Commissioner of Income Tax Vs N. Bhagavathy Ammal and Another

Court: Madras High Court

Date of Decision: March 25, 1999

Acts Referred: Income Tax Act, 1922 â€" Section 2(6A)
Income Tax Act, 1961 â€" Section 2, 2(14), 2(22), 261, 45

Citation: (1999) 240 ITR 451

Hon'ble Judges: R. Jayasimha Babu, J; A. Subbulakshmy, J

Bench: Division Bench

Advocate: C.V. Rajan, for the Appellant; T.N. Seetharaman, for the Respondent

Judgement

R. Jayasimha Babu, J.
Two questions have been referred to us at the instance of the Revenue. They are :

1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in holding that the assets mentioned in Section

46(2) would mean capital asset as defined in Section 2(14) and that, consequently, the value of agricultural lands received by the assessee on the

liquidation of Palkulam Estates (Private) Limited cannot be charged to tax u/s 46(2) of the Income Tax Act ?

2. Whether the Appellate Tribunal is correct in law and had valid materials to hold that the accumulated profits for the purpose of Section 2(22)(c)

of the Income Tax Act, 1961 should be taken at Rs. 4,37,780 after deducting Rs. 20,37,290 from the total accumulated profits of Rs. 24,75,070

and that since the assessee''s father the late S. Kumaraswamy had already been taxed u/s 2(6A)(e) of the Indian Income Tax Act, 1922, on Rs.

4,89,144 no amount could be taxed as deemed dividend u/s 2(22)(c) of the Income Tax Act, 1961 ?

2. The assessees, who are sisters and are daughters of one the late S. Kumarasamy were shareholders in Palkulam Estates (Private) Limited,

Nagerkoil, which went into liquidation, and in the process of liquidation, distributed assets in specie to its shareholders. The assessees in such

distribution received 479.89 acres of agricultural land. That distribution not having been disclosed initially by the assessees, and having

subsequently come to the notice of the Income Tax Officer, the assessments made for the assessment years 1970-71 and 1971-72 were

reopened. After such reopening, the Income Tax Officer invoking Section 2(22), Sub-clause (c), and Section 46(2) of the Income Tax Act brought to tax a sum of Rs. 24,75,070 as deemed dividend and the amounts in excess thereof under the head ""Capital gains"". On appeal the

Commissioner held that the assessments had not been validly reopened in so far as the invocation of Section 2(22)(c) of the Act was concerned,

as that was a matter on which the Income Tax Officer had merely appeared to have changed his opinion. In so far as resort had been made to

Section 46(2), the Commissioner held that the Section was inapplicable as agricultural lands did not come within the purview of that provision. The

Commissioner also held that even if Section 2(22)(c) of the Act could be invoked, the amounts due to the company totalling Rs. 20,37,290 had

been actually written off in the books, and that only a sum of Rs. 4,37,718 was available as accumulated profits and that the late Kumaraswamy

had already been assessed u/s 2(6A)(e) of the Indian Income Tax Act, 1922, for the assessment years 1957-58 to 1959-60.

3. The Revenue, having carried an appeal against the order of the Commissioner to the Tribunal, the Tribunal held that the assessees had failed to

disclose primary material facts fully and truly in their Income Tax returns, and, therefore, the reopening of the assessment was amply justified. The

Tribunal, however, on the merits, held that on a reading of Sections 45, 46(2), and 48 of the Act, the assets mentioned in Section 46(2) would

mean capital assets and since Section 47(viii) exempted transfer of agricultural lands from tax on capital gains u/s 45, the agricultural lands were

outside the scope of Section 46(2) of the Act. The Tribunal upheld the order of the Commissioner on the merits in so far as Section 2(22)(c) of the

Act was concerned.

4. We may dispose of question No. 2 first. It is not in dispute that the amounts regarded by the Income Tax Officer as accumulated profit, the

company had written off the bulk of that amount prior to the liquidation, and that the remaining amount has been assessed in the hands of the father

of the assessees. The finding of the Tribunal that there was no deemed dividend available for taxation is upheld. The Revenue also did not seriously

dispute the correctness of that order.

5. So far as the first question is concerned, the answer to that question would depend upon the true scope of Section 46(2) of the Act. Section 46

of the Act, which occurs in Chapter IV dealing with the computation of the total business income and in Schedule E thereof under the sub-head

Capital gains"", reads as under :

Capital gains on distribution of assets by companies in liquidation.-

(1) Notwithstanding anything contained in Section 45, where the assets of a company are distributed to its shareholders on its liquidation, such

distribution shall not be regarded as a transfer by the company for the purposes of Section 45.

(2) Where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to Income

Tax under the head ""Capital gains"", in respect of the money so received or the market value of the other assets on the date of distribution, as

reduced by the amount assessed as dividend within the meaning of sub-Clause (c) of Clause (22) of Section 2 and the sum so arrived at shall be

deemed to be the full value of the consideration for the purposes of Section 48.

