AIR 1986 SUPREME COURT 2111

(From : (1974) 94 ITR 592 (Delhi))

R. S. PATHAK AND
SABYASACHI MUKHARJI, JJ.

Civil Appeals Nos. 1350-51 (NT) of 1974, D/- 15-7-1986.

Commissioner of Income-tax, Delhi, Appellant v. Mahalaxmi Sugar Mills Co. Ltd., Respondent.

(A) Income-tax Act (11 of 1922), Ss. 24, 49AA, 4 — Agreement for Avoidance of Double Taxation of Income chargeable in India and Pakistan (1947), Arts. IV to VII — Dividend income received from Pakistan Company — Deductible in arriving total world loss under S. 24(1). (1974) 94 ITR 592 (Delhi), Reversed.

The dividend income received by an Indian assessee from the Pakistan company is deductible in arriving at the total world loss of the assessee under sub-s. (1) of S. 24 of the Indian Income-tax Act, 1922. (1974) 94 ITR 592 (Delhi), Reversed.

(Para 13)

In view of the provisions of Arts. IV to VII and the Schedule of the Agreement for the Avoidance of Double Taxation of Income chargeable in India and Pakistan, the dividend income derived from the Pakistan Company by the assessee is, by virtue of the Agreement, liable to charge wholly by the Dominion of Pakistan, and the Dominion of India is not entitled to charge the dividend income at all. But this is the position obtaining pursuant to the Agreement. If regard be had to the provisions of the Indian Income-tax Act, without reference to the Agreement, the dividend income, even though accruing or arising abroad, is liable to tax under the Indian law. The Agreement enjoins it will be apparent from Art. IV of the Agreement that each Dominion is entitled to make assessments in the ordinary way under its own laws. The process of determining the assessable income of the assessee is not affected by the Agreement. What the Agreement does is to give relief against double taxation. The Agreement plays no role in the application of the Indian law for the purpose of determining the total income of an assessee and the tax liability consequent upon such assessment. On the contrary, the provisions of the Agreement clearly envisage that full effect must be given to the operation of the tax law of each Dominion. All that the Agreement does is to permit a Dominion to retain the tax recovered by it pursuant to an assessment under its law to the extent that an abatement is not allowed under the provisions of the Agreement. There is no provision in the Indian Income-tax Act from which it can be inferred that the dividend income from a foreign Company is not includible in total income or is exempt from tax. Consequently, the dividend income received by an Indian assessee from the Pakistan company is deductible in arriving at the total world loss of the assessee under sub-s. (1) of S. 24 of the Indian Income-tax Act, 1922. (1974) 94 ITR 592 (Delhi), Reversed. AIR 1965 SC 1263, Rel. on.

(Paras 7, 8, 9, 11, 13)

(B) Income-tax Act (11 of 1922), S. 24 — Total income — Computation of — Assessee not claiming benefit of set off under S. 24 — It is duty of I.-T.O. to apply S. 24 in appropriate cases.

(Para 12)

Cases Referred : Chronological Paras

AIR 1965 SC 1263 : 55 ITR 699 8

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

2. The assessee is a public limited company carrying on the business of manufacturing and selling sugar. During the relevant period it also held some shares in the Premier Sugar Mills & Distillery Co. Ltd., Mardan, West Pakistan. The Pakistan company also carried on the business of manufacturing and selling sugar. In the previous year relevant to the assessment year 1956-57 the assessee earned a dividend income of Rs. 2,30,832/- from its holdings in the Pakistan company. It sustained a loss of

Rs. 20,30,006/- from the business in India. Likewise, in the previous year relevant to the assessment year 1957-58 the assessee received a dividend income of Rs. 3,30,868/- from the holdings in the Pakistan company, but sustained a loss of Rs. 9,11,728/- from the business in India. The assessee claimed that the entire loss sustained by it in India in each year should be carried forward and set off against its business profits in India in future years. It contended that the dividend income derived by it from the Pakistan company was not liable to tax in India as it was wholly taxed in Pakistan, and therefore, it could not be set off against the business loss in India. The Income-tax Officer rejected the contention and deducted the dividend income received from the Pakistan company from the business loss in India disclosed by the assessee and after making certain other adjustments he determined the total loss of the assessee for the assessment year 1956-57 at Rs. 16,51,120/- and for the assessment year 1957-58 at Rs. 3,78,661/-.

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

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

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

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

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

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

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

Article V— Where any income accruing or arising without the territories of the Dominions is chargeable to tax in both the Dominions, each Dominion shall allow an abatement equal to one-half of the lower amount of tax payable in either Dominion on such doubly taxed income.

Article VI— (a) For the purposes of the abatement to be allowed under Art. IV or V, the tax payable in each Dominion on the excess or the doubly taxed income, as the case may be, shall be such proportion of the tax payable in each Dominion as the excess

or the doubly taxed income bears to the total income of the assessee in each Dominion.

