GARDEN SILK WEAVING FACTORY, SURAT

v.

COMMISSIONER OF INCOME TAX, GUJARAT, AHMEDABAD

MARCH 22, 1991

[S. RANGANATHAN AND K. RAMASWAMY, JJ]

Income Tax Act, 1961—Sections 32(2), 72(2)—"Depreciation"—Meaning of—Unabsorbed loss and unabsorbed depreciation—Difference of—Carry forward and set off of unabsorbed depreciation—Principle and distinction of.

Income Tax Act, 1961—Sections 72(2), 32(2), 35—Unabsorbed depreciation computed in assessment of registered firm—Carry forward of—Alternatives indicated.

Income Tax Act, 1961—Section 32(2)—Unabsorbed depreciation allocated to partners of registered firm—Firm whether entitled to carry forward the depreciation and set off.

Income Tax Act, 1961—Section 32(2)—Construction and object of—Assessee—Registered firm—Steps to be taken to carry forward of unabsorbed depreciation to successive assessment years, indicated.

Income Tax Act, 1922—Section 10(2)(vib), proviso (as amended in 1953)—Effect and application of.

For the assessment year of 1968-69, the assessee appellant, a registered firm, returned a total income of Rs.3,94,483 and a provisional assessment was made.

Subsequently, the Income Tax Officer found that for the said assessment year, the assessee had made an income of Rs.11,82,056 and deducting therefrom three figures viz., (i) unabsorbed depreciation: Rs.1,59,181; (ii) unabsorbed development rebate: Rs.2,79,150; and (iii) unabsorbed business loss: Rs.3,49,242, aggregating to Rs.7,87,573 and arrived at the net income of Rs.3,94,483, which had been returned and accepted. The three figures were the figures carried over from the previous year for the assessment year 1967-68.

The Income Tax Officer allowed the unabsorbed development

A rebate pertaining to the assessment year of 1967-68 to be carried forward and set off in computing the total income for the assessment year of 1968-69, but he did not allow the amounts of unabsorbed depreciation and unabsorbed business loss. He, therefore, added back the sum of Rs.5,08,423 (the aggregate of the amounts of unabsorbed depreciation and unabsorbed business loss) to the returned income for determining the total income for the assessment year of 1968-69.

The action of the Income Tax Officer was confirmed by the Appellate Assistant Commissioners (A.A.C.). However, on further appeal, the Income-tax Appellate Tribunal (A.T.) upheld the Income-tax Officer's stand that the firm could not be allowed to carry forward and set off the business loss carried from the earlier year but, so far as the unabsorbed depreciation was concerned, it upheld the assessee's contention.

On these two issues a reference to the High Court was made and the High Court answered them against the assessee.

D For the assessment year 1967-68, the assessee filed a return on 30.6.67 showing a loss of Rs.7,87,515 but filed a revised return on 22.3.1972 showing a loss of Rs.5,46,351. On 14.3.73 the I.T.O. completed the assessment determining a loss of Rs.4,85,250.

The assessee's request that this loss should be carried forward to E the subsequent assessment year was rejected by the I.T.O. This was confirmed by the A.A.C. On further appeal, the A.T. confirmed the order of the A.A.C., following the High Court's decision for the assessment year 1968-69 which had by then been announced.

The High Court answered the question—"Whether, on the facts F and circumstances of the case, the Tribunal was justified in rejecting the claim for carry forward of business loss in the hands of the firm in view of the decision reported in 101 I.T.R. 658?" in the affirmative.

Hence the assessee's the appeals—one appeal for the assessment year of 1968-69 and the other for the assessment year of 1967-68— G under certificates of fitness granted by the High Court.

On behalf of the assessee it was contended that the firm as well as the partners had been returning losses all along with the result that no part of the unabsorbed depreciation of the firm had been set off in the partner's hands; that when there was an unabsorbed depreciation com- H puted in the assessment of a registered firm for any year, for the

purpose of carry forward, it should be retained and carried forward by the firm only. A

On the other hand, it was submitted for the Revenue that once the assessment was completed and the total income or loss of the firm ascertained, it had to be apportioned amongst the partners. Thereafter there remained nothing in the assessment of the firm to be carried forward. Only each of the partners can carry forward his share of the unabsorbed loss, which also included the unabsorbed depreciation, as there was no difference between unabsorbed loss and unabsorbed depreciation; and that the amendment to the proviso to section 10(2)(vib) in 1953 of depreciation was intended to negative the claim of carry forward, by the firm which was earlier being accepted on the strength of the earlier language resulting in a double advantage. B C

Allowing the appeals, this Court,

HELD: 1. "Depreciation" is one of the notional allowances-which expression means a deduction in respect an outgoing which is not an item of actual expenditure or is one which cannot be treated as an outgoing of a revenue nature-permitted by the statute to be deducted in the computation of the profits and gains of a business. [921H-922B] D

2. Initially, the depreciation allowances has to be deducted from the profits and gains of the business to which the assets earning the depreciation relate but, if it remains unabsorbed by such profits, the allowance has to be set off against the other business income of the assessee and, where that is also insufficient, against the other taxable income of the assessee. The carry forward of any depreciation as unabsorbed cannot arise until the stage of final assessment is reahed and the total income of the assessee otherwise computed is insufficient to absorb the year's depreciation allowance. [928E-G] E F

3. An unabsorbed depreciation is a part of the "loss". This is so because, in the first place, "depreciation" is a normal outgoing, though in a sense notional, which has to be debited in the computation of the profits of a business on commercial principles (quite apart from statute) and it is difficult to see why, when such deducation yields a negative figure of profits, it cannot be a "loss" as generally understood. Where the depreciation allowance attributable to a particular business exceeds the profits otherwise computed for that business, the deduction of the depreciation allowance from such profits can only result in a "loss" from that business and a business loss has to be set off against income G H

A from any other business, by way of intra-head adjustment, under s. 70 and the income under any other head, by way of inter-head adjustment, under s. 71. This is implicit in the provision that the excessive depreciation of one business can be "given effect to" against the profits and gains of another business in the same year and has been recognised by decisions holding that it can be set off against income from other heads. B If unabsorbed depreciation is treated as a genus totally different from a "loss", there is no statutory provision that will permit its adjustment against other business income—implicit in S. 32(2) itself—and against all other income of the assessee. "Loss" and "unabsorbed depreciation" should not be treated as antithetical to, or mutually exclusive of, each other. However, there is nothing anomalous or absurd in the statute providing for a dissection of the amount of loss for purposes of C carry forward and providing for a special or different treatment to unabsorbed depreciation in this regard although it is a component element of the genus described as "loss" [931B-C, 926C-E, 931C-F]

4. Unabsorbed losses and unabsorbed depreciation are to be D carried forward to future years to be set off against future income. There is, however, one important difference. Unabsorbed losses can be carried forward only for a period of eight years whereas unabsorbed depreciation can be carried forward indefinitely. [923G-H]

