COMMISSIONER OF INCOME TAX (CENTRAL) DELHI A

v.

HARPRASAD & CO. (P) LTD.

February 25, 1975

[Y. V. CHANDRACHUD, R. S. SARKARIA AND A. C. GUPTA, JJ.]

Income-tax Act (11 *of* 1922) *Sections* 12*B*, 22(2*A*), 24(2*A*) & (2*B*)— B
Capital loss incurred in the year when capital gains were not exigible to tax— If could be set against capital gains in subsequent years.

By the Income-tax and Excess Profit Tax (Amendment) Act, 1947 s. 12B was inserted in the Indian Income-tax Act, 1922, making capital gains which arise after March 31, 1946, taxable. The same Act inserted sub-sections (2A) and (2B) in s. 24 of the Income-tax Act. As a result of the Indian Finance Act, 1949 which restricted the operation of s. 12B to capital gains arising before April 1, 1948, and the Finance (No. 3) Act of 1956 which restored C
tax on capital gains with effect from April 1, 1948 capital gains arising from 1-4-1948 to 31-3-1956 were not taxable.

For the assessment year 1955-56 which relates to the period when capital gains were not taxable the assessee claimed a loss of Rs. 84,862/- arising from the sale of certain shares. The Income-tax Officer disallowed the loss on the ground that it was a loss of capital nature. The Appellate Assistant Commissioner, in appeal, held that the assessee's claim was exaggerated, that the actual loss was only Rs. 28,662/- and agreed with the Income-tax Officer that the loss D
was not a revenue loss but a capital loss. Before the Tribunal the assessee contended that the amount of Rs. 28,662/- which had been held to be a capital loss by the authorities should be allowed to be carried forward and set off against profits and gains under the head "Capital gains" earned in future as laid down in s. 24(2A) and (2B). The Tribunal held in favour of the assessee. The High Court, in reference, confirmed the order of the Tribunal holding that the effect of sub-sections (2A) and (2B) of s. 24 read with sections 6 and 12B was that if a capital loss was incurred in a year in which a capital gain did not attract tax under section 12B even then such loss would still be loss E
under the head 'capital gains' and if in a subsequent year the assessee had any profit under that head it would still be carried forward and set off against the taxable capital gain.

Allowing the appeal to this Court,

HELD : (1) From the charging provision of the Indian Income-tax Act it is discernible that the words 'income' or 'profits and gains' should be understood as including losses, so that both must enter into computation, wherever it becomes material, of the taxable income of the assessee. Although s. 6 classifies F
income under six heads the main charging provision is s. 3 which levies income-tax as only one tax on the 'total income' of the assessee as defined in s. 2(15). An income in order to come within the purview of that definition must satisfy two conditions, (a) it must comprise the 'total amount of income, profits and gains referred to in s. 4(1), and (b) it must be computed in the manner laid down in the Act. If either of these conditions fails the income will not be a part of the total income that can be brought to charge. [702F-703B]

(2) The concept of carry forward of loss does not stand *in vacuo*. Its sole G
purpose is to set off the loss against the profits of a subsequent year. Set off implies that the tax is exigible and the assessee wants to adjust the loss against profit to reduce the tax demand. It follows that if such set off is not permissible or possible owing to the income or profits of the subsequent year being from a non-taxable source, there would be no point in allowing the loss to be carried forward. Also, if the loss arising in the previous year was under a head not chargeable to tax it could not be allowed to be carried forward and absorbed against income in a subsequent year from a taxable source. [704C-E]

(3) Capital gains would be covered by the definition of income in s. 2(6C) H
only if they were chargeable under s. 12B. But s. 12B was not operative in the years 1948 to 1956. Thus in the relevant previous year and the assessment year or even in he subsequent year, 'capital gains' or 'capital losses' did not

A form part of the total income of the assessee which could be brought to charge and were, therefore, not required to be computed under the Act. That is condition (b) which 'total income' must satisfy is not satisfied in the present case. [703B-D]

