Bhor Industries Ltd and Others

Vs

Commissioner of Income-Tax, Bombay City I

Civil Appeals Nos. 158 to 164 of 1960

(J. L. Kapur, M. Hidayatullah, J. C. Shah JJ)

12.01.1961

JUDGMENT

HIDAYATULLAH, J. –

These seven appeals have been filed on a certificate granted by the High Court of Bombay against the judgment and order of the High Court dated October 8, 1958 in a case referred by the Income-tax appellate Tribunal, Bombay.

The first appellant is the Bhor Industries Ltd., a company incorporated in 1944 in the former Bhor State with its registered office also situated in the town of Bhor. It did the business of dyeing, printing and bleaching cloth, cloth proofing, etc., in Bhor State. The remaining five appellants are the shareholders of this company, which admittedly, was a private company limited by shares, at all materials times. We are concerned in these appeals with the account years of the company, 1946 and 1947. During these years, the income of the company was as follows :

Assessment year	Total Income accruing or arising in the State of Bhor.	World Indian income (sum of 2 & 3)
1	2	3 4
	Rs.	Rs. Rs.
1947-48	4,32,542	2,24,542 6,57,084
1948-49	4,32,709	3,47,416 7,80,125

The company held its general meeting to declare dividends, at Bhor on August 17, 1947, and August 19, 1948, respectively. For the account years 1946 and 1947 respectively, it declared a

dividend of Rs. 2,580 and Rs. 1,140.

Bhor State merged with the Province of Bombay by virtue of the States Merger (Governors Provinces) Order, 1949, which came into force on August 1, 1949. By the Taxation Laws (Extension to Merged States and Amendment) Act, 1949, which received the assests of the Governor- General on December 31,1949, the Indian Income-tax Act was extended to the merged States with effect from April 1, 1949. That Act also introduced section 60A in the Income-tax Act, by which power was given to the Central Government, if it considered necessary or expedient so to do, to avoid any hardship or anomaly or to remove any difficulty in the application of the Income-tax Act to merged States, to make a general or special order granting exemption, reduction in rate or other modification. Under the power thus conferred, the Central Government notified the Merged States (Taxation Concessions) Order, 1949.

For the assessment years 1947-48 and 1948-49 corresponding to the account years of the company 1946 and 1947, the Income-tax Officers assessed the company as non-resident and held that the company was not a public company within the meaning of section 23A of the Indian Income-tax Act. The Income-tax Officer, who passed the order for the assessment year 1947-48 under section 23A, held that the assessable income in British India of the company in 1946 minus the taxes, must be deemed to be distributed among the shareholders in the proportion of their shareholdings. The Income-tax Officer calculated the amount deemed to be distributed as follows:

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1946 (assessment year 1947-48)

Total income ... Rs. 4,32,542

Taxes ... Rs. 1,89,237

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Amount available for distribution

as dividend ... Rs. 2,43,305

Dividend declared ... Rs. 2,580

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Balance of the amount available ... Rs. 2,40,725

and deemed to be distributed _________________

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For the account year 1947, the Income-tax officer took the total world income less the taxes as the amount available for distribution as dividend. According to him, that amount was as follows :

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1947 (assessment year 1948-49)

Total income ... Rs. 4,32,709

Income in Bhor State ... Rs. 3,47,416
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Total world income ... Rs. 7,80,125

Taxes ... Rs. 2,43,399

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Amount available for distribution ... Rs. 5,36,726

as dividend

Dividend declared ... Rs. 1,140

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Balance of the amount available ... Rs. 5,35,586

for distribution --------------

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The Income-tax Officer then apportioned it among the shareholders as on August 19, 1948. This worked out at Rs. 5,39.9 per share. The Income-tax Officer then divided this amount of Rs. 539.9 in the proportion the total income bore to the income in Bhor State and taxed the former in the hands of the shareholders, but the balance was included and considered for purposes of rate only. The Tribunal in the statement of the case illustrated this by citing the case of one of the shareholders (Pushpakumar M. D. Thackersey) as follows :

> "The portion of Rs. 5,35,586 appportionable to his 90 shares at the rate of Rs. 539.9 per share worked out of Rs. 50,211. The amount of Rs. 50,211 was divide into two smaller amounts in the ration already mentioned and the amount of Rs. 27,851 was actually brought to tax whereas the amount of Rs. 22,360 attributable to Bhor State income of Rs. 3,47,416 was merely included in the total income for rate purpose."

