Sardar Baldev Singh

Vs

Commissioner of Income Tax, Delhi and Ajmer

Civil Appeal No. 371 of 1955,

(CJI B.P. Sinha, Syed Jafar Imam, A.K. Sarkar, K. Subha Rao, J.C. Shah JJ)

02.09.1960

JUDGMENT

SARKAR, J. -

In 1944, the appellant was a resident of Lahore. On October 14, 1944, he was assessed to income-tax by the Income-tax Officer, Lahore, for the assessment year 1944-45 on an income of Rs. 49,047. As is well-known, in August, 1947, India was partitioned and Lahore came to be included in the newly created Dominion of Pakistan and went out of India. After the partition, the appellant shifted to Delhi and was residing there at all material times.

The appellant held shares in a company called Indra Singh and Sons Ltd. which had its office at Calcutta. The other shares in that company were held by Indra Singh and Ajaib Singh. The holdings of all the shareholders were equal. An annual general meeting of this company was held on April 17, 1943, in which the accounts for the year ending March 31, 1942, were placed for consideration. The accounts were passed at the meeting but no dividend was declared though the accounts disclosed large profits.

On June 11, 1947, an Income-tax Officer of Calcutta passed an order under section 23A of the Income-tax Act that Rs. 14,23,110 being the undistributed portion of the assessable income of the company for the year ending March 31, 1942, after the deductions provided in the section, be deemed to have been distributed as dividend among the three shareholders on the date of the general meeting, that is, April 17, 1943. As a result of this order a sum of Rs. 4,74,370 being his share of the amount directed to be distributed, had, under the section to be included in the income of the appellant for the assessment year 1944-45. The validity of this order was never challenged.

The Income-tax Officer, Calcutta, informed the Income-tax Officer, Delhi, of the order made by him under section 23A. Thereupon the Income-tax Officer, Delhi, on April 10, 1948, issued a notice under section 34 of the Act to the appellant then residing in Delhi, requiring him to file within thirty-five days a revised return for the year 1944-45 as a part of his income for that year had escaped assessment. Obviously the notice was on the basis that the said sum of Rs. 4,74,370 had escaped assessment for the year 1944-45. On February 10.1949, the appellant submitted a revised return under protest and included in it the said sum of Rs. 474,370. The Income-tax Officer, Delhi, then reopened the earlier assessment and on March 25,1949, made a fresh assessment order for 1944-45 assessing the appellant on an income of Rs. 5,23,417. The appellant appealed against this order to the Appellate Assistant Commissioner but his appeal was dismissed. He then appealed to the Income-tax Appellate Tribunal but was again unsucce

A preliminary point as to the maintainability of this appeal was taken by the learned Solicitor-General appearing on behalf of the respondent Commissioner of Income-tax, that the appellant having been unsuccessful in availing himself of the other remedy provided in the Act should not be allowed the extraordinary remedy of approaching this court with special leave. Now, under the Income-tax Act, the Appellant could apply to the Tribunal to refer to a High court any question of law that arose out of the former's decision. The Act itself gave no right of appeal at all from that decision, nor any other remedy against it. The appellant had applied to the Tribunal for an order referring certain questions arising out of its decision to the High court at Calcutta but was unsuccessful in getting an order for reasons to be presently stated. The Tribunal was in Calcutta. The appellant who was in Delhi, asked a firm of income-tax practitioner named S. K. Sawday & Co. in Calcutta, to move the Tribunal for an order of ref

The main question in this appeal is whether the proceedings taken against the appellant under section 34 of the Act were valid. That section has been amended but we are concerned with it as it stood on April 10, 1948, when the notice under it was issued.

The first point is that the proceedings under section 34 could not be taken by the Income-tax Officer, Delhi. It is said that the proceedings under that section are only a continuation of the original assessment proceedings, and, therefore, it is the officer who made the original assessment order or his successor in office, who alone could start the fresh proceedings. It is hence contended that it is the Income-tax Officer, Lahore, who could proceed against the Appellant under section 34 and the Income-tax Officer, Delhi, had no jurisdiction to do so. The contention then comes to this that, in the circumstances of this case, no proceedings under section 34 could be taken against the appellant in India at all.

