

CALCUTTA HIGH COURT

Ezra Proprietary Estates, Ltd

Vs.

Commissioner of Income-tax

Income-tax Ref. No. 2 of 1948

(Harries, C.J. and Chatterjee, J.)

12.04.1949

JUDGMENT

Harries, C. J.

1. This is a reference under section 66 (1), Income-tax Act, made by the Income-tax Appellate Tribunal, Madras Bench, to this Court in respect of an assessment of the applicant company for the assessment years 1939-40 and 1940-41. The question which has been submitted to the Court for answer is as follows : "Whether in the facts and circumstances of this case, the provisions of section 23a were properly invoked ?"

2. The assessee is a private limited company whose main source of income is income from property assessable under section 9, Income-tax Act. Its only other source of income is interest on deposits, but such income is only slightly over 1 per cent. of the assessable income.

3. The relevant accounting years for the two assessments were the calendar years 1938 and 1939. According to the assessee the company made a profit of Rs. 30,000 in 1938 and Rs. 15,000 in 1939 and the whole of the profit for these two years was distributed amongst the share-holders as dividends.

4. The assessable income of this company was assessed by the taxing authorities at Rupees 1,26,581 for the year 1939-40 and at Rs. 1,24,787 for the year 1940-41. These figures included interest on deposits which amounted to Rs. 1,904 in the first year and Rs. 1,588 in the second year. It will be seen, therefore, that this income derived from interest on deposits formed a negligible portion of the assessable income of this company.

5. The Tribunal has found that the company distributed by way of dividends its entire net profits for the years 1938 and 1939. In other words, the Tribunal found that the accounts submitted by

this company were properly kept and were accurate and that the profits shown in the profit and loss account was the true profit earned by the company in the years in question.

6. The income-tax department, however, contended that the company had not complied with the provisions of section 23a (1), Income-tax Act, as they had not distributed by way of dividends amongst their share-holders at least sixty per cent. of the assessable income of the company for the two years in question. The only question which we have to decide in this reference is whether section 23a, Income-tax Act, can be applied to the facts of this case. Sub-section (1) of section 23a in so far as it is material reads as follows:

"Where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company up to the end of the sixth month after its accounts for that previous year are laid before the company in general meeting are less than sixty per cent. of the assessable income of the company of that previous year, as reduced by the amount of income-tax and super-tax payable by the company in respect thereof he shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profit made, the payment of a dividend or a large dividend than that declared would be unreasonable, make with the previous approval of the Inspecting Assistant Commissioner an order in writing that the undistributed portion of the assessable income of the company of that previous year as computed for income-tax purposes and reduced by the amount of income-tax and super-tax payable by the company in respect thereof shall be deemed to have been distributed as dividends amongst the share-holders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each share-holder shall be included in the total income of such shareholder for the purpose of assessing his total income..."

7. This sub-section is aimed at preventing companies from distributing too little of their profits. It had been found that frequently companies made large profits, but distributed very little. The undistributed profits were accumulated and very often distributed by way of bonus, shares and such like. By the terms of this sub-section if a company has not distributed a reasonable proportion of the profits by way of dividends then in certain circumstances the undistributed portion of the profits are deemed to have been distributed and the share-holders will be assessed as if they had received not only the dividend declared, but their share of the profits which are deemed to have been distributed. The sub-section is applicable where the profits distributed as dividends are less than sixty per cent. of the assessable income of the company. The provisions of the section are made to apply unless the Income-tax Officer is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profit made, the payment of dividend or a larger dividend than that declared would be unreasonable. It follows, therefore, that the provisions of this sub-section are not attracted to all cases where the dividend declared is less than sixty per cent. of the assessable income. There are cases in which such dividend though less than sixty per cent. of the assessable income can be regarded as a proper

dividend and there can be cases where the payment of no dividend can be regarded as proper.

