Commissioner of Income-Tax, Bombay City I

Vs

Khatau Makanji Spinning and Weaving Co. Ltd.

Civil Appeal No. 303 of 1958

(S. K. Das, J. L. Kapur, M. Hidayatullah JJ)

04.05.1960

JUDGMENT

HIDAYATULLAH, J. –

This is an appeal against the judgment and order of the High Court of Bombay dated August 3, 1956, in a reference under section 66(1) of the Indian Income-tax Act by the Appellate Tribunal, Bombay. The Tribunal referred four questions for the decision of the High Court. The High Court did not answer the first question because it was not pressed, and answered the remaining in the negative, after modifying them. It has certified this case as fit for appeal to this court, and hence this appeal. The Commissioner of Income-tax, Bombay City, is the appellant, and the Khatau Makanji Spinning and Weaving Co. Ltd., Bombay (the assessee company) is the respondent.

The assessee company has its year of account ending June 30 every year. At the close of the account year 1951, it carried forward profits amounting to Rs. 30,680. In that year, it appears it had earned a rebate by declaring dividends below the limit fixed by the Finance Act. For the account year 1952 its book profits were Rs. 28,67,235 less allowances for depreciation and tax. After these and other sundry adjustments, the balance available for distribution was Rs. 5,02,915. It may be pointed out that the Income-tax Officer on processing the income found the total income to be Rs. 5,26,681. For the account year 1952, the assessee company declared dividends amounting to Rs. 4,78,950, and carried forward the balance of Rs. 23,965.

We are concerned with the assessment year 1953-54, and the Finance Act, 1953, is applicable. The Finance Act applied the Finance Act, 1951, with some changes. The Finance Act, 1951, with the modifications will be referred to briefly, hereinafter, as the Finance Act. The Income-tax Officer found that the assessee company had declared excess dividend amounting to Rs. 1,87,691. He calculated additional income- tax on it at 5 annas in the rupee after deducting income-tax borne by the profits of the previous year at 4 annas per rupee, a surcharge of 5 per cent. less rebate of one anna in the rupee as allowed by the Finance Act. This additional tax amounted to Rs. 21,115-4-0.

The appeals of the assessee company under the Income-tax Act failed. The Tribunal held that the excess dividends were deemed to be paid out of undistributed profits of the earlier year ending June 30, 1951, amounting to Rs. 6,60,720 on which a rebate of 1 anna in the rupee was given in the assessment year 1952-53. The Tribunal observed that additional income-tax was also a tax on income, and that the Finance Act could say that the tax would be payable on the income of any year preceding the previous year. The Tribunal, however, referred four questions to the High Court, of which the first need not be quoted because it was abandoned before the High Court. The other questions were :

"(ii) If the answer to question No. 1 is in the negative whether the said provisions to beyond the ambit and scope of the Indian Income-tax Act ?

(iii) Whether additional income-tax can be levied, assessed and recovered under the provisions of the Indian Income-tax Act ?

(iv) Whether at any rate the additional income-tax has been legally charged under the Indian Finance Act, 1953, read with the Indian Income-tax Act ?"

The High Court compressed the three questions into one, and it reads :

"Whether additional income-tax has been legally charged under clause (ii) of the proviso to paragraph B of Part I of the First Schedule to the Indian Finance Act, 1951, as applied to the assessment year 1953- 54 by the Indian Finance Act, 1953, read with section 3 of the Indian Income-tax Act ?"

This question was answered by the High Court in the negative.

In the opinion of the High court, section 3 of the Indian Income-tax Act lays down the liability to tax, and it puts the tax on the total income of the previous year. The method of computing this total income is also to be found in the Finance Act. The Finance Act merely provides the rate applicable to the income so found. According to the High Court, the Finance Act in providing that additional income-tax should be paid upon the accumulated profits of the previous years goes beyond the purpose for which the Central Act is passed every year, and cannot stand by itself without the support of section 3 of the Indian Income-tax Act. The High Court held that the Finance Act had "misfired", because it did not resort to legislation which would have conformed to the object for which the Finance Act was passed every year. The learned Chief Justice, who delivered the judgment of the High Court, stated that there were several methods open to the Legislature to achieve that purpose but that it had not resorted to any o

"The Legislature could have achieved this object by one of three methods. It could have treated the excess dividend declared by the company as a notional income and made it a part of the total income of the previous year. It could have provided for rectification of the assessment of the year in which these profits were charged at a lesser rate, and we now find that Parliament has actually provided for this in the Finance Act, 1956. Or, finally, it could have provided for a penalty imposed upon a company which transgressed the direction of Parliament that it should not pay dividend beyond a particular ceiling... The ambit of section 3 is clear and the ambit is that the tax to the levied must be a tax on income and the power of Parliament is equally clear and that is to fix the rate at which income-tax is to be charged upon the total income of the previous year of the assessee. In our opinion, the provision of the Finance Act travels beyond the ambit of section 3, and if Parliament has done so then no effective