5. There is also difference between the two in the matter of their E carry forward in the case of assessment of a registered firm. In this case, the unabsorbed loss cannot be carried forward by the firm at all. The statute clearly so provides. So far as unabsorbed depreciation is concerned, three alternatives are possible to be urged: (i) It should be retained (without apportionment) and carried forward by the firm only. (ii) It should be apportioned among the partners. Thereafter, it F can be dealt with—even for carry forward purposes—only in the assessment of each of the partners in respect of his aliquot share thereof. (iii) It should be apportioned among the partners each of whom may set off his share thereof against his other income. If, after this, any amount remains unabsorbed, it will revert to the firm. The firm will carry it forward, set it off against its other income in the succeeding year. This G operation will be repeated every year indefinitely until the unabsorbed depreciation gets absorbed. [924B-E]

6. The third alternative is the correct one: (a) The unabsorbed depreciation should be allocated among the partners and, like any other loss, will be available to the partners to the extent of his share therein H for set off against his business income or other income in the same

assessment year. In fact S. 32(2), in so far as it talks of depreciation being given effect to in the partners' assessments recognises that such unabsorbed depreciation should be allocated among the partners. The question is what is to be done thereafter. [932A-B] A

(b) When there is nothing in the sub-section or the Act specifically providing even for an apportionment of the depreciation among the partners, it is too contrived a construction to read into the sub-section several words intended to provide for a number of partners, each carrying forward his share of the unabsorbed depreciation to successive assessment years. It seems natural and reasonable to construe the section as envisaging the following steps where the assessee is a registered firm: B C

(i) Excessive depreciation should be adjusted in the assessment of the assessee against other business income and against other heads of income;

(ii) Depreciation, which remains unabsorbed under (i), will be apportioned to the partners and the share of each will be adjusted against the business and other income of each of the partners *pro tanto;* D

(iii) If full effect cannot be given to the depreciation allowance of the assessee by the above processes and some depreciation remains unadjusted, the assessee-firm will carry it forward to the succeeding assessment year. [934C-G] E

(c) The sub-section, before its 1953 amendment, permitted all assessees—and this included registered firms as well—to carry forward their unabsorbed depreciation so that though the registered firm paid no tax, it could, on the language claim a carry forward of the depreciation which had been apportioned among the partners. This resulted in such carry forward being claimed even where the whole or a part of the unabsorbed depreciation of the firm had been set off in the assessment of individual partners. The amendment only seeks to make it clear that such carry forward will not be permitted to the extent it has been given effect to in the partners' assessments; by necessary implication, the carry forward, to the extent it has not been effectively allowed to the partner, continues to be available. The amendment of 1953, therefore, does not help the case of the Revenue. [935F-936A] F G

(d) The objection to the above course is also based on a mental imagery of the firm and its partners as altogether different assessees H

A and of the impermissibility of "bringing back" to the firm's "file" what has gone away to the files of the partners. This approach of viewing the two assessments in water-tight compartments for all purposes is not correct. In any event, any such theoretical dichotomy cannot prevail over the provisions of s. 32(2). [934G-935A]

B (e) The construction suggested does not result in any double advantage to the partners. [936D]

(f) It is true that the construction may result in a certain amount of imbalance in the quantum of relief available as among different partners. But similar imbalance is inherent in the application of any of the three possible alternatives. [936E-F]

C 7. The assessee—appellant firm is entitled to carry forward the unabsorbed depreciation computed for the assessment year 1967-68 and have it set off in its assessment for the assessment year 1968-69. The unabsorbed loss for the assessment year, 1967-68, however, cannot be carried forward by the firm to be set off in its assessment for the D assessment year 1968-69. [937A-B]

K.T. Wire Products v. *Union of India*, [1973] 92 ITR 459 (All); *Garden Silk Weaving Factory*, [1975] 101 ITR 658; *Garden Silk Weaving Factory*, [1983] 144 ITR 613 (Guj.): *C.I.T.* v. *Ram Swarup Gupta*, [1973] 92 ITR 495; *Raj Narayan Aggarwala* v. *C.I.T.*, [1979] 75 ITR 1 (Del.); *Shankaranarayana Construction Co.* v. *C.I.T.*, [1984] 145 ITR E 467 (Karn.); *Ballarpur Collieries Co.* v. *C.I.T.*, [1973] 92 ITR 219; *C.I.T.* v. *Nagpur Gas & Domestic Appliances*, [1984] 147 ITR 440 (Bom.); *CIT* v. *Nagapattinam Import and Export Corp.*, [1979] 119 ITR 444; *CIT* v. *Madras Wire Products*, [1979] 119 ITR 454; *CIT* v. *Madras Wire Products*, [1980] 123 ITR 722 (Mad.); *CIT* v. *J. Patel & Co.*, [1984] 149 ITR 682 (Del.); *CIT* v. *Shrinivas Sugar Co.*, [1988] 174 F ITR 178 (AP); *CIT* v. *Singh Transport Co.*, [1980] 123 ITR 698 (Gau.); *Pearl Woollen Mills* v. *CIT*, [1989] ITR 368; *CIT* v. *Mahavir Steel Rolling Mills*, [1989] 179 ITR 377 (P & H) and *CIT* v. *R.J. Trivedi & Sons*, [1990] 183 ITR 420 (M.P.), referred to.

CIT v. *Jaipuria China Clay Mines (P.) Ltd.*, [1966] 59 ITR 555 and *Rajapalayam Mills Ltd.* v. *C.I.T.*, [1978] 115 ITR 777, followed. G

CIVIL APPELLATE JURISDICTION: Civil Appeal Nos. 1249/75 & 2075/79.

From the Judgment and Order dated 26.9.1974 and 16.10.1978 of Gajarat High Court in I.T.R. Nos. 19 of 1973 and 318 of 1977.

H Harish N. Salve, P.H. Parekh and Sunil Degra for the Appellant.

V. Gauri Shankar, Sr. Adv. and S. Rajappa for the Respondent.

The Judgment of the Court was delivered by

RANGANATHAN, J. These appeals raise a question of some complexity on the interpretation of the provisions of the Income-Tax Act, 1961, ('the 1961 Act'), in regard to which there is a difference of opinion among various High Courts. In the judgment under appeal, reported in (1975) 101 ITR 658, the Gujarat High Court has answered the question raised in favour of the Revenue and against the assessees. Hence these appeals by the assessee, M/s. Garden Silk Weaving Factory, Surat.

The two appeals relate to the assessment years 1967-68 and 1968-69 for which the relevant previous years were the Saka years 2022 and 2023 respectively. The question arises in similar circumstances for both the years. We shall set out the facts relevant for the assessment year 1968-69 as the appeals and reference in respect of that year were disposed of earlier than those pertaining to the assessment year 1967-68.

