'REPORTABLE'

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NOS. 8617-8635 OF 2003

ASSISTANT COMMISSIONER OF AGRICULTURAL INCOME TAX & ORS. ...Appellants

VERSUS

M/S. NETLEY 'B' ESTATE & ORS. ...Respondents

J U D G M E N T

R. F. NARIMAN, J.

The present set of appeals are concerned with the validity of an explanation added retrospectively to Section 26(4) of the Karnataka Agricultural Income Tax Act (hereinafter referred to as 'Act').

On facts, the present appeals are concerned with the assessment of agricultural income received by a firm after it is dissolved insofar as the income of the firm pertains to actual cash receipts after the firm is dissolved but relating to income earned prior to dissolution.

Section 26 of the Act reads as follows: -

> **"26. Assessment in case of discontinued company, firm or association – (1) where agricultural income is received by a company, firm or association of persons and the business through which such income is received is discontinued in any year, an assessment may be made in that year on the basis of the agricultural income**

received during the period between the end of the previous year and the date of the such discontinuance, in addition to the assessment, if any, made on the basis of the agricultural income received in the previous year.

(2) Any person discontinuing any such business shall give to the Agricultural Income-tax officer notice of such discontinuance within thirty days thereof and where any person fails to give the notice required by this sub-section, such officer may direct that a sum shall be recovered from him by way of penalty not exceeding the amount of agricultural income-tax subsequently assessed on him in respect of any agricultural income of the company, firm or association of persons up to the date of the discontinuance of the business.

(3) Where an assessment is to be made under sub-section (1), the Agricultural Income-tax officer may service on the person whose agricultural income is to be assessed, or, in the case of a firm on any person who was a member of such firm at the time of the discontinuance or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of section 18 and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section."

Sub-section (4) was added to Section 26 by amendment in 1987 and reads as follows: -

"Where any business through which agricultural income is received is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance."

Section 27 with which we are also concerned reads as follows: -

"27. Liability in case of discontinued firm or

association – (1) where the business of a firm or association of persons is discontinued or such firm or association is dissolved, the Assistant Commissioner of Agricultural Income-Tax shall make the assessment of the agricultural income of the firm or association of persons as if no such discontinuance or dissolution has taken place and all the provisions relating to the levy of penalty or any other sum chargeable under any provisions of this Act shall apply, so far as may be, to such assessment.

(2) Every person who was at the time of such discontinuance or dissolution, a partner of such firm or a member of such association and the legal representative of any such person who is deceased, shall be jointly and severally liable to the assessment on such agricultural income and also to pay the amount of agricultural income-tax, penalty or other sum payable and all the provisions of this Act, so far as may be shall apply to any such assessment or imposition of penalty or other sum."

From a cursory reading of section 26(4) read with section 27, it becomes clear that any sum received after discontinuance of business by a firm is deemed to be the income of the recipient and charged to tax accordingly, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance. Section 27 went one step further and also spoke of income of a firm which is dissolved as opposed to a firm whose business had been discontinued. With respect to such income, every person who was, at the time of discontinuance or dissolution, a partner of such firm was liable to be jointly or severally assessed on such agricultural income as also to pay the same by way of tax penalty, etc.

In *L.P. Cardoza and others* v. *Agricultural Income Tax Officer and others* [(1997) 227 ITR 421], the question involved was as to whether a dissolved firm could be assessed to agricultural income tax after the date of its dissolution in respect of income received for supply of goods made by the firm prior to its dissolution. This question arose in the light of Section 26(4) and Section 27 as they then stood, that is, as they stood in 1987. The question was answered by the Bench after setting out the aforesaid provisions as follows: -

