Navnitlal C. Javeri

Vs

K. K. SEN, Appellate Assistant Commissioner of Income-Tax, 'D' Range, Bombay

Civil Appeal No. 45 of 1964

(CJI P. B. Gajendragadkar, K. N. Wanchoo, M. Hidayatullah, Raghuvar Dayal , J.R. Mudholkar JJ)

28.10.1964

JUDGEMENT

GAJENDRAGADKAR, C.J. –

This appeal arises from a writ petition filed by the appellant, Navnit Lal C. Javeri, in the Bombay High Court in which he challenged the validity of section 12(1B) read with s. 2(6A)(e) of the Indian Income-tax Act, 1922 (No. 11 of 1922) (hereinafter called the Act), as it stood in 1955. The High Court has rejected the appellant's contention that the said section is invalid, and the appellant has come to this court with a certificate granted by the High Court.

The appellant holds 11 out of 845 shares in a private limited company named the Malegaon Electricity Co., (Private) Ltd. (hereinafter referred to as the company). The value of each share is Rs. 100. The business of the company is to supply electricity to the residents of Malegaon. Some time during 1955, the appellant took a loan amounting to over Rs. 4 lakhs from the company. A notice was issued to the appellant by the 8th Income-tax Officer under s. 22(2) of the Act calling upon him to make his return for the assessment year 1956-57. The Income-tax Officer computed his income at Rs. 3,58,460. This amount included a sum of Rs. 2,83,126 representing the accumulated profits of the company. The Income-tax Officer took the view that under s. 2(6A)(e) the said amount must be deemed to be dividend received by the appellant and, as such, must be included in the total income of the appellant as income from other sources within the meaning of s. 12(1B) of the Act. This order was challenged by the appellant by preferring an appeal before the Appellate Assistant Commissioner. The appeal, however, failed and was dismissed. The appellant then preferred a second appeal before the income-tax Appellate Tribunal. Whilst this appeal was pending before the said Tribunal, the appellant moved the High Court under articles 226 and 227 of the Constitution, and contended that the relevant section under which the department had purported to levy assessment against him on the sum of Rs. 2,83,126, was ultra vires. That is how the only question which the High Court had to decide in the present writ proceedings was whether s. 12(1B) read with s. 2(6A)(e) was constitutionally valid.

In order to deal with this point, it is necessary to read the two relevant provisions of the Act. Section 2(6C) defines "income" as including dividend. Section 2(6A) defines "dividend" in an inclusive manner. Section 2(6A)(e) provides :-

> "Dividend" includes -
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> (e) any payment by company, not being a company, in which the public are substantially interested within the meaning of s. 23A of any sum (whether as

> representing a part of the assets of the company or otherwise) by way of advance or loan to a shareholder or any payment by any such company on behalf or for the individual benefit of a shareholder, to the extent to which the company in either case, possesses accumulated profits; but divided does not include -
>
> #(i). . . . . .##
>
> (ii) any advance or loan made to a shareholder by a company in the ordinary course of its business where the lending of money is a substantial part of the business of the company;
>
> (iii) any dividend paid by company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off."

Thus, the inclusive definition of "dividend" takes in the payments to which clause (e) of s. 2(6A) refers and makes them dividend for the purpose of the Act.

Section 12(1) provides that the tax shall be payable by an assessee under the head "income from other sources" in respect of income, profits and gains of every kind which may be included in his total income (if not included under any of the proceeding heads). Section 12(1B) provides :-

> "any payment by company to a shareholder by way of advance or loan which would have been treated as a dividend within the meaning of clause (e) of sub-section (6A) of s. 2 in any previous year relevant to any assessment year prior to the assessment year ending on the 31st day of March, 1956, had that clause been in force in that year, shall be treated as a dividend received by him in the previous year relevant to the assessment year ending on the 31st day of the March, 1956, if such loan or advance remained outstanding on the first day of such previous year."

Both these provisions, viz., s. 2(6A)(e) and s. 12(1B), were introduced in the Act by the Finance Act, 15 of 1955 which came into operation on the 1st of April, 1955.

It is thus clear that the combined effect of these two provisions is that three kinds of payments made to the shareholder of a company to which the said provisions apply, are treated as taxable dividend to the extent of the accumulated profits held by the company. These three kinds of payments are : (1) payments made to the shareholder by way of advance or loan; (2) payments made on his behalf; and (3) payments made for his individual benefit. There are five conditions which must be satisfied before s. 12(1B) can be invoked against a shareholder. The first condition is that the company in question must be one in which the public are not substantially interested within the meaning of s. 23A as it stood in the year in which the loan was advanced. The second condition is that the borrower must be a shareholder at the date when the loan was advanced; it is immaterial what the extent of his shareholding is. The third condition is that the loan advanced to a shareholder by such a company can be deemed to be dividend only to the extent to which it is shown that the company possessed accumulated profit at the date of the loan. This is an important limit prescribed by the relevant section. The fourth condition is that the loan must not have been advanced by the company in the ordinary course of its business. In other words, this provision would not apply to cases where the company which advances a loan to its shareholders carries on the business of money-lending itself; and the last condition is that the loan must have remained outstanding at the commencement

of the shareholder's previous year in relation to the assessment year 1955-56. In dealing with the question about the constitutionality of the impugned provisions, it is necessary to bear in mind these respective conditions which govern the application of the said provisions.

