

BOMBAY HIGH COURT

Sir Kasturchand Ltd

Vs.

Commissioner of Income-tax

Income-tax Ref. No. 12 of 1948

(Chagla, C.J. and Tendolkar, J.)

22.03.1949

JUDGMENT

Chagla, C.J.

1. The assessee, Sir Kasturchand Ltd., is a private limited company and the assessment years under reference are 1941-42, 1942-43 and 1943-44, the relevant previous years being the financial years 1940-41, 1941-42 and 1942-43. The annual general meetings of this company were held respectively on 16th November 1941, 26th August 1942 and 23rd August 1943, in respect of the three relevant previous years, and in none of these general meetings any dividend was declared and therefore no dividend was distributed. Now it would appear that the profits according to the accounts of the company for the accounting year 1940-41 was Rs. 35,155, for the accounting year 1941-42 was Rs. 29,882 and for the accounting year 1942-43 was Rs. 13,778. On assessment the profits were assessed by the Income-tax Officer at Rs. 48,586 for 1941-42, Rs. 82,233 for 1942-43, and Rs. 61,872 for 1943-44. The Income-tax Officer made an order under Section 23A(1), Income-tax Act on 23rd May 1946 for the previous year 1940-41 and on 18th May 1946 for the following two years that the sums of Rs. 34,610, Rs. 56,170 and Rs. 44,913 respectively are to be deemed to have been distributed as dividend among the shareholders as at the date of the general meetings held respectively on 15th November 1941, 26th August 1942 and 23rd August 1943.

2. Now, the first question that arises on this assessment is the contention put forward by the assessee that inasmuch as no profits of the company were distributed as dividends at all Section 23A is not applicable. Mr. Kolah's argument is that Section 23A requires that there must be some distribution of dividends before the section is attracted and can be made applicable. In order to understand this contention and also to appreciate some of the other questions raised in this reference, it is necessary to look at the scheme of this section. This section seems to have been enacted more in terrorem against private companies than for anything else and the object of the

Legislature was to induce private companies to distribute more than 60 per cent. of their assessable income so as to escape the drastic consequences that would follow upon their not doing so. Section 23A requires that in respect of any previous year the profits and gains distributed as dividends are less than 60 per cent of the assessable income of the previous year. It would be incorrect to read the operative part of this section as applying merely to the distribution of profits as dividends. What is emphasised by the operative part is more the distribution of less than 60 per cent. rather than the fact of distribution at all. If Mr. Kolah's contention was sound, it would lead to this absurd result that if one per cent. or quarter per cent. of the assessable income of the company was distributed, the section would apply but if no part of the assessable income was distributed, the section would have no application. A Court must always avoid as far as possible giving an utterly absurd interpretation to a section drafted by the Legislature unless a Court looking to the plain and grammatical language used has no other option except to give such a construction. But in this case I am satisfied that the Legislature has not used such language as necessarily to drive the Court to so anomalous a conclusion. Therefore, in my opinion, the section has application whether there is no distribution at all or whether there is distribution of less than 60 per cent. of the assessable income. Then the section goes on that if the conditions laid down in the operative part are satisfied, the Income-tax Officer has to make an order that the undistributed portion of the assessable income of the company of the previous year as computed for income tax purposes, but 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 and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such share-holder for the purpose of assessing his total income. Therefore, the order of the Income tax Officer brings about, as it were, an artificial distribution of profits of the whole of the assessable income of the company, and this artificial distribution is carried a step forward by including the share of each share-holder in such distribution of income in his own assessment. But the Income-tax Officer has not to make such an order if 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 declared would be unreasonable. Therefore, it is left to the satisfaction of the Income-tax Officer whether the payment of a dividend or a larger dividend than declared would be unreasonable, and he has to be satisfied as to the reasonableness or unreasonableness of the payment of a dividend or a larger dividend only with reference to two factors mentioned in that section, and those two factors are losses incurred in the previous year, or the smallness of the profit. Both these factors, are absolute in their nature and they have got to be judged per se without reference to any other factor that might be present. It is significant to note, because it has some bearing on the construction of the operative part of the section, that the Legislature has used the language "payment of a dividend or a larger dividend," which clearly implies that the company may not have paid a dividend at all or it might have paid a smaller dividend which might be increased to a larger dividend in view of the order to be made by the Income-tax Officer. Mr. Kolah's contention is that in determining whether an order should be made under Section 23A it is not enough for the Income-tax Officer merely to consider the losses incurred by

