INCOME-TAX REFERENCE

Before Mr. M. C. Chagla, Chief Justice and Mr. Justice Tendolkar.

1951
Sept. 10

S C. CAMBATTA & CO. LTD., APPLICANTS *v.* THE COMMISSIONER OF INCOME-TAX, BOMBAY CITY, RESPONDENT.*

Indian Income-tax Act (XI of 1922), s. 23A—Private Company in which public are not "substantially interested"—Such Company required by law to distribute 60 per cent of its assessable income as dividends—Whether bonus shares issued to members to the extent of more than 60 per cent of the undistributed profits of the Company were "a distribution" within the meaning of the second proviso to s. 23 (A) (1) of the Act.

An assessee company—a company in which the public were not substantially interested within the meaning of the third proviso to s. 23A of the Income-tax Act—did not sanction distribution of the profits at the annual general meetings which passed accounts for the years 1939 to 1942. At an extra-ordinary general meeting held on 31st March 1944 the company resolved to issue bonus shares to the extent of one lakh of rupees out of the undistributed profits of the company for the years 1939, 1940, 1941 and 1942 which amounted in all Rs. 1,61,569/-. The profits so distributed amounted thus to more than 60 per cent of the undistributed profits. On June 12, 1945, the Income-tax Officer intimated to the company that as it had not distributed as dividends 60 per cent of the assessable income of the company as required by s. 23A he proposed to take action under that section. Eventually the Income-tax Officer passed orders under s. 23A (*1*) in respect of the accounting years 1941 and 1942. The assessee company having challenged the orders the Tribunal held that the issue of bonus shares by the assessee company was not a distribution of profits as dividends as required by s. 23A (*1*) of the Income-tax Act. The assessee company applied for reference to the High Court.

The assessee company contended that the distribution of bonus shares was a distribution within the meaning of the second proviso to sub-s. (*1*) and no order could be made under s. 23A (*1*). The second proviso to sub-s. (*1*) of s. 23A lays down that no order under sub-s. (*1*) shall be made when the company has distributed not less than 55 per cent of the assessable income of the company.

Held, on construction that the distribution contemplated by the proviso is the same as the distribution in the sub-section itself, that is to say, distribution of profits as dividends.

In a fiscal statute the Court should not permit a wider or a more extensive obligation to be cast upon the citizen than the clear language of the fiscal statute lays down and the Court should be anxious to see that the State clearly establishes that an imposition of tax or an obligation falls within the language of the fiscal statute; if the liability to tax or obligation cannot be clearly brought within the purview or ambit of

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any particular section of the statute then the State must fail and the Court must decide in favour of the citizen. The Court never deviates from these well-known and well recognised principles, but at the same time it is the duty of the Courts to see what the Legislature is aiming at by enacting a particular statute. A proviso is not an independent section which calls for a construction entirely removed and detached from the construction placed on s. 23A (*1*). A proviso is subsidiary to the main section and is to be construed in the light of the section itself. The object of a proviso is to carve out from the main section a class or category to which the main section does not apply; but in carving out from the main section one has to bear in mind the particular class referred to in the main section and the carving out intended by the proviso is from such particular class and none other.

Held, the words "any such order" in the proviso to s. 23A means an order contemplated by s. 23A itself.

Held, therefore, that as there was no distribution of profits as dividends to the extent of 60 per cent of its assessable income, the order made by the Income-tax Officer was a valid order.

For the calendar years 1939, 1940, 1941, and 1942, the profits assessed to tax of the assessee company came to Rs. 31,244, Rs. 28,315, Rs. 18,457 and Rs. 2,65,267 respectively. No distribution of the profits was sanctioned by the shareholders at the annual general meeting which passed the accounts of the four years 1939, 1940, 1941 and 1942.

On March 31, 1944, a resolution was passed by the shareholders at an extra-ordinary general meeting sanctioning the distribution of Rs. 1 lakh amongst the shareholders in the shape of bonus shares.

The Tribunal held that the issue of the bonus shares by the assessee company was not a distribution of profits as dividends as required by s. 23A (*1*) of the Income-tax Act.

The assessee applied for reference to the High Court. The questions of law referred were:

(1) Whether* the issue of bonus shares by the assessee company is distribution of profits as dividends as required by s. 23A (*1*) of the Indian Income-tax Act?

(2) If the answer to the first question is in the affirmative, whether any distribution of profits after six months of the annual meeting dated October 14, 1942, could be a legal bar to the passing of an order under s. 23A (*1*) of the Act?

The Reference was heard.