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

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

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

xxx xxx xxx

(For Schedule see below)

7. It is apparent that in the case of

(Contd. on Col. 2)

dividend income the percentage of income which each Dominion is entitled to charge under the Agreement is in proportion to the profits of the company chargeable by each Dominion under that Agreement. The relevant entry in the Schedule indicates that as the factory is situated in Pakistan the Dominion of Pakistan is entitled to charge 100 per cent of the income and that the Dominion of India is not entitled to charge any percentage of the income. Therefore, the dividend income derived from the Pakistan Company by the assessee is, by virtue of the Agreement, liable to charge wholly by the Dominion of Pakistan, and the Dominion of India is not entitled to charge the dividend income at all. But this, it must be noted, is the position obtaining pursuant to the Agreement. If regard be had to the provisions of the Indian Income-tax Act, without reference to the Agreement, the dividend income, even though accruing or arising abroad, is liable to tax under the Indian law.

8. The High Court held that because of the operation of the aforesaid Agreement dividend income derived by the assessee in Pakistan was not assessable under the Income-tax Act in India and, therefore, could not be set off under sub-s. (1) of S. 24 of the Indian Income-tax Act, 1922 against the business loss suffered by the assessee. Now there can be no doubt that under sub-s. (1) of S. 24 an assessee who has sustained a loss of profits or

The Schedule

(See Article IV)

Source of Income or nature of transaction from which income is derived	Percentage of Income which each Dominion is entitled to charge under the agreement		Remarks
(1)	(2)	(3)	(4)
xxxx	xxxx	xxxx	xxxx
8. Dividends	By each Dominion in proportion to the profits of the company chargeable by each Dominion under this Agreement	(As in preceding column)	Relief in respect of any excess income-tax deemed to be paid by the share-holder shall be allowed by each Dominion in proportion to the profits of the company chargeable by each under this Agreement
xxxx	xxxx	xxxx	xxxx"

gains in any year under any of the heads mentioned in S. 6 is entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year, and that the income, profits or gains against which the loss is set off must be such income, profits or gains as is assessable under the Indian Income-tax Act. The statute does not contemplate a setting off of loss against income which is not assessable at all under the Act. But in order to determine whether the income in question is assessable under the Act regard must be had to the provisions of the Act itself. The High Court erred in taking into consideration the circumstance that the Agreement between the two Dominions prohibited the Dominion of India from charging income-tax on dividend income earned in Pakistan and treating it as exempt from the process of assessment to tax under the Act. It will be apparent from Art. IV of the Agreement that each Dominion is entitled to make assessments in the ordinary way under its own laws. The process of determining the assessable income of the assessee is not affected by the Agreement. What the Agreement does is to give relief against double taxation, and as is clear, from Arts. IV, V and VI it is the charge levied by a Dominion on the income of an assessee that is involved in the relief. For Art. IV goes on to say that where either Dominion under the operation of its laws charges any income from the sources or categories of transactions specified in column 1 of the Schedule to the Agreement in excess of the amount calculated according to the percentage specified in columns 2 and 3 thereof, that Dominion shall allow an abatement equal to the lower amount of tax payable on such excess in the Dominion as provided for in Art. VI. The Agreement was considered by this Court in Ramesh R. Saraiya v. Commr. of Income-tax, Bombay City I, (1965) 55 ITR 699 : (AIR 1965 SC 1263) and the position was summed up clearly as follows :—

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

Article VI also leads to the same conclusion. For if no assessment could be made on the amount on which abatement is to be allowed, there could be no question of making a demand without allowing the abatement and holding in abeyance for a period the collection of a portion of the demand equal to the estimated abatement."

9. On the basis of the Agreement the High Court came to the conclusion that the dividend income was not liable to charge by the Dominion of India. The High Court omitted to note that the Agreement functions on a different plane altogether. It enjoys no role in the application of the Indian law for the purpose of determining the total income of an assessee and the tax liability consequent upon such assessment. On the contrary, the provisions of the Agreement clearly envisage that full effect must be given to the operation of the tax law of each Dominion. All that the Agreement does is to permit a Dominion to retain the tax recovered by it pursuant to an assessment under its law to the extent that an abatement is not allowed under the provisions of the Agreement. Art. IV, it may be reiterated, specifically provides that each Dominion shall make assessment in the ordinary way under its own laws. Such assessment includes the determination of the consequential tax liability. Thereafter, the Agreement takes over and the Dominion must allow an abatement in the degree mentioned

in Art. IV. It will also be noticed that Cl. (b) of Art. VI permits the Dominion to make a demand without allowing the abatement if the tax payable on the total income in the other Dominion is not known, but the collection of the tax has to be held in abeyance for a period of one year at least to the extent of the estimated abatement. If the assessee produces the certificate of assessment in the other Dominion within the period of one year or any longer period allowed by the Income-tax Officer, the uncollected portion of the demand has to be adjusted against the abatement allowable under the Agreement. But if no such certificate is produced, the abatement ceases to be operative and the outstanding demand can be collected forthwith. Cl. (a) of Art. VII makes absolutely clear that nothing in the Agreement can be considered as modifying or incorporating in any manner the provisions of the relevant tax laws in force in either Dominion. Therefore, having regard to what is expressly stated in Article IV of the Agreement, and re-emphasised in Cl. (a) of Art. VII, there can be no escape from the conclusion that for the purposes of the assessment under the Indian Income-tax Act, the income of assessee must be determined in the ordinary way under the Indian law, and in no way can the Agreement be construed as modifying or superseding in any manner the provisions of the Indian law in that regard.