6. Section 46(1) of the Act opens with a non obstante Clause and provides that despite what has been provided in Section 45, the distribution of

assets by a company on its liquidation to its shareholders is not to be regarded as a transfer by the company for the purposes of Section 45 of the

Act. Had the Section stopped at that, no question of imposing any tax on the capital gain arising to a shareholder from the receipt of any money or

property in specie from a company in liquidation would have arisen, as by Section 45 of the Act, it is only the profit or gain arising from the

transfer"" of a capital asset that is to be charged to Income Tax under the head ""Capital gains"".

7. Section 46(2) of the Act, however, specifically provides that the money or other assets, which a shareholder may receive from a company on its

liquidation shall be chargeable to Income Tax under the head ""Capital gains"", and thus creates a charge on such monies or assets. Section 46(2) of

the Act is, therefore, an independent charging Section and in construing that provision recourse to the other provisions of the Act, are only required

to be made to the extent expressly or impliedly required by that provision itself. Section 46(2) of the Act, after making the money or assets

received by the shareholder chargeable to Income Tax under the head ""Capital gains"" provides that the amount to be charged to tax, is the amount

received or the market value of the asset as on the date of distribution as reduced by the amounts assessed as dividend within the meaning of

Section 2(22)(c) of the Act. It further provides that the amount so calculated shall be deemed to be the full value of the consideration for the

purposes of Section 48 of the Act.

8. The matters which are required to be considered while invoking Section 46(2) of the Act are :

Whether the assessee is a shareholder of a company which has gone into liquidation :

If so, whether the assessee has received any money or other asset from the company in the course of such liquidation :

If the shareholder has received any other assets, i.e., other than money on such distribution : Whether any amount has been assessed as dividend

within the meaning of Section 2(22)(c) of the Act :

If so, the amount of such dividend is to be deducted from the money or the market value of asset received on the date of distribution :

The amount so determined would constitute the full value of the consideration for the purpose of Section 48 of the Act.

9. It must be noticed that the words used in the Section in relation to assets are not capital assets, but other assets. The provisions of the Act

referred to in the Sections are 2(22)(c), 45 and 48 of the Act. Section 2(22) of the Act defines dividend. Sub-Clause (c) thereof provides that

dividend includes any distribution made to the shareholders of the company on its liquidation to the extent to which the distribution is attributable to

the accumulated profits of the company immediately before its liquidation, whether capitalised or not. For determining the amount which is to be

treated as capital gains for the purpose of Section 46(2) of the Act, from out of the amounts or the market value of the assets received by the

shareholder, the dividend referred to in Section 2(22)(c) is required to be deducted as if it is taxable as deemed dividend u/s 2(22)(c) of the Act,

the same amount cannot once again be treated as capital gain and taxed for a second time. So far as Section 45 of the Act is concerned, as

noticed earlier, had the Section merely provided that the receipt by the shareholder of money or assets from the company in liquidation does not

amount to transfer, no tax could have been levied under the head ""Capital gains"". That is the reason why Section 46(2) of the Act specifically

provides for such a levy. The several provisions of the Act which are required to be taken note of for the purposes of determining the assessable

capital gain u/s 45 of the Act are to be excluded unless required to be considered by reason of the express language in Section 46(2) of the Act, or

by any necessary implication therein.

10. Section 48 of the Act in its opening part provides that the income chargeable under the head ""Capital gains"", shall be computed, by deducting

from the full value of the consideration received or accruing as a result of the transfer of capital asset, the expenditure incurred wholly and

exclusively in connection with such transfer, the cost of acquisition of the asset and the cost of any improvement thereto. The Supreme Court in the

case of Commissioner of Income Tax, Madras Vs. Madurai Mills Co. Ltd., , while construing Section 12B of the Indian Income Tax Act, 1922,

held that when a shareholder receives money representing his share on distribution of the net assets of the company in liquidation, he receives that

money in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts

to sale, exchange, relinquishment or transfer.

11. The reference in Section 48(1) of the Act to expenditure wholly and exclusively in connection with the transfer of the capital asset would,

therefore, be inapplicable in the case of amounts required to be treated as capital gain u/s 46(2) of the Act, even though the amount as determined

under that provision is to be regarded as ""full value of the consideration for the purpose of Section 48"". Section 48, Sub-section (2) of the Act

which refers to the cost of acquisition of the asset would, however, be applicable and the cost of acquiring the shares of the company which was

liquidated and from which, the money or asset was received by the shareholder would, therefore, be deductible u/s 48(2) of the Act. The reference

in Section 48 of the Act to capital assets is not of any relevance so far as the amount to be assessed u/s 46(2) is concerned. The full value of the

consideration referred to in Section 48 of the Act is to the amount received or accruing as a result of the transfer of the capital asset. It is apparent

that the legislative intent was not to regard the receipt of money or other asset by the shareholder from the company in liquidation as amounting to

consideration for transfer of a capital asset and it has, therefore, been provided that the amount calculated u/s 46(2) of the Act shall be ""deemed to

be the full value of the consideration for the purposes of Section 48"". It is, therefore, only on account of that deeming provision, Section 48 is

required to be looked into for determining the extent of the further deduction by way of the cost of acquisition of the asset, and applying thereto,

the indexed cost of acquisition and the inflation index referred to in Section 48 of the Act.

