BOMBAY HIGH COURT

Arvind N. Mafatlal

Vs.

Income-Tax Officer

Special Civil Appln. No. 1848 of 1956

(Shah and Palnitkar, JJ.)

14.01.1957

JUDGMENT

Shah, J.

1. The firm of Mafatlal Gagalbhai and Sons consisted of four partners : Navinchandra Mafatlal, Arvind N. Mafatlal, Yogindra N. Mafatlal and Hemant Bhagubai. The respective shares of the four partners in the profits and assets of the firm were five annas, three annas, three annas and five annas. The firm was registered under the Indian Income-tax Act. The firm owned forty shares of a private limited company, Mafatlal Apte and Kantilal, Ltd., registered under the Phaltan State Companies Act. having its registered office at Sakarwadi in the former Phaltan State. Out of these forty shares, ten shares stood in the name of Navinchandra Mafatlal, ten shares stood in the name of Arvind N. Mafatlal and the remaining twenty shares stood in the name of Hemant Bhagubai minor by his guardian Mrs. Sharda Bhagubai. Mafatlal Apte and Kantilal, Ltd., which will hereafter be referred to as "the Company", were the Managing Agents of Phaltan Sugar Works, Ltd., which was also a Company registered under the Phaltan State Companies Act, having a factory at Phaltan. In the former Phaltan State the Indian Income-tax Act, 1922, was adopted almost verbatim by the Phaltan Income-tax Act III of 1941 as amended by the Phaltan Income-tax Act VIII of 1942. Navinchandra Mafatlal, whom I will hereafter refer to as "the assessee", was, as regards the Phaltan State Income-tax Act, a non-resident. The company held its General Meeting on 11th March 1946, and before the General Meeting the accounts for the year ending 30th September, 1945, were placed for adoption. The accounts showed a profit of Rs. 1,09,165/- for the year ending 30th September, 1945, but no dividend was declared by the Company. On the profit the Company paid Rs. 34,114/- as income-tax and Rs. 6,823/-as super-tax and the net profit remaining with the Company was Rs. 68,228/-.

2. After the merger of the Phaltan State, by Section 7 of the Taxation Laws (Extension to Merged States and Amendments) Act LXVII of 1949 the Phaltan State Income-tax Act III of 1941 stood

repealed, except for purposes of levy, assessment and collection of income-tax and super-tax in respect of any period not included in the previous year for the purposes of assessment under the Indian Income-tax Act, 1922, as extended to the Phaltan State by Section 3. By Section 3 of that Act, the Indian Income-tax Act, 1922, and several other Acts and the Rules made thereunder, which were in force immediately before the commencement of the Act in the dominion of India were extended to the territory of the former Phaltan State as from 1st April, 1949.

3. On 17th March, 1951, the Income-tax Officer, Satara North, passed an order under Section 23-A of the Indian Income-tax Act directing that the

> "undistributed portion of the assessable income of the Company of the previous year ended on 30th September, 1945, as computed for Income-tax purposes for the assessment year 1946-47 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 held on 11th March, 1946."

The Income-tax Officer then issued notice under Section 23 (2) of the Indian Income-tax Act against the assessee for assessing him as a non-resident for income-tax on interest and dividend deemed to have been received in Phaltan State for the year ending 31st December, 1946. In answer to that notice the constituted Attorney of the assessee appeared before the Income-tax Officer and contended that the shares of the Company, which stood in the name of the assessee, were in reality the property of the firm of Mafatlal Gagalbhai and Sons, Bombay, and that the shares were standing in the assessee's name as a nominee of the firm. It appears that the Income-tax Officer accepted this contention and determined the assessee's total world income at Rs. 19,75,328. In this total world income were included Rs. 18 as interest on deposits in Phaltan State and Rs. 8,528 being the five annas share in the dividend of Mafatlal Apte and Kantilal Ltd., deemed to have been distributed under Section 23-A of the Income-tax Act from the profits of that Company for the year ended 30th September, 1945, received through Mafatlal Gagalbhai and Sons. The total income in the Phaltan State was, therefore, computed as Rs. 8,546. The amount of Rs. 8,528, which was taken as the share of the assessee in the dividend of the Company, was presumably arrived at by the Income-tax Officer as 5/16th of the dividend on forty shares held by Mafatlal Gagalbhai and Sons out of a total of 100 shares of the Company in respect of which the net income of Rs. 68,228 was deemed to have been distributed as dividend under Section 23-A of the Indian Income-tax Act.