> **"We are, therefore, unable to hold that under section 27 the dissolved firm could be deemed to be in existence for purpose of assessment in respect of the income derived after the date of dissolution of the firm. In fact in W.P. No. 2397 and 2398 of 1988 that is the view taken by the Karnataka Appellate Tribunal and it is on that ground the assessment orders were set aside.**
>
> **The next point to be considered is whether section 26(4), as amended by Act 10 of 1987, could be of any help to the respondent.**
>
> **Learned counsel for the petitioners contended that section 26(4) applies only to a case of discontinuance of the business and not to a case of dissolution of the firm, that section 27 makes a distinction between discontinuance of a business and dissolution of the firm, and that as such section 26(4) does not apply to a case of dissolution of the firm. It is no doubt true that discontinuance of business need not necessarily imply dissolution of the firm. A firm may continue to exist but may discontinue carrying on a particular business. But where a firm is dissolved it necessarily involves discontinuance of business. As such it cannot be said that section 26(4) cannot be applied as it does not refer to dissolution of the firm, but what we are concerned with is as t whether this provision creates any legal fiction regarding the continuance of the firm notwithstanding its dissolution for purposes of assessing an income received after the dissolution. All that this provision lays down is that, any sum received after the discontinuance of business shall be deemed to be the income of the "recipient" and charged to tax in the year of receipt, if such sum would have been included in the total income of the person who carried on the**

business had such sum been received before such discontinuance. Explaining this provision the Division Bench of this Court, in E.M.V. Muthappan's case (1990) 184 ITR 161, has pointed out that since the sale proceeds received is income relating to agricultural activity carried on during the earlier years, it must be deemed to be the income of the recipient, as the original assessee is no longer continuing the business and, therefore, is liable to tax in the year of receipt in the hands of the recipient. It is, therefore, clear that this provision applies to a case where the person carrying on the business discontinues it and the income due to him, he being the original assessee, is received by another after the discontinuance of the business. In such a case, income received by the recipient could be charged to tax in the year of receipt. <u>There is nothing in this provision to indicate that where the firm is dissolved and some income is received after the dissolution in respect of agricultural produce supplied by the firm before its dissolution, the firm itself could be assessed in the year of receipt of income notwithstanding its dissolution.</u>"

On a reading of this judgment, two things become clear. Section 27 of the Act would not help in answering the question before the Court as a firm after dissolution has no existence in the eye of law and cannot for that reason be an assessee. Secondly, Section 26(4) also did not help for the self same reason and also because it referred to only discontinuance of business of a firm as opposed to dissolution of a firm.

The court specifically held that there was nothing in Section 26(4) as it then stood or Section 27 to indicate that where the firm is dissolved and income is received after dissolution in respect of agricultural produce supplied by the firm before dissolution, the firm itself could be assessed in the year of receipt of income notwithstanding its dissolution.

Faced with this decision of the Karnataka High Court, the legislature amended Section 26(4) retrospectively that is, with effect from, 01.04.1975. The amended provision now reads as follows: -

> **"26(4) Where any business through which agricultural income is received by a company, firm or association of persons is discontinued or any such firm or association is dissolved in any year, any sum received after the discontinuance or dissolution shall be deemed to be income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance or dissolution.**
>
> **Explanation: - For the removal of doubts, it is hereby declared that where before the discontinuance of such business or dissolution of a firm or association hitherto assessed as a firm or association, or as the case may be, on the company, the crop is harvested and disposed of, but full payment has not been received for such crop, or the crop is harvested and not disposed of, the income from such crop shall, notwithstanding the discontinuance or dissolution be deemed to be the income of the company, firm or association for the year or years in which it is received or receivable and the firm or association shall be deemed to be in existence, for such year or years and such income shall be assessed as the income of the company, firm or association according to the method of accounting regularly employed by it immediately before such discontinuance or dissolution."**

It will be noticed that in the amended Section 26(4), two changes are made. Whereas in the original provision, no express reference was made to companies or associations of persons, and no reference whatsoever was made to a dissolved firm, both have now been added. By the explanation, which is for the removal of doubts, the legislature declares that where before dissolution of a firm, full payment is not received in respect of income that has been earned pre-dissolution, then

notwithstanding such dissolution, the said income will be deemed to be the income of the firm in the year in which it is received or receivable and the firm shall be deemed to be in existence for such year for the purposes of assessment. It will be noticed that by this amendment, the basis of the law as it stood when *Cardoza*'s case was decided has been changed.

