(1980) 04 BOM CK 0052

Bombay High Court

Case No: Income-tax Reference No. 65 of 1971

Commissioner of Income Tax, Bombay City-II		APPELLANT
	Vs	
Ramdas Lallubhai		RESPONDENT

Date of Decision: April 28, 1980

Acts Referred:

- Income Tax Act, 1961 - Section 10, 183, 297, 67, 67(2)

Citation: (1981) 130 ITR 150 : (1981) 7 TAXMAN 317

Hon'ble Judges: Sawant, J; M.N. Chandurkar, J

Bench: Division Bench

Judgement

Chandurkar, J.
The question referred in this reference is identical to the question which we have just dealt with in Reference No. 48 of 1971, Commissioner of Income Tax Bombay City-II Vs. D.G. Goenka, The question is as follows :

"Whether, on the facts and in the circumstances of the case, dividend income of the assessee was his earned income ?"

2. The assessee is a partner of a partnership firm. M/s. Lallubhai Nagardas of Bombay. The firm consists of three partners who are brothers. The firm carried on business of purchase of sale of shares in the assessment year 1966-67, and it has earned dividend income in that year of Rs. 71,706. The question before the ITO was whether the share of dividend income received by the assessee should be treated as business income and earned income of the assessee on the ground that these shares represented the stock-in-trade.

3. The ITO assessed the dividend income under the head "other sources" and treated as unearned income. The assessee''s appeal before the AAC came to be dismissed and the matter was taken to the Tribunal. The tribunal held that the income received by the way of dividend on the shares held by the assessee as

stock-in-trade was earned income, though assessable as income from other sources. On these facts, the question reproduced above has been referred.

4. On behalf of the assessee, it was contended by Mr. Dastur that though the definition of "earned income" in s. 2 (7) (iii) (c) of the Finance (No. 2) Act, 1962 (hereinafter referred to as "the Finance Act"), requires that the source or the right which gives rise to the income in question has to be determined in so far as dividend income is concerned, the business activity of the assessee which consists of purchasing and selling of shares was also the activity which give rise to dividend income. The learned counsel contended that receipt of dividend is an integral part of business activity. We mat point out that when we heard Income Tax Reference No. 48 of 1971, Commissioner of Income Tax Bombay City-II Vs. D.G. Goenka, we found that a similar point was involved in the present reference in which Mr. Dastur appears, and he was also heard on the contention which is noticed above. We have already rejected the contention that the business activity consisting of purchasing and selling of shares gives rise to dividend income and we have already held in our judgement in Income Tax Reference No. 48 of 1971 that the dividend income cannot be said to be immediately derived from personal exertion because it is immediately derived from the ownership of the shares. The first contention of Mr. Dastur must, therefore, be rejected.

5. The learned counsel then contended that in so far as a partnership firm is concerned, cl. (c) of the definition of "earned income" given in s. 2 (7) (iii) of the Finance (No. 2) Act, 1962, has to be read in two parts. The relevant clause of the definition of "earned income" is as follows :

"The expression "earned income" means any income of an assessee who is an individual, Hindu undivided family, unregistered firm or other association of person or body or individuals, whether incorporated or not, not being a company, a local authority, a registered firm or a firm assessed under clause (b) of section 183 of the said Act - (a) which is chargeable under the head "Salaries"; or (b) which is chargeable under the head "Profits and gains of business or profession" where the profession is carried on by the assessee or, in the case of a firm, where the assessee is a partner actively engaged in the conduct of the business or profession; or (c) which is chargeable under the head "Income from other sources" if it is immediately derived from personal exertion or represents a pension or superannuation or other allowance given to the assessee in respect of the past services of any deceased person; and includes any such income which, though it is the income of another person, in included in the assessee''s income under the provisions of the Income Tax Act, 1961 (43 of 1961), but does not include any such income on which tax is not payable under clause (iii) or clause (v) of section 86 or clause (i) or clause (ii) of sub-section (i) of section 99 of that Act or which is exempted from tax under a notification issued u/s 60 of the Indian Income Tax Act, 1922 (11 of 1922), as continued in force by clause (1) of sub-section (2) of section 297 of the Income Tax

Act, 1961 (43 of 1961)."