4. On 13th April, 1954, the Income-tax Officer, North Satara, served a notice upon the assessee intimating that the dividends deemed to have been distributed under Section 23-A in respect of the shares of the company held by the assessee had been taken

> "at Rs. 8,528 net for the assessment year 1947-48 under the Phaltan State Income-tax Act

without being grossed up though the credit for the tax deemed to have been paid thereon" had been given, and as that was a mistake "apparent from the record" the Income-tax Officer intended to rectify the same under Section 35 of the Income-tax Act, and called upon the assessee to submit his objection to the mistake being so rectified. By letter, dated 19th April, 1954, it was contended on behalf of the assessee that the order, dated 26th October, 1951, assessing the assessee under Section 23 (3), was itself ultra vires and illegal and no rectification could be sought thereof. By another letter, dated 13th September, 1955, it was contended on behalf of the assessee that the original action taken under Section 23 (3) was ultra vires and illegal, that in any event in the order passed under Section 23 (3) the amount of capital gains of Rs. 9,38,011 for computing the tax payable by the assessee under the Phaltan State Income-tax Act could not be included in the total world income, that similarly the Indian dividend income could not be grossed up by adding the tax payable thereon and that no case for rectification of a mistake under Section 35 of the Income-tax Act was made out. By his order dated 12th October, 1955, the Income-tax Officer rejected the contentions raised by the assessee and he purported to rectify the mistake referred to in his notice, and ordered that an amount of Rs. 3,876, being the tax deemed to have been paid on behalf of the assessee, be added to the total world income. Accordingly he held that Rs. 19,79,204 was the total world income of the assessee for the year 1947-48, and ordered that demand notice and chalans for excess tax, income-tax and super-tax, payable thereon be issued. This order of rectification was served on the legal representatives of the assessee - whom I will hereafter refer to as "the petitioners", the assessee having died on 7th November, 1955. On 28th November, 1955, the Attorneys of the petitioners called upon the Income-tax Officer to treat the order, dated 12th October, 1955, as "void and a nullity" and to intimate accordingly. A similar communication was also made to the Commissioner of Income-tax, Bombay South, and the Secretary, Ministry of Finance. On 5th June, 1956, the Commissioner of Income-tax, Bombay South, informed the petitioners that the Central Board of Revenue declined to interfere in the matter. The petitioners then applied by this petition for a Writ in the nature of Certiorari or an appropriate writ under Article 226 of the Constitution, quashing the assessment and the rectification of the order of assessment.

5. When this application was placed for hearing for Rule before the learned Chief Justice and Mr. Justice Tendolkar the Court ordered that Rule "confined to the order, dated 12th October, 1955, be issued." It is evident in view of the order passed by this Court that the petition, in so far as it challenges the validity of the assessment order passed by the Income-tax Officer on 26th October, 1951, has been disposed of, and in this petition we are only concerned to decide whether a Writ of Certiorari may be issued quashing the order, dated 12th October, 1955.

6. There is no substance in the contention that because the Phaltan State Income-tax Act has been repealed an order under Section 35 of the Income-tax Act rectifying a mistake in an assessment order passed by the Income-tax Officer cannot be passed. Even though the Phaltan State Income-