***Cardoza*'s case noticed that there was no deeming procedure that continued a firm that had been dissolved to be an assessee for the purposes of income that was earned by it pre-dissolution but received post-dissolution. The deeming fiction has now been introduced by the explanation (and with retrospective effect from 1975) thereby making it clear that the basis of the law as it stood when *Cardoza*'s case was decided has now been changed with effect from 1975. The position which therefore, emerges is that instead of such income being taxed at the hands of the "recipient", it is now taxed in the hands of the dissolved firm.**

The said amendment was the subject matter of challenge before a learned Single Judge of the High Court of Karnataka. The Single Judge repelled the challenge basically on the ground that the explanation only clarified the main provision and therefore did not go beyond the main provision. Equally, since the legislature has the right to amend both prospectively and retrospectively, all that was done in the present case was an exercise of legislative power

retrospectively and therefore, no question arose of any discrimination on this count. The Single Judge therefore, dismissed the writ petitions before him.

In appeal before the Division Bench, the Division Bench set out all the aforesaid provisions and ultimately found, following the judgment in *D. Cawasji and Co., Mysore* v. *State of Mysore and another* [1984 (Supp) SCC 490], that the amending Act of 1997 suffered from the vice that was found in *Cawasji*'s case, namely that it interfered directly with the judgment of a High Court and would therefore, have to be struck down as unconstitutional on this score alone. This the Division Bench found, because, according to the Division Bench, in the statement of objects and reasons for the 1997 amendment, it was held that the object of the amendment was to undo the judgment of the High Court of Karnataka in *Cardoza*'s case.

Revenue is in appeal before us. It was argued by the learned counsel that the factual situation in *Cawasji*'s case was completely different from the factual situation in the present case and that therefore, *Cawasji*'s case being distinguishable, cannot be followed. Learned counsel also referred to various other judgments which we will advert to a little later. To buttress this submission, he said that all that was done on the facts in the present case was that the legislature retrospectively changed the basis of the law of

assessment of firms regarding income received after they were dissolved, which is something that the legislature is competent to do.

Learned counsel for the assessees, on the other hand, tried to support the judgment. In addition, it was argued that since there was, in fact, no lacuna to be cured, the legislative exercise of retrospective amendment undertaken would be bad as there was no necessity for the same. It was also argued that an explanation cannot defeat the substantive provision to which it is attached and the present explanation therefore, being beyond the main provision, is also bad. He also cited certain decisions which we will advert to.

First, the decision in *Cawasji*'s case. The question which fell for decision in *Cawasji*'s case was a retrospective amendment made to the Mysore Sales Tax Act, 1957, in which sales tax was retrospectively raised from 6½ per cent to 45 per cent. Notwithstanding any judgment to the contrary, even though collection of sales tax has been struck down on the ground that excise duty, education cess and health cess could not have been included in the price of arrack sold, yet such tax will be deemed to be validly levied and collected in accordance with law. The ratio of the decision emerges from paragraph 18 of the judgment which his set out hereinbelow: -

> **"In the instant case, the State instead of remedying the defect or removing the lacuna has by the impugned**

