BOMBAY HIGH COURT

The Elphinstone Spinning and Weaving Mills Co. Ltd

Vs.

The Commissioner of Income Tax

Income Tax Reference No. 31 of 1954

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

09.09.1955

JUDGMENT

M.C. Chagla, C.J. and Tendolkar, J.

1. The working of the assessee company for the accounting year 1950 resulted in a loss and therefore for the assessment year 1951-52 the assessee company was not liable to pay any tax. In that very year the assessee company declared dividends amounting to ₹ 3,29,062 in respect of the year 1950, and the contention of the Department was that this sum constituted excess dividend and was liable to pay tax, and the two questions that have been raised by the Tribunal which we have to consider are (1) whether the assessee company was liable to pay additional income-tax, and (2) if the answer to question (1) is in the affirmative, whether the levy of the additional tax was ultra vires.

2. In order to understand the contention of the assessee it is necessary as it sometimes is, to go back to the first principles of the Income-tax Act. Section 3 is the charging section and that section provides :

> "Where any Central Act 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 the members of the association individually."

3. Therefore it is left to a Central Act to prescribe the rate or rates at which tax is to be assessed, but the tax is to be assessed on the total income according to the provisions of the Income-tax Act. It is with this background that we must turn to the Finance Act, 1951, on which the

Department relies for levying this additional income-tax on excess dividend. The Finance Act of 1951 by section 2 provides that subject to the provisions of sub-section (3), (4) and (5), for the year beginning on the 1st day of April, 1951, income-tax shall be charged at the rates specified in Part I of the First Schedule, and sub-section (7) of this section emphasizes the fact that for the purposes of this section and of the rates of tax imposed thereby, the expression "total income" means total income as determined for the purposes of income-tax or super-tax as the case may be, in accordance with the provisions of the Income-tax Act. Therefore, when we turn to the First Schedule to which reference is made by section 2, it must be borne in mind that it only deals with rates of income-tax, and the relevant provision with regard to companies and excess dividend is to be found in paragraph B, and that provides the rate to be charged on the total income of a company and the rate provided is four annas in the rupee and there is a surcharge on one-twentieth of the rates specified in the preceding column. Pausing here for a moment, if as in the case the assessee company had no income at all, no question of assessing the income at any particular rate would arise. It is only when there is an income which constitutes the total income within the meaning of the Income-tax Act that the question has got to be considered as to the rate at which that income is to be assessed to tax. But what is relied upon by the Department is the proviso to this paragraph. Before we look at the language of the proviso, let us look at the scheme underlying this proviso. The Legislature was anxious that companies should not act in a spendthrift fashion and should plough back some of its profits into the industry, and therefore a bait, as it were, was held out to companies not to distribute all the profits they made to their shareholders and the bait took the form of giving the companies a certain rebate. If a company did not distribute as dividends more than nine annas of its profits (substantially speaking, as I need not go into the details of the matter), then to the extent that dividends paid were less than that figure of nine annas, a rebate of one anna was given to the company concerned. If the company paid more than nine annas, then not only it lost the rebate but it was also liable to pay an additional income-tax was to be calculated by the difference between the rate of five annas per rupee and the rate which the excess dividend had actually borne. Therefore a company which did not follow the policy indicated by the Legislature not only ran the risk of losing the rebate which was promised to it under clause (i) of the proviso, but also ran the risk of paying an additional income-tax referred to in clause (ii) which would be considered as a sort of a penalty imposed on extravagant or spendthrift companies.

4. No difficulty may arise in a case where a company has actually made profits and its profits are assessable to tax and there is a total income on which income-tax can be levied. In such a case the provisions both of clauses (i) and (ii) of the proviso can be easily and simply worked out. A company which has an income in a particular year may pay dividends which may exceed the ceiling fixed by the Legislature; in which case no question of rebate would arise with regard to those dividends, and the question of additional tax would arise under clause (ii). But the question that we have to consider in this reference is what is the position of a company which has made no profits at all, which has no income, and which is not assessable to tax under the provisions of the Income-tax Act ? The question is whether the proviso applies to the case of such a company. In