tax has been repealed by the Taxation Laws (Extension to Merged States and Amendment) Act, 1949, for purposes of levy, assessment and collection of income-tax and super-tax the Phaltan Income-tax Act does survive, and rectification of a mistake in assessment must be regarded as 'assessment' within the meaning of Section 7 of the Taxation Laws (Extension to Merged States and Amendment) Act, 1949. We are also unable to agree with the contention of Mr. Palkhivala that Section 35 of the Indian Income-tax Act contemplates rectification of mistakes which are clerical or arithmetical only. Section 35 of the Income-tax Act enables the Income-tax Officer, to rectify any mistake "apparent from the record" of the assessment. Jurisdiction under Section 35 of the Act therefore is to rectify mistakes which are "apparent from the record" and is not restricted to rectification of mistakes which are merely clerical or arithmetical. We are also unable to agree with the contention raised by Counsel for the assessee that the mistake which is to be rectified must be "apparent on the face of the record." The Legislature has not used in Section 35 the expression "mistake apparent on the face of the record" and we are unable to equate the expression "apparent from the record" used in that section with the expression "apparent on the face of the record." It is however true that the mistake to be rectified must be a mistake apparent from the record of the Income-tax Officer, i. e., it must be a mistake "patent on the record and not a mistake which may be discovered by a process of elucidation, argument or debate" See *Sidramappa Andannappa v. Commissioner of Income-tax*[1], at p. 288) .

7. Mr. Palkhivala urged that even if his contention as to the extent of the jurisdiction of the Income-tax Officer under Section 35 be not accepted, there was no error apparent from the record which attracted the application of Section 35. It was contended that if in ascertaining whether there was error apparent from the record the Income-tax Officer had not only to look at the record of the assessee but also to look at the record of the Company, i. e., he had to traverse beyond the record of the assessee, it could not be said that the error fell within Section 35 of the Act. It was also urged that as evidence had to be considered in deciding whether error had been committed, the error was not apparent from the record. Counsel further contended that assuming that an error was committed, there were several other errors committed by the Income-tax Officer in making the assessment, and the Income-tax Officer was bound to rectify those errors also. It was submitted that in making the assessment the Income-tax Officer took into consideration the total world income of the assessee as inclusive of the capital gains, which, the assessee being a non-resident, could not be taken into account. It was also submitted that the British Indian dividend income was "grossed up" by adding the tax paid by the Companies which paid the dividend and that could not lawfully be done. It was further submitted that in taking into account the income of the assessee as a partner holding a five annas share in the firm of Mafatlal Gagalbhai and Sons, the Income-tax Officer had committed an error. It was urged that, if at all, the dividend income of the assessee could be regarded as that of a holder of ten shares in the Company and the dividend income could not exceed 1/10th of the net income of the Company which was deemed to have been distributed under Section 23-A of the Income-tax Act. Finally it was contended that even assuming that there was an error committed in the assessment order in not grossing up the dividend income by adding thereto the tax paid by the Company, the assessee

having been treated merely as a nominee of the real holder of the shares, the error committed by the Income-tax Officer in making the order of assessment, was in giving credit for the tax paid by the Company and not in regarding a fraction of the net income of the Company as the income of the assessee, and inasmuch as the notice under Section 35 of the Income-tax Act did not relate to this error, the order, dated 12th October, 1955, was without jurisdiction. An elaborate argument was presented before us by Mr. Palkhivala in support of the various submissions made by him. It is sufficient to observe that there is no warrant for holding that in ascertaining whether there is an error apparent from the record, the officer can look at the order of assessment alone and nothing else. All proceedings which constitute evidence on which the assessment order is passed must be regarded as record for the purpose of Section 35. We are also unable to hold that the Income-tax Officer is prohibited from looking at the evidence to ascertain whether an error has been committed. Again, for several reasons Counsel is not entitled to contend that beside the error referred to in the notice there are other errors in the order of assessment. It was to be noted that the assesses did not prefer an appeal against the

[1]54 Bom LR 163, at page 167 : (AIR 1952 Bom 287)

original assessment, even though it was competent to him to do so. The order has, therefore, become final. Again, the Rule in this petition is confined to the validity of the order, dated 12th October, 1955, and the petitioners are not entitled to challenge the validity of the assessment, their petition in that behalf having been rejected. It was open to the assessee to submit an application invoking the jurisdiction of the Income-tax Officer under Section 35 to rectify the errors complained of, but no such application has been preferred, and the alleged errors cannot be set up in answer to a rectification already made by the Income-tax Officer.