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

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

12. Learned counsel for the assessee has placed a number of cases before us which deal with the application of the Indian Income-tax Act, and where it has been held that for the purpose of sub-s. (1) of S. 24 of that Act income which does not fall within the purview of the Act at all cannot be set off against a loss arising under the Act. These are cases which are wholly inapposite, and have no bearing, at all upon the role played by the Agreement. It is also urged that it is open to the assessee to claim or not to claim the benefit of S. 24 of the Act, and that if he does not do so no question arises of applying S. 24. In the first place, a perusal of the assessment orders for the two years shows clearly that the assessee did claim a set off of the Pakistan dividend against the losses of the Indian business. In the second place there is a duty cast on the Income-tax Officer to apply the relevant provisions of the Indian Income-tax Act for the purpose of determining the true figure of the assessee's taxable income and the consequentially tax liability. Merely because the assessee fails to claim the benefit of a set-off (it) cannot relieve the Income-tax Officer of his duty to apply S. 24 in an appropriate case.

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

Appeal allowed.

AIR 1986 SUPREME COURT 2116

(From : 1970 Lab. I. C. 950 (Patna))

E. S. VENKATARAMIAH AND
V. BALAKRISHNA ERADI, JJ.

Civil Appeal No. 683 of 1971, D/- 16-7-1986.

Kirti Bhusan Singh, Appellant v. State of Bihar and others, Respondents.

Constitution of India, Arts. 309, Proviso and 311(2) — Bihar Pension Rules, R. 116 — Bihar Sercice Code, R. 73(f) — Dismissal — Servant retired on invalid pension during pendency of disciplinary proceedings even before attaining age of retirement — Subsequent order of Govt. dismissing servant after revoking order of retirement — Not valid — R. 73(f), not attracted. 1970 Lab IC 950 (Patna), Reversed.

Where a Govt. servant during the pendency of the departmental proceedings was permitted to retire on invalid pension on medical grounds even before he had attained the age of retirement, the subsequent order of Govt. dismissing him from service after revoking the earlier order would be unsustainable. The order of retirement on medical grounds having become effective and final it was not open to the competent authority to proceed with the disciplinary proceedings and to pass an order of punishment. In the absence of such a provision which entitled the State Government to revoke an order of retirement on medical grounds which had become effective and final, the order passed by the State Government revoking the order of retirement should be held as having been passed without the authority of law and was liable to be set aside. It, therefore, follows that the order of dismissal passed thereafter was also a nullity. The order could not be supported on the basis of R. 73(f) of the Service Code when no order requiring the servant to continue in service before he had attained the age of superannuation for the purpose of concluding the departmental enquiry instituted against him was passed by the competent authority. 1970 Lab IC 950 (Patna), Reversed.

(Para 6)

VENKATARAMIAH, J. :— This appeal by certificate is filed against the judgment of the High Court of Patna in Civil Writ Jurisdiction Case No. 444 of 1967 delivered on April 3, 1969 : (reported in 1970 Lab IC 950).

2. The appellant was employed as a Clerk in the Excise Department of the State of Bihar at Hazaribagh. In a disciplinary proceeding instituted against him, 17 charges were framed against him. During the enquiry he has been kept under suspension. The Inquiring Officer however found only six of them established and accordingly a report was submitted by him on November 9, 1960. On the 8th of September, 1961 the appellant was asked by the Excise Commissioner, who was the Disciplinary Authority, to show cause why he should not be removed from service. The appellant submitted his reply to the said notice on November 1, 1961 showing cause against the proposed action. After the submission of the report by the Inquiring Officer the civil surgeon of the area issued a certificate to the effect that the appellant was an invalid and he could not discharge his duties properly in that state of health. On January 31, 1962 an order was passed by the Excise Commissioner directing the retirement of the appellant on invalid pension under rule 116 of the Bihar Pension Rules with effect from July 19, 1961. Thus he ceased to be a Government employee. Nearly one year and nine months after the date of retirement of the appellant on October 5, 1963 the Government of Bihar revoked the order of retirement and the relevant part of it communication read thus :

"I am to invite a reference to this department memo No. 869 dated 31-1-62 with which the order of the Excise Commissioner was conveyed to you allowing Excise Clerk Shri Kirti Bhusan Singh (under suspension