(1960) 12 P&H CK 0005

In the Punjab And Haryana At Chandigarh

Baldev Singh APPELLANT

Vs

The Commissioner of Income Tax RESPONDENT

Date of Decision : 22-12-1960

Acts Referred:
Constitution of India, 1950 — Article 14, 19(1), 31
Income Tax Act, 1961 — Section 23A, 3, 34, 34(1), 34(3)

Citation : (1961) 2 ILR (P&H) 313

Hon'ble Judges : G.D. Khosla, C.J;Tek Chand, J

Bench : Division Bench

Advocate : S.C. Mazumdar, S.R. Bannerjee and N.N. Goswami, for the Appellant; H. Hardy and Maharaj Krishan Chawala, for the Respondent

Final Decision : Dismissed

Judgement

G.D. Khosla, C.J.—This reference u/s 66 of the income tax Act arises out of the following facts. The Assessee in this case is Sardar Baldev Singh, and the accounting year is 1948-49. The Assessee gave a return of his income comprising his salary as Minister of the Central Government and dividends received by him from a business concern. The income given in the return was Rs. 45,779. On 19th January, 1953, the income tax Officer, while assessing the income of private limited company, Messrs Indra Singh and Sons (Private), Limited at Calcutta, took steps u/s 23-A of the income tax Act. He wished to include a sum of Rs. 3,94,475 as the deemed income of the Assessee, Sardar Baldev Singh. On 3rd March, 1954, a notice u/s 34(1)(b) was served upon the Assessee. Two other notices served on 12th March, 1954 and 23rd March, 1954, followed. Shortly after this on 10th May, 1954, the Assessee filed a return and included in this return the deemed income of Rs. 3,94,474 and added it to the income already declared. The income tax Officer assessed the Assessee on the basis of this return in November, 1954. An appeal filed by the Assessee to the Appellate Assistant Commissioner was dismissed on 23rd November, 1955, and an appeal to the Appellate income tax Tribunal also failed on 18th June, 1956. Thereafter an application was made by the Assessee to the Appellate income tax

Tribunal for the statement of the case and three points of law arising out of the order passed in appeal have been referred to us. These questions are--

(1) Whether by reason of the fact that an assessment had already been made, the proceedings initiated u/s 34 stating in the notice that income had escaped assessment were invalid?

(2) Whether the provisions of Section 34 are ultra vires Article 14 of the Constitution of India and, therefore, the assessment made under that section is invalid?

(3) Whether the inclusion in the assessment of the applicant, for the assessment year 1949-50, of the income deemed to have been distributed by an order passed u/s 23-A on 19th January, 1953, against the company in which the applicant is a shareholder, is illegal?

2. Subsequently an application was made on behalf of the Assessee for permission to raise two further law points which, it was alleged, also arose out of the order of the Appellate income tax Tribunal but had not been referred by it to us for opinion. One of the points was intimately related to the questions already referred, and the other raised the question of the vires of Section 23-A. We allowed these questions of law also to be raised before us. Therefore, two additional questions are also before us for our opinion--

(4) Is Section 23-A of the income tax Act ultra vires the provisions of Article 14, Article 19(1)(g) and Article 31 of the Constitution?

(5) Was notice issued by the income tax Officer u/s 34 of the income tax Act barred by limitation?

3. The first point argued before us was the constitutionality of Section 34. This is question No. 2 of the questions referred to us. The argument of the learned Counsel for the Assessee may be summarized as follows: Section 34 gave unfettered discretion to the income tax Officer to select a person to whom he should issue a notice. The income tax Officer, on receiving information, had complete liberty to decide whether he should or should not issue a notice and take action against the individual concerned. This was, therefore, not a case of there existing a reasonable classification among persons who were liable to pay tax and whose income had escaped assessment.

4. When, however, we come to examine the provisions of Section 34(1)(b), we find that it is not a case of naked or unfettered discretion having been given to the income tax Officer. The pith and substance of the section is that the income tax Officer is empowered to take action in every suitable case in which there is reason to believe that income has escaped assessment. Since Section 34 comes into play when the Assessee has not disclosed the whole or part of his income, it is inevitable that the income tax Officer should have the right to examine the nature and worth of the information received by him. He is bound to do so and then decide whether a prima facie case for issuing notice u/s 34 is or is not made

out. His discretion must be exercised according to the usually recognised judicial principles. It cannot be said, therfore, that he has been given unfettered discretion in this matter and that he can take action in accordance with his caprice rather than on reasonable grounds; although the decision is to be arrived at subjectively, there is an objective guide provided by the section. He can only act if he receives information which leads him to believe that some income of an individual has escaped assessment. He is bound to enquire into the nature of the information received by him and then act accordingly. It was argued before us that the protection given by the section is illusory. There is no case here of any classification, reasonable or otherwise. The income tax Officer is bound to act in every case in which he believes that prima facie grounds for taking action exist. The word ''may'' in this section is to be construed as ''must'' because it is clearly the intention of this section that in every case in which action ought to be taken, the income tax Officer should take action.