(4) Under s. 22(2A) it is a condition precedent to the carry forward and set off of the loss that the assessee must file a return either in response to a general notice, under s. 22(1) or voluntarily, without any individual notice under sub-section (2). If he does not file the return for the year in which the loss was B incurred and get the loss computed by the Income-tax Officer, the right to carry forward the loss will also be lost. But if the loss is from a source or head of income not liable to tax or exempt from tax neither the assessee is required to show the same in the return nor is the Income-tax Officer under any obligation to compute or assess it, much less for the purpose of carry-farward. [703D-F]

(5) In the instant case, the assessee in his return had not shown any 'capital loss' but claimed the loss as a revenue loss. The Income-tax Officer C should have rejected the assessee's claim to carry forward the loss merely on the ground that it was not a revenue loss and he need not have given a finding that it was a capital loss, because 'capital gains' were not taxable during the year. [703F-G]

(6) Section 24(2) expressly refers to loss, 'in any business, profession or vocation'. It does not cover a capital loss under the head 'capital gains' which at the relevant time were not chargeable and did not enter into computation of the total income of the assessee. Therefore, under s. 24(1) and (2) the assessee had D no independent right to carry forward his capital loss even if it could not be set off owing to the non-taxability of capital gains against future profits in the immediate subsequent years. [704B-C]

(7) Assuming, therefore, that the assessee in the subsequent years 1955-56 and 1956-57 when the capital gains were not taxable made huge capital gains he would not be obliged to show those capital gains in his return. Therefore, the loss suffered by him in the relevant assessment year in the instant case could not be absorbed or set off against such capital gains. [704F]

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CIVIL APPELLATE JURISDICTION : Civil Appeal No. 494 of 1970.

From the judgment and order dated the 24th January, 1969 of the Delhi High Court in Income Tax Ref. No. 51 of 1966.

V. C. Desai, J. Ramamurthy and *R. N. Sachthey*, for the appellant.

F *A. K. Sen* and *H. K. Puri*, for the respondent.

The Judgment of the Court was delivered by

SARKARIA, J.—This appeal is directed against the Judgment, dated 24-1-1969, of the High Court of Delhi answering in the affirmative the following question referred to it under s. 66(1) of the Indian Income-tax Act, 1922 (for short, the Act) by the Commissioner of Income-tax:

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> "Whether on the facts and in the circumstances of the case the capital loss of Rs. 28,662/- could be determined and carried forward in accordance with the provisions of Section 24 of the Indian Income-tax Act, 1922, when the provisions of section 12B of the Income-tax Act, 1922 itself were not applicable in the assessment year 1955-56."

H The assessee (respondent) is a Private Limited Company. The assessment year under reference is 1955-56 and the relevant previous year is from 1-5-1953 to 30-4-1954. On 10-1-1952 the assessee pur-

chased 1124 shares of M/s. Intercontinent Travancore Pvt. Ltd. at a cost of Rs. 1,12,400/- from M/s. Escorts (A&M) Ltd. In the relevant accounting year ending on 30-4-1953 the assessee received 562 bonus shares from the same company. It thus acquired a total number of 1686 shares. On 3-9-53, i.e. during the relevant previous year the assessee sold all these 1686 shares to M/s. Escorts (Agents) Ltd. for Rs. 84,300 and claimed a loss of Rs. 84,862/- in the income-tax return filed by it. The Income-tax Officer disallowed the entire loss of Rs. 84,862 on the ground that it was a loss of a capital nature.

The assessee carried an appeal to the Appellate Assistant Commissioner and contended that this loss of Rs. 84,862/- was a revenue loss arising out of dealing in shares. The Appellate Assistant Commissioner found that the assessee's claim was exaggerated and that the actual loss was to the tune of Rs. 28,662/- only. He further held that this loss of Rs. 28,662/- was not a 'revenue loss' but a 'capital loss' arising out of change of investments.

