

Commissioner Of Income-Tax, Gujarat vs Vadilal Lallubhai Etc. Etc on 29 August, 1972

Equivalent citations: 1973 AIR 1016, 1973 SCR (1)1058

Author: K.S. Hegde

Bench: K.S. Hegde, P. Jaganmohan Reddy, Hans Raj Khanna

PETITIONER:
COMMISSIONER OF INCOME-TAX, GUJARAT

Vs.

RESPONDENT:
VADILAL LALLUBHAI ETC. ETC.

DATE OF JUDGMENT 29/08/1972

BENCH:
HEGDE, K.S.
BENCH:
HEGDE, K.S.
REDDY, P. JAGANMOHAN
KHANNA, HANS RAJ

CITATION:
1973 AIR 1016 1973 SCR (1)1058
1973 SCC (3) 17
CITATOR INFO :
F 1976 SC 10 (35)
RF 1982 SC 149 (238)
F 1984 SC 790 (17)
RF 1986 SC 649 (43)
R 1989 SC 2113 (28)

ACT:
Income-Tax Act (11 of 1922) ss. 2 (6A .) (c), 2(6C) and 44F-
Deemed dividend, if income under s. 44F.

HEADNOTE:
The assessee sold his share holdings in certain managing agency companies. A few days thereafter the managing agency companies went into voluntary liquidation. Consequently, the assets of those companies were distributed among the shareholders then on the registers of the companies. They included the persons who had newly purchased the shares.

They were either not liable to pay any income-tax or were liable to pay tax at a rate lower than what the assessee would have had to pay had he received the amount distributed. The Department and the Appellate Tribunal held that the amounts distributed were dividends within the meaning of s. 2(6A)(c) of the Income-tax Act, 1922, that the assessee sold his shares with a view to avoid income-tax and super tax, and that, consequently, the assets distributed, which would have fallen to his share had he not sold his shares, were liable to be brought to tax under s. 44F of the Act. The High Court, on reference, held in favour of the assessee.

Dismissing the appeal to this Court,

HELD : (1) Section 2(6C) of the Income-tax Act gives an inclusive definition of 'income' and dividend is included therein. Therefore, if receipt can be considered as dividend it has to be considered as income under 2(6C). Section 2(6A) gives an inclusive definition of 'dividend' and under sub-cl. (c), any distribution made to the shareholders of a company on its liquidation would be deemed to be dividend; but, this definition applies only if there is nothing repugnant in the 'subject or context. [1061G-H; 1062 A-B]

(2) Legal fictions are only for a definite purpose and they are limited to the purpose for which they are created and should not be extended beyond their legitimate field. In the case of deemed dividend under s. 2(6A) (c) the assets distributed will be considered as income in the account year in which it is distributed but that conception would be inapplicable in cases coming under s. 44F. [1064 C-E]

Commissioner of Income-tax, Andhra Pradesh v. C.P. Sarathy Mudaliar, 82 I.T.R. 170; and Commissioner of Income-tax, Bombay City-1 v. Amar-chand N. Shroff, 48 I.T.R. 59, referred to.

(3) Under s. 44F (1) to (3) the income referred to therein should arise from shares or securities during a period of time. Further, it must be a periodical income which is capable of being apportioned on the basis that it is deemed to have accrued from day to day. In the case of interest on securities or dividends on shares they are paid at certain intervals and hence they can be deemed as having accrued from day to day; but in the case of distribution of the assets of a company on liquidation it is not possible to deem it as having accrued from day to day. When a company goes into liquidation the share scripts are nothing but pieces of paper and no income arises from those shares after the liquidation. What the share holder gets on liquidation is not any income 'from shares but

1059

a share of the assets of the quondam company and such a receipt is incapable of being deemed to have accrued from day to day. Moreover, the company may go into liquidation long after the accounting year ends and there is nothing to

indicate what period the income-tax officer should take into consideration for applying the fiction that "the income had deemed to accrue from day to day." [1065A-C]

(4)The two provisions, namely, s. 2(6A)(c) and s. 44F cannot be dovetailed unless three assumptions are made, (a) that the- fictional dividend contemplated by s. 2(6A)(c) is 'income' within the meaning of s. 44F; (b) that the dividend is capable of being deemed to have accrued day to day; and (c) that the day to day distribution contemplated in s. 44F commences on the commencement of the relevant accounting year and ends with the distribution of the assets. To do so, words would have to be read into the section which is impermissible in construing a provision of law. Hence, the deemed dividend contemplated by s. 2 (6A)(c) , cannot be considered as income under s. 44F. [1064 G-H]

Commissioner of Income-tax Madras v. Ajax Products Ltd. 55, 1.T.R. 741, referred to.

