

Commissioner of Income-Tax, Gujarat

Vs

Vadilal Lallubhai

Commissioner of Income-Tax, Gujarat

Vs

Sakarlal Balabhai

Civil Appeals Nos. 2348 and 2349 of 1968, No. 1139 of 1969 and Nos. 2006 and 2007 of 1971

(K. S. Hegde, P. Jagmohan Reddy, H. R. Khanna JJ)

29.08.1972

JUDGMENT

HEGDE J. -

1. The principal question of law arising in these appeals by certificate is whether on the facts and in the circumstances of each of these cases the department was right in applying section 44F read with section 2(6A)(c) of the Indian Income-tax Act, 1922 (to be hereinafter referred to as "the Act"). The Income-tax Officer, the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal answered that question in favour of the department, but the High Court answered the same in favour of the assessee. As we are in agreement with the conclusion reached by the High Court, we do not think it necessary to examine the other question arising in these appeals.

For deciding the said question of law, it is sufficient if we take up the facts of any one of these cases. For the sake of convenience, we shall set out the facts in Civil Appeal No. 2348 of 1968. The assessee in that case is Vadilal Lallubhai. He is assessed as an individual. The relevant assessment year is 1958-59, the accounting year being the year ending on March 31, 1958.

The assessee belongs to the well-known family of Vadilal Lallubhai Mehta of Ahmedabad. The members of this family (who for the sake of convenience will hereinafter to as the "Mehta group") owned shares in and controlled several companies including certain managing agency companies. These managing agency companies were private limited companies. The managed companies were also companies in which the members of the "Mehta group" had controlling interest. This group had also selling agency rights in the companies which they were managing. On the coming into force of the Companies Act, 1956, the managing agency companies gave up their managing agency rights in order to safeguard their selling agency rights. Thereafter, the assessee sold his shareholdings to the employees of some "Mehta group" companies or the relations of such employees. In addition, he sold some shares to one of the family trusts. A few days after the sales in question those managing agency companies went into voluntary liquidation. Consequently, the assets of those companies were distributed among the shareholders who were borne on the registers of the companies as on the dates of liquidation. These shareholders included those persons who had newly purchased the shares. One of the new shareholders as mentioned earlier was a charitable trust which was not liable

to pay any tax. The remaining shareholder were either not liable to pay any tax or were liable to pay tax at a lower rate than the assessee would have had to pay had he received the amount distributed by the liquidators.

The Income-tax Officer brought to tax a portion of the assets distributed on liquidation by applying section 44F read with section 2(6A)(c) of the Act. The Appellate Assistant Commissioner agreed with this view. The assessee's appeal to the Income-tax Appellate Tribunal was unsuccessful. Thereafter, at the instance of the assessee, certain questions were referred to the High Court on behalf of the assessee. We do not think it necessary to refer to those contentions as, in our view, the High Court was right in taking the view that, to the facts and circumstances of the case, section 44F read with section 2(6A)(c) was inapplicable.

It was contended on behalf of the revenue that the distribution of the assets of the various managing agency companies on liquidation is "dividend" within the meaning of section 2(6A)(c) and consequently is "income" as defined in section 2(6C). Further, the assessee sold his shares with a view to avoid income-tax and super-tax and consequently the assets distributed which would have fallen to his share had he not sold his share are liable to be brought to tax under the provision of section 44F of the Act. On the other hand, it was contended on behalf of the assessee that the definitions contained in section 2 are only to be applied "unless there is anything repugnant in the subject or context". The definition of "dividend" given in section 2(6A)(c) is repugnant to the subject dealt with under section 44F and consequently the distribution of the assets on liquidation of the several managing agencies concerns cannot be considered as "income" within the meaning of section 44F. It was urged that section 44F concerns itself with the income from securities or shares which are of a periodical nature but which an assessee may seek to convert into a capital receipt by adopting certain devices. The provisions therein do not deal with the compensation received for the very destruction of the income-yielding assets, viz., the securities or shares. We shall now consider which one of these two contentions is acceptable. But before doing so, it will be convenient to make reference to the relevant provisions in the Act.

Section 2, the definitions section, starts by saying that the definitions given therein apply "unless there is anything repugnant in the subject or context." Hence, if the definition of "dividend" found in section 2(6A)(c) is either repugnant to the subject or context with which we are dealing, that definition will not be applicable. Section 2(6A) gives an inclusive definition of "dividend". In this case we are concerned with section 2(6A)(c) which reads :

"any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not."