The assessee, M/s. Garden Silk Weaving Factory, is a registered firm. For the assessment year in question, it returned a total income of Rs.3,96,483 and a provisional assessment, under section 141 of the Act, was made accepting the income returned. Subsequently, the Income Tax Officer found that, for the assessment year in question, the assessee had made an income of Rs.11,82,056 but deducted therefrom three figures aggregating to Rs.7,87,573 to arrive at the net income of Rs.3,94,483 which had been returned and accepted. These three figures were figures carried over from the previous year for the assessemnt year 1967-68. They comprised of:

(i)	Unabsorbed Depreciation	Rs.1,59,181
(ii)	Unabsorbed Development Rebate	Rs.2,79,150
(iii)	Unabsorbed Business loss	Rs.3,49,242
	Total :	Rs.7,87,573

The Income Tax Officer (I.T.O.) agreed that, out of the above three months, the unabsorbed development rebate pertaining to the assessment year 1967-68 had been rightly carried forward and set off in computing the total income for the assessment year 1968-69. However,

for reasons which will become clear later, the Income Tax Officer was of the opinion that the sum of Rs.1,59,181 (which represented the amount of unabsorbed depreciation relating to the assessment year 1967-68) and the amount of Rs.3,49,242 (which represented the unabsorbed loss pertaining to the assessment year 1967-68) could not be carried forward, as done by the assessee, to the assessment year 1968-69. He, therefore, added back the sum of Rs.5,08,423 (the aggregate of the above two amounts) to the returned income for determining the total income for assessment year 1968-69. This action of the Income Tax Officer was confirmed by the Appellate Assistant Commissioner (A.A.C.). However, on further appeal, the Income-tax Appellate Tribunal (A.T.) took a different view. It upheld the Income-tax Officer's stand that the firm could not be allowed to carry forward and set off the business loss carried from the earlier year. But, so far as the unabsorbed depreciation was concerned, it upheld the assessee's contention. A reference to the High Court followed. The following two questions were referred to the High Court of Gujarat for its decision:

> "1. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee registered firm is entitled to carry forward unabsorbed depreciation from earlier years and that it will be deemed to be an allowance in the nature of depreciation in the previous year, relevant to assessment year 1968-69?
>
> 2. Whether the claim of the assessee to carry forward and set off loss of Rs.3,49,242 against its total income for the assessment year 1968-69 has been rightly rejected?"

The High Court, in a very detailed judgment, discussed the issues threadbare and answered both the questions against the assessee and in favour of the Revenue. Hence the assessee's appeal for the assessment year 1968-69 under a certificate of fitness granted by the High Court.

For the assessment year 1967-68, a full paper book containing all the orders and statement of facts has not been placed before us. However, the petition of appeal gives a few facts which may be sufficient to dispose of the appeal. The relevant facts are these. For this assessment year, the assessee filed a return on 30/6/67 showing a loss of Rs.7,87,515 but filed a revised return on 22/3/72 showing a loss of Rs.5,46,351. On 14-3-73 the I.T.O. completed the assessment determining a loss of Rs.4,85,250. (It will be noticed that the assessment order for 1968-69 gives a different figure and also shows its composition as partly loss, partly unabsorbed depreciation and partly unab-

sorbed development rebate but this is not very material for deciding the principle in issue before us). The assessee's request that this loss should be carried forward to the subsequent assessment year was rejected by the I.T.O. This was confirmed by the A.A.C. on further appeal, the A.T. confirmed the order of the A.A.C., following the High Court's decision for assessment year 1968-69 which had by then been announced. Thereupon the following question of law was referred to the High Court for its opinion:

> "Whether, on the facts and circumstances of the case, the Tribunal was justified in rejecting the claim for carry forward of business loss in the hands of the firm in view of the decision reported in 101 I.T.R. 658?"

The High Court answered the question in the affirmative following its earlier decision but granted a certificate of fitness for appeal to this Court. This is how the second appeal is before us. It will be seen from the above that, though there are two appeals before us, the question involved in both the appeals is the same.

Before discussing the question at issue, it may be useful to briefly summarise the procedure under the statute for determining the total income of an assessee in respect of a previous year. All income accruing or arising to the assessee and includible in his total income, is, to begin with, classified (see S. 14) under six different heads:

A. Salaries.

B. Interest on Securities: (recently omitted)

C. Income from Property.

D. Profits and gains of business, profession or vocation.

(briefly, "business income")

E. Capital gains

F. Income from other sources.

In computing the income of the assessee according to this classification, two asepcts have to be borne in mind. One is that, even under the same head, an assessee may have different sources. If so, the

A income has first to be arrived at in respect of each such source. Thus, if an assessee carries on several businesses, the income of each and every such business has to be separately computed by allowing against the gross profits and gains of that business only the deductions relevant and appropriate to that business. The second is that, for arriving at the figure of income assessable under a particular head, the individual B figures in respect of all the sources have to be aggregated. Thus, to take up the head, "profits and gains of business, profession or vocation", the statute contemplates the computation of the profits and gains of each business, profession or vocation carried on by the assessee separately. The result of such computation may be either a profit or a loss. If all the businesses end in profits, the profits are aggregated to C arrive at a resultant figure of profits from "business". On the other hand, if some of the businesses make profit and some of them result in a loss, the profits and the losses have to be added together in order to arrive at the consolidated income under the head "profits and gains of business." If the total amount of profits exceeds the total amount of losses, there will be a positive income under this head, assessable for D that particular assessment year. If on the other hand the losses exceed the profits, they will be "adjusted" against the profits, so as to reduce the assessable income under the head to nil; in addition, the losses of one or more businesses will remain "unabsorbed". There will thus be one resultant figure of profit or loss under each head. This is one aspect of the matter. This is the first stage of computation which we E may call "intra-head adjustments". This was not specifically provided for in the Indian Income-tax Act, 1922 (the 1922 Act) but now finds specific mention in S. 70 of the 1961 Act.

S. 24(1) of the 1922 Act and S. 71 of the 1961 Act next contemplate a mutual set off of the losses under one head against the income F under some other head subject to some exceptions (like speculation loss, capital loss etc. which, to avoid unnecessary complications and confusion, we shall leave out of account). Thus if, in any particular assessment year, an assessee has incurred a loss under the head "business", this loss can be set off against the income earned by the assessee during that previous year under other heads. Thus, for example, if an G assessee has got income by way of salary of Rs.20,000 and income from house property of Rs.25,000 but has sustained a loss of Rs.40,000 in business, the Act envisages the set off of the loss of Rs.40,000 against the income of Rs.45,000 resulting in a total income of Rs.5,000 only. This is the second stage in the process of assessment which we may describe as "inter-head adjustment" or "set off". H

The Acts [S. 24(2) of 1922 Act and S. 72 of the 1961 Act] next envisage a third stage in the process of assessment which can be described as the process of "carry forward and set off". By this process, the assessee is permitted to carry forward a loss he had not been able to adjust or set off in the first and second stages of assessment. This benefit is not available to all kinds of losses but, subject to certain conditions and restrictions on which we need not dilate, it is available to business losses. A business loss of one assessment year which remains "unabsorbed" by the processes of intra—and inter-head adjustments can be carried forward to the succeeding assessment years and can be set off against any other business income in those years.

