BOMBAY HIGH COURT

Haridas Achratlal

Vs.

Commissioner of Income Tax

I.T. Ref. No. 34 of 1954

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

15.02.1955

JUDGMENT

Chagla, C.J.

1. The Tribunal referred the following questions of law to the High Court:

> (1) Which are the six previous years of the company preceding the date of the liquidation for the purposes of the proviso to Section 2(6A)(c) of the Act?
> (2) Whether the amount of Rs. 62,400 or a part thereof was the distribution out of the accuimulated profits on the liquidation of the company for the purposes of Section 2(6A)(c).
> (3) Whether on declaring a dividend does the liquidator of a company in liquidation pay to the shareholders the capital subscribed by them first and then the surplus over and above the subscribed capital or 'vice versa'?

2. The assessee was a shareholder of the Gujarat Corporation Ltd. This company had a share capital of Rs. 1,00,000 divided into 1,000 shares of Rs. 100 each. With regard to 960 shares only Rs. 35 were paid up on each share. The remaining 40 shares were fully paid up. The company passed a resolution on 5-12-1946, by which it converted the partly paid up 960 shares into fully paid up shares by transferring a sum of Rs. 62,400 out of the undistributed profits of the company. The company went into liquidation on 1-5-1949. The Liquidator realized the total assets of Rs. 1,61,000. The assessee who held 251 shares received a dividend of Rs. 22,590 from the Liquidator in the year of account, and the Taxing Department held that the dividend was covered by the definition of "dividend" in Section 2(6A)(c) of the Income-tax Act and therefore liable to tax, and it is in respect of this distribution of the assets of the company in liquidation that three questions have been submitted to us by the Tribunal.

3. Now, before we look at the questions perhaps it will be better to consider generally the scheme of Section 2(6A) which defines "dividend". It is clear that the definition given by the Legislature is an artificial definition. It is an inclusive definition and it deals with four classes of cases in which a certain payment becomes dividend in the eye of the income-tax law, and the one we are concerned with is the class referred to in sub-Clause (c) and that is in the following terms:

> "(c) any distribution made to the shareholders of a company out of accumulated profits of the company on the liquidation of the company:
> Provided that only the accumulated profits so distributed which arose during the six previous years of the company preceding the date of liquidation shall be so included."

Now, it is clear that the Legislature was contemplating those profits made by the company in the past years which could have been distributed by the company, but which in fact were not so distributed. It is equally clear that the Legislature did not wish to bring within this definition all the accumulated profits of the company in the past, but only the accumulated profits of a limited duration and the limited duration is indicated in the proviso and that duration is the six previous years preceding the date of the liquidation. There is another significant feature which should be borne in mind in construing sub-Clause (c). In sub-cls. (a), (b) and (d) the Legislature has referred to "accumulated profits" and has qualified that expression by using the phrase "whether capitalized or not". In sub-Clause (c) the expression "accumulated profits" is not so qualified. In ordinary law it is clear that if a company makes profits and instead of distributing them appropriates them to capital, then they cease to be accumulated profits which could be distributed by means of declaring a dividend. As the Legislature wanted to extend the meaning of the expression "dividend" in the case of sub-cls. (a), (b) and (d), they treated accumulated profits, even though they were appropriated to capital, as dividends, but in the case of sub-Clause (c) by omitting to qualify the expression "accumulated profits" the clear intention of the Legislature was that only those accumulated profits should come within the ambit of sub-Clause (c) which had not been capitalized, because if the accumulated profits had been capitalized prior to the liquidation, then they would not be accumulated profits but they would be capital, and as it was not the intention of the Legislature that for the purpose of sub-Clause (c) accumulated profits which had been converted into capital should also be hit by that sub-clause, the Legislature advisedly did not qualify that expression.

4. Now, bearing this scheme of Section 2(6A) in mind, the first question that arises on this reference is: Which are the six previous years of the company preceding the date of the liquidation for the purpose of the proviso to Section 2(6A). In this case, as we have already pointed out, the date of liquidation is May 1, 1949, and what we have to consider is what are the six previous years preceding this date of liquidation. The accounting year of the company is the calendar year. Therefore the previous year to the date of liquidation would be the calendar year 1948 and the remaining five years must be the years preceding that calendar year 1948. Therefore, on a plain construction of the language used by the Legislature it is clear that the six previous years contemplated by the proviso are the years 1943 to 1948. Mr. Palkhivala's