Section 2(6C) gives an inclusive definition of "income". Dividend is included therein. Hence if a receipt can be considered as a "dividend", it has to be considered as an "income" under section 2(6C). This takes us to section 44F, which reads :

"(1) Any person upon whom notice is served by the Income-tax Officer requiring him to furnish a statement of particulars relating to any securities in which, at any time during the period specified in the notice he has had any beneficial interest, and in respect of which, within such period, either no income was received by him, or the income received by him was less than the sum to which the income would have amounted if the income from such securities had accrued from day to day and been

apportioned accordingly, shall, whether an assessment to income-tax or super-tax in respect of his total income has or has not been made for the relevant year of years of assessment, furnish such a statement and such particulars in the form and within the time (not being less than twenty-eight days) required by the notice.

(2) If it appears to the Income-tax Officer by reference to all the circumstances in relation to the securities of any such person (including circumstances with respect to sales, purchases, dealings, contracts, arrangements, transfers, or any other transaction relating to such securities) that such person has thereby avoided or would avoid more than ten per cent of the amount of the income-tax or super-tax for any year which would have been payable in his case in respect of the income from those securities if the income had been deemed to accrue from day to day and had been apportioned accordingly, and the income so deemed to have been apportioned to him had been treated as part of his total income from all sources for the purposes of income-tax or super-tax, then those securities shall be deemed to be securities to which sub-section (3) applies.

(3) For the purpose of assessment to income-tax or super-tax in the case of any such person, the income from any securities to which this subsection applies shall be deemed to accrue from day to day and in the case of the sale or transfer of any such securities by or to him shall be deemed to have been received as and when it is deemed to have accrued :

Provided that this section shall not apply if such person proves to the satisfaction of the Income-tax Officer that the avoidance of income-tax or super-tax was exceptional and not systematic and that there was not in his case in any of the three preceding years any such avoidance of income-tax or super-tax, or that the provisions of section 44E have been applied in his case in respect of such income.....

(6) For the purpose of this section the expression 'securities' includes stocks and shares".

From a reading of sub-sections (1) to (3) of section 44F, it is clear that the income referred to therein should arise from shares or securities. Further, it must be a periodical income which is capable of being apportioned on the basis that it is deemed to have accrued from day to day. Section 44F(1) empowers the Income-tax Officer to serve a notice on any person "requiring him to furnish a statement of particulars relating to any securities in which at any time during the period specified in the notice he has had any beneficial interest and in respect of which, within such period either no income was received by him or the income received by him was less than the sum to which the income would have amounted if the income from such securities had accrued from day to day and had been apportioned accordingly....."

The power conferred on the Income-tax Officer under this provision is not confined to any stipulated period.

Now, turning to sub-section (2) of section 44F, it speaks of "the amount of the income-tax or super-tax for any year which would have been payable in his case in respect of the income from those securities if the income had been deemed to accrue from day to day and had been apportioned accordingly....."

Again, sub-section (3) of section 44F speaks of "the income from any securities to which this sub-section applies shall be deemed to accrue from day to day, and in the case of the sale or transfer of any such securities by or to him shall be deemed to have been received as and when it is deemed to have accrued....."

It is clear from what we have said earlier that section 44F concerns itself with income arising from securities or shares, during a period of time. When a company goes into liquidation, the share-scrips are no more income yielding assets. They are mere pieces of paper. No income arises from those shares thereafter. What the shareholder gets on liquidation is not any income from shares but a share of the assets of the quondam company. Such a receipt is incapable of being deemed to accrue from day to day. In the case of interest on securities or dividends on shares, they are paid at certain intervals. Hence, it is possible to deem them as having accrued from day to day but in the case of distribution of assets of a company in liquidation, it is not possible to deem the same to have accrued from day to day. We have to bear in mind that some of the "dividends" mentioned in section 2(6A) are only deemed dividends. They are not real dividends. By a legal fiction, they are deemed as dividends. This court held in *Commissioner of Income-tax v. C.P. Sarathy Mudaliar*, that the definition of "dividend" contained in section 2(6A)(e) is an artificial definition of "dividend". It does not take in dividend actually declared or received. The dividend taken note of by that provision is a deemed dividend and not a real dividend. The same would be the position in the case of the "dividend" mentioned in section 2(6A)(c). As held by this court in *Commissioner of Income-tax v. Amarchand N. Shroff*, legal fictions are only for a definite purpose and they are limited to the purposes for which they are created and should not be extended beyond their legitimate field.

It is established on high authorities that the subject is not to be taxed unless the charging provision clearly imposes the obligation - see *Commissioner of Income-tax v. Ajax Products Ltd.* As is often said that in interpreting a taxing provision one has merely to look to the words of the provision. The language employed in section 44F cannot be said to be plain enough to bring to tax the receipts of the character with which we are concerned in these appeals.