There is another material circumstance which cannot be ignored. It appears that when these amendments were introduced in Parliament, the Hon'ble Minister for Revenue and Civil Expenditure gave an assurance that outstanding loans and advances which are otherwise liable to be taxed as dividends in the assessment year 1955-56 will not be subjected to tax if it is shown that they had been genuinely refunded to the respective companies before the 30th June, 1955. It was realised by the Government that unless such a step was taken, the operation of s. 12(1B) would lead to extreme hardship, because it would have covered the aggregate of all outstanding loans of past years and that may have imposed an unreasonably high liability on the respective shareholders to whom the loans might have been advanced. In order that the assurance given by the Minister in Parliament should be carried out, a circular [No. 20(XXI-6) /55] was issued by the Central Board of Revenue on the 10th May, 1955. It is clear that a circular of the kind which was issued by the Board would be binding on all officers and persons employed in the execution of the Act under s. 5(8) of the Act. This circular pointed out to all the officers that it was likely that some of the companies might have advanced loans to their shareholders as a result of genuine transactions of loans, and the idea was not to the effect such transactions and not to bring them within the mischief of the new provision. The officers were, therefore, asked to intimate to all the companies that if the loans were repaid before the 30th June, 1955, in a genuine manner, they would not be taken into account in determining the tax liability of the shareholders to whom they may have been advanced. In other words, past transactions which would normally have attracted the stringent provisions of s. 12(1B) as it was introduced in 1955, were substantially granted exemption from the operation of the said provisions by making it clear to all the companies and their shareholders that if the past loans were genuinely refunded to the companies, they would not be taken into account under s. 12(1B). Section 12(1B) would, therefore, normally apply to loans granted by the companies, to their respective shareholders with full notice of the provisions prescribed by it.

Mr. Pathak for the appellant contends that the impugned provision is constitutionally invalid, because it is beyond the legislative competence of Parliament. He argues that entry 82 in List I of the Seventh Schedule which deals with "taxes on income other than agricultural income" cannot justify the impugned provision, because a loan advanced to a shareholder by the company cannot, in any legitimate sense, be treated as his income; and so, the artificial manner in which such dividend is ordered to be treated as income by the impugned provision is not justified by the said Entry. He also contends that the said provision offends article 19(1)(f) and (g) and cannot be said to be justified by clause (5) or (6) of the said article. There is no doubt that if the impugned provision is beyond the legislative powers of Parliament, it would be bad. Similarly, it is now well-settled that even tax legislation must stand the scrutiny of the fundamental rights guaranteed by the Constitution, and so there can be no doubt that if the impugned provision invades the fundamental rights of the appellant and the invasion is not constitutionally justified, it would be invalid.

In dealing with this point, it is necessary to consider what exactly is the denotation of the word "income" used in the relevant entry. It is hardly necessary to emphasise that the entries in the Lists cannot be read in a narrow or restricted sense, and as observed by Gwyer C.J. in United Provinces v. Atiqa Begum ([1954] F.C.R. 110), "each general word should be held to extend to all ancillary or subsidiary matter which can fairly and reasonably by said to be comprehended in it". What the entries in the List purport to do is to confer legislative powers on the respective legislatures in respect of areas or fields covered by the said entries; and it is an elementary rule of construction that

the widest possible construction must be put upon their words. This doctrine does not, however, mean that Parliament can choose to tax as income an item which in no rational sense can be regarded as a citizen's income. The item taxed should rationally be capable of being considered as the income of a citizen. But in considering the question as to whether a particular item in the hands of a citizen can be regarded as his income or not, it would be inappropriate to apply the tests traditionally prescribed by the Income-tax Act as such.

In Navinchandra Mafatlal v. Commissioner of Income-tax, Bombay City ([1955] 1 S.C.R. 829), this court had occasion to consider the question as to whether capital gains could be treated as income within the meaning of item 54 of List I of the Seventh Schedule to the Government of India Act, 1935. Section 12-B of the Indian Income-tax Act, 1922, which had been inserted in the said Act by Act XXII of 1947, had imposed tax on "capital gains". The validity of this provision was challenged on the ground that capital gains cannot be treated as income within the meaning of entry 54. This plea was rejected by this court on the ground that the words used in a constitutional enactment conferring legislative powers ought to be construed most liberally and in their widest amplitude. Adopting this approach, Das J., as he then was, speaking for the court, observed that the word "income" used in the said entry must be given its ordinary, natural and grammatical meaning and that was, income is a thing that comes in. On this view, the court found no difficulty in coming to the conclusion that income would include capital gains. If the traditional sense of income had been accepted, then, of course, capital gains could not be treated as income. That, in fact, was the argument which was pressed by Mr. Kolah who appeared for the appellant. "If we hold", observed the learned judge, "as we are asked to do, that the meaning of the word 'income' has become rigidly crystallised by reason of the judicial interpretation of that word appearing in the Income-tax Act, then logically no enlargement of the scope of the Income-tax Act, by amendment or otherwise, will be permissible in future". And he has significantly added that a conclusion so extravagant and astounding can scarcely be contemplated or countenanced. This decision, therefore, shows that the word "income" used in entry 54, which corresponds to the present entry 82 in List I of the Seventh Schedule to our Constitution, was liberally construed, and capital gains were deemed to be included within its scope.