(6)The legislative intent in enacting s. 44F is clear from the report of the Select Committee. It was to prevent avoidance of tax by certain devices to convert revenue receipts into capital receipts known as 'bond washing' transactions. The marginal note to the section also shows that that was the intention of the Legislature. [1065C-D; 1067B]

Commissioner of Income-tax, Madhya Pradesh and Bhopal v. Sodra Devi etc., 32 I.T.R. 615, 627, referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : C.A. Nos. 2348-2349 of 1969, 1139 of 1969 and Civil Appeals Nos. 2006 & 2007 of 1971. Appeals by certificate under Article 133 'of the Constitution of India from the judgment and order dated January- 15, 1966 of the Gujarat High Court in Ahmedabad in I.T.R. Nos. 2 and 1 of 1966.

B.Sen, B. B. A huja and-B. D. Sharma for the appellant (in C.A. Nos. 2348-2349/69 & 2006-2007/71.) B.Sen and B. D. Sharma, for the appellant (in C.A. No. 1 139/69).

N. A. Palkhivala, S. T. Desai, M. C. Chagla, V. M. Tarkunde, A. K. Verma, J. B. Dadachanji, O. C. Mathur and Ravinder Narain, for the respondents (in C.A. Nos. 2348-2349/69 and 2006-2007/71).

N.A. Palkhivala, A. K. Verina, J. B. Dadachanji, o. C. Mathur and Ravinder Narain, for the respondent in C.A. No. 1139/69).

The Judgment of the Court was delivered by Hegde, J. The principal question of law arising in these appeals by certificate is whether on the facts and in the circumstances of each of these cases the Department was right in applying s. 44-F read with s. 2(6A)(c) of the Indian Income-tax Act, 1922 (to be hereinafter referred to as the Act). The Income-tax Officer, the Appellate Assistant

Commissioner and the Income-tax Appellate Tribunal answered that question in favour of the Department but the High Court answered the same in favour of the assessee. As we are in agreement with the conclusion reached by the High Court, we do not think it necessary to examine the other questions arising in these appeals.

For deciding the said question of law, it is sufficient if we take up the facts of any one of these cases. For the sake of convenience, we shall set out the facts in Civil Appeal No. 2348 of 1969. The assessee in that case is Vadilal Lallubhai. He is assessed as an individual. The relevant assessment year is 1958-59, the accounting year being the year ending on March 31, 1958.

The assessee belongs to the well-known family of Vadilal Lallubhai Mehta of Ahmedabad. The members of this family (who for the sake of convenience will hereinafter be referred to as the "Mehta Group") owned shares in and controlled several companies including certain managing agency companies. Those managing agency companies were Private Ltd. companies. The managed companies were also companies in which the members of the "Mehta Group" had controlling interest. This Group had also selling agency rights in the companies which they were managing. On the coming into force of the Companies Act, 1956, the managing agency companies gave up their managing agency rights in order to safeguard their selling agency rights. Thereafter the assessee sold his share holdings to the employees of some "Mehta Group" companies or the relations of such employees. In addition he sold some shares to one of the family trusts. A few days after the sales in question, those managing agency employees went into voluntary liquidation. Consequently the assets of those companies were distributed among the shareholders who were borne on the registers of the companies as on the dates of liquidation. These shareholders included those persons who had newly purchased the shares. One of the new shareholders as mentioned earlier was a charitable trust which was not liable to pay any tax. The remaining shareholders were either not liable to pay any tax or were liable to pay tax at a lower rate than the assessee would have had to pay had he received the amount distributed by the liquidators.