this case there is a finding of fact that the sum of ₹ 3,29,062 which the company declared as dividends were undistributed profits of preceding years and were available for the purpose of covering the amount of the excess dividend. Therefore, what the assessee company was doing in the year of assessment was that it was paying out as dividend profits which in the past year it kept back as reserve or had ploughed back into the industry, and the contention of the Department is that the assessee having paid tax at a certain rate by reason of the fact that they were not distributed as profits, the assessee should now pay the additional tax by reason of the fact that they were now being distributed a dividends. On principle the case of the Department seems to be unanswerable. We do not for a moment accept Mr. Palkhivala's contention that the Legislature may well have made a distinction between a company that makes profits and a company that makes losses. According to Mr. Palkhivala it may be that the Legislature may have though that if a company made losses in a particular year and it had no profits to distribute to its shareholders, it may well fall back upon its reserves and distribute the profits and such distribution should not attract the additional tax imposed by clause (ii) of the proviso. But there are two clear answers to this contention. If the object of the Legislature in enacting this provision at all was that a certain amount of profits should remain with the company and be ploughed back into the industry which the company was promoting, then there seems to be no reason why, because the company makes a loss, the Legislature should permit that company to take out those profits and distribute them to the shareholders. The second clear answer is that according to Mr. Palkhivala if the company made a profit of one rupee the additional tax would be attracted, but if it made no profits then the company would be exempt from the additional tax on payment of excess dividend. There seems to be no logic, there seems to be no reason nor principle why a distinction should be made between the case of two such companies. But if life is not logic, income-tax is much less so, and it is clear that we cannot impose tax upon a subject by implication or because we think that the object of the Legislature was a particular object. In order to carry out the object the Legislature must use appropriate language and if the Legislature fails to use appropriate language then this would be one of the many sad instances where the Legislature, to use the famous language of a Law Lord, has misfired and however much we may regret the misfiring it would be our duty to relieve the subject from taxation if the language of the statute does not support the contention of the Income-tax department. The Advocate-General says we should avoid giving a construction which would lead to absurd results. That canon is applicable where the language of a statute is capable of bearing a construction which would avoid absurd results. But where the language is clear and not capable of any other construction, then however illogical the position, however absurd the result, however much the construction put may defeat the object of the Legislature, the statute must be construed according to the plain language used by the Legislature and the more so if that plain language supports the subject against the taxing Department.

5. In the light of these observations let us look at the language used by the Legislature. The proviso which applies both to clauses (i) and (ii), the case of rebate and the case of additional income-tax, starts by stating "in the case of a company which, in respect of its profits liable to tax

under the Income-tax Act for the year ending on the 31st day of March, 1952..."

6. In this case the assessee company is not a company which has made any profits which are liable to tax under the Income-tax Act for the year ending on the 31st March, 1952. It may be possible to take the view, as was suggested by the Advocate-General, that the language used by the Legislature is capable of another meaning, viz., that what was intended was not that the company in fact should have made profits, but that if the company had made profits they would have been liable to tax under the Income-tax Act for the year ending on the 31st March, 1952. But even though we might have learned in favor of that construction, when we proceed with the proviso it seems to us that it is not possible to put that construction on the expression used by the Legislature. To proceed with the proviso,

> "...has made the prescribed arrangements for the declaration and payment, within the territory of India excluding the State of Jammu and Kashmir, of the dividends payable out of such profits, and has deducted super-tax from the dividends in accordance with the provisions of sub-section (3-D) or (3-E) of section 18 of that Act."

7. Therefore, it is only that company to which the proviso applies which has made arrangements to pay dividends which are payable out of profits referred to in the earlier part of the proviso. Therefore the condition precedent to the application of the proviso is that there must be a declaration of dividends by the company not payable out of any profits but out of the specific profits referred to in the first part of the proviso, viz., profits liable to tax under the Income-tax Act for the year ending on the 31st March, 1952. If that be the condition precedent, then it is clear that in this case that condition is not satisfied. The company has undoubtedly declared dividends, but those dividends are not payable out of the profits liable to tax under the Income-tax Act for the year ending on the 31st March, 1952. As a matter of fact there are no profits liable to tax under the Income-tax Act for the year ending on the 31st March, 1952. But the matter does not end there. When we turn to clause (ii) with which we are concerned, which is not a case of rebate but a case of additional tax, that clause provides :

> "Where the amount of dividends referred to in clause (i) above exceeds the total income as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, there shall be charged on the total income an additional income-tax equal to the sum, if any, by which the aggregate amount of income-tax actually borne by such excess (hereinafter referred to as "the excess dividend") falls short of the amount calculated at the rate of five annas per rupee on the excess dividend."