This aspect of the matter has also been clearly enunciated by Gwyer C.J. in In re : The Central Provinces and Berar Sales of Motor Spirit and Lubricants Taxation Act, 1938. (No 14 of 1938). "I conceive", said the learned Chief Justice, "that a broad and liberal spirit should inspire those whose duty it is to interpret it (the Constitution); but I do not imply by this that they are free to stretch or pervert the language of the enactment in the interests of any legal or constitutional theory, or even for the purpose of supplying omissions or of correcting supposed errors".

The next decision to which we ought to refer deals with s. 23A of the Act. In Sardar Baldev Singh v. Commissioner of Income-tax, Delhi & Ajmer ([1961] 1 S.C.R. 482) the validity of the said section was challenged. Section 23A(1) provides, inter alia, that subject to the provisions of sub-sections (3) and (4), where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company within the twelve months immediately following the expiry of that previous year are less than sixty per cent of the total income of the company of that previous year as reduced by the amounts specified in clauses (a), (b) and (c) of the said sub-section, the Income-tax Officer shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profits made in the previous year, the payment of a dividend or a larger dividend than that declared would be unreasonable, make an order in writing that the company shall, apart from the sum determined as payable by it on the basis of the assessment under s. 23, be liable to pay super-tax at the rate specified by the said sub-section. The

object of this section is to prevent avoidance of super-tax by shareholders of a company in which the public are not substantially interested. As is well known, the rates of super-tax applicable to companies are much lower than the rates applicable to individual assessees. The legislature thought that individuals tried to avoid the payment of super-tax at a higher rate by transferring to a private limited company in return for shares the sources of their income, and then the profits made by the company were allowed to accumulate in the hands of the company, dividends not being declared, and the said profits would ultimately be distributed in a capital form by one device or another. The object of s. 23A was to defeat such attempts. The main effect of the provisions of s. 23A appears to be that a company should not accumulate more than 40 per cent, of its net profits to build up reserves or to prove for capital expenditure. It will be recalled that s. 2(6A) has taken within the definition of "dividend" the accumulated profits of such companies; and so, s. 23A attempts to reach such accumulated profits for the purpose of taxation.

The argument which was urged before this court in the case of Sardar Baldev Singh ([1961] 1 S.C.R. 482) was that a company and its shareholders are different persons, and so, s. 23A was ultra vires inasmuch as it purported to tax the shareholders on the income of the company in which they hold shares. If the accumulated profits are distributed amongst the shareholders by way of dividends, the shareholders could legitimately be taxed in respect of the dividends by them; but when s. 23A attempts to tax the shareholders for accumulated profits even though they are not distributed as dividends, what the section purports to do is to tax the shareholders for the profits made by the company; and that according to the appellant, made s. 23A invalid. This argument was repelled by this court on the ground that the obvious intention of s. 23A was to prevent evasion of tax, and it was held that entry 54 should be read not only as authorising the imposition of tax, but also as authorising an enactment which prevents the tax imposed being evaded; otherwise the power to tax a person on his income might often be made infructuous by ingenious contrivances. It would be noticed that s. 23A wanted to deal with a situation where shareholders did not deliberately distribute the accumulated profits as dividends amongst themselves. Section 23A, therefore, provides that these accumulated profits will be deemed to have been distributed to the shareholders and tax levied against them on that basis. It is likely that in such a case, hardship may be caused in some honest cases; but this court made it perfectly clear that considerations of hardship are irrelevant for determining questions of legislative competence. It is thus clear that the result of the decision of this court in Sardar Baldev Singh ([1961] 1 S.C.R. 482) is that the income which technically belonged to the company, was treated as income belonging to the shareholders in proportion to the shares they held in the company, and on that footing tax was levied on them; and yet the said tax was held to be constitutionally valid.

There is yet another case in which a similar question was considered. In Balaji v. Income-tax Officer, Special Investigation Circle, ([1962] 2 S.C.R. 983) a person and his wife started business in partnership and admitted their three minor sons to it. In computing the total income of the said person for the purpose of assessment, the Income-tax Officer included the share of the income of his wife and three minor sons under s. 16(3)(a)(i) and (ii) of the Act. The validity of this provision was challenged on the ground that the impugned section purported to tax a person for the income of other persons, namely, his wife and minor sons. In rejecting the contention raised against the validity of the impugned section, this court held that the entries in the Legislative Lists are not powers but fields of legislation and the widest import and significance should be attached to them. On this view the conclusion reached by this court was that entry 54 of the Federal Legislative List covered legislation like s. 16(3)(a)(i) and (ii), because it was intended to prevent evasion of tax. It appears from the judgment that the validity of the said section was also challenged on the ground that it contravened articles 14 and 19(1)(f) and (g) of the Constitution. This plea was also rejected.

