Commissioner of Income-Tax, Gujarat

Vs

Distributors (Baroda) P. Ltd.

Civil Appeals Nos. 2350 to 2353 of 1968 and 1313 to 1316 of 1971

(K. S. Hegde, A. N. Grover JJ)

16.09.1971

JUDGEMENT

HEGDE. J -

1. These are some of the appeals where the appellant unfortunately had to file two different appeals in respect of the same matter. Civil appeals Nos. 2350-2353 of 1968 were brought on the strength of the certificates.

granted by the High Court of Gujarat. no reasons were given in support of those certificates. Hence those certificates must be considered as having not been properly granted. The resulting position was that the appeals brought on the strength of those certificates became unsustainable. To get over that difficulty, the commissioner of income tax, Gujarat, invoked our jurisdiction under article 136 of the constitution to appeal against the judgment of the high court. The special leave asked for was granted the judgment of the high court. The special leave asked for was granted and thus he came to file Civil Appeals Nos. 1313-1316 of 1971.

The assessee is a private limited company and the concerned assessment years are 1957-58, 1959-60, 1960-61 and 1961-62. The only only question for decision in these appeals is whether the assessee company comes within the scope of section 23A of the Indian Income tax Act, 1922 (to be herein after referred to as the act ?

The assessee company was incorporated on October 11, 1941. The subjects clause in the memorandum of association contains the usual string of objects. confining ourselves to the objects relevant for our present purpose, we get in clause (3) of the memorandum power to acquire and bold shares, stocks, debentures stocks, bonds, obligations and securities issued or guaranteed by any company constituted or carrying on business in British India". Sub-cause (p) of that clause empowers the company to take part in the formation, management supervision or control of the business or operation of any company or undertaking and for that purpose to appoint and remunerate any directors, accountants or other experts or agents." Clause (q) provides power "to carry on all or any of the following businesses; 'Agents, chief agents or licensed agents of any company..."

We are not concerned with other objects mentioned in the memorandum.

In July, 1942, the assessee company promoted a company known as new India industries Ltd. by an agreement dated July 24, 1942, the assessee company was appointed as managing agents of the said New India Industries Ltd., In 1956, the said managing agency was renewed for a period of five

years in view of the provisions of the companies Act, 1956.

The group of persons who had floated the assessee company had earlier in the year 1940 floated a company called the Cotton Fabrics Private Ltd. By agreement dated April 22, 1943, the assessee company was appointed the managing agent of the said Cotton Fabrics Private Ltd. In 1956, the said managing agency agreement was also renewed for a period of five years for the very reason referred to earlier.

We have already noted that the assessee company is a private company. As such it is not a company in which the public are substantially interested.

The Income-tax Officer was of the opinion that, as during the previous years to the assessment years in question, the assessees company's income from its business activity in the dealing in or holding of investments" was very much more than its income from its managing agencies and further as it had used a very large portion of its assets in the former activity, it must be considered as an investment company" an expression not found in the act. Basing himself on that finding, he reasoned thus statutory percentage of profits to be declared as dividends by such a company under section 23A was 100 per cent. in the first two assessments years and 90 per cent, in the remaining two assessment years. The dividends declared by the assessee company fell much below that percentage. Hence it was liable under section In appeal, the decision was affirmed by the appellate assistant commissioner excepting in regard to certain deduction with which we are not concerned.

Aggrieved by the order of the Appellate Assistant Commissioner, the assessee took up the matter in second appeal to the income tax Appellate Tribunal. The Tribunal agreed with the conclusions reached by the Appellate Assistant Commissioner. Thereafter, at the instance of the assessee, the following two questions were referred to the high court under section 66(1) of the Act :

> "(1) Whether on the facts and circumstances of the case, the tribunal was justified in holding that the assessee company is an investment company for purposes of section 23A of the Income tax Act, 1922 ?
>
> (2) Whether the tribunal was justified in law in holding that which determining the undistributed balance of the total income for charging super tax under the provisions of section 23A of the Act, no deduction can be allowed in respect of the expenses actually incurred by the assesses company but disallowed for the purposes of computing its assesses income ?"

Before the high court, counsel for the assessee did not press for an answer to the second question. Hence, the high court did not consider that question. The high court reframed the first question thus :

> "Whether on the facts and circumstances of the case, the Tribunal was justified holding that the assessee company is a company who business consists mainly in dealing in or holding of investments within the meaning of clause 1 of the second Explanation to section 23A of the income tax Act, 1922 ?"

The High Court answered that question in the negative and in favour of the assessee. It is the correctness of that decision that is in issue before us.

We have now to consider whether the High Court was right in concluding that the assessee company

did not come within the scope of section 23A. In arriving at its conclusion the high court had approached the question before it from three different angles, viz., (1) the objects of the company as mentioned in its memorandum of association (2) the points profits earned by the company during the relevant previous years from its various activity and (3) the assets used by the company in those years for the purpose of holding the shares of the managed companies, in dealing with the shares of other companies, and in connection with its other business activities.