To accept the contention of the revenue, we have to adopt threefold assumptions. Firstly, the fictional dividend contemplated by section 2(6A)(c) is an "income" within the meaning of section 44F. Secondly, we must assume that the dividend is capable of being deemed to accrue day to day and, lastly, we must assume that the day to day distribution contemplated in section 44F commences from the commencement of the relevant accounting year and ends with the distribution of the assets as contended on behalf of the department. To do so we have to read into the section many more words than it contains at present which is wholly impermissible in construing any provision, much less a taxing provision. In the case of deemed dividend under section 2(6A)(c), the assets distributed will be considered as income in the account year in which it is distributed but that conception would be inapplicable in case coming under section 44F. A company may go into liquidation long after the accounting year ends. What period should the Income-tax Officer take into consideration for applying the fiction that "the income had been deemed to accrue from day to day"? The scheme of section 2(6A)(c) is incompatible with the scheme of section 44F. The two provisions are intended to meet totally different situations. The former provision cannot be dovetailed into the latter.

In order to find out the legislative intent, we have to find out what was the mischief that the legislature wanted to remedy. The Act was extensively amended in the year 1939. Section 44F was not in the draft Bill. That section was recommended by the Select Committee consisting of very eminent lawyers. It will not be inappropriate to find out the reasons which persuaded the Select

Committee to recommend the inclusion of section 44F - if the section is considered as ambiguous - see Commissioner of Income-tax v. Sodra Devi. In recommending the inclusion of section 44F this is what the Select Committee observed :

"The new sections 44E and 44F are designed to prevent avoidance of tax by what are known as 'bond-washing' transactions, involving the manipulation of securities so that the securities will pass temporarily into the legal ownership of some second person who is either not liable at all or liable in a lesser degree to tax, under such conditions that the interest on the securities is the income of this second person. A common form of the process is the sale of securities-cum-interest with a simultaneous contract to repurchase them ex-interest. Where foreign securities are concerned this second person may be a foreign resident abroad entitled to claim exemption from the tax on the interest. More often a financial concern in India is utilised whose computation of profits includes the results of realising securities, so that the concern can profitably offer 'bond-washing' facilities to the owner of securities bearing fixed interest where the owners himself is not liable to taxation on the realisation of the securities."

Section 44F of the Act, immaterial changes apart, is a reproduction of section 33 of the English Finance Act, 1927, which was subsequently replaced by section 237 of the English Income-tax Act, 1952. Dealing with that section this is what is observed in the Law of Income Tax, Surtax and Profits Tax by Wheatcroft at page 1669 (paragraph 1-1358) :

"We now come to the more difficult problem which arises when a taxpayer sells, for a capital sum, securities which are about to pay interest and the purchaser acquires the right both to the securities and the interest.

It is the custom on British stock exchanges to notify in advance the dates in respect of each security before which a buyer of that security will be entitled to the next income payment. Up to that date the security is sold 'cum-dividend'; after that date the security is sold 'ex-dividend' and the next income payment when received after the sale, will remain the property of the seller. Apart from the general market fluctuations, the price will gradually rise up to the day when the security goes 'ex-div.' It will then normally fall sharply by a sum approximately equal to the anticipated income payment less tax at standard rate, as the average investor values the income at its net amount. If the amount is at a fixed rate, such as on Government stock, the likely fall for this reason can be calculated with considerable accuracy in advance.

A surtax payer, who pays more than the standard rate of tax, can thus find it profitable to sell his securities just before they go 'ex-div.' as he will receive as capital the equivalent of the net dividend, instead of receiving a dividend subject to tax in his hands at a higher rate than that deducted from the dividend.

To deal with taxpayers who used this, and similar devices, on a substantial scale, it was provided by the Finance Act, 1927, that if it appears to the revenue by reference to all the circumstances in relation to the assets of any individual (including circumstances with respect to sales, purchases, dealings, contracts, arrangements, transfers or any other transactions relating to such assets) that the individual has thereby avoided or would avoid more than 10 per cent. of the income from those

assets had been deemed to accrue from day to day and had been apportioned to him as part of his total income, then such income is to be so apportioned to him for the purpose of so computing his surtax. If the individual can prove that the avoidance was exceptional and not systematic and that there was no such avoidance in the preceding three years, he can avoid liability under this provision. Extensive powers are given to the revenue to obtain information for the purpose of this provision."

The marginal note for section 44F reads "Avoidance of tax by sales-cum- dividend". This marginal note also gives an indication as to what exactly was the mischief that was intended to be remedied. The legislature was evidently trying to circumvent the devices adopted by some of the assessee to convert their revenue receipts into capital receipts. The marginal note also throws light on the intention of the legislature.

From what has been stated above, it is clear that the deemed dividend contemplated by section 2(6A)(c) cannot be considered as "income" under section 44F.

From what has been stated above, we agree with the High Court that section 44F is inapplicable to the facts of the assessee's case. This question is common to all the above mentioned appeals. Hence we need not go into the other subsidiary questions arising for decision in any of these appeals.

In the result, these appeals fail and they are dismissed with costs. One hearing fee.

Appeals dismissed.

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