(1957) 09 BOM CK 0059

Bombay High Court

Case No: Income-tax Reference No. 21 of 1957

Vidyutrai Y. Desai		APPELLANT
	Vs	
Commissioner of Income Tax, Bombay City I		RESPONDENT

Date of Decision: Sept. 24, 1957

Acts Referred:

- Income Tax Act, 1922 - Section 2(6A)

Citation: (1958) 60 BOMLR 37 : (1958) 33 ITR 510

Hon'ble Judges: Tendolkar, J; S.T. Desai, J

Bench: Division Bench

Advocate: R.J. Kolah, for the Appellant; G.N. Joshi, for the Respondent

Judgement

Tendolkar, J.

This reference raised a question regarding the taxation of "dividend" as defined in section 2, sub-section (6A), clause (c), of the Income Tax Act. The assessee was a shareholder of a private limited company known as Desai Arvade Ltd. The said company were the managing agents of the Barsi Spinning and Weaving Mills Ltd. The capital of the company was Rs. 5,00,000 divided into 500 shares of Rs. 1,000 each and the assessee was a shareholder of 375 in his own name and as beneficial owner of 5 shares in the name of K.M. Oza. The company went into liquidation on the 18th of January, 1947. The liquidator realised the assets of the company excluding 1,000 shares of the Barsi Spinning and Weaving Mills Ltd. of which the company was the owner, paid thereout the costs of liquidation and the liability of the company in full, and had a balance in his hands of Rs. 3,72,907 which was distributed amongst the shareholders. The assessee''s share of this distribution was Rs. 2,83,409. The shares of the Barsi Spinning and Weaving Mills Ltd. were distributed amongst the shareholders in specie. It was found by the Appellate Assistant Commissioner that out of the distribution of Rs. 2,83,409 a sum of Rs. 1,08,720 was paid out of the accumulated profits of the company. The total

accumulated profits according to the balance-sheet of the company at the date of liquidation were Rs. 1,68,867. This sum of Rs. 1,08,720 was taxed in the hands of the assessee as "dividend" within the definition of the section 2(6A)(c). It was contended before the Tribunal by the assessee that since this distribution fell short of the paid up capital of the company and the assessee did not even receive in full the amount that he had paid for his 375 shares, the portion of the distribution which was determined as having been paid out of accumulated profits does not attract tax. This submission was negatived by the Tribunal and the question that has been referred to us by the Tribunal is :

"Whether on the facts and in the circumstances of this case, the sum of Rs. 1,08,720 out of the sum of Rs. 2,72,080 was a receipt of dividend within the meaning of section 2(6A)(c) of the Indian Income Tax Act ?"

2. Now, in the first instance, one must start with the definition of "dividend" for this purpose which is to be found in section 2(6A)(c) and it is :

""'dividend'' includes -

(c) any distribution made to the shareholders of a company out of accumulated profits of the company on the liquidation of the company."

3. In order to understand this particular definition, the historical background must be kept in mind. This sub-section was inserted by section 2 of the Indian Income Tax (Amendment) Act, 1939. Prior to that date, the position which was established in law was that any distribution by a liquidator, whether out of accumulated profits or otherwise, was a distribution of capital only and did not attract tax. This was laid down in England in the case of Commissioners of Inland Revenue v. Burrell. In that case, Pollock, M.R., pointed out that whatever may have been the nature of the assets of a company when it existed, after liquidation everything that it possesses is of a capital nature and, therefore, any distribution out of the surplus assets after payment of liabilities is a distribution of capital although it may have been paid out of accumulated profits and is not taxable in the hands of the shareholder. The contention for the Crown that undistributed profits retained their character as profits on liquidation of the company was negatived. Pollock, M.R., also pointed out at page 40 :

"It is not right to split up the sums received by the shareholders into capital and income, by examining the accounts of the company when it carried on business, and disintegrating the sum received by the shareholder subsequently into component parts, based on an estimate of what might possibly have been done, but was on done."

4. It is to get over the law as laid down in this case that the Indian Income Tax Act was amended by subjecting to tax any distribution made to the shareholders of a company out of accumulated profits on the liquidation of the company.