A modification to the above scheme had to be enacted in respect of partnership. Partnership firms are treated as separate assessees for the purposes of the Income Tax Acts. Under the Acts, firms are classified into two—registered firms and unregistered firms. Unregistered firms are distinct assessees which are liable to pay tax on their total income. The Acts provided that any unabsorbed loss in the case of such a firm could be carried forward only by the firm and not by its partners. However, under the 1922 Act, as it stood between 1939 and 1956, registered firms were treated as assessees only to this extent that the total income (or loss) of the firm in any previous year was computed. However, the firm itself was not liable to any income tax. The income of the firm was apportioned among its partners and each partner was assessed on his share of income from the firm. In this scheme, it was obvious that, as soon as the income or loss of a firm was computed, there was nothing further to be done in the case of the firm; the income or loss became that of the partner for all practical purposes. A partner's share of a business loss of the firm which remained unabsorbed became business loss in the hands of the partner liable to intra-head adjustments, inter-head adjustments and carry forward as if the loss had been incurred by the partner himself. The Act, therefore, provided that in the case of registered firms the loss which could not be absorbed in the same assessment year by the other income of the firm could be carried forward to the subsequent year not by the firm itself but only by the partners. In other words, each partner carried forward to subsequent years his share of the business loss of the firm and set it off against his business income, whether from the firm or otherwise. There is a third category of unregistered firms assessed as registered the provisions regarding which are not relevant for our present purposes. Leaving them out of account, the Acts outlined a very simple scheme which stemmed from the basic fact that a registered firm was not liable to pay tax whereas an unregistered firm had to pay

A tax. Under this scheme the full advantage of carry forward of the loss incurred by the firm was enjoyed by the partners in the case of a registered firm and in the case of an unregistered firm by the firm itself.

B The simplicity of the above scheme of assessment of registered and unregistered firms, however, was not allowed to last. In 1956, the legislature decided that registered firms should also be made to pay a tax. This tax, called "firm's tax" was at rates lower than those applicable to unregistered firms and other assessees. Under the new scheme, which became effective from 1.4.1956, the total income of a registered firm is determined and it is liable to income-tax thereon. The income C of the firm (less the firm's tax) is then apportioned among the partners (subject to certain adjustment as before). The share income of each partner is aggregated with the rest of his income to arrive at his total income on which he also pays tax. In this new scheme the question arises: "when the net result of a business carried on by a registered D firm in a particular year is a loss, who is to carry forward such loss? Is it the firm (as in the case of unregistered firms) or is it is the partners (as, earlier, in the case of registered firms) or both?" The answer to this question is furnished by the statute which, while broadly continuing the scheme of assessment of registered firms with the modification indicated above, makes a specific provision in regard to carry forward E of losses. The provisions of Ss. 75 and 77 in their present form can be usefully extracted here (though they contain references to certain amended provisions which we need not touch upon):

> 75. *Losses of registered firms:*
>
> F (1) Where the assessee is a registered firm, any loss which cannot be set off against any other income of the firm shall be apportioned between the partners of the firm, and they alone shall be entitled to have the amount of the loss set off and carried forward for set off under sections 70, 71, 72, 73, 74 and 74A.
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> G (2) Nothing contained in sub-section (1) of section 72, sub-section (2) of section 73, sub-section (1) or sub-section (3) of section 74 or sub-section (3) of section 74A shall entitle any assessee, being a registered firm, to have its loss carried forward and set off under the provisions of the H aforesaid section.

76. *Losses of unregistered firms assessed as registered firms:* A

In the case of an unregistered firm assessed under the provisions of clause (b) of section 183 in respect of any assessment year, its losses for that assessment year shall be dealt with as if it were a registered firm. B

77. *Losses of unregistered firms or their partners:*

(1) Where the assessee is an unregistered firm which has not been assessed as a registered firm under the provisions of clause (b) of section 183, any loss of the firm shall be set off or carried forward and set off only against the income of the firm. C

(2) Where the assessee is a partner of an unregistered firm which has not been assessed as a registered firm under the provisions of clause (b) of section 183 and his share in the D income of the firm is a loss, then, whether the firm has already been assessed or not—

(a) such loss shall not be set off under the provisions of section 70, section 71, sub-section (1) of section 73 or section 74A; E

(b) nothing contained in sub-section (1) of section 72 or sub-section (2) of section 73 or sub-section (1) or sub-section (3) of section 74 or sub-section (3) of section 74A shall entitle the assessee to have such loss carried forward and set off against his own income. F

In view of this specific provision the High Court, following an earlier decision of the same High Court in *C.I.T.* v. *Dhanji Shamji Manavdar*, [1974] 97 I.T.R. 173 (Guj.) answered the second question referred to it in the reference relating to assessment year 1968-69 and the only question referred in regard to the assessment year 1967-68 in favour of G the Revenue and against the assessee. The correctness of this answer has not been challenged before us.

The first question referred to the High Court in respect of assessment year 1968-69, however, arises in a slightly different way. It arises in the context of "depreciation" which is one of the notional H

A allowances—by which expression we mean a deduction in respect of an outgoing which is not an item of actual expenditure or is one which cannot be treated as an outgoing of a revenue nature—permitted by the statute to be deducted in the computation of the profits and gains of a business. In a sense, where the depreciation allowance exceeds the profits, otherwise arrived at, in respect of the business, there will be a B resultant "loss" in the business; and, indeed, the Department's contention is that there is no difference between an unabsorbed loss and unabsorbed depreciation. It would, however, be useful to refer to the treatment meted out by the statute in respect of three items of deductions allowed in the computation of the profits of a business which may be larger than the profits of the business otherwise computed. One is C the development rebate regarding which the statute provides that it has to be set off against the total income of the assessee so as to reduce it to *nil* and that the balance is to be carried forward to succeeding assessment years to be accorded a similar treatment. [See Ss. 10(2)(vib) of the 1922 Act and 33(2) of the 1961 Act]. This is an allowance which cannot be a constituent element of a figure of loss to D be carried forward to later years and stands on a totally different footing. The second is the allowance for depreciation under S. 10(2)(vi) of the 1922 Act. In respect of this allowance, S. 10(2)(vi) provided that if full effect to the allowance could not be given in the assessment of an assessee for any assessment year, the unabsorbed allowance could be carried forward and set off against business profits in E succeeding assessment years indefinitely. This provision, namely clause (b) of the proviso to S. 10(2)(vi) of the 1922 Act—after an addition in 1953 of the words underlined in the extract below—reads thus:

> "10(2)(vi) .....
>
> F Provided that .....
>
> (a) .....
>
> (b) where, in the assessment of the assessee *or, if the assessee is a registered firm, in the assessment of its partners,* full effect cannot be given to any such allowance in any year not being a year which ended prior to the 1 April, 1939, owing G to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, then, subject to the provisions of clause (b) of the proviso to sub-section (2) of section 24, the allowance or part of the allowance to which effect has not been H given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and

deemed to be the allowance for that year, and so on for succeeding years."

