

In Re: B.K. Paul and Co.

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Court : Kolkata

Decided On : Feb-24-1938

Reported in : AIR1939Cal196

Appellant : In Re: B.K. Paul and Co.

Judgement :

Derbyshire, C.J.

1. The assessees, Messrs. B.K. Paul & Co., are an undivided Hindu family. Prior to 14th April 1934 the assessees owned real property, Government securities, shares in private companies and some 17 businesses which either made or sold drugs and the like. During the accounting year ('the previous year') which ended on 13th April 1933, the assessees received income from the real property, Government securities and shares in the companies, but the 17 businesses each suffered losses. The assessees were not assessed during the normal assessment year which ended on 31st March 1934 owing to a delay on the part of the Income-tax Officer. On 11th April 1934, four private limited companies were formed the share-holders being members of the Hindu undivided family. On 14th April 1934, 16 of the 17 losing businesses were transferred to the four new companies. On 28th September 1934 the Income-tax Officer made an assessment on the assessees in respect of their income, profits and gains from the real property, Government securities and (old) company shares in respect of the year ending 13th April 1933. The amount of the assessment was Rupees 1,38,229. During the same accounting year the losses in the 17 businesses amounted to Rupees

2,18,682. The assessee claimed to set off this loss against the above mentioned gains during the same year. The Income-tax Officer allowed the assessee to set off the loss in the 17th business which was not transferred to any of the four new companies, but refused to allow the set off of the losses of the 16 other businesses transferred to the four new companies, on the ground that there had been a succession under Section 26(2) of Act and that any right of set-off had passed from B.K. Paul & Co., under the succession. The assessee, B.K. Paul & Co., relied on Section 24(1) of the Act, and the Income-tax authorities on Section 26(2) which are set out below:

Section 24(1) : Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in Section 6, he shall be entitled to have the amount of the loss set-off against his income, profits or gains under any other head in that year.

Section 26 (2): Where at the time of making an assessment under Section 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year.

2. The question submitted to the Court is as follows:

Where an assessment proceeding for 1933-34 is started but not completed during that year and during its pendency in the next year the assessee hitherto carrying on business is succeeded in such capacity by another person, whether set-off under, Section 24, Income-tax Act, for the loss sustained in that business during the year 1932-33 can be claimed by the assessee or whether such set-off will be allowable only to the successor.

3. In my opinion, it is, as Section 24(1) specifically states, the 'assessee who sustains a loss' in any year, who is entitled to have the amount of the loss set-off against his income, profits or gains under any other head in that year. Here B.K. Paul & Co. were assessed on 28th September 1934 in respect of their income,

profits or gains from real property, interest on Government securities and dividends from (old) companies during the accounting year ending 13th April 1933. B.K. Paul & Co. undoubtedly owned the 16 losing businesses throughout the whole of the same accounting year and therefore sustained a loss during that same year. It seems to me that B.K. Paul & Co. come precisely within the words of Section 24(1). It is true that in the accounting year next but one following, the four new companies which had no existence during the accounting year ending 13th April 1933 succeeded to the 16 businesses. Yet it cannot be said that these four companies sustained a loss in the year ending 13th April 1933; they were not in existence in that year and were neither making gains or sustaining losses. Cases may arise in which there will be a conflict as to the right to the set-off as between the transferor and the transferee of a business which has suffered losses during the accounting year. The terms and circumstances of the transfer may indicate whether there has been a succession within Section 26 (2) and what the rights of the respective parties are in such cases. No such conflict arises here in my opinion and I do not propose to anticipate it. The assesseees will get the costs of the reference. Hearing fee seven gold mohurs.

Khundkar J.

