

BOMBAY HIGH COURT

S.C. Cambatta

Vs

Commissioner of Income-Tax

(Leonard Stone, Kt., C.J. Chagla, J.)

06.09.1946

JUDGMENT

Leonard Stone, Kt., C.J.

1. This is a reference under Section 66 (1) of the Indian Income-tax Act, 1922, and the questions, which under order of this Court of March 29, 1945, have been submitted by the Tribunal, are these:

(1) Whether on the facts proved there was any evidence to support the conclusion that the money paid for the purchase of 1,245 shares belonged solely to the assesseees (2) Whether in a case in which the provisions of Section 23 A have been applied, the proportionate share in the undistributed profits of the company must be taxed in the hands of the shareholders in whose name the shares stood and nobody else ?

2. Section 23A creates what might be described as an artificial income. It is as follows:-

(i) 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 [as therein mentioned] 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 larger 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 [as therein mentioned] shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income :

3. Only a brief reference need be made to the facts. The company, in whose share capital those 1,245 shares stand, is a private limited company with a total share capital of 2,500 shares of Rs. 100 each, and the assessee and his wife own 2,480 of the total shares, the shares with which we are concerned, viz. the 1,245 were purchased in 1936 in the joint names of the assessee and his wife. The company did not distribute its profits for the year ending December 31, 1938, and at the annual general meeting of the company, which was held on November 22, 1939, no dividend was declared. The Tribunal, on the question as to the person or persons who is or are assessable to this artificial income under and by virtue of Section 23A has expressed the following opinion:- In our opinion, therefore, the term 'shareholder' in Section 23A(1) of the Act means, in the case of joint shareholders, the shareholders whose name stands first in the register in respect of the holding. The assessee whose name stands first must be regarded as the shareholder for the purpose of an assessment in respect of the dividends deemed to be distributed under that section. After all, Section 23A is a section that provides machinery for the purpose of bringing to tax the profits of a company which might otherwise escape assessment by reason of their non-distribution among the shareholders as dividends. It would follow that its provisions must be given effect to consistently with the scheme of taxation in Section 3 which is the main charging section of the Act. The principle of taxation is that the income must be taxed where it is found. The question as it is framed by the assessee is expressed in an abstract form and "we feel some difficulty in answering it. Our opinion, therefore, is that in the circumstances of this case the amount of Rs. 37,554 was rightly included in the petitioner's assessment.

4. With respect to the members of the Tribunal, I can find nothing in the section which gives any indication that it is the shareholder whose name stands first in the company's register, who is to be regarded as the person on whom the assessment is to be made. Under the section the undistributed portion of the assessable income of the company shall be deemed to have been distributed as dividend amongst the shareholders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder. Under the General Clauses Act, 1897, the singular includes the plural, and therefore, where a share stands registered in two or more names, it is the registered holders, regarded as an association of persons, who must, in my opinion, be regarded as the "shareholder" and who must be assessed accordingly.

5. Section 21 of the Indian Companies Act, 1913, is the section which makes the memorandum and articles of association of a company the contract between the company and its shareholders and it is as follows:-The memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by each member and contained a covenant on the part of each member, his heirs, and legal representatives, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this

Act.

6. The only relevant articles of the articles of association of this company, with whose undistributed profits this case is concerned, are Articles 106 and 171. Article 106 provides: Where they are joint registered holders of any share any one of such persons may vote at any meeting either personally or by proxy in respect of such shares as if he were solely entitled thereto; and if more than one of such joint holders be present at any meeting personally or by proxy that one of the said persons so present whose name stands first on the Register in respect of such share shall alone be entitled to vote in respect thereof.

7. There follows a provision with regard to executors. Article 171 is: Unless otherwise directed any dividend may be paid by cheque Or warrant sent through the post to the registered address of the member or persons entitled, or in case of joint holders to any one of them first named in the Register in respect of joint holding.

8. And the rest of that article is not material.

9. So that it is clear from those articles that the first named of joint registered holders has no special status in the contract between the company and its members. What is said of him is merely administrative machinery.