Against the decision of the Appellate Assistant Commissioner the assessee preferred an appeal before the Tribunal, challenging the findings of the Commissioner both in regard to the amount of loss and its nature. At the stage of arguments before the Tribunal, the assessee's Counsel did not press these grounds of appeal but took up the plea that the amount of Rs. 28,662/- which had been held to be a "capital loss" by the authorities below, should be allowed to be carried forward and set off against profits and gains, if any, under the head "capital gains" earned in future, as laid down in sub-sections (2A) & (2B) of s. 24 of the Act. Despite objection from the Departmental Representative, the Tribunal allowed this new ground to be raised with the observation that it was "a pure question of law and did not require investigation of any fresh fact". It further accepted the contention of the assessee and directed that the "capital loss" of Rs. 28,662/- should be carried forward and set off against "capital gains" if any, in future.

At the instance of the Commissioner of Income-tax, the Tribunal referred the above question (set out at the commencement of this judgment) to the High Court under s. 66(1) of the 1922 Act.

It was contended before the High Court on behalf of the Revenue that the expression "capital gains" in sub-section (2A) of s. 24 has reference only to section 12B so that the loss suffered in the year in which the profits under the head "capital gains" were not taxable, could not fall within sub-section (2A) of s. 24. S. K. Kapoor J., speaking for the Division Bench, rejected this contention in these terms :

> "This argument overlooks the fact that the head of income chargeable to income-tax are set out in section 6.
>
> Section 12-B deals only with the computation of capital gains and with their taxability if they arise during a particular period. As a matter of fact, section 12B itself refers to section 6 inasmuch as it says that "the tax shall be payable by an assessee under the head "capital gains". This obviously has reference to the VIth head in section 6. The effect of

A sub-section (2A) and (2B) of section 24 read with section 6 and 12B, therefore, is that if a capital loss is incurred in a year in which a capital gain did not attract tax under section 12B such loss would still be loss under the head "capital gains" and if in subsequent year the assessee has any profit under that head it can still be carried forward and set off against the taxable capital gain. The Tribunal, was in my B opinion, right in coming to the conclusion that it did."

Hence this appeal by the Commissioner of Income-tax (Central) Delhi.

Capital Gains Tax for the first time was introduced by the Income-tax and Excess Profit Tax (Amendment) Act, 1947 (No. 22 of C 1947) which inserted section 12B in the Act. This section made taxable "capital gains" which arose after March 31, 1946 The same Act of 1947 added as the VIth head "capital gains" in s. 6 of the Act. It also inserted sub-sections (2A) and (2B) in s. 24 of the Act.

The Indian Finance Act, 1949 virtually abolished the levy and restricted the operation of s. 12B to "capital gains" arising before the D 1st April, 1948. But s. 12B in its restricted form, and the VIth head, 'capital gains' in s. 6, and sub-sections (2A) and (2B) of s. 24 were not deleted and continued to form part of the Act. The Finance (No. 3) Act, 1956 reintroduced the "capital gains" tax with effect from the 31st March, 1956. It substantially altered the old section 12B and brought it into its present form. As a result of Finance Act (3) of 1956 "capital gains" again became taxable in the assessment year 1957-E 58. The position that emerges is that "capital gains" arising, between 1-4-1948 and 31-3-1956, were not taxable. The capital loss in question relates to this period.

Mr. V. S. Desai, learned Counsel for the appellant contends that according to the scheme of the Act a "capital loss" occurring in a previous year, could be allowed to be carried forward and set off against the capital gains of a subsequent year, only if the income under that F head was taxable in the relevant previous and subsequent years. Since during the period from 1-4-1948 to 31-3-1956, capital gains (*plus*) or capital gains (*minus*) did not enter into computation of the total income of the assessee chargeable to tax under s. 3 read with s. 12B of the Act, the question of carrying forward such loss did not arise, much less could such a loss be set off against the profits of any subse-G quent year.