The Income-tax Officer brought to tax a portion of the assets distributed on liquidation by applying s. 44-F read with s. 2 (6A) (c) of the Act. The Appellate Assistant Commissioner agreed with this view. The assessee's appeal to the Income-tax Appellate Tribunal was unsuccessful. Thereafter at the instance of the assessee, certain questions were referred to the High Court for its opinion. Various contentions were advanced before the High Court on behalf of the assessee. We do not think it necessary to refer to those contentions as in our view the High Court was right in taking the view that to the facts and circumstances of the case, s. 44-F read with s. 2 (6A) (c) was inapplicable.

It was contended on behalf of the Revenue that the distribution of the assets of the various managing agency companies on liquidation is "dividend" within the meaning of s. 2 (6A) (c) and consequently as "income" as defined in s. 2(6C). Further the assessee sold his shares with a view to avoid income-tax and super-tax and consequently the assets distributed which would have fallen to his share had he not sold his share are liable to be brought to tax under the provisions of s. 44-F of the Act. On the other hand, it was contended on behalf of the assessee that the definitions contained in s. 2 are only to be applied "

unless there is anything repugnant in the subject or context". The definition of "dividend" given in s. 2 (6A)

(c) is repugnant to the subject dealt with under s. 44-F and consequently the distribution of the assets in liquidation of the several managing agencies concerns cannot be considered as "income" within the meaning of s.

44-F. It was urged that s. 44-F concerns itself with the income from securities or shares which are of a periodical nature but which an assessee may seek to convert into a capital receipt by adopting certain devices. The provisions therein do not deal with the compensation received for the very destruction of the income-yielding assets viz. the securities or shares. We shall now consider which one of these two contentions is acceptable. But before doing so it will be convenient to make reference to the relevant provisions in the Act. Section 2, the definitions section, starts by saying that the definitions given therein apply 'unless there is anything repugnant in the subject or context'. Hence if the definition of "dividend" found in s. 2(6A)(c) is either repugnant to the subject or context with which we are dealing, that definition will not be applicable. Section 2(6A) gives an inclusive definition of "dividend". In this case we are concerned with s. 2(6A)(c) which reads :

" any distribution made to the shareholders of a company on its liquidation, to the extent to which the dis-

tribution is attributable to the accumulated profits of the company immediately before its liquidation whether capitalised or not."

Section 2(6C) gives an inclusive definition of "income". Dividend is included therein. Hence if a receipt can be considered as a "dividend", it has to be considered as an "income" under s. 2(6C). This takes us to S. 44-F, which reads:

"(1) Any person upon whom notice is served by the Income-tax Officer requiring him to furnish a statement of particulars relating, to any securities in which, at any time during the period specified in the notice he has had any beneficial interest, and in respect of which, within such period, either no income was received by him or the income received 'by him was less than the sum to which the income would have amounted if the income from such securities had accrued from day to day and been apportioned accordingly, shall, whether an assessment to income-tax or Super-tax in respect of his total income has or has not been made for the relevant year or years of assessment, furnish such a statement and such particulars in the form and within the time (not being less than twentyeight days) required by the notice.

(2) If it appears to the Income-tax Officer by reference to all the circumstances in relation to the securities of any such person (including circumstances with respect to sales, purchases, dealings, contracts, arrangements, transfers, or any other transactions relating to such securities) that such person has thereby avoided or would avoid more than ten per cent of the amount of the income-tax or super-tax for

any year which would have been payable in his case in respect of the income from those securities if the income had 'been deemed to accrue from day to day and had been apportioned accordingly, and the income so deemed to have been apportioned to him had been treated as part of his total income from all sources for the purposes of income-tax or super-tax, then those securities shall be deemed to be securities to which sub- section (3) applies.

(3) For the purposes of assessment to income-,tax or super-tax in the case of any such person, the income from any securities to which this sub-section applies shall be deemed to accrue from day-to-day and 10 63 in the case of the sale or transfer of any such securities by or to him shall be deemed to have been received as and when it is deemed to have accrued :

Provided that this section shall not apply if such person proves to the satisfaction of the Income-tax Officer that the avoidance of income-,tax or super-tax was exceptional and not systematic and that there was not in his case in any of the three preceding years any such avoidance of income-tax or super tax, or that the provisions of section 44-E have been applied in his case in respect of such income.

(6) For the purpose of this section the expression "securities"includes stocks and shares."