6. What Mr. Dastur contends is that the latter part of cl. (h) after the word "or" has to be read as an independent clause. The contention appears to be that in the case of a firm where the assessee is a partner actively engaged in the conduct of the business, the entire share income of the partner has to be treated as earned income. On a bear reading of cl. (b), such a construction is difficult to be accepted. The scheme of cls. (a), (b) and (c) is very clear. Each one of them refers to a head of income. Clause (a) refers to the head "Salaries", cl. (b) refers to the head "Profits and gains of business or profession" and cl. (c) refers to the head "Income from other sources". The entire cl. (b) if properly read, would show that the words "which is chargeable under the head ''Profits and gains of business or profession'"" govern the latter part of that clause "in the case of a firm where the assessee is a partner actively engaged in the conduct of business or profession". Therefore, cl. (b) will be attracted in the case of an assessee who is a partner of a firm and the assessee is actively engaged in the conduct of the business profession. In such a case alone, in the case of a firm, the profits and gains of business or profession will be eligible to be classified as earned income.

7. It was argued before us that the view which we are taking may run counter to the decision of this court in Commissioner of Income Tax, Bombay City-II, Bombay Vs. Narandas and Sons, . The assessee-firm, in that case, was a dealer in Govt. securities and one of the questions which was posed for consideration was whether the share income of an active partner from a firm which deals in Govt. securities and earns interest on them is business income assessable under s. 10 and, consequently, are the partners entitled to earned income relief in respect thereof under s. 15A of the Indian I. T. Act, 1922. The contention of the individual partner was that irrespective of the head under which interest on securities was assessed in the assessment of the firm, what the partner received from the firm was his share of the profit from the firm and the same was assessable in his hands as business income. The Tribunal had held that the share income of the individual partner from the firm was assessable only under s. 10 and in that view of the matter, the individual partner was entitled to earned income relief under s. 15A even in respect of a portion of share income which was interest on securities. The Division Bench, following the decision of the Supreme Court in Commissioner of Income Tax, Bihar Vs. Ramniklal Kothari, and the decision of the court in Shantikumar Narottam Morarji Vs. Commissioner of Income Tax, Bombay City, , held that the share income received by a partner from a firm is liable to be assessed as business income under s. 10 of the Act and, consequently, it was held that the individual partners would be entitled to earned income relief under s. 15A of the Act.

8. It may be noticed that a provision similar to the one under s. 67(2) of the I. T. Act, 1961, was not to be found in the Indian I. T. Act, 1922. Section 67 of the I. T. Act, 1961, deals with the method of computing a partner''s share in the income of the

firm and sub-s. (2) thereof reads as follows :

"(2) The share of a partner in the income or loss of the firm, as computed under sub-section (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."

9. Therefore, the position now under the Act of 1961 is that for the purpose of assessment, the share of the partner in the income of the firm has to be apportioned, under the same head under which it has been determined as the income of the partnership firm. It is obvious that because the Division Bench took the view in Commissioner of Income Tax, Bombay City-II, Bombay Vs. Narandas and Sons, that the share income of the partner is business income, and, consequently, in so far as the definition of earned income is concerned it would then fall in cl. (b) of s. 2 (6AA) and not in cl. (c) of s. 2 (6AA), the assessee was held entitled to the earned income relief. The position under the 1961 Act is now radically changed by the enactment of s. 67(2) of the Act. In view of the provisions of s. 67(2) of the Act, the assessees case will have to be decided with reference to cl. (c) in the definition of "earned income" and not with reference to clause (b) which was relevant to Commissioner of Income Tax, Bombay City-II, Bombay Vs. Narandas and Sons, . There was, therefore, no question of our decision in this case being in conflict with the decision in Narandas''s case.

10. Mr. Dastur has referred us to a decision of the Privy Council in Australian Mutual Provident Society v. IRC [1962] AC 135. That was a case of mutual insurance society incorporated in Australia and also carrying on the business of life insurance in New Zealand. The company held shares in English and Australia companies and the contention was that the dividends earned by the company were exempt from New Zealand tax and were therefore, deductible under s. 149(i) of the Land and Income Tax Act, 1954, the relevant part of which read as follows :

"(1) Notwithstanding anything to the contrary in this Act, every company engaged in carrying on in New Zealand the business of life insurance shall for the purpose of this Act be deemed to have derived and to derive profits from that business in accordance with the following provisions of this section, and all such profits shall be deemed accordingly to be assessable income of the company."