the company in earlier years of the smallness of the profit, but he must also take into consideration the paid up capital of the company, for how many years the company has been doing business, and various other factors. In my opinion, to put that construction upon the section would be to import into it words which the Legislature did not think fit to insert in that section and it would be to expand the ambit of the discretion to be exercised by the Income-tax Officer in determining whether the payment of a dividend or a larger dividend than that declared would or would not be unreasonable. It is left to the Income-tax Officer entirely to decide whether such a payment of a dividend or a larger dividend would or would not be unreasonable, but such satisfaction must be arrived at by the Income-tax Officer only after consideration of those two factors which the Legislature thought fit he should consider before arriving at his decision. It is also important to note that what the Income tax Officer has got to consider is the smallness of the profit made by the company in contra-distinction to the assessable income of the company. Whereas the company has got to declare more than 60 per cent. of the assessable income of the company in order to escape the consequences laid down in Section 23A, in determining whether an order should be made or not under that section, the Income-tax Officer has got to consider not the assessable income of the company but the actual profits made by the company. It is hardly necessary to emphasize the very great distinction that may exist between the assessable income of the company and the actual accounting profits made by the company, and what the Income tax Officer has got to consider is the actual accounting profits made by the company and not the profits assessed to income-tax or super-tax by the Income-tax Officer.

3. Therefore I would suggest that the first question as framed by the Tribunal which is in the negative form should be reframed so as to read, "Whether an order under Section 23A(1) can be passed by an Income tax Officer on the ground that no dividend was declared by the company at its annual general meeting and distributed thereafter," and suggest that the answer to that should be in the affirmative, With regard to the second question, that has not been pressed by Mr. Kolah on this reference and that also must be answered against the assessee in the negative. With regard to the third question that question relates to the question of limitation and it is argued that the order made by the Income-tax Officer is barred under Section 34(2) of the Act. Under that subsection, no order of assessment under Section 23 can be made after the expiry of four years from the end of the year in which the income, profits or gains were first assessable. In this case the accounting year 1941-42 expired on 31st March 1942 and the relevant order under Section 23A(1) was made on both May 1946 and, therefore, it is argued that as the order is made four years after the expiry of the end of the assessment year the order is barred under Section 34(2). It will be noticed that this order has been made not in the course of assessment under Section 23, but it has been made under the special powers given to the Income-tax Officer under Section 23A, and there is no provision in the Income-tax Act which lays down the period of limitation after which no order can be made under Section 23A. Therefore the order under Section 23A is clearly not barred.

4. One other question has been suggested by the assessee and in respect of which a notice of

motion has been taken out, and that question is whether the profits made by the company in the relevant years were so small as to make it unreasonable for a declaration of a dividend and so as not to attract the application of Section 23A of the Act. Now, in my opinion, whether the losses incurred by the company in earlier years or the smallness of the profits made is such as to make the payment of a dividend or a larger dividend than that declared unreasonable, is one entirely for the satisfaction of the Income-tax Officer. It is a question of fact on which no reference could lie. It is not for this Court to substitute its judgment for the judgment of the Income-tax Officer, which is the only judgment intended by the Legislature to operate upon the facts of the case. But in refusing to make the reference the Tribunal has construed the section. To the extent that the question arises as to the construction of the section itself, undoubtedly that would raise a question of law in respect of which we can exercise our advisory jurisdiction. The Income-tax Tribunal has construed the section, in our opinion, rightly, and, as I suggested in the earlier part of the judgment, the smallness of the profit has reference merely to the possibility of a dividend or a larger dividend being declared being unreasonable. The smallness of the profit has no bearing on other factors, e.g., the extent of the paid up capital or the fact that the company has been functioning for a very short period, or any other factor, and, therefore, we would permit Mr. Kolah to raise that question in the form which I shall presently suggest. No additional statement of the case is necessary in order to answer that question, and, therefore, after formulating that question we will be in a position to answer it straightway. The proper question I would suggest is "whether in applying the provisions of Section 23A of the said Act the smallness of the profits made is to be considered with reference to the possibility of it being unreasonable to pay a dividend or a larger dividend than that declared, or whether the smallness of the profits may be considered in relation to other factor or factors." Having formulated that question, the answer I would suggest to that question would be as indicated in the judgment.

5. The assessee must pay the costs of the reference. There will be no order as to costs on the notice of motion.

Tendolkar, J.

6. I agree.

Answer accordingly.