This provision has, in substance,—there are certain verbal differences which are not material for our purposes—been reenacted as S. 32(2) of the 1961 Act, which now reads thus:

"32(2) Where, in the assessment of the assessee (*or, if the assessee is a registered firm or an unregistered firm assessed as a registered firm, in the assessment of its partners)* full effect cannot be given to any allowance under clause (ii) of sub-section (1) in any previous year, owing to there being no profits or gains chargeable for that previous year, or owing to the profits or gains chargeable being less than the allowance, then, subject to the provisions of sub-section (2) of section 72 and sub-section (3) of section 73, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years."

The third type of allowance of this nature, a carry forward of which is contemplated, is an allowance in respect of expenditure on capital assets related to a business. This, by virtue of clause (f) of the proviso to S. 10(2)(xiv) of the 1922 Act, re-enacted in S. 35(4) of the 1961 Act, is treated on the same lines as the depreciation allowance dealt with in S. 10(2)(vi) and S. 32(2). We shall, however, leave this out of account in our future discussion as it is not material for the purposes of the present case and as, in any event, whatever is decided in regard to unabsorbed depreciation would apply equally in respect of such allowance as well.

From the above discussion, it will be seen that unabsorbed losses and unabsorbed depreciation are to be carried forward to future years to be set off against future income. There is, however, one important difference. Unabsorbed losses can be carried forward only for a period of eight years whereas unabsorbed depreciation can be carried forward indefinitely. A rule of priority of set off—as between these two—therefore becomes necessary and this is provided by S. 72(2) of the 1961 Act which deals with carry forward of losses—the counterpart of

A the proviso to S. 24(2) of the 1922 Act—which reads thus:

> "Where any allowance or part thereof is, under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to the provisions of this section."

B

This is the historical context and statutory language on the basis of which the issue before us has to be resolved. The issue is: when there is an unabsorbed depreciation computed in the assessment of a registered firm for any year, how is it to be treated for purposes of carry forward? Three alternatives are possible: (i) It should be retained (without apportionment) and carried forward by the firm C only. (ii) It should be apportioned among the partners. Thereafter, it can be dealt with—even for carry forward purposes—only in the assessments of each of the partners in respect of his aliquot share thereof. (iii) It should be apportioned among the partners each of whom may set off his share thereof against his other income. If, after D this, any amount remains unabsorbed, it will revert to the firm. The firm will carry it forward, set it off against its other income in the succeeding year. This operation will be repeated every year indefinitely until the unabsorbed depreciation gets absorbed. The three alternatives will yield widely different results and hence the present controversy.

E

On the above issue there has been a strong cleavage of opinion between the various High Courts. The view that unabsorbed depreciation once allocated to the partners cannot be taken back to the firm's assessment for being carried forward by the firm and that the partners alone are entitled to carry forward the unabsorbed depreciation for F being set off against their income, has been taken in the following cases: (a) *K.T. Wire Products* v. *Union of India,* [1973] 92 ITR 459 (All) (b) *Garden Silk Weaving Factory,* [1975] 101 ITR 658 and *Garden Silk Weaving Factory,* [1983] 144 ITR 613 (Guj.): (c) *CIT* v. *Ram Swarup Gupta,* [1973] 92 ITR 495 and *Raj Narayan Aggarwala* v. *CIT,* [1979] 75 ITR 1 (Del.); (d) *Shankaranarayana Construction Co.* v. *CIT,* G [1984] 145 ITR 467 (Karn.). The view that the unabsorbed depreciation, after being carried forward by the partners and set off against their income, reverts back to the registered firm for being carried forward and set off against its income and that any depreciation still remaining unabsorbed will again go to the partners and that if it still remained unabsorbed would revert back to the firm and so on, has H been accepted in: (a) *Ballarpur Collieries Co.* v. *CIT,* [1973] 92 ITR

219 and *CIT* v. *Nagpur Gas & Domestic Appliances,* [1984] 147 ITR 440 (Bom.); (b) *CIT* v. *Nagapattinam Import and Export Corp.*, [1979] 119 ITR 444; *CIT* v. *Madras Wire Products,* [1979] 119 ITR 454 and *CIT* v. *Madras Wire Products*, [1980] 123 ITR 722 (Mad); (c) *CIT* v. *Singh Transport Co.,* [1980] 123 ITR 698 (Gau); (d) *CIT* v. *J. Patel & Co.,* [1984] 149 ITR 682 (Del.); (e) *CIT* v. *Shrinivasa Sugar Co.,* [1988] 174 ITR 178 (A.P.): (f) *Pearl Woollen Mills* v. *CIT,* [1989] 179 ITR 368 and *CIT* v. *Mahavir Steel Rolling Mills,* [1989] 179 ITR 377 (P & H); and (g) *CIT* v. *R.J. Trivedi & Sons*, [1990] 183 ITR 420 (M.P.)

Shri Harish Salve, learned counsel for the assessee, canvassed the latter of the above views but with a slight modification. He submitted that, in the present case, the firm as well as the partners had been returning losses all along with the result that no part of the unabsorbed depreciation of the firm had been set off in the partners' hands. He, therefore, submitted that it was sufficient for him to urge the first of the three alternatives set out earlier and that he need not, for the purposes of this case, seek to support the third alternative, upheld in some of the decisions, which may create an impression in the mind that the assessee was deriving a double benefit by having the unabsorbed depreciation set off in the hands of both the firm and the partners. On the other hand, Dr. Gaurishankar, for the Revenue, strongly advocated the second alternative. According to him, once the assessment is completed, and the total income or loss of the firm ascertained, it has to be apportioned amongst the partners. Thereafter, there remained nothing in the assessment of the firm to be carried forward. Only each of the partners can carry forward his share of the unabsorbed loss (and this, according to him, will include also the unabsorbed depreciation) for set off in his future assessments.

The answer to the problem before us has to be discovered in the language of S. 32(2) supplemented by that of other sections which deal with the mode of assessment of a firm and its partners. Before turning to these provisions, it will be necessary to clear up one aspect of S. 32(2) to which Sri Salve drew attention in the course of his reply. He pointed out that S. 32(2) permits the carry forward of the depreciation allowance "where full effect cannot be given to it" owing to there being no *profits or gains* chargeable for that previous year, or owing to the *profits or gains* chargeable being less than the allowance. Laying emphasis on the words "profits or gains", he contended that the carry forward of depreciation allowance is at a stage much anterior to that of the determination of the total income of the assessee. On this construction, if an assessee A carries on two businesses, in one of which there is