11. The section dealing with exemption from taxation was section 86, the relevant part of which reads as follows;

"86. (1) The following incomes shall be exempt from taxation (i) Dividends and other profits derived from shares to other rights of membership in companies, other that companies which are exempt from Income Tax."

12. The argument advanced before the Privy Council on behalf of the assessee-company was that the dividends derived from the Australian companies

whose shares were held by the New Zealand branch must be "deemed to be derived from New Zealand "because s. 167(a) of the 1954 Act declared that "income derived from any business carried on in New Zealand" shall be deemed to be derived from New Zealand. Under s. 165(2) all income derived from New Zealand was assessable to Income Tax and the argument was that (p. 151) : "...it is part of the business of a life insurance company to invest money, that income from such investments is, therefore derived from its business and that if the investments are held in New Zealand, the income is derived from a business in New Zealand". It was further argued that, therefore, it is assessable income u/s 165(2) and but not for section 86(1)(i) would be taxable and, therefore, is "exempt" within the narrower meaning of that word (i.e., "exempt"), which meant the assessee in that case could not be exempt unless but for the exemption the assessee would have been liable. It was observed by the Privy Council that there was evidence that in the accounts of the assessee, the income from these shares was appropriated to the New Zealand branch and it was said that the securities themselves were kept in New Zealand, but there was no evidence to show whether or not the investments had been purchased out of money earned in New Zealand. The Privy Council the observed that (p. 152) : "On these facts their Lordships do not think it can be said that the income from the shares was income derived from the life insurance business which the appellants carried in New Zealand." Stress was laid on these observations by the learned counsel for the assessee and it was contended that these observation must be read as meaning that the amount received as dividend was income derived from life insurance business. It is not possible for us to read the observations in the manner contended for by the learned counsel for the assessee. The question as to whether the dividend was to be treated as income from life insurance business was not debted before nor decided by the Privy Council and the real question which arose was whether the money out of which the investments were purchased was earned in New Zealand. This decision, therefore is not of any assistance to us.

13. Mr. Dastur then relied upon a decision of the court of Appeal in White (Inspector of Taxes) v. Franklin [1965] 1 WLR 492. Having gone through the facts in that case, we find that the decision is not of any assistance to us because the relevant clause of section 525 (1) of the English Income Tax Act, 1952, which fell for consideration before the court of Appeal was cl. (a) under which "any income arising in respect of any remuneration from any office or employment of profit held by an individual was included in the definition of earned income. The question in that case did not relate to the construction of the words "immediately derived from personal exertion". The taxpayer in that case was an assistant managing director of a family company, receiving certain salary and bonuses. He held no shares in the company, but in 1938, his mother and brother at that time each held 101 out of the total 400 odd issued ordinary shares, conveyed 100 of those shares each to the trustees of the trust to pay the income arising therefrom to the taxpayer "so long as he shall be engaged in the management of the company" with provision made in case of

default. The contention on behalf of the revenue from the shares which were the subject matter of the trust did not come to the assessee as a reward for his services but was paid for purely family reasons and with a view to keeping the business in the family. It was therefore, not earned income, according to the revenue. According to the assessee, the income in question had to be earned by complying, so that it was in the truth income earned by him as a reward for his services as an employee or, in other words, according to the assessee, the income came to him in virtue of the office. The court of Appeal held that the words "income arising in respect on any remuneration" in cl. (a) of s. 525(1) meant income which constitutes remuneration and that it was not in dispute that the taxpayer''s employment was an office or an employment of profit within the meaning of s. 525. The Court of Appeal the referred to the test which had to be satisfied for the purposes of s. 525 (1) (a), as laid down by Collins M. R. in Herbert v. McQuade [1902] 2 KB 631 and test was "whether from the standpoint of the person who receives it, it accrues to him in virtue of his office." The court of Appeal also referred to the test laid down by the court in Hochstrasser v. Mayes [1958] 3 WLR 215 and by the House of Lords in the same case in appeal reported in [1960] AC 376 and the test was "whether the fact of the employment was the causa causans of the payment as opposed to a mere sine qua non" [1965] 1 WLR 492. Applying this test, the court of Appeal observed thus (p. 514) :

"..on the facts recited in the case stated, there was ample evidence to justify the conclusion of the commissioners that the character of the income received in this case was such as to constitute it remuneration from the taxpayers office or employment with the company, so as to come within the definition of earned income."