4. I agree. I have had the advantage of seeing the judgment just pronounced by my Lord the Chief Justice and also that which my learned brother Mukherjea J. proposes to deliver. As the facts are fully set out in those judgments, I do not repeat them. I desire only to add a few observations on one aspect of the case. Section 24 in clear terms gives to an 'assessee' the right to set-off a loss of profits or gains in any year against income, profits and gains in that year. The undivided family in this case is the assessee whose return the income-tax authorities had under consideration, and who in fact was on 28th September 1934 held to be the person by whom income-tax was payable, in respect of the accounting year 1932.33 but in the assessment year 1933-34. It is to be noted that the position of the undivided family was exactly the same in the two years 1932-33 and 1933-34 in regard to the sources of its income, profits or gains, as well as in regard to the heads of its losses. In other words throughout the whole of these two years the income, profits or gains of the undivided family were derived from properties and

securities and throughout the whole of these two years it admittedly was and continued to remain the owner of 17 drug concerns which were productive of losses in 1932-33. The assessment proceedings were commenced on 18th May 1933 though the final order of assessment was not made till 28th September 1934.

5. In these circumstances it appears to me that to refuse to allow the set-off which the undivided family claimed was prima facie a negation of the right which Section 24(1) expressly gave to it as an assessee. An assessee, it undoubtedly became, when the order of assessment was passed upon it. But it has been contended that that right is taken away by Section 26(2) which says that where at the time of making an assessment under Section 23 it is found that the person carrying on any business, etc. has been succeeded in such capacity by another the assessment shall be made on such person succeeding, etc. For, upon an examination of the facts it becomes very clear that at the material time no order of assessment could in the circumstances of this case have been made upon the limited companies which had succeeded to the ownership of the drug concerns for the plain and simple reason that those companies never had any income from any source whatever, and were successors to the ownership of the businesses which had been during the year in question productive only of loss. In the Bombay and Madras cases cited by the Commissioner there are observations of a somewhat general nature which seem to be opposed to the view I have stated. Those observations are authority for the decision on the special facts of the cases to which they applied, and the situation which has arisen in this case was not present before the Judges who made those observations. In Commissioner of Income-tax, Madras v. Best. & Co. (1932) 19 A.I.R. Mad. 434, no question as to a right of set-off under Section 24 arose for consideration. As to the case in Bhogilal Hargovandas Patel v. Commissioner of Income-tax, Bombay (1935) 9 I.T.C. 110, it was not established, as it has been here, that at the time in question an order of assessment could not have been passed upon the successors. If that had been proved, a very different situation would have arisen. The Court would then have been called upon to consider whether the words 'the assessment shall be made on such person succeeding' in Section 26(2) was not entirely inapplicable as there was nothing upon which an assessment could be based. Beaumont C.J. evidently envisaged such a situation and observed that the facts of that case did not give

rise to it, for he says:

There is no evidence that there were no profits made and that therefore no assessment on the purchasing company was necessary, and in the absence of evidence to that effect, it seems to me that the Income-tax Officer was quite right in saying that the Section applied.

6. Beaumont C.J. has in fact expressly distinguished the question which he was considering from a question of the kind which has arisen here, for he goes on to say:

It is not necessary to deal with the question whether Section 26, Sub-section (2), would apply if there were no profits in respect of the business transferred and therefore no assessment was necessary on the successor, assuming that he had no other source of income.

7. It is, I think, desirable to say a word about the opinion of the Commissioner which is that the Section allows set-off only to the person who would have been the assessee had there been profits or gains under the head under which he has sustained a loss. According to the definition in Section 2 (2) 'assessee' means a person by whom income-tax is payable'. The language in my judgment does not support the Commissioner's view which would embrace not only persons liable, but also all persons who would be liable to income-tax in a certain eventuality, that is had there been profits or gains. If the facts of this case are to be accepted, the limited companies did not come within the meaning of the words 'person by whom income-tax is payable' because they never had any income from any source. Upon the facts established in this case, the limited companies would not obtain any benefit out of the right of set-off given by Section 24. Yet, upon the argument advanced on behalf of the income-tax authorities, the joint Hindu family from which the limited companies took over the businesses would have to be denied that right. Speaking for myself I think there is something inherently wrong in this and such a result could never have been intended.