8. Therefore, the purpose of enacting clause (ii) of the proviso is to levy an additional income-tax and the rate of that additional income-tax is specified in this clause. But it is difficult to understand how there can be an additional income-tax when to start with there is no income-tax at all. An additional income-tax must postulate first a total income liable to tax, and secondly, an income-tax which has been levied of that total income in this case neither of those two postulates

are present. There is neither a total income liable to tax, nor is there any income-tax which has been assessed on that total income. Therefore it is clear that looking at the language of the proviso what the Legislature - whether it intended it or not is a different matter - what the Legislature has provided is that on the total income of a company which is being assessed for the year ending on the 31st March, 1952, there shall be paid income-tax at the rate of 4 annas in the rupee and an additional income-tax as provided in clause (ii) of the proviso. It was suggested that Parliament was competent to alter the definition of "total income" as appearing in the Income-tax Act and it was open to Parliament to create a notional total income, although in fact there may be no income at all. It may be, very likely it is, that Parliament has the power to alter the definition of "total income" in the Income-tax Act. But we must find in the Finance Act an attempt on the part of Parliament to modify the definition of "total income" given in the Income-tax Act, and as already pointed out it emphasises the fact that the total income referred to in the Finance Act and all that the Finance Act does is, while accepting the foundation of total income as embodied in the Income-tax Act, to raise as it were the super-structure upon that foundation of the different rates on different incomes to be assessed in the manner laid down in the Finance Act.

9. Two contentions which were urged by the Advocate-General may be noticed. One is that in the proviso the expression "...a company which, in respect of its profits liable to tax under the Income-tax Act for the year ending on the 31st day of March, 1952, has made the prescribed arrangements for the declaration and payment within the territory of India excluding the State of Jammu and Kashmir, of the dividends payable out of such profits.." is merely descriptive of a particular type of company which has made the necessary arrangements for the declaration of dividends. This contention would have considerable force if we were not faced with the expression "payable out of such profits." The Legislature has emphasized the fact that the dividends in question are not payable out of profits but out of such profits to which reference is made in the earlier part of the proviso. The second contention of the Advocate-General is that at the end of the proviso it is enacted that the expression "dividend" shall have the meaning assigned to it in clause (6A) of section 2 of the Income-tax Act, but any distribution included in that expression, made during the year ending on the 31st day of March, 1952, shall be deemed to be a dividend declared in respect of the whole or part of the previous year. We fail to see how this definition of "dividend" can help us in construing the provision with regard to the liability of the company to pay additional income-tax. The tax which the Department proposes to levy is not a tax on dividend, it is a tax on the income of the company, and whatever the significance of this definition may be with regard to dividends, what we are concerned with is whether the Legislature has effectively provided for levying additional income-tax on a company which has no income at all in the year in question. The matter may also be looked at from another aspect. The whole scheme of the Income-tax Act, and that indeed is the basic scheme, - is that what is taxed is the income of the previous year. What is sought to be taxed is the income of the previous year. What is sought to be taxed here is not the previous year's income of the company. What is sought to be taxed is the income of the company which it made or which accrued to it in the year preceding to the previous year and there is no provision in the Income-tax Act for taxing income

of this character. The Finance Act could have provided that in the income of the previous year certain income which was not made or not accrued in that particular year should be included, but we do not find anything in the Finance Act which supports such a contention. Indeed the demand of the taxing Department comes to this that they want to tax a company which has no income in the year of account. They want to tax the income of the company which it made or which accrued to it in the year or years preceding the previous year and which income has already borne tax. The contention is that although this income has borne tax, although it is not the income of the previous year, although the company has no income at all, still by reason of the proviso this income should bear an additional income-tax. Before we could accede to that contention we would require much clearer and much stronger language in the Finance Act. It is always with some reluctance that a Court comes to the conclusion which seems to defeat the object of the Legislature. But the rights of a subject under a fiscal statute are equally important, if not more important than giving effect to the object of the Legislature, and if the Legislature uses inappropriate language and fails to bring some income to tax, we must come to the conclusion that the Department is not justified in taxing the subject.