One of the considerations which weighed with the court in repelling the said plea was that the additional payment of tax made on the income of the wife or the minor children would ultimately be borne by them in the final accounting between them. Having regard to this consideration and bearing in mind the fact that the mode of taxation authorised by the impugned section, though harsh, was thought to be necessary to prevent evasion of payment of tax, this court held that the said section was valid. It is in the light of these decisions that we must proceed to consider Mr. Pathak's argument that s. 12(1B) of the Act is ultra vires.

In dealing with Mr. Pathak's argument in the present case, let us recall the relevant facts. The companies to which the impugned section applies are companies in which at least 75 per cent of the voting power lies in the hands of persons other than the public, and that means that the companies are controlled by a group of persons allied together and having the same interest. In the case of such companies, the controlling group can do what it likes with the management of the company, its affairs and its profits within the limits of the Companies Act. It is for this group to determine whether the profits made by the company should be distributed as dividends or not. The declaration of dividend is entirely within the discretion of this group. When the legislature realised that though money was reasonably available with the company in the form of profits, those in charge of the company deliberately refused to distribute it as dividends to the shareholders, but adopted the device of advancing the said accumulated profits by way of loan or advance was to evade the payment of tax on accumulated profits under s. 23A. It will be remembered that an advance or loan which falls within the mischief of the impugned section is advance or loan made by a company which does not normally deal in money-lending, and it is made with the full knowledge of the provisions contained in the impugned section. The object of keeping accumulated profits without distributing them obviously is to take the benefit of the lower rate of super-tax prescribed for companies. This object was defeated by s. 23A which provides that in the case of undistributed profits, tax would be levied on the shareholders on the basis of that the accumulated profits will be deemed to have been distributed amongst them. Similarly, s. 12(1B) provides that if a controlled company adopts the device of making a loan or advance to one of its shareholders, such shareholders will be deemed to have received the said amount out of the accumulated profits and would be liable to pay tax on the basis that he has received the said loan by way of dividend. It is clear that when such a device is adopted by a controlled company, the controlling group consisting of shareholders have deliberately decided to adopt the device of making a loan or advance. Such an arrangement is intended to evade the application of s. 23A. The loan may carry interest and the said interest may be received by the company; but the main object underlying the loan is to avoid payment of tax. It may ultimately be repaid to the company and when it is so repaid, it may or may not be treated as part of accumulated profits. It is this kind of a well-planned device which s. 12(1B) intends to reach for the purpose of taxation.

It appears that such a device is adopted by private companies in many countries. Simon has referred to this device in these words :-

> "Generally 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 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 borrowing from the company, any interest payable by him going to swell the savings fund; and at any time the individual could acquire the whole balance of the fund in the character of capital by putting the company into liquidation".

What Simon says about one-man company can be equally true about the controlled company whose affairs are controlled by a group of persons closely knit and having the same interest.

The question which now arises is, if the impugned section treats the loan received by a shareholder as a dividend paid to him by the company, has the legislature in enacting the section exceeded the limits of the legislative field prescribed by the present Entry 82 in List I ? As we have already notice, the word "income" in the context must receive a wide interpretation; how wide it should be it is unnecessary to consider, because such an inquiry would be hypothetical. The question must be decided on the facts of each case. There must no doubt be some rational connection between the item taxed and the concept of income liberally construed. If the legislature realises that the private controlled companies generally adopt the device of making advances or giving loans to their shareholders with the object of evading the payment of tax, it can step in to meet this mischief, and in that connection, it has created a fiction by which the amount ostensibly and nominally advanced to a shareholder as a loan is treated in reality for tax purposes as the payment of dividend to him. We have already explained how a small number of shareholders controlling a private company adopt this device. Having regard to the fact that the legislature was aware of such devices, would it not be competent to the legislature to devise a fiction for treating the ostensible loan as the receipt of dividend ? In our opinion, it would be difficult to hold that in making the fiction, the legislature has travelled beyond the legislative field assigned to it by entry 82 in List I.

It is, however, urged by Mr. Pathak that while providing for such a fiction, the legislature should have required the Income-tax Officer to consider in each case whether the loan was genuine, or was the result of a device; and he argues that since no such provision has been made and a uniform presumption by fiction is sought to be raised, the legislature has gone beyond its legislative competence. In support of this argument, Mr. Pathak has referred to the fact that under s. 108(1) of the Common wealth Income-tax Act it is provided that the amount paid to the shareholder by way of advance or loan can be taxed if in the opinion of the Commissioner it represents distributions of income. Such a provision would have made the impugned section valid. Mr. Pathak argues that omission of Parliament to exclude from the operation of s. 12(1B) genuine loans or advances, and its failure to distinguish between such loans and advances and loans and advances made as device shows that it has acted blindly and must, therefore, be held to have exceeded its legislative power. We are not inclined to accept this argument. If the legislature thinks that the advances or loans are in almost every case the result of the device, it would be competent to it to prescribe a fiction and hold that in cases of such advances or loans, tax should be recovered from the shareholders on the basis that he has received the dividend. Therefore, we are satisfied that the High Court was right in coming to the conclusion that the impugned section is not beyond the legislative competence of the legislature.