8. But as we have already pointed out, in answer to the notice under Section 23 (2) of the Income-tax Act, the assessee contended that he held the shares of the Company as nominee of Mafatlal Gagalbhai and Sons, and that contention was accepted by the Income-tax Officer. It was open to the Income-tax Officer to assess the assessee on the dividend income received in respect of the ten shares held by him, but the officer chose to assess the real owner. Under Section 16 (2) of the Income-tax Act in computing the total income to an assessee,

> "any dividend shall be deemed to be income of the previous year in which it is paid, credited or distributed or deemed to have been paid, credited or distributed to him, and shall be increased to such amount as would, if income-tax (.....) at the rate applicable to the total income of a company (.....) for the financial year in which the dividend is paid, credited or distributed or deemed to have been paid, credited or distributed were deducted therefrom, be equal to the amount of the dividend."

Under Section 18, Sub-Section (5), an assessee is entitled to be given credit for the income-tax or super-tax on the dividend income paid on his behalf, and that is made further clear by Section 49-B which provides that "where any dividend has been paid, credited or distributed or is deemed to have been paid, credited or distributed" to a share-holder of a company assessed to

income-tax, the shareholder, "if the dividend is included in his total Income, be deemed in respect of such dividend himself to have paid income-tax.....at the rate applicable to the total income of the Company." It was, therefore, open to the Income-tax Officer to have assessed the dividend on the ten shares held by the assessee after grossing up the tax attributable to the shares, and the assessee would in that event have been entitled to claim credit for the tax paid by the Company on the dividend received by him. But the Income-tax Officer did not assess the assessee as a share-holder; he accepted the contention of the assessee that the assessee was a nominee of the firm of Mafatlal Gagalbhai and Sons and on that footing he distributed the dividend income between the partners. On the distribution of the dividend income so made, the amount deemed to have been received by the assessee in that income as partner of the firm could not be regarded as dividend income in the hands of the assessee. In the hands of the firm it was evidently dividend income, but in the hands of the assessee it could only be his share of the profits of the firm. Not being dividend income in the hands of the assessee. Section 16 (2) of the Income-tax Act had no application, and the income which has to be taken into account was 5/16th share in the net income received by the firm of Mafatlal Gagalbhai and Sons. It may be that even the income was not grossed up by adding thereto the income-tax paid thereon by the Company, the assessee could not be given credit for the tax paid by the Company. But the mistake committed by the Income-tax Officer was in giving credit for the tax paid and not in failing to gross up the income under Section 16 (2).

9. In taking this view as to the nature of the 5/6th share deemed to have been received by the assessee from the income of Mafatlal Gagalbhai and Sons, we are supported by a judgment of this Court in *Shree Shakti Mills Ltd. v. The Commissioner of Income-tax, Bombay City*[2]**.** In that case it was held :

> ".....it is only the share-holders of a company to whom dividends are paid who is entitled to the procedure of processing permissible under Sections 16 (2) and 18 (5). Consequently, a person who purchased certain shares but did not get himself transferred in the books of the company as the share-holder is not entitled to the procedure laid down in Sections 16 (2) and 18 (5) in respect of the amount representing dividend received by him from the registered holder who had sold the shares to him."

In Shree Shakti Mill's case, the assessee-company had purchased certain shares during the accounting year and had received from the transferor in respect of those shares certain amount representing dividends. In the return made by the assessee-company, a claim was made that the amount received from the transferor be processed under Sections 16 (2) and 18 (5) of the Income-tax Act. The Taxing Authorities refused to grant to the assessee-company the rights and concessions permissible under Sections 16 (2) and 18 (5) because the certificates under Section 20 of the Act were not produced. It appears that even though the shares were purchased by the assessee-company, the shares were not transferred in the books of the company in the name of the assessee, and they continued to stand in the name of the transferor. This Court held that the

assessee had not received any dividend from the company but had only received an amount representing the dividend from the registered holder of the shares. It was observed by the learned Chief Justice in delivering the principal judgment that as the assessee had purchased the shares but had not taken steps to get the same transferred in the books of the company,

> "the share-holder from whom the shares were purchased received the dividend from the company and qua the assessee the share-holder became a bare trustee with regard to the dividend received by him and the share-holder would be liable to pay the assessee an amount representing the dividend."