A an unabsorbed depreciation of Rs.15,000 and the profits and gains of the other business is only Rs.10,000, the net unabsorbed depreciation of Rs.5,000 has to be carried forward irrespective of the other income of the assessee in that year, to the succeeding year. This contention, however, cannot be accepted. Though the section, somewhat infelicitiously, uses the expression "profits and gains" as it occurs in the statute B in the fasciculus of sections dealing with the computation of business income, the question of the carry forward of unabsorbed depreciation has always been understood and interpreted as arising only after the intra-head and inter-head adjustments, referred to earlier, have been carried out. Thus, in the illustration given above, if A has a property income of Rs.6,000 the unabsorbed depreciation of Rs.5,000 will be C set off against the property income and there will be no unabsorbed depreciation left for being carried forward to the subsequent assessment year. This is because, where the depreciation allowance attributable to a particular business exceeds the profits otherwise computed for that business, the deduction of the depreciation allowance from such profits can only result in a "loss" from that business—this, how- D ever, is subject to a limitation that will be discussed later—and a business loss has to be set off against income from any other business, by way of intra-head adjustment, under S. 70 and the income under any other head, by way of inter-head adjustment, under S. 71. This principle indeed emerges even from the language of S. 32(2) in so far as it implicitly recognises that the excessive depreciation of one busi- E ness can be "given effect to" against the profits and gains of another business in the same year. This, indeed, is a well settled proposition, and it should be sufficient to cite two decisions of this Court which make this clear, In *C.I.T.* v. *Jaipuria China Clay Mines (P) Ltd.*, [1966] 59 I.T.R. 555 this Court observed:

F "Mr. Shastri, learned counsel for the revenue, urges that depreciation, although a permissible allowance under section 10(2) of the Act, serves to compensate an assessee for the capital loss suffered by him by way of depreciation of his assets. He says that if it had not been expressly allowed as allowance, it would have been treated as capital G expenditure and would have been excluded. He further says that depreciation is a charge on the profits of a business. Bearing these two factors in mind, he urges that the expression "loss of profits and gains" in section 24(1) does not include any deficiency resulting from depreciation and, therefore, an assessee is not entitled to ask the department H to include the depreciation in the amount which can be set

off against income, profits and gains under other heads such as income from property or dividends. Mr. Rajagopala Sastri for the assessee relies on the history of the legislation and a number of authorities to support the judgment of the High Court.

Apart from authority, looking at the Act as it stood on April 1, 1952, it is clear that the underlying idea of the Act is to assess the total income of an assessee. *Prima facie,* it would be unfair to compute the total income of an assessee carrying on business without pooling the income from business with the income or loss under other heads. The second consideration which is relevant is that the Act draws no express distinction between the various allowances mentioned in section 10(2). They all have to be deducted from the gross profits and gains of a business. According to commercial principles, depreciation would be shown in the accounts and the Profit and Loss account would reflect the depreciation accounted for in the accounts. If the profits are not large enough to wipe off depreciation, the profits and loss account would show a loss. Therefore, apart from proviso (b) to section 10(2)(vi), neither the Act nor commercial principles draw any distinction between the various allowances mentioned in section 10(2); the only distinction is that while the other allowances may be outgoings, depreciation is not an actual outgoing."

and expressly disproved the observations of the Madras High Court in *C.I.T.* v. *Nagi Reddy,* [1964] 51 I.T.R. 178 that the deduction for depreciation should be limited to the amount of the profits and cannot result in working out a loss. The following observations in the more recent decision in *Rajapalayam Mills Ltd.* v. *C.I.T.,* [1978] 115 I.T.R. 777, S.C. place the position beyond doubt:

"It is clear on a plain reading of the language of provision (b) to cl. (vi) that it comes into operation only where full effect cannot be given to the depreciation allowance for the assessment year in question owing to there being no profits or gains chargeable for that year or profits or gains chargeable being less than the depreciation allowance. Now, it is well settled, as a result of the decision of this court in *CIT* v. *Jaipuria China Clay Mines (P) Ltd.*, [1966] 59 ITR 555 (SC), that the words "no profits or gains chargeable for that year" are not confined to profits and gains derived

A from the business whose income is being computed under s. 10, but they refer to the totality of the profits or gains computed under the various heads and chargeable to tax. It is, therefore, clear that effect must be given to depreciation allowance first against the profits or gains of the particular business whose income is being computed under s. 10 and if B the profits of that business are not sufficient to absorb the depreciation allowance, the allowance to the extent to which it is not absorbed would be set off against the profits of any other business and if a part of the depreciation allownce still remains unabsorbed, it would be liable to be set off against the profits or gains chargeable under any other head and it is only if some part of the depreciation C allowance still remains unabsorbed that it can be carried forward to the next assessment year. Obviously, therefore, there would be no scope for the applicability of provision (b) to cl. (vi), if the total income of the assessee chargeable to tax is sufficient to absorb the depreciation allowance, for D then there would not be any unabsorbed depreciation allowance to be carried forward to the following assessment year. But where any part of the depreciation allowance remains unabsorbed after being set off against the total income chargeable to tax, it can be carried forward under provision (b) to cl. (vi) to the following year and set off E against that year's income and so on for succeeding years."

The resultant position, therefore, is that initially, the depreciation allowance has to be deducted from the profits and gains of the business to which the assets earning the depreciation relate but, if it remains unabsorbed by such profits, the allowance has to be set off against the F other business income of the assessee and, where that is also insufficient, against the other taxable income of the assessee. The carry forward of any depreciation as unabsorbed cannot arise until the stage of final assessment is reached and the total income of the assessee otherwise computed is insufficient to absorb the year's depreciation allowance. Sri Salve's argument that the stage of carry forward of G depreciation arises at a stage anterior to the completion of the assessment and determination of the total income cannot, therefore, be accepted.

Sri Salve, then, contended that there is no statutory provision which enables the apportionment of the firm's unabsorbed depreciation among the partners and that, therefore, the unabsorbed depreciaH

tion has to be carried forward by the firm itself and none else. In our opinion, this contention also is not well-founded. S. 182, to the extent relevant for our present purposes, reads—

> "*S. 182.(1)—Assessment of registered firms*—Notwithstanding anything contained in section 143 and 144 and subject to the provisions of sub-section (3), in the case of a registered firm, after assessing the total income of the firm,—
>
> (i) the income-tax payable by the firm shall be determined; and
>
> (ii) the share of each partner in the income of the firm shall be included in his total income and assessed to tax accordingly.
>
> (2) If such share of any partner is a loss it shall be set off against his other income or carried forward and set off in accordance with the provisions of sections 70 to 75.
>
> (3) When any of the partners of a registered firm is a non-resident, the tax on his share in the income of the firm shall be assessed on the firm at the rate or rates which would be applicable if it were assessed on him personally, and the tax so assessed shall be paid by the firm.
>
> (4) A registered firm may retain out of share of each partner in the income of the firm a sum not exceeding thirty per cent thereof until such time as the tax which may be levied on the partner in respect of that share is paid by him; and where the tax so levied cannot be recovered from the partner, whether wholly or in part, the firm shall be liable to pay the tax, to the extent of the amount retained or could have been so retained."