amendment sought to raise the rate of tax from 6 ½ per cent to 45 per cent with retrospective effect from April 1, 1966 to avoid the liability of refunding the excess amount collected and has further purported to nullify the judgment and order passed by the High Court directing the refund of the excess amount illegally collected by providing that the levy at the higher rate of 45 per cent will have retrospective effect from April 1, 1966. The judgment of the High Court declaring the levy of sales tax on excise duty, education cess and health cess to be bad become conclusive and is binding on the parties. It may or may not have been competent for the State Legislature to validly remove the lacuna and remedy the defect in the earlier levy by seeking to impose sales tax through any amendment on excise duty, education cess and health cess; but, in any event, the State Government has not purported to do so through the Amending Act. As a result of the judgment of the High Court declaring such levy illegal, the State became obliged to refund the excess amount wrongfully and illegally collected by virtue of the specific direction to that effect in the earlier judgment. It appears that the only object of enacting the amended provision is to nullify the effect of the judgment which became conclusive and binding on the parties to enable the State Government to retain the amount wrongfully and illegally collected as sales tax and this object has been sought to be achieved by the impugned amendment which does not even purport or seek to remedy or remove the defect and lacuna but merely raises the rate of duty from 6 ½ per cent to 45 per cent and further proceeds to nullify the judgment and order of the High Court. In our opinion, the enhancement of the rate of duty from 6 ½ per cent to 45 per cent with retrospective effect is in the facts and circumstances of the case clearly arbitrary and unreasonable. The defect or lacuna is not even sought to be remedied and the only justification for the steep rise in the rate of duty by the amended provision is to nullify the effect of the binding judgment. The vice of illegal collection in the absence of the removal of the illegality which led to the invalidation of the earlier assessments on the basis of illegal levy, continues to taint the earlier levy. In our opinion, this is not a proper ground for imposing the levy at the higher rate with retrospective effect. It may be open to the Legislature to impose the levy at the higher rate with prospective operation but levy of taxation at higher rate which really amounts to imposition of tax with retrospective operation has to be justified on proper and cogent grounds. This aspect of the matter does

> **not appear to have been properly considered by the High Court and the High Court in our view was not right in holding that "by the enactment of Section 2 of the impugned Act the very basis of the complaint made by the petitioner before this Court in the earlier writ petition as also the basis of the decision of this Court in C*awasji case* that the State is collecting amounts by way of tax in excess of what was authorised under the Act has been removed." We, accordingly, set aside the judgment and order of the High Court to the extent it upholds the validity of the impugned amendment with retrospective effect from April 1, 1966 and to the extent it seeks to nullify the earlier judgment of the High Court. We declare that Section 2 of the impugned amendment to the extent that it imposes the higher levy of 45 per cent with retrospective effect from April 1, 1966 and Section 3 of the impugned Act seeking to nullify the judgment and order of the High Court are invalid and unconstitutional."**

It is clear from this judgment that two reasons were given for striking down the retrospective levy. The first reason given was that, in the facts and circumstances of the case, retrospectively enhancing of the levy of duty from 6 ½ per cent to 45 per cent is in itself arbitrary and unreasonable. The second reason given is that the defect or lacuna found by the High Court is not sought to be remedied and the only justification for the steep rise in the rate of duty is to nullify the effect of an earlier binding judgment. It was held that the vice of illegal collection in the absence of the removal of the illegality which led to the invalidation of the earlier levy continued to taint the earlier levy.

This judgment is wholly distinguishable from the facts in the present case. All that has been done in the present

case is to remove the basis of the law as it stood in 1987 which was interpreted in *Cardoza*'s case as leading to a particular result. All that the legislature has done in the present case is to say that with effect from 01.04.1975, dissolved firms will by legal fiction, continue to be assessed, for the purposes of levy and collection of agricultural income tax, insofar as they receive income post dissolution but relating to transactions pre-dissolution. In no manner has the legislature in the present case sought to directly nullify the judgment in *Cardoza*'s case. All that has happened is that the legal foundation on which the *Cardoza*'s case was built is retrospectively removed, something which is well within the legislative competence of the legislature.

In *Sri Ranga Match Industries and others* v. *Union of India and others* [1994 (Suppl.) 2 SCC 726], this court dealt with the same situation of a retrospective validation of a statute otherwise declared unconstitutional. *Cawasji*'s case which was relied upon there (as it has been relied upon in the present case) was distinguished in the following terms: -