It is clear from this decision that the dividend received by a nominal holder of shares and paid to the real owner cannot be regarded as dividend income of the real owner within the meaning of Section 16 (2) of the Act and such income is not liable to be processed in terms of Sections 16 (2) and 18 (5) of the Act.

10. In the case before us, the firm of Mafatlal Gagalbhai and Sons being the real owners of the shares and the assessee being merely a nominal holder, the firm could not claim to process the income under Sections 16 (2) and 18 (5) of the Act. The assessment of the assessee quae the dividend income received by the firm is as a partner of that firm and not in his capacity as holder of the shares. The principle of Shree Shakti Mill's case, must, therefore, apply.

[2](1948) 16 ITR 187

11. It is clear, therefore, that an error was committed in the order of assessment for the year 1947-48, but the error lay in giving credit for the income-tax paid by the Company to the assessee as a partner of the firm of Mafatlal Gagalbhai and Sons, who were held to be the real owners of the shares and not in failing to process the dividend income in the hands of the assessee.

12. The first proviso to Section 35, Sub-Section (1) of the Income-tax Act provides that no rectification shall be made having the effect of enhancing an assessment, unless the Income-tax Officer has given notice to the assessee of his intention to do so and has allowed the assessee a reasonable opportunity of being heard. In the present case, the notice not being in relation to the error committed, but in respect of what was not an error at all, the Income-tax Officer had no jurisdiction to rectify the order of assessment. It may be pointed out that rectification can only be made within four years from the date of the order passed by the Income-tax Officer and the jurisdiction to rectify the assessment to the prejudice of the assessee can only be exercised after giving notice of the intention to rectify, and after giving reasonable opportunity to the assessee of being heard against the proposed rectification.

13. Mr. Joshi, who appears on behalf of the Income-tax Officer, has contended that the ground which is accepted by us was never set up before the Income-tax Officer and it has not been even clearly mentioned in the petition to this Court. It must be conceded that this ground does not appear to have been urged before the Income-tax Officer. But in the petition, a plea of want of

jurisdiction of the Income-tax Officer has been raised. If in fact there was no error committed which the Income-tax Officer sought to rectify, we will not be justified in refusing to quash the order merely on the plea that the Income-tax Officer was not asked to stay his hands on the ground mentioned before us. It may also be stated that the application before this Court is somewhat argumentative and even though at more places than one it is urged that the order dated 12th October, 1955, is without jurisdiction, the argument that it is without jurisdiction, in that the error mentioned in the notice under Section 35 is not an error at all, has not been clearly pleaded. This infirmity in the petition, however, does not affect the jurisdiction of this Court to grant relief, especially when the plea of want of jurisdiction but not the true ground in support thereof has been raised. We have invited Counsel for the Commissioner to make his submission on this plea, and it has not been submitted before us that he was taken by surprise or that any material, which has a bearing on that contention, has not been placed before us.

14. Mr. Joshi also contended that Shree Shakti Mill's case has not been correctly decided. He urged that the income received as dividend by a trustee or a nominal holder of share does not lose its character in the hands of the beneficial owner of the shares. We are unable to entertain this argument. The decision in Shree Shakti Mill's case is binding upon this Court. It may be pointed out that this decision has also been followed by other Courts (see, e. g., *Bikaner Trading Co. v. Commissioner of Income-tax*[3], and *Jaluram Bhikulal v. Commissioner of Income-tax*[4],

15. On the view taken by us, the Rule is made absolute and the order passed by the Income-tax Officer on 12th October, 1955, modifying the total world income of the assessee, is set aside. The consequent demand notice and the challans for recovery of

[3](1953) 24 ITR 419 (Cal)

[4](1952) 22 ITR 490 : AIR 1953 Nag187

excess tax are also quashed. Having regard to the circumstances of the case, and especially the circumstances that the petitioners are succeeding on a question which was not raised before the Income-tax Officer and not clearly set up even in the petition to this Court; we make no order as to costs of this application.

Rule made absolute.