Then it is argued by Mr. Pathak that the impugned provision contravenes the appellant's

fundamental rights under article 19(1)(f) and (g) and is not saved by clauses (5) and (6) of the said article. It is not easy to appreciate this argument. Article 19(1)(f) recognises the right of a citizen to acquire, hold and dispose of property and article 19(1)(g) recognises the right to practice any profession, or to carry on any occupation, trade or business. The impugned provision does not contravene either of these rights. The shareholder's right to borrow money from his own company cannot be said to be fundamental right, besides all that the impugned section does it to provide that if a loan is borrowed by a shareholder from a company to which the said provision applies, it will be deemed to be a receipt by him of the dividend. This provision does not affect the appellant's right to borrow money from any other source; and his company from which he borrows does not ordinarily do money-lending business. That is why the restriction imposed by the section cannot be said to be unreasonable at all. In dealing with the question about the reasonableness of this provision, we cannot also overlook the fact that past transactions were excluded from its operation by the issue of a circular to which we have already referred. There is no element of unfairness in the fiction, because the other shareholders have deliberately agreed to make the loan or the advance and the shareholder to whom the loan is advanced deliberately takes it with a view to assist the company to evade the payment of tax to have the benefit of the use of the amount subject to the payment of interest. The company receives interest, the shareholder enjoys the use of the money, and in the process the payment of due tax is evaded. That is the assumption made by the legislature in making this provision. How can it be urged that either the shareholder who is taxed, or the other shareholders who deliberately make the advance to a colleague of theirs, are unfairly dealt with by the impugned provision. In our opinion, there is no scope for arguing that the fundamental rights of the shareholder under article 19(1)(f) and (g) have been contravened by the impugned provision. Therefore, we must reject Mr. Pathak's argument that the impugned provision is invalid on the ground that it contravenes article 19(1)(f) and (g). There is obviously no scope for suggesting that the impugned provision contravenes article 14; and in fact Mr. Pathak has not raised this point before us. In that connection, he himself fairly invited our attention to the decision of the Madras High Court in K.M.S. Lakshmana Aiyar v. Additional Income-tax Officer, Special Circle, Madras, ((1960) 40 I.T.R. 469) where the challenge to the validity of the impugned section on the ground that it contravened article 14 has been repelled.

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

RAGHUBAR DAYAL J.-

I am of the opinion that the appeal should be allowed as sections 12(1B) and 2(6A)(e), of the Indian Income-tax Act, 1922, hereinafter called the Act, as they stood in 1955, are void.

The two provisions were enacted by Parliament in view of entry 82, List I, Seventh Schedule of the Constitution which reads : "Taxes on income other than agricultural income." It is not disputed that whatever wide connotation the word "income" in this entry may have, the item taxed should really be capable of being considered as income, that there be some rational connection between the item taxed and the concept of "income" and that it is not open to Parliament to choose to tax, as income, an item which in no rational sense can be regarded as income. It is also not disputed that Parliament can enact a law dealing with the evasion of payment of income-tax.

In Navinchandra Mafatlal v. The Commissioner of Income-tax Bombay City ([1955] 1 S.C.R. 829) this Court had to consider the content of the word "income" as used in entry 54, List I, Seventh Schedule to the Government of India Act, 1935 (which is identical with entry 82, List I, Seventh Schedule to the Constitution), in determining whether the imposition of a tax under the head "capital

gains" by the Central Legislature, was ultra vires. Section 12-B inserted in the Income-tax Act by the Indian Income-tax and Excess Profits Tax (Amendment) Act, 1947 (Act XXII of 1947) provided for the imposition of a tax on capital gains arising from certain transaction mentioned in the section. This court said that "income", according to the dictionary, means "a thing that comes in" and that in the United States of America and Australia, the word "income" was used in a wide sense so as to include "capital gains". It referred to certain cases of those countries in which a very wide meaning was ascribed to the word "income" as its natural meaning and held that "its natural meaning embraces any profit or gain which is actually received".

In the United States, the word "income" was first defined in Stratton's Independence v. Howhert (231 U.S. 399-59 L. Ed. 285) decided on December 1, 1913, as "gain derived from capital, from labour, or from both combined." The court had to construe the word "income" as used in s. 38 of the Corporation Excise Tax Act of August 5, 1909, which imposed an excise tax "equivalent to one per cent upon the entire net income .... received by it from all sources during the year".

In Eisner v. Macomber (252 U.S. 189=64 L.Ed. 521) referred to by this court in Mafatlal's case ([1955] 1 S.C.R. 829) the court had to construe the word "income" as used in the XVI Amendment of the Constitution of the United States, which is :

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

and observed, at page 206 :

> "Congress cannot by any definition it may adopt conclude the matter, since it cannot be legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.
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> ..... For the present purpose we require only a clear definition of the term 'income', as used in common speech, in order to determine its meaning in the Amendment; and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue.
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> After examining dictionaries in common use ..... we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of August 5, 1909. ..... : 'Income may be defined as the gain derived from the capital, from labour, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle case .....
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> Brief as it is, it indicates the characteristic and distinguishing attribute of income, essential for a correct solution of the present controversy."