B.K. Mukherjea, J.

8. I agree with my Lord the Chief Justice in the decision which he has arrived at, and I desire to give shortly my own reasons in support of the same. The reference has been made by the Commissioner of Income-tax, Bengal, under Section 66(3), Income-tax Act, in pursuance of an order passed by this Court on 30th July 1936. The material facts may be shortly stated as follows : Messrs. B.K. Paul & Co. who admittedly constitute an undivided Hindu family and were assessed as such in previous years were called upon to furnish a return of its income for the year 1339 B.S. (1932-33) which was taxable in the year 1933-34. On 6th December 1933, a return was filed showing three sources of income which the family owned, viz. (1) house property, (2) securities and shares in limited companies and (3) 17 businesses, all of which related to manufacture and sale of drugs. The first two items showed a profit of Rs. 1,15,024-6-6, but the loss on Item 3 came up to Rs. 2,18,682-11-7 resulting in a net loss to the extent of Rupees 1,03,658-5-1. There was a notice on the assessee to produce its account books which were examined in March 1934, but no order of assessment was passed within the financial year 1933-34, probably because, as the Commissioner says, the case not being a revenue producing one, was not considered to be sufficiently urgent. On 14th April 1934, the businesses owned by this Hindu joint family with one exception were transferred to four private limited companies. The Income-tax Officer passed his assessment order on 28th September 1934. He assessed the family upon the profits obtained by it from the first two sources of income mentioned above and refused to give a set-off in respect of the loss on business suffered by it. He took his stand upon Section 26(2), Income-tax Act, and was of opinion that as at the time of making the assessment, the businesses owned by the family were transferred to other persons, the assessment in respect of the businesses must be made on the succeeding companies, and as the family could not be regarded as assessee in respect of the same, it could not claim any set-off as was provided for in Section 24 of the Act. This view was upheld by the Assistant Commissioner on appeal. The assessee then made an application to the Commissioner for a reference to the High Court under Section 66(2), Income-tax Act. This was refused on 11th April 1935. Subsequently there was an application to this Court under Section 66(3), Income-tax Act, and in pursuance of the order of this Court, the present reference has been made. The question referred to our decision stands

thus:

Where an assessment proceeding for 1933-34 is started but not completed during that year, and during its pendency in the next year, the assessee hitherto carrying on business is succeeded in such capacity by another person, whether set-off under Section 24, Income-tax Act, for the loss sustained in that business during the year 1932-33 can be claimed by the assessee, or whether such set-off will be allowable only to his successor.

9. The Commissioner has expressed his opinion adversely to the assessee. According to him the loss sustained by the assessee on the various businesses owned by it could not be taken into consideration in determining the profits or losses of the undivided Hindu family as the assessment in respect of the businesses must under the mandatory provision of Section 26(2), Income-tax Act, be made on the successors. He has relied for this view upon certain decisions of the Madras and Bombay High Courts which are to be found reported in *Commissioner of Income-tax, Madras v. Best & Co q.* and *Bhogilal Hargovandas Patel v. Commissioner of Income-tax, Bombay (1935) 9 I.T.C. 110*. Mr. Banerjee who appears for the assessee has challenged the propriety of the view taken by the Commissioner and has asked us to hold that his clients are entitled to claim set-off under Section 24, Income-tax Act, Section 26(2) having no application to the facts of the present case. His contention in substance is that to attract the operation of Section 26(2) which makes it obligatory on the Income-tax Officer to assess the person who has succeeded to any profession, business, or vocation, the succession must take place within the year of assessment; and if as here, it takes place, after the tax year has expired, Section 26(2) would have no application. It is not disputed that there are no clear words to that effect in the subsection itself, and the only thing necessary to attract its operation, is the discovery of the fact of succession by the Income-tax Officer when the assessment is made. Mr. Banerjee argues, that a limitation, as suggested by him, must be implied, as otherwise it would lead to absurd and anomalous consequences. A case can be imagined, he says, when the assessment is made three or four years after the expiry of the tax year, and if just before that a transfer of, or succession to, a business takes place, it would be absurd to suggest that the transferee who had