The learned Solicitor-General said that this was an objection as to the place of assessment under section 64 of the Act, and could not be entertained as it had not been taken within the time provided under the second proviso to sub-section (3) of that section. If that proviso applied to the present case, the appellant had to raise the objection that proceedings under section 34 could not be taken at Delhi within the thirty-five days mentioned in the notice under the section,. It is said that this had not been done. It seems to us, however, that the proviso would apply only if an objection to a place of assessment had been taken under section 64 and the objection that the appellant has taken in this case is not one under that section. That section applied where the assessment can be made in one place or another in India and an objection is taken to one of such places. Here the contention is that the assessment under section 34 can be made only in Lahore and, therefore, cannot be made in India at all. To such

We are, however, of the opinion that the contention of the appellant is without foundation. Section 34 provides that in the cases mentioned in it, the income may be assessed or reassessed and the provisions of the Act shall, so far as may be, apply accordingly as if the notice issued under the section had been issued under section 22(2) of the Act. Now the place where an assessment is to be made pursuant to a notice under section 22(2) has to be determined under section 64. Indeed that is the only provision in the Act for deciding the proper place for any assessment. There is nothing which makes section 64 inapplicable to an assessment made under section 34. Therefore, it seems to us clear, that the place where an assessment under section 34 can be made has to be decided under section 64. Now the appellant was not carrying on any business, profession or vocation. He was working as the Defence Minister of the Government of India and residing in Delhi. He could be properly assessed by the Income-tax Officer, D

We find nothing in the two cases cited by Mr. Sastri, who appeared for the appellant, to support the contention that in this case the assessment under section 34 could not have been made in India at all. In neither of these cases any question as to the place of assessment under section 34 or any other section arose. In the first, Govindarajulu v. Commissioner of Income-tax, it was held that the proceedings under section 34 and the original assessment proceedings were not separate and, therefore, in the former, a penalty could be levied under section 28 for failure to submit a return pursuant to a general notice under section 22(1) on which the latter were deemed to have commenced. It does not follow that because the two assessments are not separate for certain purposes, the latter must take place only where the first had been made. In the second, Lakshminarain Bhadani v. Commissioner of Income-tax, this court held that a proceedings under section 34 may be taken against a karta of a Hindu undivided family to

Then it is said that the Income-tax Officer reassessed the appellant's income under section 34 on the basis that part of it, namely, the dividend that became liable to be included in the appellant's income under section 23A, had escaped assessment. It is contended that on a proper reading of section 34 this would not be a case of income escaping assessment because that section applies to income actually escaping assessment and not to income deemed to have escaped assessment which is all that has happened in the present case. It is said that in order that income may escape assessment there must in fact have been an income. It is also said that in order to apply section 34 to this case two fictions have to be resorted to, namely, (a) bringing an income into existence where none existed and (b) holding that income has escaped assessment where to income actually did so. It is argued that the language of section 34 does not permit two fictions being created, and that as the section reopens a closed transaction, i

Reliance was placed on certain decisions in support of this contention. First, we were referred to two English cases, namely, Dodworth v. Dale and Rankine v. Commissioners Inland Revenue. These cases do not assist the appellant for they were not concerned with a statutory provision like section 23A on which the present case turns and which requires that an assessee would be deemed to have received a certain income on a specified date in the past and also requires that income to be included in his total income for assessment to tax. The other case to which we were referred was the decision of this court in Chatturam Horilram Ltd. v. Commissioner of Income-tax, where it was said that the contention "that the escapement from assessment is not to be equated to non-assessment simpliciter, is not without force." This court, however, in the very next sentence proceeded to state clearly that "it is unnecessary to lay down what exactly constitutes 'escapement from assessment'." The actual decision in this case afford

On its own merits also we are unable to accept the arguments of the learned counsel for the appellant. Section 23A requires that on an order being made under it, the undistributed portion of the assessable income of the company for a year as computed for income-tax purposes and after the deductions provided in the section, is to be "deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting", being the meeting at which the accounts for the year concerned were passed, and "thereupon, the proportionate share thereof of each shareholder shall be included in the total income." The section creates a fictional income arising as on a specified date in the past and it does so for the purpose of that income being included in the income of the shareholder for assessment of their income-tax. The income must, therefor, be deemed to have been in existence on the date mentioned for the purpose of assessment to tax. It is as if it actually existed then. Now if the assessment

It is said that section 23A was meant to apply only to cases where pending assessment for any year,

an order is made under that section creating a fictional income in that year. We see no reason, however, so to restrict the operation of the section; the words in it to do not warrant such restriction. There is no limitation of time as to when an order under section 23A can be made. Therefore, it can be made at a time when the assessment of the income of the shareholder for the year concerned has been completed. There is no reason why that order should not be given effect to by proceedings duly taken under section 34.