The definition of "income" given in this case has been followed in the other two cases referred to in Mafatlal's case ([1955] 1 S.C.R. 829) viz., Merchants' Loan and Trust Co. v. Smietanka (255 U.S. 509=65 L.Ed. 751) and United States v. Stewarrt (311 U.S. 60=85 L.Ed. 40) cases, which dealt with the taxation of gains from the sale of capital assets.

The question in the Australian case, viz., Resch v. Federal Commissioner of Taxation (66 C.L.R.

198) was about the validity of the provision in the income-tax legislation to the effect that distribution of profits in the course of the winding up of a company would be treated on the same footing as the distribution by the company as a going concern. The provision was held valid as Parliament possessed power to bring to charge in an Income-tax Act all profits and gains occurring to a taxpayer, without distinguishing whether the profit or gain should be regarded as a receipt on capital or on income or revenue account.

The word "income" has been interpreted in a natural sense in these cases and the definition given in Eisner's case (252 U.S. 189=64 L.Ed. 521) is much narrower and limited in content than the widest meaning which is now sought to be given to it by the respondent. In Mafatlal's case ([1955] 1 S.C.R. 829) too, this court has not given such a wide meaning to the word "income" as to include "anything which comes in" and therefore to include the amount of a loan which may be said to come in the hands of the borrower. Loans borrowed by a shareholder from the company do not, as such, come within the above general definition of "income". They do not represent gains from his labour or capital or profits gained through sale of capital assets. The borrower has to repay them. If a shareholder is really paid his share of the profits ostensibly as a loan, such a nominal loan - but really a share of profits - can be taxed as "income" under an appropriate enactment.

We may now consider the nature of what had been taxed in this case and to which objection has been taken on the ground that ss. 2(6A)(e) and 12(1B) are invalid.

The appellant holds 11 out of 845 shares in a private limited company. The value of each share is Rs. 100. In 1955 he took a loan of over Rs. 4,00,000 from the company. Rs. 2,83,126, the amount of accumulated profits the company had then, have been added to the appellant's total income for the relevant assessment year, in view of ss. 2(6A)(e) and 12(1B) of the Act. The appellant's share in the accumulated profits, if distributed as dividend, would be 11/845th of Rs. 2,83,126, i.e., Rs. 3,686. Rs. 2,79,440, the balance, would then be the dividend payable to the other co-shares. The appellant contends that Rs. 2,79,440 is not his income and that Parliament was not competent to enact ss. 2(6A)(e) and 12(1B) which treat it as his "income" from dividend.

Before dealing with the contention. Reference may be made to what the impugned sections provide. Section 2(6A)(e) defines "dividend", in the circumstances mentioned in that clause, to include any payment by a company of any sum by way of advance or loan to a shareholder, or any payment by any such company on behalf of or for the individual benefit of a shareholder to the extent to which the company in either case possesses accumulated profits. Section 12(1B) provided that any such payment to a shareholder made by way of advance or loan in certain circumstances would be treated as dividend received by him in the previous year relevant to the assessment year ending March 31, 1956, if such loan or advance remained outstanding on the first day of such previous year. Now, the contention for the appellant is that though Parliament can enact a law dealing with evasion of payment of income-tax, it cannot tax what is not "income", that the amount in excess of his proportionate share is Rs. 2,83,126, if it had been actually distributed as profits by the company, could not have been his income from dividend, that he could not have evaded payment of income-tax on this amount from its being not distributed as dividend and that, therefore, Parliament could not enact that such excess amount be treated as dividend paid to him and, consequently, as his "income".

The contention has force. The essence of an amount paid as dividend is that it has to represent the proportionate amount a particular shareholder is to get on the basis of the shares held by him out of the profits of the company set apart for payment of dividend to shareholders. Any ad hoc payment

of money to a shareholder as advance or loan unrelated to his share in the accumulated profits cannot rationally come within the expression "dividend". I am therefore of opinion that it is not open to the legislature to describe any payment of money by a company to a shareholder by the word "dividend" and then provide that such payment (called dividend) will come within the expression "income" for the purposes of any law enacted by virtue of entry 82, List I, Seventh Schedule to the Constitution. The definitions of "dividend" must have rational connection with the concept of "dividend" in the context of the profits of a company and its distribution amongst shareholders at any time after the profits have been earned. Clauses (a) to (d) of s. 2(6A) may be said to have such a connection.