10. In my opinion, therefore, the answer to question (1) will be in the negative. On that answer question (2) will not arise.

11. The Commissioner to pay the costs.

Tendolkar, J.

12. I agree, but having regard to the importance of the questions of law that are involved I should like to state my own reasons for coming to the same conclusion as my Lord, the Chief Justice.

13. The question that is referred to us for decision is whether a company which has no taxable income in the accounting year is liable to pay additional income-tax by reason of the fact that it has declared an "excess dividend" within the meaning of that expression in paragraph B of Part I of the First Schedule to the Indian Finance Act, 1951.

14. In order to appreciate this question it is useful in the first instance to have a clear idea of what an "excess dividend" is. The expression "excess dividend" was for the first time introduced in the Indian Finance Act in 1948. It has been repeated in the subsequent Acts, but the meaning of that expression has not altered throughout this period. Apparently, the Legislature thought it desirable that an inducement should be held out to companies not to declare dividends over what I may describe as a ceiling for the dividends. That ceiling was nine annas in the rupee of the total income reduced by any portion of that income which was exempt from income-tax; and what the Legislature did was that if any company declared a dividend below the ceiling, the Legislature offered a rebate on that portion of the income which was the difference between the dividend

actually declared and the ceiling at one anna per rupee. Simultaneously, the Legislature also enacted that if any company declared a dividend above the ceiling, then such portion of the dividend as exceeds the ceiling shall be considered as "excess dividend" and by reason of the fact that the company has declared an excess dividend there shall be charged on the total income of the company an additional income-tax calculated on the basis of the excess dividend, the actual calculation being that the charge shall be the difference between five annas per rupee and the amount actually borne by such excess dividend. There was also a further provision that the excess dividend shall be deemed to have been paid out of the undistributed profits of previous years. There is the concept of "excess dividend" under the Finance Act, and the question is, where a company pays an "excess dividend" nor part of which is out of the profits of the accounting year, does it by reason of the fact that it has paid an "excess dividend" become liable to pay additional income-tax ?

15. Now, the question as framed appears to me to be capable of a very simple answer and does not really require consideration of the provisions of the Finance Act at all. The Indian Income-tax Act under section 3 makes total income of the previous year taxable to income-tax, and section 55 makes the same total income taxable to super-tax. What therefore attracts tax is the total income of the previous year and nothing else. It is true that this total income need not be actual. It may in certain cases be deemed income and there are provisions in the Income-tax Act which make deemed income the total income which attracts tax. But whether it is actual or deemed, what can be subjected to tax is total income only and nothing else. Then section 3 provides that income-tax shall be charged for any year at the rate or rates that are to be charged in respect of any year on the total income for the previous year. Undoubtedly it is competent to the Legislature by the Finance Act to amend any provisions of the Income-tax Act and it could, if it so chose, so amend the Finance Act as to affect its basic structure and provide that anything other than total income is taxable. But it must be a question of construction in each case whether the Finance Act purports to bring about any such result. In this particular case the provision of the Finance Act that is relied upon as bringing about the result that a non-existing total income shall attract a so-called "additional tax" is to be found in the First Schedule, Part I, to the Indian Finance Act. The operative part of that Act, in so far as the Schedule is concerned, is to be found in section 2 which provides that for the year beginning on the 1st of April, 1951, income-tax shall be charged at the rate specified in Part I of the First Schedule. It is perfectly clear therefore that what the First Schedule purports to prescribe is nothing more or less than the rates to be charged on the total income of the previous year which is the income which is chargeable under the substantive provisions of the Income-tax Act. Therefore, where a company has no total income for the previous year, and indeed in this case the total income of the company is negative, no rate can be attracted by such an income at all. Obviously, a rate prescribed can apply to a positive income and not to a negative income; and in my opinion therefore no occasion arises for turning to the provisions of the Schedule to the Indian Finance Act, 1951, for the purposes of determining the question that has been referred to us. Obviously, since there is no total income of the previous year which can attract tax, there can be no question of paying any tax or additional tax. But

assuming for a moment that the view that I have taken is not the correct one and it may be open to the Legislature even whilst prescribing the rates of income-tax so to frame the rates as to impose a tax on non-existing total income, I now turn to the relevant provisions of the Act relied upon the bring about this result.