nothing to do with the business in the year of accounting would be deemed in the eye of the law to have received the whole of the profits of the previous year. I must say that at first I was tempted to take the view that Section 26(2) contemplates a case where the succession takes place during the 'previous year as defined in Section 2(11), and it is to avoid a splitting up of the income or profits earned during that period, that the Legislature makes the assumption that the transferee or successor received the whole-profits of the previous year. The last two lines of the sub-section may lend an apparent countenance to this view, but the clear words at the beginning make it impossible for me to accept this interpretation as correct. The only material time for purposes of the sub-section is the time of making the assessment, and if there is discovery at that time of a succession or transfer, for which no date has been specified by the Legislature, the provisions laid down in the sub-section if it is otherwise-applicable, would be attracted, and the fiction would be that the transferee carried on the business during the whole of the previous year and received all the profits, even though that fiction is manifestly contradictory to facts. It may be that the intention of the Legislature was to find out somebody who was more justly or conveniently assessable, and under the circumstances set out in Section 26(2) the successor is deemed to be the more convenient or proper person to be assessed than his predecessor.

10. The case relied upon by the Commissioner may be distinguishable on facts, as in neither of them the transfer or succession took place after the expiry of the year of assessment, but the pronouncement of the Judicial Committee in *Maharaja of Darbhanga v. Income-tax Commissioner B. & O.* has in my opinion placed the matter beyond the pale of controversy. The process of assessment begins, as their Lordships have said, with the service of notice under Section 22(2) and it continues until some order of assessment is made. If therefore after the aforesaid notice has been received by the assessee and before filing a return he dies, and is succeeded by a person, it would be competent to the Income-tax Officer to find, if the evidence justified the finding, that the person on whom the notice was served had carried on a business, and was succeeded in that capacity by another person. The same view was taken in *Commissioner of Income-tax, Madras v. Nachal Achi* (1934) 21 A.I.R. Mad. 63 and *Bam Bakha Mai & Sons v. Commissioner of Income-tax, Punjab* (1937) 24 A.I.R. Lah. 830, in both of which the succession took place

after the close of the year of assessment. The contention of Mr. Banerjee is therefore not tenable. But even though I cannot accept the argument of Mr. Banerjee, it does not necessarily follow that the assessee is not entitled to claim set-off in the circumstances of the present case. The Advocate-General has argued that once it is found by the Income-tax Officer at the time when he makes the assessment that there has been a succession to a particular business, he cannot take the profit or loss of that business into consideration any further, and cannot grant a set-off to the assessee, who no longer remains an assessee in respect of that business. It is incumbent upon him to ignore this item altogether so far as the assessee is concerned, and it can be taken into account only in assessing the successor, whom he is bound to assess under Section 26(2), Income-tax Act.

11. The proposition requires to be carefully examined. Section 24, Income-tax Act, in clear words gives a right of set-off to an assessee who suffers loss under any of the heads mentioned in Section 6. It seems that the word 'assessee' has not been used here in the strict sense of a person by whom income-tax is payable, but means and signifies the person against whom assessment proceedings have been started and who has been asked to give a return of his total income during the previous year under Section 22(2), Income-tax Act. If such person sustains a loss of profits or gains under any of the heads of income, he shall be entitled to have the amount of loss set off against his income, profits or gains under any other head. In other words, his total income will be shown in the return by deducting the losses from the profits earned, and he can be assessed on the balance, if any, that remains after making the deduction. It cannot be imagined, I think, that the Legislature by Section 26(2) intended to deprive the person who suffered loss in his business of his right to get a set-off under Section 24. Under Section 26(2), if the Income-tax Officer is apprised of a succession to a business at the time of making the assessment the assessment shall be made on the person succeeding. This means that so far as that business is concerned, the assessment which was started against the transferor or predecessor, would end in an order of assessment upon the successor or transferee. But this can be done only when there is income, profit or gains from the particular business for which assessment is possible under Section 3, Income-tax Act. If there was no profit for the business

