

Kishanchand Lunidasingh Bajaj

Vs

Commissioner of Income-Tax, Mysore

Civil Appeal No. 234 of 1965

(CJI P. B. Gajendragadkar, K.N. Wanchoo, J. C. Shah, S. M. Sikri, V. Ramaswami-I JJ)

10.02.1966

JUDGMENT

SHAH, J. -

Kishanchand Bajaj and his seven sons formed a Hindu undivided family which owned shares exceeding Rs. 91,000 in value, in public limited companies. The family commenced business in money-lending and as commission agents on May 16, 1956 in the name of Messrs. Mangoomal Kishanchand and in the books of account of the firm the shares which stood registered in the name of Kishanchand with the companies were credited as capital of the business. On August 22, 1956 Shyam Sundar and Girdharlal, two of the sons of Kishanchand separated from the family, each receiving rupees two lakhs in lieu of his share. On August 23, 1956 a partnership was formed between Kishanchand representing the Hindu undivided family of himself and his five sons and Shyam Sundar and Girdharlal, for carrying on the business of Messrs. Mangoomal Kishanchand. Under the deed of partnership, Shyam Sundar and Girdharlal were each entitled to a seventh share and the remaining five-sevenths share was to belong to Kishanchand as karta of the Hindu undivided family. Dividends received in respect of the shares were credited to the profit and loss account of the firm.

In proceedings for assessment of the firm for the year 1959-60 it was claimed that the shares which stood registered in the name of Kishanchand belonged not to the Hindu undivided family but to the firm of Messrs. Mangoomal Kishanchand. The Income-tax Officer rejected that contention. He held that the Hindu undivided family was "the real and legal owner of the shares", and that the shares were at no time the property of the firm. The order of the Income-tax Officer was confirmed in appeal by the Appellate Assistant Commissioner. In second appeal to the Income-tax Appellate Tribunal, it was contended on behalf of the Hindu undivided family that the dividend from the shares could be assessed only in the hands of the person who held ownership "legal as well as equitable" in the shares, and as the family had ceased to be the "equitable owner" of the shares, the Hindu undivided family could not be assessed under the Income-tax Act, 1922 on the dividend. The Tribunal rejected the contention. The Tribunal then referred under section 66(1) of the Indian Income-tax Act, 1922, the following question to the High Court of Mysore for opinion :

"Whether on the facts and circumstances of the case, the dividend income from shares standing in the name of Kishanchand Lunidasingh Bajaj and acquired with the funds of the Hindu undivided family of which the said person was the karta was assessable in the hands of the assessee family ?"

The High Court answered the question in the affirmative, and with special leave the Hindu

undivided family has appealed to this Court.

In this appeal it was urged that where one taxable entity is the registered holder of shares in a company and the real owner of the shares is another taxable entity, the registered shareholder alone is liable to be assessed to tax in respect of the dividend from those shares, and therefore Kishanchand alone was liable to be taxed in respect of the dividend income from the shares, and not the Hindu undivided family. Reliance in support of this contention was placed upon section 16(2) of the Indian Income-tax Act, 1922, and certain observations made by this Court in the judgment in *Howrah Trading Company Ltd. v. Commissioner of Income-tax, Central, Calcutta* ((1959) Supp. 2 S.C.R. 448 : 36 I.T.R. 215).

In our judgment the contention is wholly without substance. Under section 3, total income of the previous year of every individual, Hindu undivided family, company and local authority, and of every firm and other association of persons or the partners of the firm or the members of the association individually is charged to tax. By section 4 the total income of any previous year of any person includes, subject to the provisions of the Act, all income, profits and gains from whatever source derived, which are received or deemed to be received in the taxable territories in such year by or on behalf of such person, or if such person is resident in the taxable territories during such year the income which accrue or arise or is deemed to accrue or arise to him in the taxable territories during such year, or accrue or arise without the taxable territory during such year, or having accrued or arisen to him without the taxable territories or brought in the taxable territories during such year, or if such person is not residing to the taxable territories during such year, accrue or arise or are deemed to accrue or arise to him. By sub-section (3) of section 4 any income, profits or gains falling within the clauses (i) to (xxii) are not liable to be included in the total income of the person receiving them. Tax being charged by section 3 upon dividend income and not being excluded under section 4(3), such income would be chargeable to income-tax under the Act in the hands of the person to whom it accrues or by whom it is received. A company for its purposes does not recognize any trust or equitable ownership in shares : it merely recognises the registered shareholder as the owner and pays the dividend to that shareholder. But the shares may, because of a trust or other fiduciary relationship, belong to a person other than the registered shareholder, and the dividend distributed by the company would for the purpose of tax be deemed to accrue to the real owner of the shares.

