

under the provisions of that Act and the last case cited by the learned counsel does not apply to the facts of the present case.

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The result is that this appeal fails and is dismissed with costs.

Mehar Singh, J.

K.S.K.

INCOME-TAX REFERENCE

Before D. K. Mahajan and S. K. Kapur, JJ.

MESSRS BHARAT FIRE & GENERAL INSURANCE LTD.,—
Applicant.

versus

THE COMMISSIONER OF INCOME-TAX, DELHI AND
RAJASTHAN,—*Respondent.*

Income-Tax Reference No. 17-D of 1962.

Income-tax Act (XI of 1922)—Ss. 23-A and 34—Finance Act (XV of 1955)—Ss. 15 and 20—Finance (No. 2) Act of 1957—S. 11—Assessment year 1954-55—Assessee a shareholder in a private company, in respect of which order under S. 23-A passed—Deemed dividend falling to the share of the assessee not distributed—Whether assessable in the hands of the assessee—Previous year for the purpose of deemed dividend—Whether the same as for dividend income—S. 2(6-C)—Deemed dividend—Whether income.

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Held, that sub-section (4) of section 20 of the Finance Act, 1955, had amended section 23-A of the Indian Income-tax Act, 1922, and provided that the provisions of section 23-A as in force immediately before the 1st of April, 1955, would continue to apply to the shareholders of a company referred to in sub-section (1) of section 23-A in respect of their appropriate previous years. Sub-section (4) of section 11 of the Finance (No. 2) Act of 1957 did not at all deal with the existing rights and obligations of the shareholders and in terms provided that the provisions of section 23-A as in force on a particular day "shall continue to apply". The term "continue" signifies that something which was applicable is continued. It cannot, therefore, be held that the liability of the shareholders was completely wiped out retrospectively by section 11 of the Finance (No. 2) Act of 1957. The assessee company was liable to be assessed in respect of the deemed

dividend falling to its share in the assessment year 1954-55 in accordance with the provisions of section 23-A before its amendment by the Finance Act 15 of 1955.

Held, that the effect of section 23-A was that by reason of the fiction created thereby the undistributed portion of the assessable income of the company was deemed to have been distributed as dividend amongst the shareholders. By reason of this fiction the deemed dividend had to be added to the dividend income of the assessee company. Consequently the previous year opted for that source of income, namely, dividend income would also be the previous year for the purposes of deemed dividend.

Held, that a reference to section 2(6-C) of the Indian Income-tax, 1922, clearly shows that dividend is included within the term "income". Section 23-A fictionally includes an amount, though not distributed amongst the shareholders, in the category of the term income. By the creation of the fiction under section 23-A the inevitable consequence that flows is that it becomes a dividend and would, therefore, fall under the definition of the term 'income' as given in section 2(6C).

Reference under Section 66(1) of the Indian Income-tax Act (Act XI of 1922) made by the Income-tax Appellate Tribunal, Bombay, referring the following question :—

"Whether on the facts and in the circumstances of case, the sum of Rs. 1,07,708 is assessable in the assessee's hands as income, profits and gains of the assessee?"

S. K. AIYAR & B. N. KIRPAL, ADVOCATES, for the Petitioner.

H. HARDY AND D. KAPUR, ADVOCATES, for the Respondents.

ORDER

Kapur, J.

KAPUR, J.—Messrs Bharat Fire and General Insurance Ltd. (hereinafter referred to as the assessee-company) is a public limited company and the dispute relates to the assessment year 1954-55 (previous year ending 31st December, 1953). The assessee-company owned 1,250 shares in another private Limited Company, called Govan Agencies Private Ltd. By an order passed under section 23-A of the Income-tax Act, in the assessment of Govan Agencies Private Ltd., dividend deemed to have been distributed as on 31st March, 1953, came to Rs. 1,07,708. Since this amount was not included in the original assessment of the assessee-company, action was taken by the Income-tax Officer, under

section 34(1)(b) of the Indian Income-tax Act, 1922, and the said amount of Rs. 1,07,708 assessed in the hands of the assessee-company. The assessee-company challenged the legality of section 34(1)(b) proceedings and also contended that the amount could not be taxed in the hands of the assessee-company as the action under section 23-A, in the case of Govan Agencies Private Ltd., was illegal. In the alternative the assessee-company prayed for the assessment proceedings being kept pending till the disposal of the appeal preferred by Govan Agencies Private Ltd., against the order passed under section 23-A of the Act, in their case. The Income-tax Officer, decided against the assessee-company and held that—

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“ * * It is neither necessary nor within my jurisdiction to consider on merits the validity of the order under section 23-A of the Act, passed by the Income-tax Officer, Central Circle 1, in the case of M/s. Govan Agencies Private Ltd., nor do I see any reason for keeping this case in abeyance. So far as the assessee's case is concerned notice under section 34 was duly served within time and it was perfectly valid.”