in the year of accounting Section 26(2), Income-tax Act, would not come into operation at all. No question of assessing the successor would then arise and the language of the Section itself shows that the assessment is based on the assumption that the successor received the entire profits of the previous year. It is idle, in my opinion, to suggest that the successor may have other sources of income for which assessment might be possible; for the primary object of Section 26(2) is not to allow set-off to the successor, who in the ordinary course, might and ought to have been taxed on his other incomes. The object undoubtedly is to assess the successor on the profits of the business, which he is deemed constructively to carry on during the previous year, it being considered just or convenient by the Legislature, that the tax should be recovered from him and not from his predecessor. Section 26(2) has therefore in my opinion no application, when there is loss in the year of accounting in the business in respect to which succession has taken place, and there are no profits for which the successor could be taxed. To put any other construction, would lead to clear injustice. For various reasons, good or bad, the assessment proceedings might be delayed, and the assessee though he actually suffered loss in the business in the year of accounting, would lose the privilege of a set-off, for no fault of his. No injustice however would result, if the business yielded profits. No question of claiming set-off by the assessee would, then arise and the successor on the other hand would get the benefit of a set-off in respect of his losses on other heads of income. There will be thus no conflict between Sections 24 and 26(2), and one of them would not exclude the other. The injustice is all the more palpable in a case like the present one, where the successor gets no corresponding advantage from which the predecessor is deprived. The succeeding companies in the present case, were brought into existence for the first time in 1934, and as they had no business at any time before, a claim of set-off under Section 24 is of no advantage to them.

12. In the Madras case, Commissioner of Income-tax, Madras v. Messrs. Best & Co. (1932) 19 A.I.R. Mad. 434, no question of set-off was raised, and the decision does not in any way militate against the view I have taken. In Bhogilal Hargovandas Patel v. Commissioner of Income-tax, Bombay (1935) 9 I.T.C. 110, which was decided by the Bombay High Court, the facts are undoubtedly distinguishable as the succession there took place within the year of accounting,

but even then the observations of Beaumont C.J. are rather in agreement with the opinion I have expressed above. The observation is as follows:

It is argued on behalf of the assessee that Section 26(2) does not apply unless there are profits. There is no evidence that there were no profits and that therefore no assessment on the purchasing company was necessary; and in the absence of any evidence to that effect it seems to me that the Income-tax Officer was quite right in saying that the Section applied.

13. Blackwell J. undoubtedly took a different view, but I do not consider the reasoning to be sound. Now, if we look at the matter from the standpoint of the transferee of the businesses, it is clear that they cannot set off under Section 24, Income-tax Act, which allows set-off to the assessee who suffers loss under any of the heads of his income. The transferees are, as I have said already, not the assessee in the sense in which the word is used in Section 24 and cannot be said to have suffered any loss in the businesses, which in fact they have not carried on, and which they purchased after the year of assessment was over. There is no presumption under Section 26(2) that they suffered loss in the businesses which they have purchased. Loss has been suffered by the undivided Hindu family Messrs. B.K. Paul & Co., and they are the persons entitled to claim set-off under Section 24. For these reasons, I concur with my Lord the Chief Justice in holding that under the circumstances stated by the Commissioner, Messrs. B.K. Paul & Co. are entitled to claim set-off in respect of the loss of businesses under Section 24, Income-tax Act, and this set-off cannot be claimed by the succeeding companies to which these businesses were transferred.