In computing these "deemed dividends", the two Income-tax Officers did not deduct the interest charged to the company under section 18A(8), from the assessable income along with income-tax and super-tax under section 23A(1).

The company as well as the shareholders appealed to the Appellate Assistant Commissioner, but their appeals were unsuccessful. Their further appeals to the Tribunal were also dismissed. They raised the contentions that sections 23A a was not applicable to the company, that the deemed income arising from a fictional distribution of the dividends could not be taxed in the hands of the shareholders because section 23A did not apply to them and that they were protected by the Concessions Order in the same way in which the company was. They also raised the contention that, in determining the balance of the amount available for distribution, interest charged under section 18A(8) ought to have been deducted. All these contentions were not accepted by the Department and the Tribunal.

At the instance of the company and the shareholders, the tribunal drew up a statement of the case and referred three question to the High Court for its decision. These question were as follows :

"1. Whether paragraph 12 of the Merged States (Taxation Concessions) Order, 1949, precluded the Income-tax Officer from making an order under section 23A in the case of the assessee company in respect of its profits and gains of the previous year ended 31st December, 1946, and 31st December, 1947 ?

2. Whether in making an order under section 23A in respect of the profits and gains of the year 1946-47 the assessable income of that previous years is to be reduced not only by the amount of income-tax and super-tax payable by the company in respect thereof but also by the amount of interest charged to it in accordance with the provisions of section 18A ?

3. Having regard to the order passed by the Income-tax Officer under section 23A in respect of the company's profits of the year 1947 and having apportioned the sum of Rs. 17,641 to the shareholder, Pushpakumar, as his proportionate share in the distribution made by the Income-tax Officer under section 23 A and having regard to the provisions of section 14(2)(c), whether the said sum of Rs. 17,641 has been properly included in his total income for the purpose of charging it to tax ?"

The third question was typical question, as similar questions also arose in the case of other shareholders with variation in the amount. The amount of Rs. 17,641, the Tribunal stated, replaced Rs. 50,211 in view of certain directions given by the Tribunal. The High Court framed one more question as the second part of question No. 1 in disposing of the reference, which read as follows :

"Whether paragraph 12 of the Merged States (Taxation Concessions) Order, 1949, precluded the Income-tax Officer from making any order under section 23A so as to affect the assessee shareholders in respect of their profits and gains for the assessment year 1949-50 ?"

The High Court answered the first and the first and second question framed by it in the negative, and the third question, in the affirmative. The High Court, however, granted a certificate under section 66A of the Income-tax Act, and the present appeals have been filed. The contentions raised before the High Court have been raised before us. The company questions the application section 23A to the two assessment years 1947-48 and 1948-49, while the shareholders question the application of section 23A to the company and also to them in the assessment year, 1949-50. Both the company and the shareholders contend that interest under section 18A(8) ought to have been deducted along with the income-tax to find out the available surplus. The shareholders claim the benefit of section 14(2)(c) in respect in respect of the entire amount of the balance deemed to be distributed.

To begin with, one must remember that the Indian Income-tax Act was applied to Bhor State from April 1, 1949, and that there was no income-tax law in force in Bhor State prior to its merger. This position also obtained in many other Indian States, which merged with the Provinces in British Indian. The fact that income-tax is charged in an assessment year on the income, profits or gains of the previous year would have made persons resident in merged States to pay tax on income which, but for the extension of the Indian Income-tax Act, was either not liable to income-tax at all or was liable at lesser rate. In view of the apprehended difficulties and anomalies, the Extension Act itself gave power to remove such anomalies and hardships. Section 60A was added to the Income-tax Act, and it read as follows :

> "If the Central Government considers it necessary or expedient so to do for avoiding any hardship or anomaly, or removing any difficulty, that may arise as a result of the extension of this Act to the merged territories or to nay Part B State, the Central Government may, by modification in respect of income-tax in favour of any class of income, or in regard to the whole or any part of the income of any person or class of persons."

The Concessions Order, 1949, was passed in furtherance of this power. We are concerned only with with paragraph 12 of the Concessions Order, 1949, which has been relied upon by the company and the shareholders, who are appellants before us. It is not necessary to refer to paragraphs 4, 5, and 6 to which a passing reference was made in the arguments, because they deal with income in an Indian State, which has not been taxed in these cases at all.

Paragraph 12 provided for the application of section 23A to a previous year ending on or after August 1, 1949, but not to a previous year ending before August I, 1949. It may be quoted here :

> "The provisions of section 23A of the Indian Income-tax Act shall not be applied in respect of the profits and gains of any previous year ending before 1st day of August, 1949, unless the State law contains a provision corresponding thereto."