We do not also agree that the rejections of the appellant's present argument will compel us to raise two fictions. There is only one fiction, namely, that raised by section 23A. That fiction having been raised, the income that has thereby to be deemed to exist must be held to have actually escaped assessment. We are unable to agree that in order to apply section 34 to an income deemed to exist under section 23A, we would have to read the former section to cover a case where income has to be deemed to have escaped assessment. If the income had come into existence, and not been assessed, it has escaped assessment; it is no a case where the income has to be deemed to have escaped assessment. In our view, therefore, the present contention of the appellant must fail and the income deemed to have been received by him by virtue of the order made under section 23A on June 11, 1947, must be held to have escaped assessment for the year 1944-45 and his income must, therefore, be liable to reassessment under section 34.

It is now necessary to refer to one of the reason on which the judgment of the Tribunal is based. It was there said that : "It was incumbent on the Income-tax Officer, Calcutta, passing the order under section 23A to have included the sum of Rs. 4,74,370 in the other assessed income of the assessee and to have recomputed the assessable income and the tax thereon." It was held that "the income-tax Officer, Delhi, went wrong in having recourse to the provisions of section 34 and making an assessment thereunder" but that this amounted to a mere irregularity not vitiating the assessment made under that section. In the end the Tribunal observed : "Anyhow, the Tribunal is empowered to substitute its own order for the that of the Income-tax Officer and acting under that power we assess the assessee under the provisions of section 23A(1) of the Indian Income-tax Act."

It seems to us that the Tribunal was wrong in the view that it took. The learned Solicitor-General conceded that this is so. We are unable to agree that an assessment could be made under section 23A. That section does not provide for any assessment being made. It only talks of the fictional income being included in the total income of the shareholders "for the purpose of assessing his total income". The assessment, therefore, has to be made under the other provisions of the Act including section 34, authorising assessments. In our view, the assessments in this case had been properly made by the Income-tax Officer, Delhi, under the provisions of section 34.

Lastly, it is said that section 23A is unconstitutional inasmuch as it was beyond the competence of the legislature that enacted it. This section has been redrafted and amended several times since it was first enacted in 1930. We are concerned with the section as it stood on June 11, 1947, when the order under it was made in this case. Sub- section (1) of the section in the form that it stood then - and that is the material portion of the section for our purposes - was enacted by Act VII of 1939. It is that sub-section which gave the power to make an order that the undistributed portion of the assessable income of the company shall be deemed to have been distributed as dividends and provided that thereupon the proportionate share thereof of each shareholder shall be included in his income for assessment. The enactment was by the Central Legislature which then derived its competence to legislate from the Government of India Act, 1935. There is no doubt, and neither is it disputed, that that sub-section had bee

Mr. Sastri says that in laws a company and its shareholders are different persons - a proposition which is indisputable - and, therefore, section 23A is incompetent as it purports to tax the shareholders on the income of the company in which they hold shares. He points out, and this again is not in dispute, that the section does not give a right to a shareholder on an order being made under it, to realise from the company the dividend, which by the order is to be deemed to have been paid to him. He says, and this also seems right, that the income remains the income of the company and a shareholder is taxed on a portion of it representing the dividend deemed to have been paid to him.

In spite of all this it seems to us that the legislation was not incompetent. Under entry 54 a law could, of course, be passed imposing a tax on a person on his own income. It is not disputed that under that entry a law could also be passed to prevent a person from evading the tax payable on his own income. As is well-known the legislative entries have to be read in a very wide manner and so as to include all subsidiary and ancillary matters. So entry 54 should be read not only as authorising the imposition of a tax but also as authorising an enactment which prevents the tax imposed being evaded. If it were not to be so read, then the admitted power to tax a person on his own income might often be made infructuous by ingenious contrivances. Experience has shown that attempts to evade the tax are often made.