5. The matter was considered by a Division Bench of the Madras High Court in C.W. Spencer and Others Vs. Income Tax Officer, Madras, , but the constitutionality of Section 34 does not appear to have been raised before the Court. The constitutionality of Section 23-A was raised, and the Hon''ble Judges held that that section was intra vires the Constitution. I am clearly of the view that there is nothing in Section 34 that offends the provisions of the Constitution as set out in Article 14, 19(1)(g) or 31 of the Constitution.

6. The next point raised was that the notice served upon the Assessee was beyond the period of four years mentioned in Section 34 and that, therefore, the assessment was barred by time. The argument of the learned Counsel for the Assessee was that the notice must be served within four years of the end of the accounting year. A reading of Section 34, however, makes it quite clear that the period of four years is to be computed from the end of the assessment year which in this case was 1949-50. Therefore, the notice, having been served on 3rd March, 1954, was well within the period of four years computed from 1st April, 1950. Section 34 deals with the income which has escaped assessment for any particular year. Assessment for any particular year obviously means assessment for the year of assessment which, in the present case, is 1949-50; it does not mean the year during which income was earned. This is clear from two other provisions of the Act. Section 3 speaks of income tax being charged for any year, and the assessment is to be made in respect of the income received during the previous year. Therefore, the expression "any year" refers to the year of assessment, and the "previous year" refers to the accounting year. The same phraseology is used in Section 34. Assessment for any year is the assessment which is made in the year of assessment, and the period of four years, therefore, is to be computed from the end of "that year". That year clearly is the year to which the assessment relates, namely, the year of assessment. The matter, however, is set at complete rest by Sub-section (3) of Section 34. According to Sub-section (3), the period of four years is to be computed "from the end of the year in which the income, profits or gains were first assessable". This clearly

means that the four years must be computed from the end of the assessment year. The proviso makes the matter even more clear. The proviso reads--

Provided that where a notice under Clause (b) of Sub-section (1) has been issued within the time therein limited, the assessment or re-assessment to be made before the expiry of one year from the date of the service of the notice even if at the time of the assessment or re-assessment the four years aforesaid have already elapsed.

This proviso can never come into play if the four years are to be computed from the end of the accounting year. For example, if in the present case the accounting year is the terminus a quo, then the notice must have been served before 31st March, 1953. Supposing the notice were served on 30th March, 1953, then on the interpretation placed upon the section by the learned Counsel for the Assessee, the notice was served according to the provisions of Section 34. The Department is given by the proviso a period of one year from the date of the service of the notice, i.e., the assessment must be made before 30th March, 1954. The first part of Sub-section (3), however, makes it clear that the assessment can be made within four years of the end of the year of assessment. If that be so, then the proviso can never come into play. It is clear, therefore, upon a consideration of the provisions of Section 34 read with the provisions of Section 3, that the period of four years mentioned in Sub-section (1) is to be computed from the end of the assessment year. This is the only interpretation consistent with various other provisions of this Act where "that year" or "year" always means the assessment year and the "previous year" or the "accounting year" means the year during which the income is received.

7. This matter was considered by the Madras High Court in the case to which a reference has already been made, C.W. Spencer and Others Vs. Income Tax Officer, Madras, , and the Court held that a notice served within four years computed from the end of the assessment year was within time. This case, therefore, is a direct authority on the point now raised. The learned Judges observed--

Though the expression ''year'' has not been further defined by Section 34 itself, it should be clear from the context to the section itself that the year referred to is the assessment year and has no reference to the accounting year, which is elsewhere specified by the Act itself as the previous year.

The assessment, therefore, must be held to be within time.

8. The next point raised on behalf of the Assessee was that the notice served was not valid, because it was misleading inasmuch as the notice spoke of income having escaped assessment. This was a case, it was argued, of underassessment at best and not of escaped income. The argument of the learned Counsel for the Assessee was based upon the consideration that where a return is made and upon that return the income tax Officer assesses the income tax due, then if it is subsequently found that an item of income was not included in the assessment,

it is a case not of escaped assessment but of underassessment. This matter is, however, clear from the wording of the section itself and there are a number of authorities in which the view has been taken that if an item of income is not charged because it is not shown in the return, the section applies and the item must be regarded as having escaped assessment. A reference may be made to a number of authorities mentioned on page 703 of Kanga''s Law and Practice of income tax, Volume I, fourth edition. I do not think, this, point need be further laboured and the dividends received from Messrs Indra Singh and Sons (Private) Limited, which were not included in the original return, are clearly income which has escaped assessment.