14. It is apparent that the requirements of cl. (a) of s. 525 (1) of the English Income Tax Act, 1952, were materially different from the provisions of s. 2 (7) (iii) (c) of the finance (No. 2) Act, 1962, with which we are concerned. What Mr. Dastur, however contended was that when the Court of Appeal referred to the test "whether the fact of the employment was the causa causans of the payment", a similar test should be applied in the instant case and since the business of purchase and sale of shares was the causa and causans of the receipt of the dividend income, the dividend income should be considered as earned income of the assessee. As we have already pointed out the test which is required to be satisfied for the purpose of cl. (c) of s. 2 (7) (iii) of the Finance (No. 2) Act, 1962, is whether the income was immediately derived from the personal exertion of the assessee. That alone will have to be the test on which the question as to whether any particular income is earned income will have to be determined and that test, as laid down by the Legislature, cannot be substituted by the test adopted by the Court of Appeal while construing cl. (a) of s. 525 (1) of the English Income Tax Act, 1952, which as already pointed out, is very differently worded as compared with the provision with which we are concerned.

15. One other decision which was referred to by the learned counsel was Pay (Inspector of Taxes) v. Newton [1971] 1 WLR 133 . That was a case dealing with the determination of whether the capital gain in that case were "earned income" as defined by s. 525 (1) (c) of the Income Tax Act, 1952 (UK). One Mrs. Newton who carried on a hairdressing business sold the goodwill of the business for Pound 179 net. She had taken over the business earlier but had made no payment for goodwill. It was not in dispute that the capital gain of Pound 179 in respect of goodwill was correctly chargeable for 1967-68 under Case VII of Sch. D. What was in dispute was whether the husband Mr. D. C. Newton, was entitled to claim earned income relief and wife''s earned income allowance of Pound 179. Brightman J., who dealt with the case, stated at the instance of the revenue, observed that the only question was "whether the Pound 179 was derived by the taxpayers wife from the carrying on or exercise by her of her trade and, if so, was immediately so derived". The contention of the assessee was accepted with the following observation (see [1970] 46 TC 653 :

"The sum of Pound 179 receivable on or about February 24, 1968, was exclusively attributable to the carrying on by Mrs. Newton of her hairdressing business between July 10, 1967, and February 24, 1968. It was therefore, derived from carrying on of that business. It was none the less immediately so derived because it was money receivable under a contract for sale with a purchaser, and was not, for example, money receivable under a contract for hairdressing with a customer."

16. It is difficult to see what assistance the assessee can derive from this decision. Whether income which is sought to be classified as earned income falls in that classification has to be determined on the facts and circumstances of each case in the light of the relevant statutory provision an unless on facts it is possible to reach a conclusion that a particular income is immediately derived from personal exertion of the assessee, that income cannot be classified as earned income. All that can be said about the decision relied upon is that, in that case, the capital gain held to have been directly derived from the hair dressing business carried on by the assessee''s wife. There is nothing in that decision which can be assistance to the assessee.

17. We may also point out that the test laid down by the Privy Council in Kamakhya Narayan Singh''s case [1948] 16 ITR 325 has been referred to with approval by the Supreme Court in Commissioner of Income Tax, Uttar Pradesh Vs. Kunwar Trivikram Narian Singh,

18. Having regard to the view which we have taken, it is not possible to hold that the dividend income earned by the assessee was his earned income for the purpose of s. 2 (7) (iii) (c) of the Finance (No. 2) Act, 1962. The question referred to us must, therefore, be answered in the negative and in the favour of the revenue. Assessee to pay the cost of this reference.