Section 16 of the Indian Income-tax Act deals with the exemptions and exclusions in determining the total income. The expression "total income" is defined in section 2(15) : it means "total amount of income, profits and gains referred to in sub-section (1) of section 4, computed in the manner laid down in this Act". Section 16, insofar as it is relevant, provides :

"(1) In computing the total income of an assessee -

(a) any sums exempted under the first proviso to sub-section (1) of section 7, the second and third provisos to section 8, sub-sections (2), (3), (4) and (5) of section 14, section 15, section 15B and section 15C shall be included, and any sum exempted under section 15A shall also be included except for the purpose of determining the rates at which income-tax (but not super-tax) is payable by the assessee to whom the exemption is given;

(b) when the assessee is a partner of a firm, then, whether the firm has made a profit or loss, his share (whether a net profit or a net loss) shall be taken to be any salary,

interest, commission or other remuneration payable to him by the firm in respect of the previous year increased or decreased respectively by his share in the balance of the profit or loss of the firm after the deduction of any interest, salary, commission or other remuneration payable to any partner in respect of the previous year :

#Provided. . . .##

"(c) all income arising to any person by virtue of a settlement or disposition whether revocable or not, and whether effected before or after the commencement of the Indian Income-tax (Amendment) Act, 1939 (VII of 1939), from assets remaining the property of the settlor or disponer, shall be deemed to be income of the settlor or disponer, and all income arising to any person by virtue of a revocable transfer of assets shall be deemed to be income of the transferor;

#Provided##

(2) For the purposes of inclusion in the total income of an assessee any dividend shall be deemed to be income of the previous year in which it is paid, credited or distributed or deemed to have been paid, credited or distributed to him and shall be increased to such amount as would, if income tax (but not super-tax) at the rate applicable to the total income of the company without taking into account any rebate allowed or additional income-tax charged for the financial year in which the dividend is paid, credited or distributed or deemed to have been paid, credited or distributed, were deducted therefrom, be equal to the amount of the dividend :

#Provided##

(3) In computing the total income of any individual for the purpose of assessment, there shall be included -

(a) so much of the income of a wife or minor child of such individual as arises directly or indirectly -

(i) from the membership of the wife in a firm of which her husband is a partner;

(ii) from the admission of the minor to the benefits of partnership in a firm of which such individual is a partner;

(iii) from assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration or in connection with an agreement to live apart; or

(iv) from assets transferred directly or indirectly to the minor child not being a married daughter, by such individual otherwise than for adequate consideration; and

"(b) so much of the income of any person or association of persons as arises from assets transferred otherwise than for adequate consideration to the person or association by such individual for the benefit of his wife or a minor child or both."

Under the Income-tax Act, 1922, certain items of income are exempt from liability to tax and do not

enter into the computation of total income : there are other items of income, which though exempt from tax are liable to be included in the total income of the assessee for determining the rate applicable. Sub-sections (1) & (3) of section 16 provide that certain income which does not accrue or arise to the assessee or which is not received as income by him is deemed to be part of his total income. These sub-sections deal with inclusion of the specified classes of income in the computation of total income. The only difference between the two clauses is that sub-sections (1) applies to all assesses, whereas sub-section (3) applies to individuals only. But sub-section (2) does not direct the inclusion of any item of income in the computation of the total income of an assessee to whom it does not accrue or arise : it is only a processing clause applicable in respect of dividend income. In terms it provides that for the purpose of inclusion of dividend in the total income of an assessee, dividend shall be deemed to be income of the previous year in which it is paid, credited or distributed, or deemed to be paid, credited or distributed, and further that the dividend shall be increased, or as it is sometimes called "grossed up" by adding thereto the income-tax deemed to have been paid by the company on behalf of the shareholder. The sub-section in the first instance designates the year in which the dividend income is to be included in the total income. Therefore dividend will be included in the income of the assessee in the year in which it is paid, credited or distributed, or be deemed to be paid, credited or distributed. Since the same income cannot be taxed twice over, dividend income will be taxed in the hands of the real owner of the shares and in the year designated by section 16(2). But by virtue of the second part of section 16(2), dividend may be grossed up only if the registered shareholder is the real owner of the shares. If the registered holder is not the real owner of the shares i.e. he is a trustee or benamidar for the real owner, dividend income cannot be grossed up when including it in the total income of the real owner. But sub-section (2) of section 16 does not operate as an exemption from the pale of either section 3 or section 4(1) of the Act : nor does it provide that liability to tax arises only when the person by whom dividend is received from the company is the real owner of the shares. Sub-section (5) of section 18 also does not lead to that result. The clause provides that deduction made by a company and paid to the account of the Central Government in accordance with the provisions of section 18 and any sum by which a dividend has been increased under sub-section (2) of section 16 shall be treated as payment of income-tax or super-tax on behalf of the person from whose income the deduction was made, and credit shall be given to him therefor. Insofar as it deals with dividend which is "grossed up", sub-section (5) of section 18 forms a corollary to section 16(2). Therefore when tax is paid on behalf of a shareholder and deduction is made from dividend, credit is given to him for the tax paid in his final assessment. But the scheme of "grossing up" is not susceptible of the interpretation that the income from dividend is to be regarded as the income only of the registered shareholder and not of the real owner of the shares.