9. The next point raised before us was that Section 23-A of the income tax Act is ultra vires the Constitution inasmuch as it seeks to expropriate, in certain instances, the property of a private company. The learned Counsel for the Assessee put his argument in this way. A certain firm declares less than 60 per cent of its net profits (after the payment of income tax) to its shareholders. The income tax Officer, on coming to know of this fact, decides to take action. He can hold the shareholders liable for income tax in respect of the undistributed profits, and if the tax cannot be recovered from the shareholders, then he can recover the amount from the company. In a given instance it is possible that the tax, which is recovered from the company, may amount to more than the profits earned by it, and this would involve an incursion into the capital reserves of the company. Thus, Section 23-A has the effect of contravening Article 31 of the Constitution This argument, in my view, is very far-fetched and I cannot imagine a case in which such an eventuality would arise. There is ample protection afforded by Section 23-A to the company and to the shareholders. It must be remembered that Section 23-A. is not to be invoked in the case of public companies and it is only where a private company does something in order to avoid the payment of income tax by declining to declare its dividends that Section 23-A comes into play. There is a quadruple protection afforded to the company and to the shareholders by this section. The first condition, which must be satisfied, is that the dividends distributed must be less than 60 per cent of the assessable income minus the income tax and super-tax payments thereon. There is no reason why any private company should not disburse the entire amount of net profits in any given year to its shareholders. The withholding of the disbursement can only be due to the fact that the shareholders wish to avoid the payment of income tax. The second condition is that the losses in the previous years or the smallness of the profits made must not justify the withholding of the disbursement. This means that even where the distributed profits are less than 60 per cent, the income tax Officer will not take action if it can be proved to him that in previous years there were heavy losses or unduly small profits which justified the building up of reserves, and so having regard to the past history of-the company, it was found necessary to withhold distribution of all the profits This, in my view, is a very good safeguard for honest companies where the withholding of the dividends has been done for good reasons. The third condition

required is that the income tax Officer cannot take action unless he obtains the previous approval of the Inspecting Assistant Commissioner of income tax. The income tax Officer must, therefore, place all the facts before the Inspector and only when the Inspector is satisfied that there is good reason for taking action u/s 23-A that sanction would be given. And lastly, the section provides that the approval of the Inspector will not be given until a notice has been sent to the company concerned and the company has been afforded an opportunity of being heard. These four conditions are, in my view, ample protection and it cannot be said, therefore, that the income tax Officer is capable of acting capriciously or unreasonably. It is well-known that a private limited company consists of a few shareholders who are either intimately related or are members of one family. Their object of forming a private limited company is to prevent any incursion of outside influence and to keep the entire business to themselves. The shareholders completely control the company and its policies. Whatever they do is done not in the public interest but in their own interest. If, therefore, they withhold the payment of dividends in any particular year, then they must have done it in order to protect their interests and protection of interests in this context means the avoidance of payment of income tax. A case of this type will hardly ever arise in the case of public companies, and that is why the legislature thought it fit to confine the application of Section 23-A to non-public companies. The classification of companies into public and private for this purpose is reasonable and fully justified.

10. It cannot, therefore, be said that there is any violation of the provisions of Article 14 on the ground of unreasonable discrimination, because there is ample justification for the classification introduced; nor can it be said that this section imposes too harsh a burden or restriction upon the freedom guaranteed by Article 19(1)(g) of the Constitution. The aim of the section is to prevent avoidance of income tax. And finally, the section does not go counter to the provisions of Article 31, because it does not seek to expropriate private property. In a hypothetical case, perhaps, the reserves of the company may have to be drawn upon, but those reserves are not really capital, because they are made up of the accumulation of profits in previous years. If a private company acts bona fide and distributes its legitimate profits by means of dividends, paid to its various shareholders, then the danger of the capital being expropriated will never arise.

11. The vires of Section 23-A were considered in the Madras case to which I have already made a reference, and the Judges, after a long discussion, held that the section was intra vires. With great respect I find myself in complete agreement with the Hon''ble Judges of the Madras High Court. I, therefore, find that the three questions referred to us by the Appellate income tax Tribunal and the two points raised before us must all be decided against the Assessee. I would answer the three questions referred to us in the negative and hold that the proceedings u/s 34 were not barred by time and Section 23-A is intra vires the Constitution. The Department will recover costs of this reference which we assess at Rs. 250.

Tek Chand, J.

12. I agree.

