provision has received its interpretation at the hands of courts in several decided cases, suggests that apportionment under different heads cannot be regarded as implicit under the scheme of the 1922 Act. Thirdly, it may be pointed out that the observation on which Mr. Joshi has placed strong reliance will have to be regarded as obiter, for the real question that arose for determination before the Gujarat High Court was whether the corrective jurisdiction under s. 35 of the 1922 Act was attracted when the question involved was a highly debatable question. The Gujarat High Court has clearly upheld, on this principal question which arose before it, that the question whether the capital gains in the hands of the firm would be business income in the hands of partners was a highly debatable question on which there might conceivably be two opinions, and, therefore, even if any mistake was committed by the officer, it was not a mistake apparent from the record so as to attract the corrective jurisdiction under s. 35 of the old Act. It was after giving its conclusion on this point in this manner that the court went on to consider the question on merits and made the observations on which reliance has been placed by Mr. Joshi. As we have said above, the old Act of 1922 was completely replaced by the new enactment of 1961 and a new provision of the type which is to be found in

s. 67(2) came to be incorporated in the 1961 Act and it will be difficult to hold that provision as declaratory and as such the same cannot be applied retrospectively to a case arising under the 1922 Act.

10. As against the obiter observation on which Mr. Joshi relied, Mr. Munim appearing for the assessee has invited our attention to the decision of the Madras High Court in [M. Ct. Muthiah Vs. Commissioner of Income Tax](#), which is directly on the point. In this case the Madras High Court has clearly taken the view that s. 67(2) regarding the apportionment of the income of a partner introduced in the I.T. Act, 1961, is neither clarificatory nor declaratory in nature and does not have retrospective operation. That was a case where the firm was in receipt of income from different sources and the question was what was the nature of the share income in the hands of the partner after apportionment had been effected, and the Madras High Court has held that where a partner gets his share income from a firm, he receives that income only in his capacity as a partner and not as owner or joint owner of the property from which the firm received its income and cannot be classified as income from property under s. 9 in his assessment. The share income of a partner which gets included in the total income under s. 23(5)(a)(i) of the I.T. Act, 1922, does not constitute an independent head of income not falling under any of the heads of income referred to in s. 6. Whatever be the source of income of the firm, so far as the partner is concerned his source of income is only from business coming under s. 10 and the partner's unabsorbed business losses of earlier years could be set off against his share income from the firm. Dealing with the contention of the revenue that even in the hands of the partner who receives the share income, the identity and character of the income earned by the firm are kept intact, the Madras High Court has observed at page 520 of the report as follows :

"The contention of the revenue that even in the hands of the partner who received the share income, the identity and character of the income earned by the firm are kept intact, which found acceptance before the Tribunal, cannot also be accepted. Even though the firm derived income from various sources, it cannot be said that the partner's share of income is also from those sources. In the assessment of the firm there is a pooling of income from all the sources and the total income is arrived at and the firm is assessed on such total income under s. 23 (5)(a)(i). Thereafter, the total income is allocated among the partners and brought in for assessment in the hands of the partner. At that stage, his share income from the firm cannot be traced to the corresponding sources from which the firm had derived his income from those sources. It is to obviate this difficulty, s. 67(2) had been enacted in the 1961 Act." If this was the purpose for which s. 67(2) was incorporated in the 1961 Act, obviously the said provision cannot be regarded as clarificatory or declaratory so as to give it any retrospective effect. The Madras High Court, we may point out, has referred to and relied upon the two decisions - one of the Supreme Court in the case of CIT v. Ramniklal Kothari [1969] 74 ITR 57, and the other of this court in [Shantikumar Narottam Morarji Vs. Commissioner of Income Tax, Bombay City](#). In

the former case the Supreme Court held that the share income of a partner is just like any other income of that partner from any other source and that he is entitled to deduction therefrom the expenditure necessarily incurred by him for the purpose of earning that share income. The observations of Justice Shah appearing at page 59 of the report [Commissioner of Income Tax, Bihar Vs. Ramniklal Kothari](#), have been set out by the Madras High Court and those observation run as follows :

"Where a person carried on business by himself or in partnership with others, profits and gains earned by him are income liable to be taxed under s. 10 of the Indian I.T. Act, 1922. Share in the profits of a partnership received by a partner is "profits and gains of business" carried on by him and is on that account liable to be computed under s. 10, and it is a matter of no moment that the total profits of the partnership were computed in the manner provided by s. 10 of the I.T. Act and allowances admissible to the partnership in the computation of the profits and gains were taken into account. Income of the partnership carrying on business is computed as business income. The share of the partner in the taxable profits of the registered firm liable to be included under s. 23(5)(ii) in his total income is still received as income from business carried on by him."

11. It was sought to be urged before the Madras High Court that this decision of the Supreme Court cannot be taken to lay down a general proposition that any share income received by a partner is a business income without reference to the source from which the firm had received its income. But the Madras High Court rejected the contention by observing that it was not in a position to restrict the scope of that decision in the manner suggested by the learned counsel, and that it did not appear from the facts set out in that decision that the firm derived income exclusively by carrying on business operations as such and that the decision was confined to the facts of that case. It may be mentioned that one of the reasons given by Chief Justice Chagla in [Shantikumar Narottam Morarji Vs. Commissioner of Income Tax, Bombay City](#), for taking the view that the partner's income should be regarded as having been derived from business, was approved by the Madras High Court. Madras derived from business, was approved by the Madras High Court. Madras high Court observed as follows in that behalf at page 524 of the report :

"The learned Chief Justice also gave another reason for treating the partner's income as having been derived from business. The first proviso to s. 23(5) permits the carrying forward of losses sustained by a partner in accordance with s. 24. Sub-s. (2) of s. 24 which alone deals with a carry forward permits the carry forward and set off only for losses sustained in a business. These provisions show that the legislature itself looked upon the income earned by the assessee by the assessee of his partnership income as derived from business. With respect, we entirely agree with the view expressed in that case."

12. Having regard to the above discussion, we are clearly of the view that the provision which are to be found in s. 67(2) of the 1961 Act cannot be regarded as

declaratory provisions so that any retrospective operation could be given thereto, and applying the same to a case arising under the 1922 Act. In fact, having regard to the decision of the Supreme Court and of this court referred to above, a consistent view has been held that the share income which a partner receives on apportionment of the firm's income affected under s. 23(6) of the 1922 Act, has been always regarded as business income assessable under s. 10 of the Act and, therefore, it would be clear that the individual partners in the instant case before us would be entitled to earned income relief under s. 15A of the Act.

13. In the result, the questions referred to above are answered thus :

Question No. 2 : The apportionment made in the manner done by the ITO was neither legal nor valid.

Question No. 3 : In the affirmative in favour of the assessee.

14. The department will pay the costs of the reference.