R. J. Kolah with *N. A. Palkhiwalla,* for the applicants.

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*The first question was re-framed by the High Court as under:—
"Whether the issue of bonus shares by the assessee company was a distribution within the meaning of the second proviso to s. 23A (*1*)."

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G. N. Joshi with *C. K. Daphtary*, Solicitor-General, for the respondent.

CHAGLA C. J. The assessee company is a company in which the public are not "substantially interested" within the meaning of the third proviso to s. 23A of the Indian Income-tax Act. It appears that with regard to the assessment year 1942-43 (accounting year 1941) and the assessment year 1943-44 (accounting year 1942) general meetings were held on October 14, 1942, for passing the accounts of the year 1941, and on October 11, 1943, with regard to the accounts of the year 1942. On March 31, 1944, at an extraordinary general meeting of the company it was resolved that bonus shares to the extent of one lakh of rupees should be issued to the members out of the undistributed profits of the company. Now it is not disputed that this sum of one lakh of rupees represents more than 60 per cent of the undistributed profits of the company for the years, 1939, 1940, 1941 and 1942, which undistributed profits aggregated in all to Rs. 1,61,569. On June 12, 1945, the Income-tax Officer wrote to the company pointing out that the company had not distributed as dividends 60 per cent of the assessable income of the company as required by s. 23A and he intimated to the company that he proposed to take action under that section. The company replied to this letter, but ultimately the Income-tax Officer passed orders under s. 23A (*1*) in respect of accounting years 1941 and 1942 on February 28, 1948, and on August 30, 1948, respectively. These orders are the orders that are being challenged by the assessee company.

Now in order to understand the nature of the challenge it is necessary to appreciate the scheme of s. 23A of the Act. The object of the Legislature is clear from this section, and it is the object of the Legislature that every company in the nature of a private limited company in which the public are not substantially interested should disribute as dividends its assessable income to the extent of 60 per cent., and this distribution must take place within six months of the meeting before which the accounts of the previous years were laid. If this is not done, then power is given to the income-tax authorities to declare that the whole of the assessable income of the company had been distributed as dividends and on that basis the proportionate share of each shareholder in the dividends shall be included in the total income of the shareholder

for the purpose of assessing his income. Therefore, if the company distributes less than 60 per cent of the assessable income as dividends, then by a legal fiction the whole amount of its undistributed profits is deemed to have been distributed and the shareholders are taxed on the basis of that distribution. Now it must be borne in mind that the distribution of the assessable income of the company is to be by way of dividends. "Dividend" is defined as any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company, or, a distribution which may not entail such release. Therefore, a company may distribute its profits by bonus shares, in which case a shareholder is entitled to a share in the increased capital of the company. By that method the company capitalises its profits, and to the extent that capital is increased it issues bonus shares and distributes them amongst its shareholders. Such a distribution does not entail a release of any of the company's assets because the assets which were represented by the accumulated profits continue to remain as part of the company's assets, the only difference being that instead of the assets being profits they are capitalised and become part of the capital of the company. But when the company distributes its profits by declaring dividends to its shareholders which dividends are made payable by the company, then undoubtedly when the dividends are paid the company releases part of its assets. This distinction is clear and well-settled.

Now it is clear that what s. 23A (*1*) contemplates is a distribution by the company of its assessable income, reduced as laid down in that section, by means of dividends. In other words an obligation is cast on the company which comes within the purview of this sub-clause to release its assets to the extent at least of 60 per cent. of its assessable income by declaring dividends in favour of the shareholders. The object of doing this is clear. The company pays income-tax and super-tax on its profits. But the Legislature wants to aim at the tax which the shareholder is liable to pay when he has got to show dividends received by him in his own assessment. This aim of the Legislature is carried out by insisting upon dividends being paid to the shareholders to the extent of 60 per cent. The penalty imposed in default is that the whole of its assessable income may be declared as having been distributed as dividends and the shareholders would be liable to have

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their proportionate share of the dividends included in their own assessment and a vicarious liability is cast upon the company under s. 23A (*3*) (*ii*) by which the tax payable in respect of the dividend declared under the penal provision of s. 23A (*1*) can be recovered from the company if it cannot be recovered from the shareholder himself.

Now there is no dispute here that as far as s. 23A is concerned the company failed to discharge the obligation cast upon it by that sub-section. No profits were distributed as dividends by the company at all, and therefore the order made by the Income-tax Officer under s. 23A was a perfectly proper and competent order. But what is relied upon by the assessee company is, not the section but the second proviso to sub-s. (*1*) which lays down that

> "no order under the sub-section shall be made where the company has distributed not less than fifty five per cent. of the assessable income of the company...unless the company, on receipt of a notice from the Income-tax Officer that he proposes to make such an order, fails to make within three months of the receipt of such notice a further distribution of its profits....so that the total distribution made is not less than sixty per cent., of the assessable income of the company of the previous year concerned."