Reading the Extension Act, section 60A and the Concessions Order, 1949, together, the following position emerges. The Indian Income-tax Act applied to and from the assessment year 1949-50 (April 1, 1949 to March 31, 1950) in the merged States. Corresponding previous years were comprehended. The difficulty which was likely to be felt was with respect to the fact that the merger with the Province of Bombay operated from August 1, 1949, and not from April 1, 1949. In respect of the exemption under section 14(2)(c), the position was preserved by applying paragraphs 5 and 6 to the exempted income. These two paragraphs made the States rate applicable to that exempted income. Similarly, previous years ending after March 31, 1948, were to be assessed to Indian income-tax, but the excess of the tax computed at Indian rates over the tax computed at State rates was to be given away as rebate, and profits and gains of the companies of any previous year ending before August 1, 1948, earned in an Indian State were saved f

By the definition in section 2(5A) of the Indian Income-tax Act, a company formed in pursuance of an Act of an Indian State was a company for the purposes of the Act, and it was open to the Income-tax officer exercising power under section 23A to declare the income of such a company accruing or arising within the taxable territory as distributed among the shareholders. The right of the Department to pass an order. M under section 23A(1) of the Indian Income-tax Act was not challenged before the Tribunal, and it was not the subject of a decision in the High Court. The argument still has been, on behalf of the company as well as the shareholders, that paragraph 12 of the Concessions Order saved the profits and gains, whether made in Bhor State or in British India, from the application of section 23A, and that indirectly the shareholders were entitled to the same benefit.

Paragraph 12 ofthe Concessions Order depends on whether a company was being assessed under the Indian Income-tax Act in respect of its profits and gains an Indians State for any previous year ending before the first day of August, 1949. By the application of the Indian Act to an Indian State, the income of a company in an Indian state was likely to be taxed to Indian income-tax from the assessment year 1949-50. For the earlier assessment year, a company's income in the Indian State was exempt, without the assistance of the Concessions Order. The exemption granted by the

Concession Order was to operate in respect of those profits and gains which, but for the exemption, would have been included in the assessment year 1949-50 and subsequent years. In so far as paragraph 12 ofthe Concessions Order was concerned, it gave exemption in respect of action under section 23A to income of "any previous year" ending before the first day of August, 1949. The date, August 1, 1949, was chosen because the merger with the Pro nd ending before the first day of August, 1949. The words "any previous ending before the first day of August, 1949. The words "any previous year" mean, therefore, only one previous year, which would be a previous year for the purposes of the assessment year 1949-50, but which, to get the exemption, must end before the first-day of August, 1949. The exemption, therefore, did not apply to previous years other than the one described, and in respect of the earlier previous years, paragraph 12 of the Concessions Order was hardly needed. Otherwise, there would be no need to mention in the paragraph the date on which the previous year must end.

It is thus quite clear that paragraph 12 provided for income profits and gains of those previous years which were specially mentioned and in respect of which anomalies were likely to arise by reason ofthe fact that the merger took place on August 1, 1949, while the Income- tax Act was applied from April 1, 1949. In view of the fact that specific terminii of previous years are expressly mentioned in the Concessions Order, it is not possible to accept the argument on behalf of the appellants that "all" previous years before the date mentioned were comprehended in paragraph 12. The application of that paragraph must be limited to one previous year only, which ended prior to August 1, 1949.

The previous years, with which we are concerned, ended on December 31, 1946, and December 31, 1947, respectively. In the case of this company, the previous year which would answer the description in paragraph 12 would be the previous year ending December 31,1947. To that previous year, the Provisions of section 23A where not applicable, and the profits and gains made in Bhor State would be protected. The position which obtained in the assessment year 1947-48 would thus obtain also in the assessment year 1948-49 in so far as the company was concerned, and its profits and gains in Bhor State could not be considered for purposes of application of section 23A.

The prosition was, however, different in regard to the income in British India, which former the total income of the company in the taxable territory. It was not contended that the assessable income of the company in the taxable territories would not attract section 23A. if the distribution of dividends from that income was below the mark set in section 23A. There is thus no difference between the assessment years 1947-48 and 1948-49, and the method of calculation adopted in the first year is also applicable to the second. To this extent, the answer to the first question (first part) must be deemed to be modified in respect of the previous year ending December 31, 1947.