How this share is to be computed is set out in S. 67 which may be set out here:

> *S. 67(1)—Method of computing a partner's share in the income of the firm*—In computing the total income of an assessee who is a partner of a firm, whether the net result of the computation of total income of the firm is a profit or a

loss, his share (whether a net profit or a net loss) shall be computed as follows:

(a) any interest, salary, commission or other remuneration paid to any partner in respect of the previous year, [and, where the firm is a registered firm or an unregisterted firm assessed as a registered firm under clause (b) of section 183], the income-tax, if any, payable by it in respect of the total income of the previous year, shall be deducted from the total income of the firm and the balance ascertained and apportioned among the partners;

(b) where the amount apportioned to the partner under clause (a) is a profit, any salary, interest, commission or other remuneration paid to the partner by the firm in respect of the previous year shall be added to that amount, and the result shall be treated as the partner's share in the income of the firm;

(c) where the amount apportioned to the partner under clause (a) is a loss, any salary, interest, commission or other remuneration paid to the partner by the firm in respect of the previous year shall be adjusted against that amount, and the result shall be treated as the partner's share in the income of the firm.

(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.

(3) Any interest paid by a partner on capital borrowed by him for the purposes of investment in the firm shall, in computing his income chargeable under the head "Profits and gains of business or profession" in respect of his share in the income of the firm, be deducted from the share.

(4) If the share of a partner in the income of a registered firm or [an unregistered firm assessed as a registered firm under] clause (b) of section 183, as computed under this section, is a loss, such loss may be set off, or carried forward and set off, in accordance with the provisions of this Chapter.

Explanation: In this section, "paid" has the same meaning as is assigned to it in clause (2) of section 23.]" A

Sri Salve contends that these provisions talk only of "loss" and that to take this expression as including "unabsorbed depreciation" as well will obliterate the distinction in the treatment meted out to these as separate items by S. 32(2) and S. 72(2) and (3). We think this argument is misconceived. An unabsorbed depreciation is indeed a part of the "loss". This is so because, in the first place, "depreciation" is a normal outgoing though in a sense notional, which has to be debited in the computation of the profits of a business on commercial principles (quite apart from statute) and it is difficult to see why, when such deduction yields a negative figure of profits, it cannot be a "loss" as generally understood. *Jaipuria* definitely says so as pointed out earlier. Again, as pointed out earlier, if it is treated as a genus totally different from a "loss", there is no statutory provision that will permit its adjustment against other business income—implicit in S. 32(2) itself—and against all other income of the assessee as held by the above decisions. We therefore do not see why "loss" and "unabsorbed depreciation should be treated as antithetical to, or mutually exclusive of, each other. B C D

Nor are we persuaded that any mix-up or anomaly will result as suggested by counsel if we treat the expressions as synonymous except to the extent specifically treated differently by the statute. In our view, there is nothing anomalous or absurd in the statute providing for a dissection of the amount of loss for purposes of carry forward and providing for a special or different treatment to unabsorbed depreciation in this regard although it is a component element of the genus described as "loss". To illustrate, suppose an assessee has a "profit" of Rs.5,000 in one business before deduction of depreciation of, say, Rs. 10,000 and a loss of Rs. 15,000 in another business, it will be quite correct to say that he has a business loss of Rs.20,000 in that assessment year. But for purposes of carry forward this has to be considered under to headings: (a) an unabsorbed depreciation of Rs.5,000 and (b) a business loss of Rs. 15,000. The amount of Rs.20,000 will be carried forward to the subsequent year but the carry forward of Rs.5,000 will be according to the provisions of S. 32(2) and the carry forward under S: 72 will have, perforce, to be restricted to the other amount of Rs. 15,000. The language of S. 72(2) itself contains an indication that, where unabsorbed depreciation is a component of the figure of loss carried forward, the amount of loss proper should be set off first and the unabsorbed depreciation later. But for the special treatment ac- E F G H

corded by S. 32(2) and S. 72 for purposes of carry forward, there is no difference between an item of "unabsorbed depreciation" and an item of "loss". We are, therefore, of opinion that the unabsorbed depreciation will be allocated among the partners and, like any other loss, will be available to the partner for set off against his business income or other income in the same assessment year. In fact S. 32(2), in so far as it talks of depreciation being given effect to in the partners' assessments recognises that such unabsorbed depreciation should be allocated among the partners. So the first of the three alternatives referred to by us earlier is, in our opinion, out.

We now come to the crucial question as to what is to be done when the amount of unabsorbed depreciation does not get absorbed by the other income of the firm and, further, the aliquot shares of the partners therein do not also get absorbed in the partners' assessments against their other income. There can be two answers to this:

(1) that the partners—in whose hands the unabsorbed depreciation has been allocated—should carry forward the depreciation to succeeding years; or

(2) that the amount of depreciation so remaining unabsorbed should be carried forward by the firm for set off in future assessments.

We have given our most careful consideration to this matter, particularly in view of the controversy of judicial decisions prevailing thereon, and we have come to the conclusion that the second of these alternatives is what is truly envisaged by the statute. The most formidable obstacle put forward to this course is that, once the unabsorbed depreciation gets divided and allocated to the partners, there is no statutory provision for recalling, to the firm's "file", the amount remaining unabsorbed. We think this criticism really proceeds on an unduly narrow construction placed on the provisions of S. 32(2). In our opinion, S. 32(2) itself contains an inbuilt mechanism for doing this. It is plain, on the language of this sub-section, that the benefit of the carry forward is to be given to the assessee. Where the assessee is other than a registered firm or an unregistered firm assessed as a registered firm, this is indeed very plain. In the case of this category of assessee, the difficulty arises because of the words in paranthesis. But a moment's thought will make it clear that the word "or" in the subsection is really used as a conjunctive. It cannot be an alternative, for there can be no doubt that even in the case of such an assessee the

unabsorbed depreciation, for reasons already set out, has to be adjusted against its other income. The assessment of the firm cannot be complete without such a set off. Thus, where a firm assessed as a registered firm, has only unabsorbed depreciation of say, Rs.8,000, in the business carried on by it but a property income of Rs.12,000 its total income for the year has to be Rs.4,000; it cannot be assessed on an income of Rs.12,000 with the depreciation of Rs.8,000 apportioned to its partners. We have already pointed out that the partner's share in the unabsorbed depreciation is part of his share in the loss of the firm and, by virtue of S. 67(3), will be treated as business loss which is capable of adjustment against his business and other income. This is the position envisaged by S. 32(2) when it talks of effect being given to the unabsorbed depreciation in the assessment of the partners. This can refer only to cases where the depreciation cannot be given effect to in the firm's assessment. It is, therefore, clear that S. 32(2) contemplates the situation where the unabsorbed depreciation in the hands of the firm is too large to get absorbed, first, in the hands of the firm and then, after apportionment, in the hands of the partners. What remains thereafter has obviously to be carried forward by the firm which is the assessee referred to in the sub-section. Perhaps the meaning of the provision will become clearer if its relevant words are rearranged as follows:

> "Where full effect cannot be given to any (depreciation) in any previous year in the assessment of the assessee (whatever category it belongs to) *and*, if the assessee is a registered firm or an unregistered firm assessed as a registered firm, in the assessment of its partners, ... the allowance shall be added .....".

As in the case of all other assessees, the carry forward will be available to the registered firm which is the assessee that is referred to in the sub-section.