The contention of Mr. Palkhiwalla is that what is required by the proviso is a distribution of not less than 55 per cent of the assessable income, and the further contention is that this distribution is in no way conditioned by the limit of time laid down in s. 23A (*1*). Therefore, according to him if a company distributes (not necessarily as dividends, but merely distributes) not less than 55 per cent of its assessable income and if such distribution takes place any time before the order under s. 23A is made, then the proviso is satisfied and there is an obligation upon the Income-tax Officer to serve the company with a notice which would enable it to raise its distribution from 55 per cent to 60 per cent in which case no order under s. 23A can be made. Mr. Palkhiwalla's contention is that in this case by giving bonus shares to the extent of one lac of rupees at the extra-ordinary general meeting on March 31, 1944, the assessee has distributed more than 60 per cent of its assessable income and therefore the proviso is attracted and no order can be made under s. 23A (*1*). Now, the whole of this argument is rendered possible by the unfortunate omission on the part of the Legislature to use the same expression in the proviso which it has used in the sub-section. In the sub-section the Legislature has clearly indicated

that the distribution must be as "dividends", but in the proviso the distribution referred to is not "as dividends" and and that makes it possible for Mr. Palkhiwalla to contend that whereas in the main section distribution must necessarily be as dividends, when we come to the proviso "any" distribution of the assessable income is permissible provided it is not less than 60 per cent, so that even if the assessable income is distributed by means of issue of bonus shares, the proviso is satisfied. Now Mr. Palkhiwalla is right in saying that in a fiscal statute the Court should not permit a wider or a more extensive obligation to be cast upon the subject than the clear language of the fiscal statute lays down. He is also right in saying that the Court should be anxious to see that the State clearly establishes that any imposition of tax or any obligation falls clearly within the language of the fiscal statute. If liability to tax or any obligation cannot be clearly brought within the purview or ambit of any particular section of the statute, then the State must fail and the Court must decide in favour of the subject. These are indeed well-known and well-recognised principles and the Courts never deviate from these principles. But it is equally the duty of the Courts to see what is the Legislature aiming at by enacting a particular statute. Fortunately in this case there is no doubt or ambiguity, the benefit of which can be given to the subject, as far as s. 23A (*1*) is concerned. As I have pointed out before, the scheme is clear, the obligation is categorical, and the penalty in case of default certain. The proviso on which reliance is placed is not an independent section which calls for a construction entirely removed and detached from the construction that we have placed on s. 23A (*1*). If the proviso were an independent section by itself, then undoubtedly the loose expression used in it would have called for a proper construction and interpretation from us. But it must not be forgotten that a proviso is subsidiary to the main section and it must be construed in the light of the section itself. The object of the proviso, as it has so often been stated, is to carve out from the main section a class or category to which the main section does not apply. But in carving out from the main section one must always bear in mind what is the class referred to in the main section and must also remember that the carving out intended by the proviso is from the particular class dealt with by the main section and from no other class. Therefore, the main topic with which the section deals is the topic with

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regard to the distribution as dividends of the 60 per cent of the assessable income of the company. To my mind it is inarguable that the proviso can possibly deal with an entirely different topic or subject matter; because, if we were to give the interpretation to the proviso for which Mr. Palkhiwalla contends, the proviso would be dealing with the distribution of the assessable income not as dividends but distribution otherwise than as dividends. It is clear that taking the section and the proviso together the object is to give a sort of *locus penitentiae* to the assessee when he has failed to declare not less than 55 per cent of the assessable income as dividends. That failure is trifling inasmuch as the obligation upon him is to declare 60 per cent. In order to avoid the serious penalty of the whole of 100 per cent of the assessable income being declared as dividends the law permits the company within a period laid down in the proviso to make up the difference between the 60 and 55 per cent by increasing the distribution as dividends to 60 per cent. This construction and this object is further clarified by reason of the fact that the proviso lays down that the Income-tax Officer has to give a notice to the company that he proposes to make such an order in cases where the distribution is not less than 55 per cent "Any such order" can only be an order contemplated by s. 23A. Therefore, when the Income-tax Officer is satisfied that the obligation cast upon the company under s. 23A has not been discharged he is bound to make the order. But when he finds that the distribution although not in accordance with s. 23A (*1*) is not less than 55 per cent of the assessable income, he is compelled by law to issue a notice to the company to give the company an opportunity to make up the difference between 60 per cent and 55 per cent. In my opinion it is impossible to accept the contention that in the proviso the expression "distribution" has been used otherwise than distribution as dividends as used in the sub-section. If we were to give that interpretation to the expression "distribution" in the proviso, it would wholly stultify the object of the Legislature as laid down in s. 23A (*1*) because by means of the proviso a private company would be doing exactly what s. 23A (*1*) says it cannot do. By resorting to the proviso it may fail to distribute as dividends any profits and capitalise all its profits, whereas the section itself says that it must distribute as dividends at least 60 per cent of the assessable income. I do not think that we are called upon to give this startling interpretation to the proviso merely