8. In the present case it is found as a fact that the profits of this company as disclosed in their balance sheet were divided amongst the share-holders. In one year the whole of the profits, namely Rs. 30,000 was divided and in the following year the whole of the profits which amounted to Rs. 15,000 was divided. In fact no part whatsoever of the profits made in those years was retained by the company. It is true that the profits divided as dividends did not amount to sixty per cent. of the assessable income and that is not strange having regard to the nature of this company. The company was mainly concerned with holding and managing house property for profit. The assessable income of the company was not the profit which it made in the business of managing and developing its properties. By reason of Sections 6 and 9, Income-tax Act, the income of this company assessed to tax was a notional income and not its actual income. Admittedly it was assessed under Section 9 of the Act and rightly so and it is quite clear from the provisions of Section 9, that the assessable income of an assessee assessed under that section need not be the real income of such assessee. It may be greater or it may be less. In the present case it has been found that for the two years in question the assessable income of this company was Rs. 1,26,581 and Rs. 1,24,787 whilst admittedly the profits which it made in running the business were Rs. 30,000 in the first year and Rs. 15,000 in the second.

9. It is quite clear that this company could not have distributed by way of dividends more than the actual profits which it made in this year. Dividends can only be distributed out of profits and quite clearly a dividend could not be distributed out of the assessable income, because as I have said, assessable income is in the case of a property owning company a notional income and may be far greater or far less than its real income. Dividends must be paid out of the actual profits made. The payment of dividends out of capital is a breach of trust on the part of the directors and they are jointly and severally liable to make good an amount paid out of capital with interest at five per cent. per annum and it makes no difference whatsoever that the payment of a dividend out of capital has been sanctioned by all the share-holders: see *In re National Funds Assurance Co^l*. Further, a member who receives a dividend knowing that it is paid out of capital is liable to make good the amount for the money of a company is a trust fund because it is applicable only to the special purposes of the company in the hands of the directors of the company, and it is in that sense a trust fund applicable by them to those special purposes; and a person taking it from them, with notice that it is being applied to other purposes, cannot, in this Court, say that he is not a constructive trustee : see the judgment of Jessell M. R. in *Russell v. Wakefield Waterworks²*,

10. It is clear, therefore, that this company could not, in the years in question, have distributed as dividends more than it did. Had it distributed sums equal to its assessable income, it could only have done so by drawing on its capital and distributing the same. That, as I have said, is prohibited by law.

11. As this company could not have distributed more how can the share-holders be assessed as if

they had received considerably more than they had. Dr. Gupta for the department has argued that the share-holders can be so assessed because this section allows such to be done. If this section allowed such to be done on the facts of this case it would be a most inequitable and unjust section. In my view, however, on the facts of this case the section can have no application whatsoever. The section will only apply to cases where the dividend declared is less than sixty per cent. of the assessable income if the Income-tax Officer is satisfied that the declaration of a larger dividend would not have been unreasonable. On the other hand, if he is satisfied that having regard to the losses incurred by the company in earlier years or to the smallness of the profit a larger dividend could not reasonably be declared then the section does not apply.

¹(1879) 10 Ch. D. 118 : (48 L. J. Ch. 163)

²1875-20 Eq. 474 at p. 479 : (44 L. J. Ch. 496)

12. In the present case it is quite clear that no Income-tax Officer could be satisfied that a larger dividend could have been declared, because all the profits out of which a dividend could be declared were actually distributed as dividends. There was nothing more to distribute and nothing more could have been distributed without serious breaches of the company law. That being so, an Income-tax Officer was bound to be satisfied that the payment of a larger dividend would have been not only unreasonable but impossible having regard to the smallness of the profits made.

13. Whether the payment of a larger dividend would be unreasonable by reason of losses in earlier years or the smallness of the profit for that particular year is of course a question of fact and it was suggested that the Income-tax Officer in the present case must have been satisfied that a larger dividend would have been reasonably paid in this case. If the Income-tax Officer was satisfied that that was so, then it is clear that his satisfaction was based on no evidence whatsoever. The evidence in this case shows that the whole of the fund available for the payment of dividends was distributed as dividend and there was nothing further which could be distributed as dividend. That being so, how could a larger dividend have been paid ? If the Income-tax Officer ever addressed his mind to this question and did come to the conclusion that a larger dividend could have been declared, then that finding is clearly supported by no evidence whatsoever. The plain facts of the case make it clear that not only would it be unreasonable to declare a larger dividend, but that the declaration of a larger dividend was legally and in fact impossible.

14. The question as framed in the referring order is in these terms : "Whether in the facts and circumstances of this case, the provisions of Section 23A were properly invoked?"

15. The question as framed does not directly give rise to the question whether or not there was any evidence upon which the Income-tax Officer could be satisfied that a larger dividend could reasonably be declared and therefore apply the provisions of this section. However, the questions which the Tribunal were asked to deal with were as follows :

"(1) Whether Section 23A applies to the income of a company from 'property' assessable under Section 9?