> **"At this stage, it would be appropriate to deal with the decision of this Court in *D. Cawasji & Co., Mysore* v. *State of Mysore* on which too reliance was placed by Shri Vaidyanathan, learned counsel for the appellants, Sales tax on liquor was levied at 6½ %. The Government was collecting it on the entire sale price of arrack. However, in a batch of writ petitions filed by the licensees, the Karnataka High Court held that the levy of sales tax on excise duty and cesses component of the sale price was incompetent. In other words, it was held that sales tax can be levied only on the price proper but not upon excise duty and cesses which form**

part of the sale price. The said judgment of the High Court was questioned in this Court but later on the Government withdrew the appeal, with the result that the judgment of the High Court became final. With a view to nullify claims for refund, the Karnataka Legislature intervened and amended the Mysore Sales Tax Act with retrospective effect. The amending Act enhanced the rate of tax from 6½ % to 45 % which meant that the Government need not refund any amount to the licensees pursuant to the aforesaid judgment of the High Court. The Amendment Act was questioned in the High Court but was upheld. On Appeal, this Court held the Amendment Act unconstitutional. On a close reading of the judgment, it is clear that the main ground on which the Act was held to be incompetent was that raising the rate of tax from 6½ % to 45% with retrospective effect was "clearly arbitrary and unreasonable" and, therefore, violative of Articles 14 and 19. It was observed that instead of removing the defect/lacuna pointed out by the High Court, the legislature sought to raise the rate of tax steeply with retrospective effect and that it was bad. The judgment cannot be read as laying down that in no event can the legislature seek to render the judgment of the Court ineffective and inoperative by amending or rectifying the defect or the lacuna pointed out, on the basis of which the judgment was rendered. In my opinion, therefore, the said judgment cannot be understood as supporting the appellant's submission nor can it be read as militating against the well-accepted power of Parliament which has been reiterated in innumerable judgments of this Court."

In the *Indian Aluminium Co. and others* v. *State of Kerala and others* [(1996) 7 SCC 637], there is a long discussion coupled with a large number of judgments on validation acts. *Cawasji*'s case was dealt with in para 52 in the following terms:

> **"In *D. Cawasji & Co.* v. *State of Mysore* the High Court in a writ filed by the appellant had held that the State Government was devoid of power under Section 19 of the Sales Tax Act to collect sales tax and excise duty which is not a part of the selling price. Mandamus for refund was issued. Appeal filed in this Court was withdrawn and the Sales Tax (Amendment) Act was enacted enhancing sales tax from original 6 per cent to 45 per cent with retrospective effect. Section**

3 validated the previous assessments. This Court struck down the amendment so far as it related to retrospectivity pointing out that the lacuna pointed out by the court was not cured and the judgment could not be nullified by legislative amendment."

Finally, a number of principles were laid down in para 56 as follows: -

"From a resume of the above decisions the following principles would emerge:
(1) The adjudication of the rights of the parties is the essential judicial function. Legislature has to lay down the norms of conduct or rules which will govern the parties and the transactions and require the court to give effect to them;
(2) The Constitution delineated delicate balance in the exercise of the sovereign power by the legislature, executive and judiciary;
(3) In a democracy governed by rule of law, the legislature exercises the power under Articles 245 and 246 and other companion articles read with the entries in the respective lists in the Seventh Schedule to make the law which includes power to amend the law.
(4) Courts in their concern and endeavour to preserve judicial power equally must be guarded to maintain the delicate balance devised by the Constitution between the three sovereign functionaries. In order that rule of law permeates to fulfil constitutional objectives of establishing an egalitarian social order, the respective sovereign functionaries need free play in their joints so that the march of social progress and order remains unimpeded. The smooth balance built with delicacy must always be maintained;
(5) In its anxiety to safeguard judicial power, it is unnecessary to be overzealous and conjure up incursion into the judicial preserve invalidating the valid law competently made;
(6) The court, therefore, needs to carefully scan the law to find out; (a) whether the vice pointed out by the court and invalidity suffered by previous law is cured complying with the legal and constitutional requirements; (b) whether the legislature has competence to validate the law; (c)whether such validation is consistent with the rights guaranteed in Part III of the Constitution.
(7) The court does not have the power to validate an invalid law or to legalise impost of tax illegally made and collected or to remove the norm of invalidation or

provide a remedy. These are not judicial functions but the exclusive province of the legislature. Therefore, they are not encroachment on judicial power.