Section 23A to the extent relevant for our present purpose, reads :

> "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 the statutory percentage of the total income of the company of that previous year as reduced by - (a) ... (b) ... (c) ...

the Income-tax Officer shall, unless he is satisfied that, having regard to the 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 is writing that the company shall, apart from the sum determined as payable by it on the basis of the assessment under section 23, be liable to pay super tax at the rate of fifty percent. In the case of a company whose business consists wholly or mainly in the dealing in or holding of investments, and at the rate of thirty seven percent, in the case of any other company on the undistributed balance of the total income of the previous year, that is to say, on the total income as reduced by the amounts, if any referred to in clause (a), clause (b) or clause (c) and dividends actually distributed, if any..."

Explanation 2 to that section says :

"For the purpose of this section, statutory percentage means, -

> (i) in the case of company whose business consists wholly or mainly in the dealing in or holding of investments .....100%"

We have not to see what exactly is the meaning of the expression "in the case of a company whose business consists wholly or mainly in the dealing in or holding of investments" in the main section 23A and the expression "in the case of a company whose business consists wholly or mainly in the dealing in or holding of investments" in clause (i) of Explanation 2 to section 23A. The Act contains many mind-twisting formulas but section 23A along with some other sections takes the place of pride amongst them. Section 109 of 1961 Income-tax Act which has taken the place of the old section 23A of the Act is more understandable and less abstruse. But in these appeals we are left with section 23A of the Act.

> Clause (i) of Explanation 2 to section 23A concerns itself with a company whose business consists "wholly or mainly in the dealing in or holding of investments." The word "mainly" in that clause as well as in the main section 23A must necessarily take its colour from the word "wholly" preceding that word, in those provisions. In other words, the company which comes within the scope of those provisions must be one whose primary business must be "in the dealing in or holding of investments". If a company engages itself in two or more equally or nearly equally important business activities, then it cannot be said that the company's business consists "wholly or

> mainly" in dealing in a particular thing. Further, even in cases where a company has more than one business activity and one of its activities is more substantial than the others, unless that activity is the primary activity of the company, it cannot be said that that company is engaged in "wholly or mainly" in any one of its business activities. Section 23A, in our opinion, applies only to cases where the primary activity of the company is in "the dealing in or holding of investments". We shall presently see whether, on the facts found by the Tribunal, it can be said that the assessee-company's business in the relevant years consisted "of mainly in the dealing in or holding of investments" as it was not the case of the revenue that it was wholly engaged in that business.

We next come across another expression which is far more difficult to comprehend than the one that we were considering till now. Section 23A speaks of the business of "holding of investments". Here comes the enigma. It is easier to understand when the section speaks of a company having the business of dealing in investments though to say that the company is dealing in investments may, at first sight, look somewhat incongruous. When the legislature spoke of dealings in investments, it meant dealing in shares, stocks and securities, etc. But when a person invests in the shares of some of the companies, it is difficult to say that his business is one of investing. In commercial circles investing is not considered as business. An investor may feel perplexed if he is called a businessman.

This court in Bengal and Assam Investors Ltd. v. Commissioner of Income-tax came to the conclusion that an individual who merely invests in shares for the purpose of earning dividend, does not carry on a business and that the only way he can come under section 10 of the Act is by converting the shares acquired by him into stock-in- trade, i.e., by carrying on the business of dealing in stocks and shares. In that case this court was considering whether the dividend income of the assessee-company therein could be considered as business income under section 10 of the Act. Therein this court was not considering the scope of section 23A. But all the same in that case this court proceeded on the basis that no one can make a business of investing. But then section 23A speaks of the business of "holding of investments". We were told by the counsel for the assessee that that expression is an incongruous one and that we should, following the decision of this court in Bengal and Assam Investors Ltd., hold that there is nothing like a business of "holding of investments". We feel unable to accede to that contention. We cannot say that the legislature did not know its own mind when it used that expression in section 23A. We must give some reasonable meaning to that expression. No part of a provision of a statute can be just ignored by saying that the legislature enacted the same not knowing what it was saying. We must assume that the legislature deliberately used that expression and it intended to convey some meaning thereby. The expression "business is a well-known expression in income-tax law. It means as observed by this court in Narain Swadeshi Weaving Mills v. Commissioner of Excess Profits Tax : "some real, substantial and systematic or organised course of activity or conduct with a set purpose". This is also the meaning given to that expression in the earlier decisions of the High Courts and the judicial Committee. We must, therefore, proceed on the basis that the legislature was aware of the meaning given by courts to that expression when it incorporated section 23A into the Act in 1957. Hence we must hold that when the legislature speaks of the business of "holding of investments", it refers to real, substantial and systematic or organised course of activity of investments carried on by an assessee for a set purpose such as earning profits.

Now let us leave section 23A and proceed to examine the facts of the case to find out whether the assessee-company can be held to come within the scope of section 23A in the light of our

interpretation of that provisions.