16. Paragraph B of Part I of the First Schedule to the Finance Act, 1951, in the first instance provides that on the whole total income of every company the rate shall be four annas in the rupee with a surcharge with which we are not concerned. Then follows the important proviso which is the subject-matter of interpretation upon this reference :

> "Provided that in the case of a company which, in respect of its profits liable to tax under the Income-tax Act for the year ending on the 31st day of March, 1952, has made the prescribed arrangements for the declaration and payment within the territory of India excluding the State of Jammu and Kashmir, of the dividends payable out of such profits, and has deducted super-tax from the dividends in accordance with the provisions of sub-section (3-D) or (3-E) of section 18 of that Act -
> (i) where the total income, as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, exceeds the amount of any dividends (including dividends payable at a fixed rate) declared in respect of the whole or part of the previous year for the assessment for the year ending on the 31st day of March, 1952, and no order has been made under sub-section (1) of section 23A of the Income-tax Act, a rebate shall be allowed, at the rate of one anna per rupee on the amount of such excess;
> (ii) where the amount of dividends referred to in clause (i) above exceeds the total income as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, there shall be charged on the total income an additional income-tax equal to the sum, if any, by which the aggregate amount of income-tax actually borne by such excess (hereinafter referred to as "the excess dividend") falls short of the amount calculated at the rate of five annas per rupee on the excess dividend."

17. Now, the words in this proviso which have been relied upon by Mr. Palkhivala in support of his argument that this proviso does not bring within its scope companies which have no total income, are the following four expressions : (I) "in respect of its profits liable to tax," (2) "dividends payable out of such profits," (3) "charged on the total income," and (4) "an additional income-tax." In so far as the first part of the proviso is concerned, the first two expressions occur in that part and they undoubtedly refer to the company in respect of which these provisions apply. In respect of such a company its profits must be liable to tax. No doubt this expression is quite capable of meaning not that the company has actually made profits but that if it had made profits they would have been liable to tax. One must in this connection remember the definition of "total income" in section 2(15) which is that "total income" means total amount of income, profits and gains computed in the manner laid down in this Act, and upon such a computation the total income may arithmetically be zero or negative. It would still be total income in one sense,

