

Commissioner of Income-Tax, Bombay

Vs

West Coast Paper Mills Ltd.

Civil Appeal Nos. 1344 of 1971 and 139 of 1969

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

17.09.1971

JUDGMENT

GROVER J. -

Civil Appeal No. 1344 of 1971 is by special leave from a judgment of the Bombay High Court in an income-tax reference. The other appeal was brought by certificate against the same judgment. But the certificate being defective for want of reasons, the same had to be revoked.

The assessee is a public limited company which was incorporated on March 25, 1955. Part of its paid up capital consisted of 60,000 six per cent. (free of tax) cumulative preference shares of Rs. 100 each. As the company did not make profits out of which it could distribute dividend no dividend was declared on the preference shares during the years of account ended on June 30, 1956, June 30, 1957 and June 30, 1958. During the account year ended on June 30, 1960, the company made profits. On February 9, 1960, the board of directors of the company passed the following resolution :

"That dividends on 60,000 cumulative preference shares of Rs. 100 each in respect of the years ended 30th June, 1956, and 1957, remaining in arrears be paid at the rate of 6% (free of tax).... out of the profits of the current year ending 30th June, 1960."

The dividends were distributed in accordance with the resolution of April 25, 1960. On May 30, 1960, the board of directors passed a similar resolution for distributing the dividends on the preference shares in respect of the year ended on June 30, 1958. These dividends were actually paid from June 24, 1960, onwards. Adjustments with regard to these dividends were made in the balance-sheet prepared as at June 30, 1960.

The Finance Act, 1959 (12 of 1959), made certain changes in the scheme of taxation of an incorporated company and of its shareholders. The main changes were : (i) reduction in the rate of tax levied on the company, (ii) taking away the credit given till then to the shareholder for income-tax paid by the company on the dividends declared, and (iii) imposition of an obligation on the company to deduct tax at source on dividends declared by the company which was to be remitted to the Government. The duty to deduct the tax was imposed by amendments to section 18(3D) and (3E) of the Income-tax Act, 1922 (hereinafter called "the Act"), which were introduced by section 9 of the Finance Act, 1959 (12 of 1959) which was brought into force with effect from April 1, 1959. However, an exemption was provided from the operation of the provisions of the amended sections under certain circumstances by section 19(4) of the Finance Act, 1959 (12 of 1959). That provision, as amended retrospectively by the Finance Act, 1960, was in the following terms :

"Notwithstanding anything contained in sub-section (2) or sub-section (3), in relation to dividends declared or payable by a company on or before the 30th day of June, 1960, in respect of any previous year relevant to any assessment year prior to the assessment year 1960-61, the Income-tax Act shall have effect as if the amendments contained in section 5, section 7, section 9, section 10, section 14, section 15, section 16, and section 18 had not been made."

The assessee did not deduct any tax from the dividends declared on February 9, 1960, and May 30, 1960, and paid from April 24, 1960, and June 24, 1960, onwards, respectively. In the course of the assessment for 1960-61, made on the company, the Income-tax Officer called upon the assessee to show cause why it should not be treated as an assessee in default under section 18(7) of the Act in respect of the taxes which according to him should have been deducted and paid but which were not paid. The assessee submitted that the dividends were declared in respect of previous years relevant to the assessment year 1959-60 and the earlier year and that under section 19(4) of the Finance Act, 1959 (12 of 1959), there was no obligation to deduct tax from dividends declared in respect of those years. This Objection based on section 19(4) of the Finance Act, 1959 (12 of the 1959), was overruled by the Income-tax Officer. He held that the assessee was liable under section 18(7) of the Act for payment of tax amounting to Rs. 2,32,748.70. The assessee appealed to the Appellate Assistant Commissioner but that appeal failed. There was a further appeal to the Appellate Tribunal. The Tribunal upheld the orders of the departmental authorities. Thereupon, the assessee moved the Tribunal for submitting a statement of the case and referring for the following question of law to the High Court :

"Whether, in view of section 19(4) of the Finance Act, 1959 (as amended by the Finance Act, 1960), there was any obligation to deduct tax under section 18(3D) and (3E) from the dividends declared on February 9, 1960, and May 30, 1960, so as to justify the order under section 18(7) of the Income-tax Act, 1922, on failure to do so?"

The High Court answered the question in favour of the assessee and against the revenue.

The whole controversy centers on the true interpretation of section 19(4) of the Finance Act, 1959 (12 of 1959) as amended by the Finance Act of 1960. The assessee claimed that that section was enacted to give exemptions with regard to such dividends which were in respect of the earlier years and which were declared between the dates April 1, 1959, when the new obligation of deducting a tax at the source was imposed and June 30, 1960. According to the Tribunal, the dividends declared on February 9, 1960, and May 30, 1960, were dividends in respect of the year 1959-60 and were in respect of the previous year relevant to the assessment year 1960-61. These dividends were not entitled to any exemption under section 19(4) of the Finance Act, 1959 (12 of 1959).