Aggrieved by the order of the Income-tax Officer, the assessee-company filed an appeal before the Appellate Assistant Commissioner and again questioned the legality of the action taken under section 34(1)(b) on the grounds (a) that the notice was barred by time and (b) that the order passed under section 23-A, in the case of Govan Agencies Private Ltd., was wrong, time-barred and illegal. The Appellate Assistant Commissioner held that the notice was within time and that the assessee-company could not challenge the legality or validity of the order passed under section 23-A in the case of Govan Agencies Private Ltd. in view of the third proviso to sub-section (1) of section 30 of the Act. The assessee-company then took up the matter in appeal to the Income-tax Appellate Tribunal and contended that (a) the amount being only a deemed dividend by virtue of section 23-A, it could not be included in the re-assessment under section 34; (b) the assessment made by the Income-tax Officer was illegal, time-barred and without jurisdiction; (c) deemed dividend income could not be

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taxed as dividend income and (d) the deemed dividend was a source of income different from dividend income and the assessee-company having chosen no previous year with respect to this source, the previous year could only be the financial year with the result that the amount did not fall to be taxed in the assessment year 1954-55. The Tribunal held against the assessee-company and on the application of the assessee-company referred the following question of law for the opinion of this Court:—

“Whether on the facts and in the circumstances of the case, the sum of Rs. 1,07,708 is assessable in the assessee’s hands as income, profits and gains of the assessee?”

Mr. S. K. Ayer, for the assessee-company has raised the following contentions:—

- (a) That section 23-A applicable to the case is the section as it stood in 1959 and it is Govan Agencies Private Limited, which could be called upon to suffer the consequence of not having distributed dividend in conformity with section 23-A and not the shareholders;
- (b) The assessee-company had not opted for any previous year with respect to this source of income and, therefore, the previous year should have been taken as the financial year with the result that the amount would not fall to be taxed in the assessment year 1954-55; and
- (c) Deemed dividends are not income, profit or gains under section 34(1)(b) read with section 2(6a) and 2(6c) and consequently the said amount could not be held to be assessable in the hands of the assessee-company under section 34(1)(b).

I will take up the points in the order in which they have been mentioned. In support of the first contention the learned counsel submitted that the order under section 23-A was passed in January, 1959. He then proceeded to give the legislative history of section 23-A and pointed out

that the position before amendment of the section in 1955 was that where the whole or a part of the company's income of the previous year was not distributed by way of dividends in accordance with the provisions of section 23-A, the Income-tax officer could, in the circumstances set out in the section, make an order that the undistributed income of the company should be deemed to have been distributed amongst the shareholders and thereupon the proportionate share thereof of each shareholder was included in the total income of such shareholder and assessed in his hands as his income. In short the section created a notional dividend income which in fact was not received by the shareholders. The section was then amended by the Finance Act, 1955 (No. 15 of 1955), and the change relevant for the purposes of the present controversy was that instead of shareholders having to pay the tax on notional income, the company was made liable to pay super-tax at specified rates on the undistributed balance of the total income of the previous year. This amendment in section 25-A was brought about by section 15 of the Finance Act, 1955. Section 20 of the said Finance Act specified the dates regarding the commencement of amendments to the Income-tax Act. Sub-section (1) of section 20 provided that save as otherwise expressly provided the amendments to the Income-tax Act, made by sections 3 to 19 shall have effect on and from the 1st day of April, 1955. Since strong reliance has been placed on sub-section (4) of section 20 of the Finance Act, 1955, we would like to quote the same. The said sub-section reads as under:—

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“For the removal of doubts, it is hereby declared that the provisions of section 23-A of the Income-tax Act, as in force immediately before the 1st day of April, 1955, shall continue to apply to a company in respect of its profits and gains of a previous year relevant to any assessment year prior to the assessment year ending on the 31st day of March, 1956, and also to its shareholders referred to in sub-section (1) of section 23-A, as then in force in respect of their appropriate previous year, notwithstanding that the relevant assessment years in respect of such previous years end on or after the 31st day of March, 1956.”

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Our attention is next invited to the Finance (No. 2) Act of 1957, which *inter alia* substituted sub-sections (1) and (2) of section 23-A, for the then existing sub-sections (1) and (2), with effect from 1st of April, 1957. There were a number of changes brought about by the amendment in 1957, but so far as the shareholders are concerned the position continued to be the same as under section 23-A, after its amendment by the Finance Act of 1955. In short the amendment in 1955 had done away with the liability of the shareholders to pay tax on notional dividend and imposed a super-tax on the companies on the undistributed balance of the total income of the previous year. Even after the 1957 amendment the company remained liable in case of short distribution to pay super-tax and no liability was imposed on the shareholders. By section 11, different dates were set out for the commencement of different amendments to the Indian Income-tax Act, 1922. The amendment in section 23-A was made by section 7 of the Finance (No. 2) Act of 1957 and, therefore, by virtue of section 11 sub-section (2), it came into force from the 1st of April, 1957. Since the principal argument of the learned counsel under this head is based on the construction of section 11(4) of the 1957 Act, it would be appropriate to reproduce the same—

“For the removal of doubts, it is hereby declared that the provisions of section 23-A of the Income-tax Act, as in force immediately before the 1st day of April, 1957, shall continue to apply to a company in respect of its profits and gains of a previous year relevant to any assessment year prior to the assessment year ending on the 31st day of March, 1957.”