From a reading of sub-ss. 1 to 3 of s. 44-F, it is clear that the income referred to therein should arise from shares or securities. Further it must be a periodical income which is capable of being apportioned on the basis that it is deemed to have accrued from day to day. Section 44-F(1) empowers the Income-tax Officer to serve a notice on any person "requiring him to furnish a statement of particulars relating to any securities in which at any time during the period specified in the notice he has had any beneficial interest and in respect of which, within such period either no income was received by him or the income received by him was less than the sum to which the income would have amounted if the income from such securities has accrued from day to day and had been apportioned accord- ingly.

The power conferred on the Income-tax Officer under this provision is not confined to any stipulated period. Now turning to subs.(2) of s.44-F, it speaks of "the amount of the income-tax or super-tax for any year which would have been payable in his cause in respect of the income from those securities if the income had been deemed to accrue from day to day and had been apportioned accordingly. Again sub-(3) of s.44-F speaks of ",the income from any securities to which this sub-section applies shall be deemed to accrue from day to day, and in the case of the sale or transfer of any such securities by or to him shall be deemed to have been received as and when it is deemed to have accrued.. ." "

It is clear from what we have said earlier that s.44-F con- cerns itself with income arising from securities or shares, during a period of time. When a company goes into liquidation, the share-scripts are no more income yielding

-assets, They are mere pieces of paper. No income arises from those shares thereafter. What the shareholder gets on liquidation is not any income from shares but a share of the assets of the quondam company. Such a receipt is incapable of being deemed to accrue from day to day. In the case of interest on securities or dividends on shares, they are paid at certain intervals. Hence it is possible to deem them as having accrued from day to day but in the case of distribution of assets of a company in liquidation, it is not possible to deem the same to have accrued from day to day. We have to bear in mind that some of the 'dividends' mentioned in s. 2(6A) are only deemed dividends. They are not real dividends. By a legal fiction, they are deemed as dividends. This Court held in Commissioner of Income-Tax, Andhra Pradesh v. C.P. Sarathy Mudaliar,⁽¹⁾ that the definition of "dividend" contained in s. 2 (6A) (c) is an artificial definition of "dividend". It does not take in dividend actually declared or received. The dividend taken note of by that provision is a deemed dividend and not a real dividend. The same would be the position in the case of the 'dividend' mentioned in s. 2 (6A) (c). As held by this Court in Commissioner of Income-tax, Bombay City-1 v. Amarchand N. Shroff,⁽²⁾ legal fictions are only for a definite purpose and they are limited to the purpose for which they are created and should not be extended beyond their legitimate field.

It is established on high authorities that the subject is not to be taxed unless the charging provision clearly imposes the obligation see Commissioner of Income-tax Madras v. Ajax Products Ltd. (3) As is often said that in interpreting a taxing provision one has merely to look to the words of the provision. The language employed in S. 44- F cannot be said to be plain enough to bring to tax the receipts of the character with which we are concerned in these appeals.

To accept the contention of the Revenue, we have to adopt threefold assumptions. Firstly the fictional dividend contemplated by s. 2 (6A) (c) is an "income" within the meaning of S. 44-F. Secondly we must assume that that dividend is capable of being deemed to accrue day to day and lastly we must assume that the day to day distribution contemplated in S. 44-F commences from the commencement of the relevant accounting year and ends with the distribution of the assets as contended on behalf of the Department. To do so we have to read into the section many more (1) 82 I.T.R. 170.

(2) 48 I.T.R. 59.

(3) 55 I.T.R. 741.

words than it contains at present which is wholly impermissible in construing any provision much less a taxing provision. In the case of deemed dividend under s. 2(6A)

(c), the assets distributed will be considered as income in the account year in which it is distributed but that conception would be inapplicable in cases coming under s. 44-F. A company may go into liquidation long after the accounting year ends. What period the Income-tax Officer should take into consideration for applying the fiction that "the income had deemed to accrue from day to day ?" The scheme of s. 2(6A) (c) is incompatible with the scheme of s. 44-F. The two provisions are intended to meet totally different situations. The former provision cannot be dovetailed into the latter.