12. The term ""asset"" has not been defined in Section 2 of the Act. Section 2(14) of the Act defined ""capital asset"" as meaning property of any kind

held by an assessee, whether or not connected with his business or profession. Section 2(14) expressly excludes, inter alia, agricultural lands in

India, not being land situate in the jurisdiction of a municipality, corporation, notified area committee, town area committee, town committee or

cantonment Board which has a population of not less than ten thousand according to the last preceding census, and any area within such district not

being more than eight kilometres, from the local limits of any such municipality or other body to which reference is made in Section 2(14)(iii)(a) of

the Act. The exclusion of agricultural lands to the extent provided in Section 2(14)(iii)(a) is, therefore, only for the purpose of not treating such

lands as capital assets. The fact that agricultural lands are not capital assets to the extent provided in the definition does not, however imply that

they are not assets at all. The need for exclusion to the extent provided in the definition Clause arose only because they were assets, and would

have been treated as such, but for the exclusion. Section 46(2) of the Act does not make any reference to capital assets. The invocation of Section

2(14) of the Act is, therefore, wholly unnecessary for the purpose of construing Section 46(2) of the Act, and the ambit of Section 46(2) cannot be

whittled down by excluding all assets excluded from the definition of capital assets.

13. The enquiry required to be made for the purpose of Section 46(2) of the Act is not as to whether the asset that was transferred by the

company in liquidation is of a kind, which falls within the excluded categories in the definition of ""capital asset"". The enquiry is to be limited to

ascertaining the amount of money, or the market value of other asset distributed by the company in liquidation to its shareholders. So long as what

the shareholder receives is money or other asset, Section 46(2) would apply to such a receipt. What the shareholder receives from the company in

liquidation when the assets of the company, whether in the form of money or other assets is distributed, is a receipt which is in satisfaction of the

rights which the shareholder had in the company by virtue of his holding the shares. What Section 46(2) of the Act seeks to bring to tax is that

receipt, which the shareholder has received by way of satisfaction of his rights in the company in liquidation. It is, therefore, immaterial as to

whether the company while it functioned as a company held the assets subsequently distributed as a capital asset, or as an asset, which was

excluded from the scope of the definition of ""capital asset"". The fact that the company, if it had chosen to transfer the asset may not have been

liable to be assessed to capital gains, is wholly irrelevant while considering the amount assessable in the hands of the shareholder, who receives the

asset from the company in liquidation in satisfaction of his rights in the company. If a company in liquidation chooses to convert all its assets into

money and thereafter, effects distribution among its shareholders, the money so received would clearly be liable to be taxed as capital gains as

provided u/s 46(2) of the Act. The same result would follow even in cases where the company in liquidation chooses to transfer the asset in specie,

rather than converting the same into money and, thereafter distributing the money. The thing that is being taxed u/s 46(2) of the Act is, therefore,

that which the shareholder receives--any money or other asset.

14. It is no doubt true that after the shareholder receives the asset from the company in liquidation, that very asset may be regarded as a capital

asset, when he in his turn chooses to effect a transfer. That would be so because a transfer effected by him after he has become the owner of the

asset is clearly a transfer for the purposes of Section 45, which refers to capital assets, and which necessarily requires the consideration of the

definition of the capital asset. If the asset so transferred by the shareholder falls within the excluded categories, he may not be liable for capital gains on such transfer. That fact, however, cannot have any impact on the effect of Section 46(2) of the Act, when he receives the asset from the

company in liquidation.

15. When the terms of a statutory provision are clear, there is no warrant whatsoever for rewriting the provision, or for reading into it any other

provision of the Act, which in terms of that Section, and having due regard to the purpose of the provision and the scheme of the enactment in

which it occurs, does not require the other provision to be read into the provision, which is required to be construed. The definition of ""capital

assets"" u/s 2(14) of the Act is not of any relevance for the purpose of construing Section 46(2) of the Act. The fact, therefore, that agricultural

lands to the extent provided in Section 2(14)(iii) of the Act are excluded from the definition does not have any impact on the taxability of the

market value of the agricultural lands received by the assessee on the distribution of the assets of a company in liquidation.

16. We, therefore, answer the first question referred to us in favour of the Revenue, and against the assessee. Parties to bear the respective costs.

17. Counsel made an oral application for leave to appeal to the Supreme Court. We do not see any good reason for granting such leave, as the

plain language of the provision does not support the construction sought to be placed on it by the assessee, and the mere fact that the interpretation

of a provision of law is involved, by that reason alone, cannot be regarded as raising a substantial question of law, which would require the decision

of the Supreme Court thereon. Leave sought is refused.