Section 19(4) lays down two conditions. The first is that the dividend must be declared or payable by a company on or before June 30, 1960. The second is that it should be in respect of any previous year relevant to any assessment year prior to the assessment year 1960-61. The only dispute is confined even with regard to the above two conditions to the meaning of the words "in respect of" in section 19(4). In other words, the point for determination in the present case is whether the dividends declared by the company on February 9, 1960, and on May 30, 1960 and paid out by it from April 25, 1960 and June 24, 1960, onwards were dividends in respect of the previous years relevant to the assessment years which were prior to the assessment year 1960-61. As has been observed by the High Court the resolutions of the company, its annual report and accounts, the

notice of the annual general meeting setting out the agenda, all showed that the dividends were referred to as the dividends paid on the preference shares for the accounting years ended on June 30, 1956, June 30, 1957 and June 30, 1958. The argument on behalf of the revenue, however, has been that under the provisions of the company law, dividend can be declared and paid only out of profits of a particular year. As there were no profits during the three years in question it could not be said that the dividends declared by means of the resolutions passed on February 9, 1960, and May 30, 1960 and paid were in respect of the years which had ended on June 30, 1956, June 30, 1957 and June 30, 1958. In the eye of law, the dividends, which were declared and paid in the year of account 1959-60, could only be dividends in respect of that year and they could not be dividends in respect of any earlier years in which the preference shareholders were entitled to the same but were not paid. The argument on behalf of the revenue, in other words, has been that the so-called dividends, which were declared and paid for the three years in question, were payments only of such amounts as were due to the preference shareholders as arrears. It is not disputed that a preference shareholder is entitled to the payment of the dividend whenever the company has profits even though it has not earned profits in any earlier year when the dividend became due. But, it is contended when such a payment is made after it ceases to have the character of a dividend and is just a bare payment of what had become due to the preference shareholder. Our attention has been invited by the learned counsel for the revenue to the statement in Buckley on the Companies Acts, thirteenth edition, at page 896, to the following effect :

"In the absence of anything to the contrary in the regulations, members are entitled to profits in proportion to their shares in the undertaking. The company may, if it has or can acquire power so to do, issue preference shares. Where it is intended that a deficiency in a fixed preferential dividend in any one year shall be made good out of profits of a subsequent year, it is commonly and conveniently expressed as a cumulative preference dividend. But the words 'preference dividend', without adding 'cumulative', bear, in the absence of anything to the contrary, the same meaning. There is no magic in a year; a preference dividend is a thing to be paid out of the proper fund, viz., the profits before the ordinary share comes into receipt. 'Arrears of dividend' and 'back dividends' are inaccurate expressions."

In Palmer's Company Law, seventeenth edition, it is stated that the term "cumulative preferential dividend" meant a dividend payable out of the profits generally in priority to the subordinate class or classes of shares so that if the profits of one year are not sufficient to pay the dividend for that year, the deficiency accumulates as against subsequent profits and has to be paid before any dividend can be paid on the subordinate class or classes.

There can be no manner of doubt that so far as company law is concerned the correct position is the one suggested on behalf of the revenue and dividend would be payable only for the year in which profit is made.

That expression may not be appropriate or the deficiency which accumulates on account of non-payment of dividend in a particular year because no profits have been made by the company. But we are not concerned with the connotation of the expression "dividend" as it is understood in company law. The Finance Act, 1959 (12 of 1959), introduced the changes which have already been adverted to and an obligation was imposed upon the company to deduct tax on dividends. Section 19(4) contains an exemption and the language appears to be unambiguous. We apprehend that the exemption would be rendered meaningless and nugatory if the interpretation sought to be placed by the revenue were to be accepted. In plain language the legislature has enacted that any dividend

declared or payable before June 30, 1960, in respect of any previous year, etc., would be exempt from the operation of the amendments contained in the sections by which the obligation was imposed on the company to deduct the tax. A good part of section 19(4) would become otiose if "dividend" is given its technical meaning in accordance with its signification in the company law. We invited the learned counsel for the revenue to give us any illustration of the actual operation of sub-section (4) of section 19. He was unable to give us any satisfactory or cogent illustration. We entirely concur in the view of the High Court that the language used in section 19(4) applies to payments, the right to receive which had been acquired in the previous years on account of the dividend of the preference shares and that the said expression is wide enough to include payments relating to the "undischarged liabilities in respect of those prior years". The answer returned by the High Court is affirmed.

In the result, the appeal by special leave fails and it is dismissed with costs. As regards the appeal by certificate, the same is dismissed for the reasons already stated. There will be no order as to costs in that appeal.

Appeal dismissed.

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