In order to find out the legislative intent, we have to find out what was the mischief that the legislature wanted to remedy. The Act was extensively amended in the year 1939. Section 44-F was not in the draft bill. That section was recommended by the Select Committee consisting of very eminent lawyers. It will not be inappropriate to find out the reasons which persuaded the Select Committee to recommend the inclusion of s. 44-F, if the section is considered as ambiguous-see Commissioner of Income-tax, Madhya Pradesh and Bhopal v. Sodra Devi etc.(1). In recommending the inclusion of s. 44-F, this is what the Select Committee observed :

"The new Sections 44E and 44F are designed to prevent avoidance of tax by what

-are known as "bondwashing" transactions, involving the manipulation of securities so that the securities will pass temporarily in the legal ownership of some second person who is either not liable at all or liable in a lesser degree to tax, under such conditions that the interest on the securities is the income of this second person. A common form of the process is the sale of securities-cum- interest with a simultaneous contract to purchase them ex-interest. Where foreign securities are concerned this second person may be a foreigner resident abroad entitled to claim exemption from the tax on the interest. More often a financial concern in India is utilised whose computation of profits includes the results of realising securities, so that the concern can profitably offer "bond- washing" facilities to the owner of securities bearing fixed interest where the owner himself is not liable to taxation on the realisation of the securities."

Section 44-F of the Act, immaterial changes apart, is a reproduction of s. 33 of the English Finance Act, 1927 which was (1) 32 I.T.R. 615 at p. 627.

subsequently replaced by s.237 of the English Income-tax Act, 1952. Dealing with that section this is what is observed in the law of Income-tax, Surtax and Profits Tax by Wheateroft at p. 1669 (Paragraph 1-1358) :

We now come to the more difficult problem which arises when a taxpayer sells, for a capital sum, securities which are about to pay interest, and the purchaser acquires the right both to the securities and the interest. It is the custom on British stock exchanges to notify in advance the dates in respect of each security before which a buyer of that security will be entitled to the next income payment. Up to that date the security is sold Cum dividend"; after that date the security is sold "exdividend" and the next income payment when received after the sale will remain the property of the seller. Apart from the general market fluctuations, the price will gradually rise up to the day when the security goes "exdiv." it will then normally fall sharply by a sum appropriately equals to the anticipated income payment less tax at standard rate, as the average investor values the income at its net amount. If the amount is at a fixed rate, such as on Government stock, the likely fall for this reason can be calculated with considerable accuracy in advance.

A surtax payer, who pays more than the standard rate of tax, can thus find it profitable to sell his securities just before they go "ex div." as he will receive as capital the equivalent of the net dividend, instead of receiving a dividend subject to tax in his hands at higher rate than that deducted from the dividend.

To deal with taxpayers who used this, and similar devices, on a substantial scale, it was provided by the Finance Act, 1927, that if it appears to the Revenue by reference to all the circumstances in relation to the assets of any individual (including circumstances with respect to sales, purchases, dealings, contracts, arrangements, transfers or any other transactions relating to such assets) that the individual has thereby avoided or would avoid more than 10 percent of the amount of surtax for any year which would have been payable in his case if the income from those assets had been deemed to accrue from day to day and had been apportioned to him as part of his total income, then such income is to be so apportioned to him for the purpose of computing his surtax. If the individual can prove that the avoidance was exceptional and not systematic, and that there was no such avoidance in the following three years, he can avoid liability under this provision. Extensive powers are given to the Revenue to obtain information for the purpose of this provision."

The marginal note for S.44-F reads "avoidance of tax by sales cum dividend". This marginal note also gives an indication as to what exactly was the mischief that was intended to-be remedied. The legislature was evidently trying to circumvent the devices adopted by some of the assesseees to convert their revenue receipts into capital receipts. The marginal note also throws light on the intention 'of the legislature.

From what has been stated above, it is clear that the deemed dividend contemplated by s. 2 (6A) (c) cannot be considered as "income" under s. 44-F. For the reasons mentioned above we agree with the High Court that s.44-F is inapplicable to the facts of the assessee's case. This question is common to all the above-mentioned appeals. Hence we need not go into the other subsidiary questions arising for decision in any of those appeals. In the result these appeals fail and they are dismissed with costs. One hearing fee.

V.P.S. Appeal dismissed..