It is next contended that interest that was charged to the company under section 18A(8) ought to have been deducted along with the income-tax before the fictional dividends were computed. Section 18A(8) reads as follows :

> "Where, on making a regular assessment, the income-tax Officer finds that no payments of tax has been made in accordance with the foregoing provisions of this section, interest calculated in the manner laid down in sub-section (6) shall be added to the tax as determined on the basis of the regular assessment."

The words of the sub-section are clear to show that interest as interest is added to the tax as determined. There is nothing to show that it is to be treated as tax, and it thus retains its character of

interest but is recoverable along with the tax. Indeed, section 29 of the Income-tax Act makes a distinction between tax, penalty and interest. Income-tax Act makes a distinction between tax, penalty and interest. Since section 23A peaks of deduction only of income-tax and super-tax, no deduction could be made in respect of this interest. Question No. 2 was thus correctly answered by the High Court.

In so far as the shareholders who were all resident in the taxable territories were concerned, paragraph 12 of the Concessions Order did not in terms protect them. Section 23A enjoins that dividends to the extent of 60 per cent, of the assessable income of the company after deduction of income-tax and super-tax must be paid. When the assessable income of the company has been determined and after the necessary deductions have been determined and after the necessary deductions have been made, if dividends are not distributed in accordance with section 23A, the fiction applies to that portion of the profits and gains, which were taxable as assessable income of the company in the taxable territories and which ought to have been so distributed. Section 23A, as it was before the amendment in 1955, mentioned 60 per cent, of the assessable income of a company as reduced by the amount of income-tax and super-tax payable by a company, and provided further that the undistributed portion of the assessable income of a co

We have already shown that the benefit of the paragraph 12 is not available in respect of these fictional dividends, in so far as the assessable income of the company was concerned. It is, however, contended that these dividends would be deemed to be declared in Bhor State and to have the fiction created by section 23A. these deemed dividends cannot be taxed in the hands of the shareholders. No doubt, the section implies a fiction; but if the fiction is given effect to, such income must be deemed to be distributed to the shareholders, and the fiction thus transcends all questions of accrual or receipt in the taxable territories. What is deemed to be distributed must be deemed to have accrued and also received by the person to whom it is deemed to be distributed [see sections 4(I)(a) and 4(I)(b)(i) and (ii)] Paragraph 12 of the Concessions Order saved the company in respect of income in Bhor State for the assessment year 1948-49 for the corresponding previous year ending before August 1, 1949, but it did not

In our opinion, the High Court was right in holding that the dividends deemed to have been distributed out of the assessable income of the company in the taxable territories were rightly assessable in the total income of the shareholders resident in the taxable territories. No question has been referred on the method of calculation of the dividends deemed to have been distributed, and we need, therefore, express no opinion on that part of the case.

The shareholders (appellants Nos. 2 to 6) claim the benefit of section 14(2)(c) of the Act, which provides :

> "14(2). The tax shall not be payable by an assessee - ....
>
> (c) in respect of any income, profits or gains accruing or arising to him within an Indian State, unless such income, profits or gains are received or deemed to be received in or are brought into British India in the previous year by or on behalf of the assessee, or are assessable under section 12B or section 42."

We have already shown that the force of the fiction makes the dividends which ought to have been distributed, to be so distributed. We have also said that this fiction transcends all questions of accrual and receipt. The effect of section 23A is to make dividends payable out of British Indian

income to the shareholders. Paragraph 4 or the Concessions Order and section 14(2)(c) saved for the shareholders the income of the company outside the taxable territories only, that is to say, the income earned in Bhor State. They do not affect the operation of section 23A on the assessable income of the company which, by reason of the application of the Indian Income-tax Act even prior to the Extension Act, was assessable under the Indian Income-tax Act. Dividends payable out of that portion of the income will attract section 23A, and section 14(2)(c) does not apply. Section 14(2)(c) saves only that portion of the income which was not assessable in the taxable territories by reason of its accrual in the State. The Inco

The answer to question No. 1 is thus in the negative, with the modification that section 23A applied only to that portion of the income which was earned in British Indian and not in Bhor State. The answer to the second question is in the negative. The answer to the third question is in the affirmative. The question posed and answered by the High Court hardly arises, in view of the answer to the first question. The question and the answer to it are set aside as being not necessary.

The appeals thus fail except for a slight modification in the answer to the first question, and, subject to that modification, are dismissed. The appellants must bear the costs of these appeals. There shall be one hearing fee.

Appeals dismissed.

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