As against this, Shri Ashok Sen, learned Counsel for the assessee maintains that a right to carry forward a loss under any of the heads enumerated in s. 6, is not dependent upon the taxability of income under that head; it is sufficient if at the relevant time "capital gains" is one of the heads of income recognized by the charging s. 6 and the loss is adjustable against "capital gains", if any, in future under s. 24. H The argument proceeds, that s. 6(vi) was not lying inert on the statute book but was operative, throughout, for the purpose of calculating the losses under that head. Shri Sen compared the non-taxability of

capital gains during the period from 1-4-1948 to 31-3-1956, to a tax holiday for those years. Another illustration given by the learned Counsel is of a person whose total income falls entirely on the negative side on account of losses suffered by him under any of the heads of income given in s. 6. Such a person notwithstanding the fact that he had no assessable income has a right to file a return and get his losses computed by the Income-tax Officer merely for the purpose of carrying forward the loss. The Income-tax Officer, it is added, cannot ignore the return filed by the assessee, voluntarily, showing losses even though such a return is filed beyond time. In this connection, Shri Sen has referred to *Commissioner of Income-tax, Punjab* v. *Kulu Valley Transport Co. Ltd.*(1), *Jaikishan Gopikishan and Sons* v. *Commissioner of Income-tax, M.P.*(2) and *Commissioner of Income-tax, Madhya Pradesh* v. *Khushal Chand Daga*(3).

Before dealing with the contentions canvassed, it will be appropriate to have a clear idea of the terms 'income', 'total income', 'computation of total income', 'carrying forward' of a loss and its purpose, in the context of the scheme of the Act.

Section 2 Cl. (15) defines "total income" to mean total amount of income, profits and gains referred to in sub-section (1) of section 4 computed in the manner laid down in this Act. Section 3, captioned as "Charge of Income-tax", emphasises that the income-tax shall be *charged* in respect of the total income of the previous year of every assessee. Section 4 defines the ambit of that total income. Section 6 enumerates six heads of income, profits and gains chargeable to income-tax. They are :

"(i) Salaries.

(ii) Interest on securities.

(iii) Income from property.

(iv) Profits and gains of business, profession or vocation.

(v) Income from other sources.

(vi) Capital gains."

Sections 7, 8, 9, 10, 12 and 12B relate to payability and computation of tax under the various heads of income. The material part of s. 12B at the relevant time was as follows :

> "12B. (1) The tax shall be payable by an assessee under the head "Capital gains" in respect of any profits or gains arising from the sale, exchange or transfer of a capital asset effected after the 31st day of March 1946 and before the 1st day of April, 1948 and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or transfer took place."

(1) 77, I. T. R. 518 (S.C.). (2) 84, I. T. R. 635.

(3) 42, I. T. R. 177 (S.C.).

A Section 22(1) requires a general notice to be published requiring every person whose total income during the previous year exceeds the maximum non-taxable limit to file a return. Sub-section (2) of this section enables the Income-tax Officer to issue notice to any such person requiring him to furnish a return. Sub-section (2A)—which was inserted by the Income-tax Amendment Act 25 of 1953 with effect B from 1-4-1952—provides :

> "If any person who has not been served with a notice under sub-section (2) has sustained a loss of profits or gains in any year under the head Profits and gains of business, profession or vocation, and such loss or any part thereof would ordinarily have been carried forward under sub-s. (2) of section 24, he shall, if he is to be entitled to C the benefit of the carry forward of loss in any subsequent assssment, furnish within the time specified in the general notice given under sub-s. (1) all the particulars required under the prescribed form of return."