because the Legislature has not repeated in the proviso "distributed as dividends" though this expression is used in the sub-section itself. I again say that the position might have been very different if the proviso had taken the shape of an independent section, but inasmuch as it has not, but is subsidiary to the main section, one cannot overlook the main section, and when one looks at the main section, one cannot overlook the object of the Legislature in enacting this sub-section. Besides we have to construe this proviso also in the light of sub-s. (*4*) of s. 23A, which provides that where tax has been paid in respect of any undistributed profits and gains of a company under s. 23A, and such profits and gains are subsequently distributed in any year, the proportionate share therein of any member of the company shall be excluded in computing his total income of that year. Now the use of the expression "distributed" in this sub-section makes it clear that whenever the Legislature has used "distributed" with reference to assessable profits or gains of the company in s. 23A, it has always used it in the sense of "distributed as dividends." Therefore, the whole of s. 23A deals with distribution of the assessable income or profit or gains of a company which comes within the ambit of s. 23A as dividends and not any other sense. If that be the true interpretation of the proviso, then it is clear that the assessee company did not distribute as dividends, any amount not less than 55 per cent of its assessable income and therefore it cannot come within the ambit of the proviso.

It is unnecessary to decide the other question which has been raised before us viz., whether assuming that distribution had taken place as contemplated by the proviso whether that distribution had to be within the period laid down in s. 23A (*1*). As there is no distribution at all as contemplated by the proviso in the case before us the question whether it was made within time does not arise.

Now the question raised by the Tribunal for our decision really does not properly arise on the statement of the case. The question is:

> "Whether the issue of bonus shares by the assessee company is distribution of profits as dividends as required by s. 23A (*1*) of the Indian Income-tax Act?"

Now this question really answers itself and there is no dispute either between the Commissioner and the assessee that the issue of bonus shares can never be regarded as distribution

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as dividends as required by s. 23A (1). The real question that arises is:

"Whether the issue of bonus shares by the assessee company was 'distribution' within the meaning of the second proviso to s. 23A?"

We, therefore, reframe the question accordingly and having reframed it answer the question in the negative. The second question which relates to the distribution of profits after six months after the annual meeting of the company dated October 14, 1942, does not arise in view of what we have stated in our judgment. Assessee to pay the costs of the reference. No order on the notice of motion; no order as to the costs of the notice of motion.

Attorneys for applicants: *Gagrat & Co.*

Attorney for respondent: *N. K. Petigara.*

Answer accordingly.

A. J. P.

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CALTEX (INDIA), LTD., APPLICANT *v.* THE COMMISSIONER OF INCOME-TAX, BOMBAY CITY, RESPONDENT.*

Indian Income-tax Act (XI of 1922), ss. 4 (1) (c), 42 and 43—Liability of a foreigner and non-resident to pay tax—Territorial connection between the taxing country and the person taxed—Dividends received by a foreign non-resident company out of profits made in India—Government of India Act, 1935, Sch. VII, List I, Entry 54—Explanation 3 to s. 4 (1) (c) of the Income-tax Act intra-vires.

The assessee company—a company incorporated in the Bahama Islands—dealt with petroleum products which were sold in India. Another company called the California Texas Oil Co. Ltd.,—also incorporated in the Bahama Islands—held all the shares of the assessee company. The assessee company having made profits declared dividends which were paid to the California Texas Oil Co. Ltd. The dividends were assessed to tax, the assessment not being against the non-resident company but against the assessee company which was declared the statutory agents of the California Texas Oil Co. Ltd. under s. 43 of the Act.

The Income-tax Authority taxed the California Texas Oil Co. Ltd. in respect of dividends received by them under s. 4 (1) (c) on the ground

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* Income-tax Reference No. 32 of 1951.