This construction is also strengthened by the last part of the sub-section. When it talks of the depreciation allowance carried forward being added to the allowance for depreciation for the following previous year it obviously refers to the depreciation allowance due to the assessee (that is, the firm) in the subsequent previous year. In the normal run of cases, it will thus either get added to the subsequent year's depreciation in respect of the same assets and get set off against the income from the same business or some other business of the same assessee or, failing that, against other income of such assessee. What

A the sub-section clearly provides for is that the aggregate of the depreciation available to an assessee over the years will be taken into consideration for set off against its income over a period of years. No doubt, the latter portion of S. 32(2) does not envisage that the business carried on by the assessee in the subsequent years should be the same or that the assets to the depreciation in respect of which the unabsorbed B depreciation is to be added should be the same or, indeed, that any depreciation at all should be allowable to the assessee in the subsequent year. It is no doubt true that the words of the sub-section are so widely couched that they can, with a certain amount of difficulty, be rendered capable of application to the situation of each partner carrying forward his share of the unabsorbed depreciation for set off, even where he has no business or business income, against his other income. C But we think that it is too strained a construction of the sub-section. When, as pointed out by Sri Salve, there is nothing in the sub-section or the Act specifically providing even for an apportionment of the depreciation among the partners, it is too contrived a construction to read into the sub-section several words intended to provide for a D number of partners, each carrying forward his share of the unabsorbed depreciation to successive assessment years. It seems natural and reasonable to construe the section as envisaging the following steps where the assessee is a registered firm:

(i) Excessive depreciation should be adjusted in the assessment E of the assessee against other business income and against other heads of income;

(ii) Depreciation, which remains unabsorbed under (i), will be apportioned to the partners and the share of each will be adjusted against the business and other income of each of the F partners *pro tanto;*

(iii) If full effect cannot be given to the depreciation allowance of the assessee by the above processes and some depreciation remains unadjusted, the assessee-firm will carry it forward to the succeeding assessment year.

G

The objection to this course is based on a mental imagery of the firm and its partners as altogether different assessees and of the impermissibility of "bringing back" to the firm's "file" what has gone away to the files of the partners. We think this approach of viewing the two assessments in water-tight compartments is not correct. The Act H itself contains several provisions [e.g. Ss. 67(2) & (3)] which indicate

that this is not so. The observations of this Court in *Sankappa* v. *I.T.O.*, [1968] 68 I.T.R. 760 at pp. 766-7 also bring out the regions of inter-dependence of these two assessments. In any event, any such theoretical dichotomy cannot prevail over the provisions of s. 32(2). A

There is also one further reason why this view should find acceptance. As we have pointed out earlier, unabsorbed depreciation is only a species of business loss. But for purposes of carry forward the statute has drawn a distinction between them. In doing so, it specifically outlines the procedure for carry forward and set off of losses in the case of a registered firm but is silent in regard to unabsorbed depreciation. There is no statutory prohibition against the carry forward of unabsorbed depreciation by the registered firm as there is against carry forward of loss. The need felt to enact a specific prohibition in respect of losses and the absence of a like provision in respect of depreciation are significant pointers in support of the above construction. B C

An argument has been put forward by Dr. Gaurishankar on the basis of the amendment to the proviso to s. 10(2)(vib) in 1953 to submit that it was intended to negative the claim of carry forward by the firm which was earlier being accepted on the strength of the earlier language resulting in a double advantage. Attention has been drawn to the objects and reasons of the amendment, set out thus at p. 57 in (1952) 21 I.T.R. (Statutes): D

> "The (amendment) is intended to make it clear that *where unabsorbed depreciation has been effectively allowed* in the assessment of a partner of a registered firm, it would not be carried forward in the case of the firm."
>
> (emphasis added)

E F

It is true that the clause, before its amendment, permitted all assessees—and this included registered firms as well—to carry forward their unabsorbed depreciation and that though the registered firm paid no tax, it could, on the language claim a carry forward of the depreciation which had been apportioned among the partners. This resulted in such carry forward being claimed even where the whole or a part of the unabsorbed depreciation of the firm had been set off in the assessment of individual partners. The amendment, *vide* the words emphasised in the extract above, only seeks to make it clear that such carry forward will not be permitted to the extent it has been given effect to in the partners' assessments; by necessary implication the carry forward, to the extent it has not been effectively allowed to the partner, continues G H

A to be available. The amendment of 1953, therefore, not only does not help the case of the Revenue, it actually lands support to the construction we are inclined to place on the proviso.

It is possible that our conclusion may give scope for two grounds of criticism: (i) that the partners derive a double advantage of setting B off the unabsorbed depreciation to reduce the taxable income of the firm as well as the partners; and (ii) that this will distort the relief available to various partners depending upon the variations in income as between the several partners as well as over a period of years. We do not think that the first criticism is a valid one. For it is now settled law, that though a firm and its partners are distinct assessees for purposes of income-tax, the Act still recognises the principle that a C firm is only a compendious name for its partners and that the business carried on by the firm is also a business carried on by each of the partners too—vide S. 67(2) and (4)—and the loss of a registered firm is treated as the losses of its partners too. The procedure envisaged by it will only enable a firm and the partners to set off the aggregate of the D unabsorbed depreciation of the firm against the aggregate income of the firm and partners. To the extent effect is given to such unabsorbed depreciation to one or more of the partners the firm cannot again get the benefit and *vice versa*. There is, therefore, really no double advantage.

E There is some point in the second criticism. But, then, a certain amount of imbalance among the partners is inherent in the application of any one of the three possible alternatives. If, as suggested by Sri Salve, only the firm and not the partners can carry forward the unabsorbed depreciation, there will be an injustice to the partners who may have other income against which it could be set off. On the other hand, F if the unabsorbed depreciation is allocated to the partners and they alone can carry forward and set it off, it will have this consequence that the partners who have other high income will derive the benefit of set off *qua* their shares but no benefit can be got by partners whose total income is not enough to offset their share of the depreciation and the unabsorbed depreciation will not get absorbed even though the firm G may have sufficiently large income in subsequent years. In other words, whichever procedure is adopted, the relief available to the partners will not be uniform. This is a consequence flowing from the variations in the income sources of various partners and cannot be avoided under any scheme of carry forward and set off. We, therefore, do not think that this consideration should weigh against our reaching H the conclusion which naturally flows from the language of the subsection.

For the reasons discussed above, we are of the opinion that the assessee-appellant-firm is entitled to a carry forward of the unabsorbed depreciation computed for the assessment year 1967-68 and have it set off in its assessment for the assessment year 1968-69. The unabsorbed loss computed for the assessment year 1967-68, however, cannot be carried forward by the firm to be set off in its assessment for the assessment year 1968-69. So far as the assessment year 1967-68 is concerned, the High Court was right in holding that unabsorbed business loss of one year cannot be carried forward and set off by the firm in a subsequent year; but, if there was any unabsorbed depreciation computed for the assessment year 1966-67, it could have been allowed to be brought forward and set off in the assessment for the assessment year 1967-68 in the manner discussed in the judgment.

In the result, appeals for both the assessment years are allowed to the extent indicated and the assessments directed to be modified appropriately. We, however, make no order regarding costs."

V.P.R. Appeals allowed.