contention is that inasmuch as the company carried on business till 30-4-1949, the first previous year which must be taken into consideration is the year 1949 and not the year 1948. Now, "previous year" is defined in the Income-tax Act itself and it is a period of 12 months according to the method of accounting of the assessee. A previous year is never a broken period of a few months. Undoubtedly, the company is liable to pay tax on the profits made by it during this broken period, but the Income-tax Act provides a special machinery for taxing an assessee whose business is discontinued during a particular period. Therefore, for the purpose of the Income-tax Act the period 1-1-1949 to 30-4-1949, would be part of the previous year for the assessment year 1950-51. It may be that during the whole of that previous year the company did not do business and its business was discontinued, but as we said before, although the Income-tax Act might lay down the machinery and provide the procedure for assessing the income of the company during this broken period, it does not follow that for the purpose of the Income-tax Act this broken period becomes the previous year for the purpose of the proviso to Section 2(6A)(c). Therefore, in our opinion, it is clear that the six previous years in this case are the years 1943 to 1948.

5. The second question that arises for our consideration is the question as to whether the amount of Rs. 62,400 which was transferred to the capital account on 5-12-1946, could be looked upon as accumulated profits for the purpose of Section 2(6A)(c). The contention of the Advocate General is that once the company goes into liquidation, the duty of the Liquidator is to realize the assets of the company and the assets of the company so realized do not bear any particular impress. They are neither profits nor capital, and according to the Advocate General the intention of the Legislature was that when these assets are distributed, they should be looked upon as dividends and liable to tax. It is impossible to accept that contention because the Legislature has clearly subjected only particular kinds of assets distributed by the Liquidator to tax. It is not all assets distributed by the Liquidator which are liable to tax or which can fall in the category of dividend as defined by Section 2(6A). It is only those assets distributed by the Liquidator which are refer able to accumulated profits of the six previous years preceding the date of liquidation that fall in the category of dividend and are liable to tax.

6. The Advocate General relied on an old English, decision reported in - *'Commrs. of Inland Revenue v. Burrell[1]',* In that case what was held was that when the liquidation of a company begins, all distinction disappears and there are only surplus assets and the share-holder only gets this money in that character and that money no longer bears the character of profits which are liable to tax. It is in view of this that the English Court held that the surplus assets on liquidation distributed to a share-holder were not liable to income-tax. Now, it was after this decision that the Legislature incorporated sub-Clause (c) in Section 2(6A) of the Income-tax Act and the reason was obvious. So long as this decision stood, the share-holder was not liable to pay any tax on any portion of the assets distributed to him by the Liquidator. By enacting Sub-Clause (c) the Legislature subjected a portion of these assets to tax and the Legislature clearly defined what portion of these assets was liable to tax, and it was that portion only which was referable to accumulated profits of six previous years that was made liable to tax. The Advocate General then

contends that even if this larger proposition is not acceptable, in view of this English decision it should at least be held that once the liquidation takes place the distinction between accumulated profits which are capitalized and which are not capitalized disappears and therefore all accumulated profits, whether capitalized or not, must come within the ambit of sub-Clause (c). Now, if sub-Clause (c) stood by itself, there would undoubtedly be considerable force in the contention put forward by the Advocate-General. But when we compare the language used by the Legislature in sub-cls. (a), (b) and (d) and when we note the omission of the qualifying words in sub-Clause (c), then it is clear that the Legislature advisedly did not intend to subject to tax those accumulated profits which had been capitalized. There is a further answer to the Advocate General's contention. The accumulated profits referred to in sub-Clause (c) are the profits made by the company

[1](1924) 9 Tax Cas 27

before it went into liquidation, and as the expression stands it can only mean the accumulated profits which have not been capitalized, because, as we have already pointed out, once accumulated profits are capitalized, in ordinary law they would cease to be profits which are capable of being distributed as dividend. Therefore, if the Legislature wanted to extend the meaning of accumulated profits as it has done in sub-cls. (a), (b) and (d), it would have used the same qualifying expression in sub-Clause (c) as it has done in the other sub-clauses. Therefore, in the absence of any such expression we can only come to the conclusion that the accumulated profits which are capitalized do not come within the ambit of sub-Clause (c). In view of this it is clear that the sum of Rs. 62,400 are not accumulated profits for the purpose of sub-Clause (c). They ceased to be accumulated profits when they were transferred to the capital account. They were appropriated to capital and they constituted the capital of the company and were no longer profits which were capable of being distributed as dividends.

7. The third question which has been raised raises a much larger issue. Fortunately it is not necessary to decide that issue on this reference because Mr. Palkhivala who appears for the assessee does not contest that question and accepts the contention of the Department for the purposes of this reference. In view of that concession made by the assessee, it is unnecessary to decide that question.

8. The result is that we must answer question No.1: 1943 to 1948. Question No.2 in the negtive. Question No.3 does not arise. No order as to costs.

Answers accordingly.