The material part of s. 24 runs thus :

> "24.(1) Where any assessee sustains a loss of profits D 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 :
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> * * * * *
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> Provided that in computing the profits and gains chargeable under the head "Profits and Gains of business, profession E or vocation", any loss sustained in speculative transaction which are in the nature of a business shall not be taken into account except to the extent of the amount of profits and gains, if any, in any other business consisting of speculative transactions :
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> F (2) Where any assessee sustains a loss of profits or gains in any year, being a previous year not earlier than the previous year for the assessment for the year ending on the 31st day of March 1940, in any business, profession or vocation, and the loss cannot be wholly set off under sub-section (1), so much of the loss as is not so set off or the whole loss where the assessee had no other head of income shall be G carried forward to the following year, and
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> (i) where the loss was sustained by him in a business consisting of speculative transactions, it shall be set off only against the profits and gains, if any, of any business in speculative transaction carried on by him in that year;
>
> H (ii) where the loss was sustained by him in any other business, profession or vocation, it shall be set off against the profits and gains, if any, of any business, profession or vocation carried on by him in that year pro-

vided that the business, profession or vocation in which the loss was originally sustained continued to be carried on by him in that year; and

(iii) if the loss in either case cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following year and so on.....

* * * * *

2A. Notwithstanding anything contained in sub-section (1), where the loss sustained is a loss falling under the head "Capital gains", such loss shall not be set off except against any profits and gains falling under that head.

2B. Wherean assessee sustains a loss such as is referred to in sub-section (2A) and the loss cannot be wholly set off in accordance with the provisions of that sub-section, the portion not so set off shall be carried forward to the following year and set off against capital gains for that year, and if it cannot be so set off, the amount thereof not so set off shall be carried forward to the following year and so on, so however, that no such loss shall be so carried forward for more than six years :

Provided that where the loss sustained in any previous year does not exceed fifteen thousand rupees, it shall not be carried forward.

(3) When, in the course of the assessment of the total income of any assessee, it is established that a loss of profits or gains has taken place which he is entitled to have set off under the provisions of this section, the Income-tax, Officer shall notify to the assessee by order in writing the amount of the loss as computed by him for the purposes of this section."

Section 2(6C) provides that 'income' includes (among other things)-"(vi) any capital gain *chargeable under Section* 128."

From the charging provisions of the Act, it is discernible that the words 'income' or 'profits and gains' should be understood as including losses also, so that, in one sense 'profits and gains' represent '*plus* income' whereas losses represent '*minus* income'(1). In other words, loss is negative profit. Both positive and negative profits are of a revenue character. Both must enter into computation, wherever it becomes material, in the same mode of the taxable income of the assessee. Although s. 6 classifies income under six heads, the main charging provision is s. 3 which levies income-tax, as only one tax, on the 'total income' of the assessee as defined in s. 2(15). An income in order to come within the purview of that definition must satisfy two conditions. Firstly, it must comprise the "total amount of income,

(1) *CIT* v. *Karamchand Prem Chand* 40 ITR 106 (SC); *CIT* v. *Elphinston Spinning & Weaving Mills*; 40 ITR 142(SC).

A profits and gains referred to in s. 4(1)." Secondly, it must be "computed in the manner laid down in the Act". If either of these conditions fails, the income will not be a part of the "total income" that can be brought to charge.

Now, capital gains would be covered by the definition of 'income' in sub-section (6C) of s. 2, only if they were chargeable under s. 12B. B As noticed already, s.12B as modified by the Finance Act, 1949, did not charge any 'capital gains' arising between 1-4-1948 to 1-4-1957. Indeed, s. 12B was not operative in these years (1948—57). During this period, "capital gains", whether on the positive or the negative side, could not be computed and charged under s. 12B or any other provisions of the Act. In the instant case, the second condition, namely, "the manner of computation laid down in the Act" which—to use C the words of Stone C.J. (1)—"forms an integral part of the definition of 'total income' " was not satisfied. Thus in the relevant previous year and the assessment year, or even in the subsequent year, capital gains or "capital losses" did not form part of the "total income" of the assessee which could be brought to charge, and were, therefore, not required to be computed under the Act.