(2) Whether in the facts and circumstances of this case, there was evidence to show that owing to the smallness of the profit made by the company the declaration of a larger dividend than that declared would be unreasonable?"

16. During the course of argument before the Tribunal the assessee abandoned his contentions which gave rise to question (1) and the whole of his argument was addressed to the question raised in question (2). However, for reasons best known to the Tribunal, question (2) was re-framed and re-framed in such a manner as not directly to give rise to this question whether there was any evidence to show that the declaration of a larger dividend would be reasonable. The Tribunal must state a case giving rise to the questions proposed or they may refuse to state a case, in which case they may be compelled by this Court to state a case. But where the Tribunal agrees to state a case it cannot re-frame the question so as to give rise to any point other than the point dealt with in the question upon which they are asked to state a case. Dr. Gupta on behalf of the department has to concede that the question as framed by the Tribunal must be construed as a question giving rise to the point intended to be raised by the second question as proposed by assessee, and that point is whether there was evidence upon which the Income-tax Officer could hold that a declaration of a larger dividend in the circumstances was reasonable.

17. For the reasons which I have given, I am satisfied that there was no evidence at all upon which such a finding could be arrived at and that the evidence shows beyond all doubt that the declaration of a larger dividend was not only unreasonable but impossible. That being so, I am bound to hold that there was no evidence at all upon which the Income-tax Officer could have held that a larger dividend could reasonably have been declared and therefore the provisions of sub-section (1) of Section 23A were not attracted to this case.

18. It was suggested that this case was governed by a previous Bench decision of this Court in the matter of *Kilburn Properties Limited, Calcutta v. Commissioner of Income-tax, Bengal*³, decided on 6-9-1948. In that case the question submitted by the Tribunal was whether in view of the fact that the entire income of the assessee was derived from property assessable under Section 9, Income-tax Act, the provisions of section 23A were at all applicable to the case. The Bench held that Section 23A was applicable to an assessment of a company whose entire income was derived from property assessable under Section 9 and with that view I agree. The Bench, however, was of opinion that the words "profits and gains" used at the commencement of sub-section (1) of section 23A were synonymous with the words "assessable income" which appear later in the section. It was urged by Mr. Mitra on behalf of the assessee that this decision was clearly wrong because it would mean that for the purposes of this sub-section dividends would be payable not out of the profits of the company, but out of assessable income which is a notional income and which might be far in excess of the actual profits. It appears to me that it is unnecessary to consider the correctness of this view. In this judgment I have held that Section 23a applies to a property owning company the income of which is assessed under section 9 of the Act. It is true that a property owning company does not carry on business as the term is used in

the Income-tax Act. It is not assessed on the profits of business, but is assessed on the income of property which it holds under section 9 of the Act. Though it does not carry on business as that term is understood in the Income-tax Act nevertheless it must be regarded as carrying on business vis-a-vis the share-holders and for the purposes of the Companies Act. Being a limited liability company it is governed by the Companies Act and any dividend which it pays must be paid out of profits, that is profits ascertained in the ordinary business way. It is clear that the company does carry on business in the ordinary sense of the term and does make profits and therefore I see no reason why section 23A should not apply to such a company. But that does not mean that I agree with the view that the words "profits and gains" in the opening sentence of section 23A mean the same as assessable income. Even if the words "profits and gains" in the opening sentence of the section mean actual profits of the business, yet the section would apply to house owning companies. That being so, the decision in the earlier Bench case to which I have referred in no way compels this Bench to hold that the decision of the Tribunal is right. As held in the earlier decision, the section applies to property owning companies and therefore to this case. But when the section is applied it is clear from the plain facts of the case that there was no evidence at all upon which it could be held by the Income-tax Officer that a declaration of a higher

³1949-17 I. T. r. 134 (Cal.)

dividend was reasonable or even possible. That being so, the view of the Tribunal was in my judgment clearly erroneous and the question propounded must be answered in the negative.

19. The section applies to property owning companies but it was improperly applied on the facts of this case.

20. The assessee will be entitled to the costs of this reference. The assessee is also entitled to the return of the deposit made by him.

21. Certified for two counsel.

Chatterjee, J

22. I agree.

Answer in the negative.