It may be pointed out that before the High Court it was conceded that in order that the provisions of the Finance Act might be effective, the Finance Act had to come within the scope of section 3 of the Income-tax Act. The point that was argued here was that it was not necessary to look only to section 3 of the Indian Income-tax Act but also to the provisions of the Finance Act, through which Parliament could impose

a new tax, if it so pleased. Other arguments involved modifications of language suitable to sustain the tax independently of section 3 of the Indian Income-tax Act, a procedure which we do not think is open, for reasons which we have given in Civil Appeal No. 427 of 1957 decided today. These modifications, which were suggested, involve a recasting of the entire relevant paragraph of the Finance Act to made it independent of section 3 of the Indian Income-tax Act, a course which is only open to a Legislature and not to a court. We need not give all the modifications suggested, because, in our opin

The learned Chief Justice, with respect, very rightly pointed out that the Income-tax Act puts the tax on income or something which it deems to be income. In other words, the tax deals with income and income only. It further provides that this tax shall be collected at a particular rate on the total income for which provision shall be made in an yearly Central Act. The Finance Act also follows the same scheme, and lays down the rate at which the tax is to be collected. In the Finance Act, the tax is laid on the total income, but two provisos modify the rate under certain circumstances. We may at this stage read the relevant provision (Part I, First Schedule) :

"B. In the case of every company -

Rate SurchargeOn the whole of total income Four annas One-twentieth of in the rupee the rate specified in the preceding column :##

Provided that in the case of a company which, in respect of its profits liable to tax under the Income-tax Act for the year ending on the 31st day of March, 1954, has made the prescribed arrangements for the declaration and payment within the territory of Indian excluding the State of Jammu and Kashmir, of the dividends payable out of such profits, and had deducted super-tax from the dividends in accordance with the provisions of sub-section (3D) or (3E) of section 18 of that Act -

(i) where the total income, as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, exceeds the amount of any dividends (including dividends payable at a fixed rate) declared in respect of the whole or part of the previous year for the assessment for the year ending on the 31st day of March, 1954, and no order has been made under sub-section (1) of section 23A of the Income-tax Act, a rebate shall be allowed, at the rate of one anna per rupee on the amount of such excess;

(ii) where the amount of dividends referred to in clause (i) above exceeds the total income as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, there shall be charged on the total income an additional income-tax equal to the sum, if any, by which the aggregate amount of income-tax actually borne by such excess (hereinafter referred to as 'excess dividend') falls short of the amount calculated at the rate of five annas per rupee on the excess dividend...

For the purposes of clause (ii) of the above proviso, the aggregate amount of income-tax actually borne by the excess dividend shall be determined as follows :-

(i) the excess dividend shall be deemed to be out of the whole or such portion of the undistributed profits of one or more years immediately preceding the previous year as would be just sufficient to cover the amount of the excess dividend and as have not likewise been taken into account to cover an excess dividend of a preceding year;

(ii) such portion of the excess dividend as is deemed to be out of the undistributed profits of each of the said years shall be deemed to have borne tax, -

(a) if an order has been made under sub-section (1) of section 23A of the Income-tax Act, in respect of the undistributed profits of that year, at the rate of five annas in the rupee, and

(b) in respect of any other year, at the rate applicable to the total income of the company, for that year reduced by the rate at which rebate, if any, was allowed on the undistributed profits."

By the first proviso, a rebate of one anna per rupee is given to a company which pays dividends less than 9 annas in the rupee out of its profits. By the second proviso, the rebate disappears, and an additional income-tax has to be paid on dividends in excess of that limit, paid in the year. The explanation says that "the excess dividend shall be deemed to be out of the whole or such portion of the undistributed profits of one or more years immediately preceding the previous year as would be just sufficient to cover the amount of the excess dividend and as have not likewise been taken into account to cover an excess dividend of a preceding year". This fiction, as we have already pointed out, provides only that the dividends shall be deemed to be out of the profits not of the previous year under assessment but of some other years. What the Finance Act fails to do is to make them "total income", so as to take in the rate which is prescribed for the total income in the proviso. Unless the Finance Act stated tha

For these reasons, we are of opinion that the High Court was right in answering the question which it had framed, in the negative.

In the result, the appeal fails, and is dismissed with costs.

Appeal dismissed.

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