D Before the insertion of sub-section (2A) in s. 22 by the amendment of 1-4-1952, an assessee was entitled to carry forward a loss even if he had submitted no return for the year in which the loss was sustained. After the enactment of sub-section (2A), it is a condition precedent to the carry-forward and set off of the loss, that the assessee must file a return either in response to a general notice under sub-section (1) of s. 22 or voluntarily, without any individual notice under E sub-section (2) of that section. If he does not file the return for the year in which the loss was incurred and get the loss computed by the Income-tax Officer, the right to carry forward the loss will also be lost. But if the loss is from a source or head of income not liable to tax or congenitally exempt from income-tax, neither the assessee is required to show the same in the return, nor is the Income-tax Officer under any obligation to compute or assess it, much less for the purpose of F "carry forward". It is noteworthy that in the instant case, the assessee in his return had not shown any "capital losses". He had claimed this loss as a revenue loss. The Income-tax Officer could, therefore, reject the assessee's claim to carry forward the loss, merely on the ground that it was not a "revenue loss". His further finding that it was a "capital loss" was only incidental and, in fact, was not necessary.

G From what has been said above, it follows as a necessary corollary, that during the period s. 12B did not make income under the head, 'capital gains' chargeable, an assessee was neither required to show income under that head in his return, nor entitled to file a return showing "capital losses" merely for the purpose of getting the same computed and carried forward. Sub-section (2A) of s. 22 would not give him such a right because the operation of that sub-section is, in H terms, confined to (i) a loss which is sustained "under the head 'profits and gains' of business, profession or vocation" and would ordinarily

(1) In re Kamdar [1946] I.T.R. 10, 21.

have been carried forward under sub-section (2) of s. 24, and (ii) to "income" which falls within the definition of 'total income'. Both these conditions necessary for the application of the sub-section are lacking in the present case. A

Nor do we find any substance in the contention that under sub-section (2) read with sub-section (1) of s. 24, the assessee had an independent right to carry forward his capital loss, even if it could not be set off, owing to the non-taxibility of capital gains, against future profits, if any, in the immediate subsequent years. Sub-section (2) of s. 24 expressly refers to loss 'in any business, profession or vocation'. It does not cover a "capital loss", or the minus income under the head 'capital gains' which at the relevant time, were not chargeable and did not enter into computation of the 'total income' of the assessee under the Act. B C

It may be remembered that the concept of carry forward of loss does not stand *in vacuo*. It involves the notion of set off. Its sole purpose is to set off the loss against the profits of a subsequent year. It presupposes the permissibility and possibility of the carried-forward loss being absorbed or set off against the profits and gains, if any, of the subsequent year. Set off implies that the tax is exigible and the assessee wants to adjust the loss against profit to reduce the tax-demand. It follows that if such set-off is not permissible or possible owing to the income or profits of the subsequent year being from a non-taxable source, there would be no point in allowing the loss to be "carried forward". Conversely, if the loss arising in the previous year was under a head not chargeable to tax, it could not be allowed to be carried forward and absorbed against income in a subsequent year, from a taxable source. D E

Now let us test the claim of the assessee in the light of the above principles. The "capital loss" of Rs. 28,662/- in the present case, was sustained in September 1953, that is, in the previous year 1953-54. Let us assume that in the subsequent years 1955-56 and 1956-57 when the capital gains were not taxable, he made huge capital gains far exceeding this loss, could he be obliged to show those capital gains in his return? Could the loss of the year 1953-54 be absorbed or set off against such capital gains of the subsequent years? The answer is emphatically in the negative. F

The cases cited by Shri Sen are not relevant. In all those cases, the heads of income under which the losses were sustained, were chargeable to tax. None of them was a case of 'capital loss' pertaining to the period, 1948 to 1957. G

For the foregoing reasons, we are of the opinion that the High Court was in error in answering the question referred to it, in favour of the assessee. We would reverse that answer in favour of the Revenue.

In the result, the appeal is accepted with costs. H

Appeal allowed.

V.P.S.