The authorities of this Court which have interpreted section 16(2) may be reviewed. In *Howrah Trading Company's case* ((1959) Supp. 2 S.C.R. 448) it was held that a person who had purchased share in a company under a blank transfer and in whose name the shares had not been registered in the books of the company is not a "shareholder" in respect of such shares within the meaning of section 18(5) of the Income-tax Act, notwithstanding his equitable right to receive dividend on such shares. Such a person was therefore held not entitled to have the dividend income grossed up under section 16(2) of the Act by the addition of the income-tax paid by the company in respect of those shares, and to claim credit for the tax deducted at source under section 18(5) of the Act. In that case the only dispute which arose was with regard to "grossing up". The dividend income was included in the total income of the person who was the real owner of the shares, though the shares were not registered in his name. In *Income-tax Officer, North Satara v. Arvind N. Mafatlal and Others* ((1962) Supp. 3 S.C.R. 455 : 45 I.T.R. 271) it was held, following the judgment in *Howrah Trading*

Companys 'case' ((1959) Supp. 2 S.C.R. 448), that the registered shareholder alone is entitled to the benefit of the credit for tax paid by the company under section 18(5) and the corresponding "grossing up" under section 16(2). In that case shares belonging to a firm registered under the Income-tax Act were held in the names of three partners of the firm. The Income-tax Officer sought to treat the dividend from the shares as income of the firm and to "gross up" the dividend by adding the income-tax paid. This Court held that the only persons who were entitled to be treated as shareholders to whom the provisions of sections 16(2) and 18(5) were attracted were the three partners. The judgment of this Court in Commissioner of Income-tax, Bombay City II v. Shakuntala and Others ((1962) 2 S.C.R. 871 : 43 I.T.R. 352) does not support any different rule. That was a case in which a Hindu undivided family held certain shares in a company in the names of different members of the family. The Income-tax Officer applied the provisions of section 23A of the Indian Income-tax Act, 1922, before it was amended in 1955, and ordered that the undistributed portion of the distributable income of the company shall be deemed to be distributed. In proceedings for assessment the amount of deemed income appropriate to the shares of the family was ordered by the Income-tax Officer to be included in the income of the family. It was held that the expression "share-holder", in section 23A of the Indian Income-tax Act meant the shareholder registered in the books of the company. Therefore the amount appropriate to the shares had to be included in the income of the members of the family in whose names the shares stood in the register of the company, and as the Hindu undivided family was not a registered shareholder of the company, the amount deemed to be distributed could not be assessed as the income of the family under section 23A. The Court in Shakuntala's case ((1962) 2 S.C.R. 871 : 43 I.T.R. 352) was dealing with notional income. The amounts which were not distributed by the company, but which by virtue of an order under section 23A of the Act were deemed to be distributed were sought to be assessed and the Court held in the light of the express provisions of section 23A that the undistributed portion of the distributable income of the company of the previous year as computed for income-tax purposes shall be deemed to be distributed as dividend among the shareholders. The decision of the Court was that for the purpose of section 23A, the expression "shareholder" meant only the registered shareholder and not an equitable owner. The decision has no bearing on the true interpretation of section 16(2).

Reliance was placed by counsel for the appellant on the following observations made by Hidayatullah, J., in delivering the judgment of this Court in Howrah Trading Company's case ((1959) Supp. 2 S.C.R. 448):

"The words of section 18(5) must accordingly be read in the light in which the word "shareholder" has been used in the subsequent sections, and read in that manner, the present assessee, notwithstanding the equitable right to the dividend, was not entitled to be regarded as a "share-holder" for the purpose of section 18(5) of the Act. That benefit can only go to the person who, both in law and in equity, is to be regarded as the owner of the shares and between whom and the company exists the bond of membership and ownership of a share in the share capital of the company."

It was said by counsel for the appellants that by the use of the expression "benefit can only go to the person who, both in law and in equity, is to be regarded as the owner of the shares", it was laid down that dividend may be taxed only in the hands of a person who is "in law as well as in equity" the shareholder. But these observations are not susceptible of any such meaning. Hidayatullah, J., in that case was seeking to explain that dividend income cannot be "grossed up" in the hands of the real owner of shares if the shares are registered in the name of another person. He did not say that the real owner of shares cannot be taxed in respect of dividend received by him, if the shares are registered in the name of another person.

We are unable to accept the argument of counsel for the appellants that because the dividend income in respect of the shares cannot be "grossed up", and credit for tax paid cannot be obtained by the appellants, the appellants are not liable to be taxed in respect of dividend received by them. There is no provision in the Act which supports this plea, and the scheme of the Act lends no countenance to an expedient which may lead to gross evasion of tax.

The appeal therefore fails and is dismissed with costs.

Appeal dismissed.

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