It is conceivable, and not disputed for the appellant, that attempts are made by persons to evade payment of income-tax and that one mode of such attempts is that companies accumulate profits, do not use them for payment of dividends and later pay the amount to shareholders by way of profits but in the form of advance of moneys or loans to some shareholders who pass on the ratable share of the remaining shareholders and the shareholders thus escape payment of super-tax at a higher rate as their receiving such amounts could not be treated as "dividends" and so could not be added to their "income". At the same time, it is not disputed for the respondent that there can be genuine cases of loans taken by shareholders from a company when the company was in a position to lend money out of its funds. In fact, after the enactment of s. 2(6A)(e), the Central Board of Revenue issued a circular directing its officers to intimate to all companies that if loans advanced by them were rapid before June 30, 1955, in a genuine manner, they would not be taken into account in determining the tax liability of the shareholders to whom they had been advanced as it was likely that some companies might have advanced loans to their shareholders as a result of genuine transactions of the loans and the idea was not to affect such transactions and not to bring them within the mischief of the new provision. The provisions of s. 2(6A)(e) take into account all cases of advances or loans made by companies to their shareholders, be they bona fide or be they for the purpose of evading payment of super tax, and make the borrower liable for the tax on even such amount of the loan as be in excess of his proportionate share in the accumulated profits up to the amount of the loan.

Reference may be made to the fact that in other countries too, notice has been taken of attempts to evade payment of income-tax by similar devices, and that enactments to defeat the devices have been made by the legislatures of those countries. We have been referred to s. 108 of the Income-tax and Social Services Contribution Assessment Act 1936-53 (of the Commonwealth of Australia) which deals with loans to shareholders. Its provisions materially differ in one respect from those of the impugned sections. Only so much of the advances or loans are deemed to be dividends paid by the company as in the opinion of the Commissioner represents distributions of income. The entire amount of advance or loan is not treated as dividend received by the borrower-shareholder.

Imposition of a tax is a restriction on the right of an assessee to hold property and a particular tax can be justified only as a reasonable restriction on the exercise of that right in the interests of the general public. The shareholder who takes a loan or advance from a company which possesses accumulated profits is, under the impugned provisions, treated to have received the amount of the loan or advance to the extent of the accumulated profits, as dividend. As already stated, the amount of profits set apart for dividends is to be proportionately distributed among the various shareholders. If any enactment provides that certain profits of the company, though not distributed as dividend, be treated as used for the payment of dividends, it should necessarily follow that a particular shareholder be deemed to have received a proportionate amount of such profits as dividend. It would be deemed to have received an amount in excess of his proportionate share as dividend. The other shareholders should, in the circumstances, be deemed to have received their proportionate

shares of the profits deemed to have been distributed as dividends. A reasonable law may provide for their assessment as well on the amount of dividends deemed to have been distributed to them. It appears to me unreasonable that a particular shareholder who receives a loan or advance from a company be deemed to have received that entire amount as dividend when his proportionate share be much less. I would, for this reason also, consider the provisions of the impugned sections to amount to imposing unreasonable restrictions on the fundamental right to hold property under article 19(1)(f).

I would now refer to certain cases on which reliance is placed for the proposition that this court has held valid laws made to cover attempts for evasion of income-tax and that therefore the impugned provisions enacted with the same object to cover attempts to evade payment of super-tax should be held valid. These cases are : Mafatlal's case ([1955] 1 S.C.R. 829), already referred to; Sardar Baldev Singh v. Commissioner of Income-tax, Delhi & Ajmer ([1961] 1 S.C.R. 482); and Balaji v. Income-tax Officer, Special Investigation Circle ([1962] 2 S.C.R. 983)

Mafatlal's case ([1955] 1 S.C.R. 829), dealt with the validity of the tax on capital gains under s. 12B of the Act. In that case what was taxed was what had been gained by the assessee as a result of some dealing in capital assets. The capital gain was to be computed after making certain deductions including the actual cost to the assessee of the capital assets, and did not represent the entire amount that came in as a result of the transaction. This case is therefore an authority for the simple proposition that the word "income" in entry 82, List I, Seventh Schedule to the Constitution, has wide connotation and is not to be restricted to have the same content as judicial decisions had given to that word as used in the Act. "Income", in the Act, has been construed in the context of the scheme of the Act and has been considered to mean generally what one earns mostly in a recurring form from some existing sources. The profits that one earns from the transfer of a capital asset could be rationally considered, as held by this court, to be income, as it represented the amount in excess of what the transferor assessee had spent in acquiring that asset.

Baldev Singh's case ([1961] 1 S.C.R. 482) was concerned about the validity of the provisions of s. 23A of the Act which authorised the income-tax Officer to order in writing that the undistributed portion of the ostensible income of a company calculated as profit therein shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting aforesaid and that thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income. The Income-tax Officer was to make such an order only when he was satisfied that the profits and gains distributed as dividends by any company up to the end of the sixth month after its accounts for the previous year are laid before the company in general meeting, were less than 60 per cent of the assessable income of the company and that payment of a larger dividend would not be unreasonable keeping in view the losses incurred by the company in the earlier years and of the smallness of the profits made.