We have earlier referred to the objects clause in the memorandum of association. The memorandum permits the assessee-company to take up the management of the other companies, to invest in the shares of the other companies and to deal in the shares of the companies. Therefore, it cannot be said that the assessee-company was incorporated primarily with the object of carrying on the business of the "dealing in or holding of investments." The objects of the assessee company are manifold. The object of carrying on the business of dealing in or holding of investments is only one of them. Hence, the memorandum of association does not assist us in deciding whether the business of the assessee company consists of wholly or mainly in the dealing in or holding of investments".

We shall now take up the question of the profits earned by the assessee company during the relevant previous years. The High Court has its judgment set out a statement showing the profits earned by the assessee company through its various activities. It would be convenient to set out the same now :

#---------- ASSESSMENT YEAR 1957-58 1959-60 1960-61 1961-62 Rs. Rs. Rs. Rs.----------1. Managing agency 209,999 2,56,315 2,41,705 1,96,3842. Dividend on shares ofmanaged companies 1,95,179 2,58,511 3,21,746 3,12,2513. Income from shares heldas stock in trade : (i)interest on debentures 379 342 309 312 (ii) Dividends 3,40,695 4,68,775 5,48,325 5,53,999(iii) Dealing in shares 23,867 16,755 28,329 22,100 (iv) Share transfer fee 10 10 10 10 Total No of (i) to (iv) ---------- --------- ---------- ---------- 3,64,941 4,85,882 5,76,973 5,76,421 ---------- --------- --------- ---------4. Income from interest 4,595 3,358 15,276 23,61?----------##

In order to find out the implications of this statement we have to first decide whether the assessee company can be said to be a company engaged in the business activity of holding of investments. The finding of the Tribunal on this point is stated thus :-

> "We agree with the assessee that the shares in the managed-companies were acquired with a view to safely hold the managing agencies in the business activity of we do agree that for that reason only those shares cannot be taken into account for the purpose of a business of dealing in or holding of investments".

All the shares held by the assessee company as its investments were the shares of the two companies of which it was a managing agent It invested in no other shares. The tribunal has found that the managed company's shares were acquired by the assessee company for the purpose of safeguarding its managing agency business. Therefore, it is quite clear that those investments were made not in the course of any business of investment but for the purpose of securing its managing agencies. Those investments were made for a collateral purpose, viz. , to have a firm grip over its managing genus business. If we are correct in this finding - we think we are - then it follows that the dividend income from shares of the managed-companies cannot be taken into consideration in finding out whether the assessee-company's business "consisted wholly or mainly in the dealing in or holding of investments". The investments made by the assessee-company in the shares of the managed-companies are essentially linked with its managing agencies and not with the dealing of that company in shares of the other companies. In other words those investments form part of the assessee-company's managing agency business activity. If we add the dividend income of the shares of the managed companies to the managing agency commission, the total income from those two sources is much more than the income earned by the assessee-company from its share dealings, in

each one of the assessment years. Hence, viewed from the point of view of profits earned by the assessee-company, it cannot be said that in the relevant previous years the assessee- company's business "consisted wholly or mainly in the dealing in or holding of investment."

Now let us look at the question from the point of view of the assets employed by the assessee-company. Here again we can take assistance from the schedule given in the judgment of the High Court setting out in detail the assets used by the assessee-company in its several business activities. That schedule read thus :

I. SHARES OF MANAGED COMPANIESTreated by the income-tax department as investments not formingpart of the business of dealing in shares.1. New India Industries 6,91,084 6,96,883 6,96,883 6,96,8832. Cotton Fabrics Ltd. (i) Ordinary shares 3,69,285 3,69,285 3,69,285 3,69,285 (ii) Preference shares 88,463 88,469 90,483 90,483 -------- -------- -------- --------- 11,48,832 11,54,631 11,56,651 11,56,651 --------- --------- --------- ----------II. SHARES OF OTHER COMPANIESTreated by the income-taxdepartment as held fordealing in shares (stock-in-trade) 25,07,969 30,13,518 29,88,946 36,07,063 --------- --------- --------- ---------Total investment as perbalance-sheet 36,56,801 41,68,149 41,45,597 47,63,714 --------- ---------- --------- ---------##

It is true that the assets used by the assessee-company in its share dealing are more than that used by it for investment in the shares of the managed-company. But then we have to bear in mind we do not exhaust the total assets of the company by merely referring to the tangible assets used by it. In addition, we have to take into consideration the value of the managing agencies held by the assessee- company. Looked that way, it cannot be said that the assets of company, used in its share dealings, are far more than its other assets. At any rate, on the basis of the assets used, it cannot be concluded that the assessee's business consisted "wholly or mainly" in the dealing in investments.

It follows from the conclusions reached by us earlier, that our answer to the question before us must be the same as that given by the High Court. We not only agree with the conclusions reached by the High Court but also with the premises on the basis of which those conclusions were reached.

In the result Civil Appeals Nos. 1313 to 1316 of 1971 are dismissed on merits with costs - one set of fees; and Civil Appeals Nos. 2350-2353 of 1968 are dismissed as being not maintainable but without any order as to costs.

Appeals dismissed.

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