10. It will be convenient in the first place to consider question No. 2, because, if that question be answered by saying that it is the joint holders of these shares who are assessable under Section 23A in respect of their joint holding, like any other association of persons, then question No. 1 will not arise.

11. Mr. Setalvad in his submissions on behalf of the Commissioner has referred us to the charging sections, viz. Sections 3 and 4 of the Indian Income-tax Act. It is Section 3 which provides that where any Act of the Central Legislature enacts that income-tax shall be charged for any year at any rate or rates, tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions of, this Act in respect of the 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 members of the association individually.

12. Section 4(i) provides that subject to the provisions of this Act, the total income of any previous year of any person includes ail income, profits and gains from whatever source derived, and then in lettered sub-paragraphs are the descriptions of the, possible sources from which income arises or is to be deemed to arise.

13. In my opinion, looking at the scheme of the Act, Section 23A is a procedural section and not A.C.harging section. It creates a notional income, which is wholly artificial, and which does not in fact exist in the pocket of any shareholder. Within the terms of that section this artificial income is to be deemed to have been distributed, in this case to the assessee and his wife as the registered holders of the shares. We are not dealing with anything concrete as no distribution has in fact taken place and no shareholder has in fact received any income. Who will ultimately receive these undistributed profits of the company cannot now be predicted, it may depend on survivorship. The section says nothing about equities or beneficial ownership, and nothing would have been easier, if the Legislature had so intended, to have provided that the undistributed income of the company should be deemed to be the income of the persons, who would be entitled to it beneficially, if it had in fact been distributed on the specified date. Accordingly, in my opinion, question No. 2 should be answered in the affirmative. It is the joint holders, viz. the assessee and his wife who are assessable to tax. Taking that view of the matter, question No. 1 does not arise. In my opinion the Commissioner must pay the costs.

Chagla, J.

14. I agree. Section 23A deals with the power to assess individual members of certain companies and it provides that the proportionate share of the undistributed dividends of the company of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income. Now, the scheme of the Act is fairly plain. Section 3 is the charging section and it charges the total income of the previous year of every individual, Hindu undivided family, company, local authority, and of every firm and other association of persons or the partners of the firm or members of the association individually. But Section 3 does not tell us what the total income of the assessee is. For that you have got to turn to the definition of "total income" contained in Section 2, Sub-clause (15), and that sub-clause defines "total income" to be income, profits and gains referred to in Sub-section (I) of Section 4 computed in the manner laid down in the Act. Section 4 tells us what the total income of an assessee is to include and we have to turn to the various sections of the Act in order to find out how total income is to be computed.

15. Now, in my opinion Section 23A lays down that certain notional income shall form part of the total income of an assessee who answers to the description contained in that section. It provides, as I have pointed out, that in the case of a shareholder of a company whose dividends have not been distributed, but for the purposes of that section shall be deemed to be distributed, in the total income of such shareholder his share of the undistributed dividends shall be included. Mr. Setalvad has argued on behalf of the Commissioner that what we have to determine is whose real income the share of the undistributed dividends is, and that although a particular person may, stand on the register of a company as a shareholder, still, if it is found on the facts that he is

merely a benamidar and the shares really belong to someone else, then the income should be deemed to be not of the shareholder but of the real owner. The simple answer to that argument is that Section 23A does not so provide.

16. We have been asked by Mr. Setalvad, in face of the mandatory provisions of Section 23A that this particular share in the undistributed dividends of the company shall be included in the total income of the shareholder that we should hold that this should be included not in his total income but in the total income of someone else. In my opinion, it is perfectly clear that under the terms of Section 23A it is only the shareholder who is assessable and no, one else. In this case the assessee is not the shareholder. The shareholders are the assessee and his wife. They are the joint shareholders, and within the meaning of Section 23A they constitute the shareholder who is to be assessed in respect of this income.