It will be noticed that the order of the Income-tax Officer could not be to the effect that the undistributed profits would be deemed to be the dividend paid to any particular shareholder or shareholders but could be to the effect that they were distributed as dividends amongst all the shareholders. The validity of this provision was not questioned in the case. What was questioned in the case was that the proportionate share of Baldev Singh, assessee, in such undistributed profits, could not be added to his total income of the particular year to which it was added. It was held that in view of the deeming provision with respect to the distribution of profits as dividends amongst shareholders, the proportionate share of the dividends would be deemed to be income of the

assessee and that therefore when it was not taxed, would be deemed to have escaped assessment for the purposes of s. 34 of the Act. The case is distinguishable on several grounds. One is that the Income-tax Officer is to make the order when he is satisfied that a larger dividend could have been justifiably distributed, a view necessarily leading to the inference that a lower dividend was distributed in order to escape payment of super-tax by shareholders liable to pay such tax. The other is that the Income-tax Officer was given power to make the order only when profits less than 60 per cent of the assessable income were distributed as dividend. This indicates that the company could accumulate profits up to 40 per cent of the assessable income for the reasons which would be deemed to be genuine. This should lead to the inference that the accumulation of profits with respect to which no action has been taken under s. 23A was justified and that therefore if in case a company could spare the money to advance to a shareholder for his needs, that alone should not lead to the inference that the advance was made to evade the payment of super-tax by the shareholder. The third point of distinction, and of significance, is that no individual shareholder is made liable for tax on an amount of the undistributed profits in excess of his proportionate share in those profits. The shareholder is not thereby prejudiced. His income is increased by an amount which he could have legitimately got from the company if the persons in control had acted reasonably and had retained such profits undistributed as were necessary for the purposes of the company.

Another objection taken in Baldev Singh's case ([1961] 1 S.C.R. 482) was about the constitutionality of s. 23A on the ground that it purports to tax the shareholders on the income of the company in which they held shares, especially when it does not give a right to the shareholders to realise from the company the dividend which by the order is deemed to have been paid to them. The section was held to be constitutionally valid as it was enacted for preventing evasion of tax in view of the conditions of its applicability. In the circumstances of the cases covered by s. 23A, there was a reasonable connection between the amount deemed to be distributed as dividend and the possible attempt for evading payment of super-tax. The assessee could not have been prejudiced if the persons in control of the management of the company had acted reasonably or actually distributed that amount as profits subsequent to the order of the Income-tax Officer.

In Balaji's case ([1962] 2 S.C.R. 983), the validity of s. 16(3)(a), clauses (i) and (ii), came up for consideration. These clauses provide that in computing the total income of any individual for the purpose of assessment there shall be included so much of the income of his wife or minor child as arises directly or indirectly from the membership of the wife in a firm of which her husband is a partner or from the admission of the minor to the benefits of partnership in a firm of which such an individual is partner. These provisions were held valid. The court left open the question whether A could be taxed on the income of B and formulated the question for decision as to whether s. 16(3)(a), clauses (i) and (ii), is a provision made by the legislature to prevent evasion of tax and answered it in the affirmative, as the husband or the father could nominally take his wife or minor child, in partnership with him, so that the tax burden may be lightened and as this device enabled the assessee to secure the entire income of the business and yet evade income-tax which he would otherwise have been liable to pay. It was said at page 999 :

> "The scope of the provisions is limited only to a few of the intimate members of a family who ordinarily are under the protection of the assessee and are dependents of him. The persons selected by the provisions, namely, wife and minor children, cannot also be ordinarily expected to carry on their business independently with their own funds, when the husband or the father is alive and when they are under his protection."

It is therefore clear that the basis for holding s. 16(3)(a), clauses (i) and (ii), valid was that in effect the husband or the father was the real person who ran the firm and that the others were made partners nominally and, therefore, the partnership was not genuine. In this view, there could be no question of the provisions affecting the husband or the father prejudicially or including in his income amounts which were not his income. This, however, cannot be said in the present case or in cases which come within the purview of the impugned sections.

In dealing with the contention that the provisions of s. 16(3)(a), clauses (i) and (ii), contravened article 14 of the Constitution, it was said at page 991 :

> "We have held that the object of the legislation was to prevent evasion of tax. A similar device would not ordinarily be resorted to by individuals by entering into partnership with persons other than those mentioned in the sub-section, as it would involve a risk of the third-party turning round and asserting his own rights. The legislature, therefore, selected for the purpose of classification only that group of persons who in fact are used as a cloak to perpetrate fraud on taxation."

Such a risk is always involved in a company making payments as advances or loans to a shareholder when it possesses accumulated profits as the other shareholders run the risk of not getting their proportionate share of profits which they would have got if they had been really distributed as dividends. This consideration, again, points to the conclusion that the probability of such an advance or loan being genuine would be dependent not so much on the existence of accumulated profits but on the number of shareholders in the company and the proportion of the number of shares the borrower has to the total number of shares held by the shareholders of the company. The lesser the proportion, the greater is the chance of the advance or loan being genuine, as there would in that case be greater risk of the other shareholders losing their share in the profits deemed to be distributed as dividends.

I am therefore of the opinion that the impugned sections, viz., ss. 2(6A)(e) and 12(1B) of the Act, are void and that this appeal should be allowed.

Appeal dismissed.

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