although of course if the total income is zero or negative it is not such total income as can be taxed or which attracts tax. The use of the expression "in respect of its profits liable to tax" therefore is not by itself useful for determining whether the proviso deals with a company which has or has not made profits during the accounting year. Turning next to the phrase "dividends payable out of such profits," this phrase obviously appears to me to be incapable of being applied to a company which has no profits to distribute and if it has no profits there can be no dividends payable out of such profits and the expression "such profits" obviously in this proviso refers to the profits of the year ending on the 31st day of March, 1952, and not to any previous year at all. This expression therefore in this proviso is in my opinion entirely and wholly inconsistent with the proviso being applicable to a company which has made no profits out of which dividends could be declared at least in part. Turning next to clause (ii) of the proviso, the third expression relied upon by Mr. Palkhivala is "charged on the total income." The Tribunal took the view that what the Finance Act did was to modify the Indian Income-tax Act, 1922, by providing that tax shall be paid on certain undistributed profits of the previous year, although the Income-tax Act subject to tax only the total income of the previous year. With respect to the Tribunal, such a view appears to me to be wholly untenable. In the first instance, the plain language of the proviso indicates that the tax is to be charged on the total income and on nothing else : but quite apart from it, as I have pointed out earlier, the entire scheme of the Income-tax Act is that income-tax or super-tax is payable on the total income of the previous year and in prescribing a rate or rates applicable to the total income, which is all that section 2 of the Indian Finance Act, 1951, purports to do in terms of the First Schedule of that Act, it cannot conceivably be held that the Legislature intended to subject to tax anything other than the total income which alone attracts tax under the scheme of the Indian Income-tax Act. Obviously, although as I have pointed out earlier total income in a given case might be calculated as negative, total income for the purpose of attracting tax must of necessity be a positive figure, and therefore this proviso cannot apply to a company which does not have a total income which attracts tax. I next come to the last phrase that has been relied upon by Mr. Palkhivala, viz., "an additional income-tax." Now, that phrase appears to me to be inappropriate in a case in which there is no income-tax attracted at all. One can only talk of an additional tax when there is some tax to which it is an addition, and in the case of a company whose total income for the accounting year is not taxable at all it seems to me to be quite inappropriate to talk of an additional income-tax. It is true that the additional tax that is made payable by reason of this proviso is calculated not at any rate which has relationship to the total income of the company. It has, one the other hand, relationship to what is termed "excess dividend" and it is to be calculated on the basis of the excess dividend. But the fact that it is calculated on the basis of the excess dividend and not on the basis of the amount of total income does not make it any the less a tax on the total income, nor does it make it a tax on such excess dividend. Indeed, excess dividend by virtue of the further provisions in paragraph B of the Indian Finance Act, 1951, shall be deemed to be out of the undistributed profits of previous years, and the First Schedule prescribes a rate of tax for the total income of the previous year and not for any portion of the income of years preceding the previous year and it cannot possibly be that what was sought to be taxed was excess dividend and not the total income.

18. Then again, the Advocate-General made a half-hearted attempt to argue from a provision to which I will presently draw attention in paragraph B of the Indian Finance Act, 1951, that the Legislature had converted this excess dividend into a deemed income of the assessee, and the provision on which the Advocate-General relied is in the following terms :

> "For the purposes of the above proviso, the expression 'dividend' shall have the meaning assigned to it in clause (6-A) of section 2 of the Income-tax Act, but any distribution included in that expression, made during the year ending on the 31st day of March, 1952, shall be deemed to be a dividend declared in respect of the whole or part of the previous year."

19. The argument of the Advocate-General was that the dividend dealt with in the proviso is a deemed dividend. Now, in the first instance, on a plain reading of the proviso, what it provides is not that anything is a deemed dividend; what it provides is that the dividend declared, although it may be stated to relate to any year other than the previous year, shall be deemed to be for the previous year and not that a dividend which is not actual shall be deemed to be a dividend. But assuming that we were dealing with a case of a deemed dividend, a deemed dividend could only be taxable in the hands of the shareholder and not in the hands of the company, and what is sought to be taxed by the proviso where a company declared an excess dividend is, as I have pointed out earlier, not the excess dividend at all, but it is an additional tax on the total income of the company. In my opinion, therefore, this particular proviso in the Indian Finance Act, 1951, cannot be read as having amended the Income-tax Act so as to provide that the excess dividend shall be the deemed income of the company and shall therefore the liable to tax. I must confess that the object of this proviso in the Indian Finance Act could, so far as I can see, only be to make an attempt to limit the dividends and to encourage or induce the companies to plough back at least a substantial part of the profits into the industry itself; and if for achieving that object the Legislature thought fit to provide that a company which has made profits should be induced not to declare a dividend above the ceiling and to inflict a penalty on a company which declares a dividend in excess of the ceiling, there can be no logical reason why the same penalty should not be imposed or sought to be imposed on a company which has no profits to distribute by way of dividend at all in the preceding year and yet declares a dividend. But although there may be no logical reason for this distinction, the function of this Court is to interpret the statute as it stands. It may be a case where the Legislature has not succeeded in giving effect to its intentions; and in any event it appears to me that if the Legislature intended that in the case of a company which has no total income which attracts tax a tax should be levied within the framework of the Income-tax Act as it exists, such an object could only be achieved by providing that the company shall be deemed to have a total income and proceeding to tax such total income. I find nothing in the provisions of the Indian Finance Act which can possibly be construed to have that result.

20. I am therefore clearly of opinion that the answer to the questions should be as indicated by

my Lord the Chief Justice.
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