Now it seems to us that section 23A was enacted for preventing such evasion of tax. The conditions of its applicability clearly lead to that conclusion. The first condition is that the company must have distributed as dividend less than sixty per cent. of its assessable income after deduction of income-tax and super-tax payable by it. The taxing authority must then be declared, would, in view of losses incurred in earlier years or the smallness of the profit made, be unreasonable. Lastly, the section does not apply to a company in which the public are substantially interested or a subsidiary company of a public company whose shares are held by the parent company or by the nominees thereof. The section provides by an explanation as follows :

> "For the purpose of this sub-section, a company shall be deemed to be a company in which the public are substantially interested if shares of the company (not being shares entitled to a fixed rate of dividend, whether with or without a further right to participate in profits) carrying not less than twenty-five per cent. of the voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by, the public (not including a company to which the provisions of this sub-section apply), and if any such shares have in the course of such previous year been the subject of dealing in any stock exchange in the taxable territories or are in fact freely transferable by the holders to other members of the public".

The section thus applies to a company in which at least 75 per cent. Of the voting power lines in the hands of persons other than the public, which can only mean, a groups of persons allied together in the same interest. The company would thus have to be one which is controlled by group. The group can do what it likes with the affairs of the company, of course, within the bounds of the companies Act. It lies solely in its hands to decide whether a dividend shall be declared or not. When, therefore, in spite of there being money reasonably available for the purpose, it decides not to declare a dividend it is clear that it does so because it does not want to take the dividend. Now it may not want to take the dividend if it wants to evade payment of tax thereon. Thus by not declaring the dividend the persons constituting the group in control could evade payment of super-tax, which, of course, is a form of income-tax. They would be able to evade the super-tax because super-tax is payable on the dividend in the h

In conceivable circumstances, the section may work hardship on members of the public who hold shares in which a company but that would not take the section outside the competence of the legislature. It would still be an enactment preventing evasion of tax. Considerations of hardship are irrelevant for deciding questions of legislative competence.

It is further quite clear that in the absence of a provision like section 23A it is possible so to manipulate the affairs of a company of this kind as to prevent the undistributed profits from ever being taxed and experience seems to have shown that this has often happened. The following passage from Simon's Income-tax, second edition, volume 3, page 341, fully illustrates the situation :

> "General speaking, surtax is charged only on individuals, not on companies or other bodies corporate. Various devices have been adopted from time to time to enable the individual to avoid surtax on his real total income or on a portion of it, and one method involved the formation of what is popularly called a 'one-man company'. The individual transferred his assets, in exchange for shares, to a limited company, specially registered for the purpose, which thereafter received the income from the assets concerned. The individual's total income for tax purposes was then limited to the amount of the dividends distributed to him as practically the only shareholder, which distribution was in his own control. The balance of the income, which was not so distributed, remained with the company to form, in effect, a fund of savings accumulated from income which had not immediately attracted surtax. Should the individual wish to avail himself of the use of any part of these savings he could effect this by borrowings from

The section prevents the evasion of tax by, among others, the means mentioned by Simon.

The learned Solicitor-General sought to support the competence of the legislature to enact the section also on another ground. He said that entry 54 permitted tax on income and contended that it authorised taxing of A on the income of B. He said that, where a shareholder was taxed on the income of the company, the two being considered separate legal entities, the tax was none the less on income though the burden of the tax was put on one to whom the income had not accrued or by whom it had not been received and so was within the scope of entry 54. In support of this contention he referred to Amina Umma v. Income-tax Officer, Janab Jameelamma v. Income-tax Officer, Nagapattinam and C. W. Spencer v. Income-tax Officer, Madras. As earlier stated, Mr. Sastri disputes the correctness of this contention. We do not consider it necessary to pronounce on this question or as to the correctness of the decision cited so far as they support it. In our view, the legislative competence to enact the section can be clearly u

The appeal, therefore, fails and it is dismissed with costs.

Appeal dismissed.

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