(8) In exercising legislative power, the legislature by mere declaration, without anything more, cannot directly overrule, revise or override a judicial decision. It can render judicial decision ineffective by enacting valid law on the topic within its legislative field fundamentally altering or changing its character retrospectively. The changed or altered conditions are such that the previous decision would not have been rendered by the court, if those conditions had existed at the time of declaring the law as invalid. It is also empowered to give effect to retrospective legislation with a deeming date or with effect from a particular date. The legislature can change the character of the tax or duty from impermissible to permissible tax but the tax or levy should answer such character and the legislature is competent to recover the invalid tax validating such a tax on removing the invalid base for recovery from the subject or render the recovery from the State ineffectual. It is competent for the legislature to enact the law with retrospective effect and authorise its agencies to levy and collect the tax on that basis, make the imposition of levy collected and recovery of the tax made valid, notwithstanding the declaration by the court or the direction given for recovery thereof.

(9) The consistent thread that runs through all the decisions of this Court is that the legislature cannot directly overrule the decision or make a direction as not binding on it but has power to make the decision ineffective by removing the base on which the decision was rendered, consistent with the law of the Constitution and the legislature must have competence to do the same."

We are concerned in this case directly with principles 8 and 9. On facts, the judicial decision in *Cardoza*'s case has been rendered ineffective by enacting a valid law on a topic within the legislative field which fundamentally alters or changes the character of legislation retrospectively. The changed or altered conditions are such that the previous decision would not have been rendered by the court if those conditions had existed at the time of declaring the law as

invalid. The legislature has not directly over-ruled the decision of any court but has only rendered, as has been stated above, such decision ineffective by removing the basis on which the decision was arrived at.

Learned counsel for the respondent cited three decisions before us. *Panchi Devi* v. *State of Rajasthan and others* [(2009) 2 SCC 589], para 9 was cited before us for the proposition that a delegated legislation being ordinarily prospective in nature should not be interpreted to give a retrospective effect to take away a right or liability which was created for the first time. In the present case, we are concerned with an Act of the Legislature and not delegated legislation. No right or liability is created for the first time – the only thing done in the present case is that a firm is by fiction of law continued as such for certain purposes of assessment even after its dissolution. Equally, no question of interpretation qua retrospectivity arises. The legislature in the present case has expressly made the impugned provision retrospective. On all these counts, this judgment is distinguishable and would not apply at all here.

It was then contended based on *Tata Motors Ltd.* v. *State of Maharashtra* and others [(2004) 5 SCC 783] from para 12 thereof, that withdrawal with retrospective effect of relief properly granted by statute to an assessee which the

assessee has lawfully enjoyed as a vested statutory right cannot be taken away unless there be strong and exceptional circumstances justifying the said withdrawal. On facts again, this judgment does not apply. There is no withdrawal of any right which has become a vested statutory right which deprives an assessee of anything in the present case. As has been noted above, what was taxable in the hands of a recipient assessee is now taxable in the hands of a dissolved firm post-dissolution only for certain purposes. This judgment also therefore, cannot have any application in the present factual scenario.

Lastly, the judgment in *Hardev Motor Transport* v. *State of M. P. and others* [(2006) 8 SCC 613] was cited before us. Para 31 thereof was read out in support of the proposition that by inserting an explanation in a statute, the main provision of the Act cannot be defeated or enlarged. Applying this test to the present case, it is clear that in 1997 both the main provision, that is Section 26(4), as well as explanation were added retrospectively. The main provision has been expanded to include dissolved firms and the explanation creates a legal fiction in furtherance of the main provision by deeming a dissolved firm to be in existence as an assessee for certain purposes. This being the case, this judgment would also have no application to the present factual scenario.

For these reasons, we set aside the impugned judgment dated 03.07.2002 and allow the appeals. There shall be no orders as to costs.

......, J.
[A.K. SIKRI]

.....,J.
[ROHINTON FALI NARIMAN]

New Delhi;
March 17, 2015.