17. Now, with great respect to the Tribunal, I fail to find any warrant or authority for the proposition that the term "shareholder" in Section 23A(1) means anyone of the joint shareholders who for the company's purpose is regarded as the shareholder. Both the assessee and his wife are on the register of the company as the joint shareholders, and I fail to understand how the fact that the company may for the purpose of convenience agree to permit one or the other to exercise some of the rights of the shareholder can affect the question as to who is the shareholder for the purposes of Section 23A of the Act.

18. In this connection it is material to refer also to Section 16 of the Act. That also is a computing section and Sub-clause (3) provides that in computing the total income of any individual for the purpose of assessment, there shall be included so much of the income of a wife or minor child of such individual as arise directly or indirectly in the manner provided in the following sub-clauses. Therefore that section provides that the income of the wife shall be deemed to be the income of the husband if the conditions laid down in that sub-clause are complied with. That is a mandatory section and the income-tax authorities are entitled to include in the total income of the husband the income of the wife, provided, as I said, the conditions laid down in that sub-section are complied with. It would not be open to the husband to contend that in fact he is not the real owner of the income but his wife is. Just as that is a mandatory section and provides for computing the total income of the individual under certain circumstances, similarly Section 23A is a mandatory section and lays down rules of computation in computing the total income of the shareholder referred to in that section.

19. Mr. Setalvad has relied on a decision of our Court, *Shapurji v. Commissioner of Income-tax, Bombay*¹ In that case one S.P. Mistry and P.P. Mistry were two of the partners in a partnership firm. That partnership was registered under Section 26A of the Income-tax Act. In that registration the father was shown as having 6 as. 8 p. share and the son as having 4 as. share. In

the assessment the taxing authorities came to the conclusion that the son was merely a benamidar and that the 4 as. share given to the son really belonged to the father, whereupon under Section 23, Sub-clause (5)(a), they assessed the father in his individual assessment not in respect of the 6 as. 8 p. share but in respect of the whole of the 10 as. 8p. share. It was thereupon contended that the income-tax authorities having registered the firm and the firm continuing to be registered under Section 26A it was not open to the taxing authorities to assess the father on the basis that the share was 10 as. 8 p., when in the partnership deed, which was registered with the authorities, it was shown that his share was only 6 as. 8 p. That contention was rejected by a division bench consisting of the learned Chief Justice and Mr. Justice Kania.

20. Now, with respect to Mr. Setalvad, I fail to see the analogy between that case and the case we have before us. Section 23(5) provides that in the case of a registered firm, the sum payable by the firm itself shall not be determined, but the total income of each partner of the firm, including therein his share of its income, profits and gains of the previous year, shall be assessed, and the sum payable by him on the basis of such assessment shall be determined. Therefore, in the case of an individual partner, in his total assessment is to be included his share in the income, profits and gains of the partnership. There was nothing to preclude the taxing authorities from determining what the real share of the individual partner was in the income, profits and gains of the previous year. Although the partnership deed stated that his real share was only 6 as. 8 p., the taxing authorities came to the conclusion that in fact the real share was 10 as. 8 p. The learned Chief Justice held in his judgment that the taxing authorities were not estopped by Section 26A and Mr. Justice Kania decided the case on another ground, viz. that Section 23(5)(a) did not provide in terms for the assessment of the partners in their names according to the instrument registered with the Income-tax Office. There is, it need hardly be pointed out, nothing mandatory in Section 23(5) (a) which lays down that in the case of an assessment of an individual partner in his total income shall be included his share in the income, profits and gains of the firm according to the tenor of the partnership deed registered with the income-tax authorities. If we turn to Section 23A, as I have pointed out more than once, you have a mandatory provision saying what should be included in the total income of a shareholder of certain companies.

21. In the circumstances I feel that the taxing authorities are wrong in assessing the share of the undistributed profits as the income of the assessee. He is not the shareholder, and under Section 23A this income can only be assessed as that of the shareholder, and that shareholder is not the assessee but the assessee and his wife who are the joint holders of the shares in question. I, therefore, agree with the learned Chief Justice that the question referred to us should be answered in the manner suggested by him.

Cases Referred.