The argument of the learned counsel is that on the true construction of section 11(4) it should be held that for all previous years relevant to assessment years prior to the assessment year ending on 31st day of March, 1957, section 23-A, as in force immediately before the 1st of April, 1957, was applicable. Consequently, according to the learned counsel, by virtue of the said provision even for the assessment year 1954-55, section 23-A, to be applied would be as it was in force immediately before the 1st of April, 1957, and not as in force before its amendment by

Finance Act, 1955. The learned counsel would, therefore, like us to hold that it is Govan Agencies Private Ltd., who could be liable to pay super-tax by reason of short distribution, but not the shareholders. We must frankly confess that we were not totally unmoved by the argument of the learned counsel which appeared attractive at first sight. On a closer scrutiny, however, we find that there is no force in this contention. The Finance (No. 2) Act of 1957 amended only sub-sections (1) and (2) of section 23-A, as they stood immediately before this said amendment. So far as the shareholders are concerned, their liability to pay additional tax had already come to an end from the date, the amendment in section 23-A, came into force by the Finance Act of 1955. By 1957 amendment the legislature was only altering certain rights and obligations of the companies and were not concerned with any obligations of the shareholders. It was for this reason that sub-section (4) of section 11 provided that the provisions of section 23-A of the Income-tax Act, as in force immediately before the 1st of April, 1957, shall continue to apply to a company in respect of its profits and gains of a previous year relevant to any assessment year prior to the assessment year ending on 31st day of March, 1957. So far as the obligations of the shareholders are concerned they had already been settled by sub-section (4) of section 20 of the Finance Act of 1955. Having already provided that the provisions of section 23-A, as in force immediately before the 1st of April, 1955 shall continue to apply to its shareholders referred to in sub-section (1) of section 23-A in respect of their appropriate previous years, no such provision was necessary in the 1957, Act which brought about certain changes regarding the liability of companies. In short sub-section (4) of section 11 of 1957 Act did not at all deal with the existing rights and obligations of shareholders. It may also be noticed that the section in terms provided that the provisions of section 23-A, as in force on a particular day "shall continue to apply". The term "continue" signifies that something which was applicable is continued. In this view we cannot agree with the learned counsel for the appellant that the liability of the shareholders was completely wiped out retrospectively by section 11 of the Finance (No. 2) Act of 1957.

The second contention of the learned counsel has also no force. It is conceded that the company was being taxed

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in this year as well as in earlier years on dividend income and it was filing returns adopting the period ending December 31, as the previous year. The effect of section 23-A was that by reason of the fiction created thereby the undistributed portion of the assessable income of the company was deemed to have been distributed as dividend amongst the shareholders. By reason of this fiction the deemed dividend had to be added to the dividend income of the assessee company. Consequently the previous year opted for that source of income, namely, dividend income would also be the previous year, for the purposes of deemed dividend.

We are also unable to agree with the third contention of the learned counsel for the assessee company. Reference to section 2(6C) clearly shows that dividend is included within the term "income". As we have said earlier section 23-A, fictionally included an amount, though not distributed amongst the shareholders, in the category of the term income. If we are bidden to treat any imaginary state of affairs as real, we must also imagine as real the consequences which inevitably flow from it. By the creation of the fiction under section 23-A, the inevitable consequence that flows is that it becomes a dividend and would, therefore, fall under the definition of the term 'income' as given in section 2(6C). In the circumstances, we do not feel called upon to decide the question of the scope of third proviso to sub-section (1) of section 30.

In the result, the question must be answered against the assessee company and in the affirmative. There will, however, be no order as to costs.

Mahajan, J.

D. K. MAHAJAN, J.—I agree.

B.R.T.

FULL BENCH

Before D. Falshaw, C. J., D. K. Mahajan and S. K. Kapur, JJ.

UNION OF INDIA AND OTHERS,—*Petitioners*

versus

MESSRS CALTEX (INDIA) LIMITED,—*Respondent.*

Civil Reference No. 5-D of 1964.

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March 22nd

Indian Stamp Act (II of 1899)—Schedule I Article 35(a)(iii) and 35(c)—Lease for five years, monthly rent being Rs. 700, providing for payment of 3 years' rent in advance—Stamp payable—Whether under Article 35(a) (iii) or 35(c).