5. Mr. Kolah, in the first instance, attempted to argue that the amount of Rs. 1,08,720 which was determined by the Appellate Assistant Commissioner as the amount of distribution out of accumulated profits of the company was arrived at on a basis which, he submits, is not warranted by law. Unfortunately for Mr. Kolah, this question does not appear to have been argued before the Tribunal at all and has certainly not been dealt with by the Tribunal. On the other hand, the Tribunal states in its order :

"The Appellate Assistant Commissioner worked out this figure which was accepted by the counsel for the assessee and in this connection the Appellate Assistant Commissioner writes as follows :

''I would like to state here that the working of the figures mentioned above was shown by me to Shri Tricumdas. Subject to his contention that no amount can be taxed u/s 2(6A)(c) unless a shareholder receives something over and above the cost price of those shares to him, he accepts the working of these figures.''"

6. It appears that at the stage of settling the statement of the case, the assessee objected to the statement that the amount of Rs. 1,08,720 had been accepted by Mr. Tricumdas. In this connection, the Tribunal observes in the statement of the case :

"But as we read the order of the Appellate Assistant Commissioner and our own order we decided the case on the understanding that this fact as stated was a common ground before the Appellate Assistant Commissioner and before us."

7. It is clear, therefore, that the case was dealt with by the Tribunal on the footing that this was the admitted figure of distribution out of accumulated profits of the company. It might have been open to the assessee to seek to question the basis upon which it was arrived at before the Tribunal. They apparently did not do so; but assuming for the moment that they challenged the basis before the Tribunal and the Tribunal failed to deal with this question in its order, the assessee could have sought to raise a question for reference to this court by an application to the Tribunal, or, if such an application was refused, by a notice of motion on this reference. No such course having been adopted, the question as to the quantum of the amount which was paid out of accumulated profits had become final and conclusive and the assessee cannot be allowed on this reference to dispute that quantum.

8. The sole question, therefore, that remains for determination is whether the assessee''s contention, that he is not liable to payment of tax unless the capital subscribed by him for the shares in respect of which he received the distribution had been fully paid and there was an excess distribution, is correct.

9. Now, the argument of Mr. Kolah on this part of the case is that under company law, in liquidation proceedings the surplus resulting after realising assets and paying off liabilities is to be used in the first instance for repaying the capital and the

balance, if any, is to be distributed pro rate amongst the shareholders. That position in law cannot be disputed; and in the case of this particular company is further reinforced by a specific article in the articles of association, being article 155.Therefore, Mr. Kolah argues that until the capital has been fully repaid, there is no distribution to the shareholders which can attract tax. The argument appears to proceed on the footing that what is liable to tax is a profit made by the shareholder by investing monies in the purchase of shares. If he does not receive the capital he subscribed, then he has made no profit at all; it is only if he receives something in addition to the capital that he may be said to have made some profit and that may attract tax. This argument, however, cannot avail Mr. Kolah because, when the assessee is sought to be taxed u/s 2(6A)(c) he is not taxed on what is his actual income, but he is taxed on what is his deemed income for the purchase of Income Tax law. He may have made an actual loss by subscribing to the capital of this company and may have in the distribution of assets in winding up received much less than the capital subscribed; but the law prescribes that in whatever form the distribution may have been made, to the extent to which the distribution is out of accumulated profits, it is a dividend and attracts tax as any ordinary dividend would under the Income Tax law. To illustrate the matter, one may take an extreme case. There may be a company in respect of which all the assets other than accumulated profits have been burnt down by fire or destroyed, but the accumulated profits have been deposited in a bank or have remained safe in some locker or safe. The distribution of such profits, although it may be a meagre percentage of the capital of the company, would none the less attract tax because in this simple case it is a distribution out of the profits of the company accumulated in previous years and, in the particular illustration that we have taken, kept apart during all those years as such. Therefore, it appears to us to be difficult to accept the submission made by Mr. Kolah that until the capital is repaid, whatever is received by way of distribution cannot attract tax.

10. In this connection, one may also look at the definition of "dividend" contained in clause (d) of section 2(6A),which provided :

""'dividend'' includes -

(d) any distribution by a company on the reduction of its capital to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not."

11. Now, quite clearly, in the case of a reduction of capital, the distribution is for the purpose of returning part of the capital to the shareholder, and yet, if there is a distribution which amounts to nothing more than a return of part of the capital to the shareholder, in terms such part of the distribution as arises out of accumulated profits has been rendered taxable. There is, therefore, in our opinion, no warrant for the proposition that the distribution in a winding up u/s 2(6A)(c) does not attract tax

even if it is out of accumulated profits unless the capital has been repaid in full.

12. The result, therefore, is that the Tribunal was right in the view that they took and our answer to the question will be in the affirmative.

13. Assessee to pay costs.

14. Question answered in the affirmative.