
(1974) 08 MAD CK 0043

In the Madras High Court

Case No : Tax Case No. 214 of 1968 (Reference No. 59 of 1968)

Commissioner of Income Tax

APPELLANT

Vs

A. Vimalan

RESPONDENT

Date of Decision : 16-08-1974

Acts Referred:

Income Tax Act, 1922 — Section 16(3), 2(6A)

Citation : (1975) 98 ITR 529

Hon'ble Judges : V. Ramaswami, J;G. Ramanujam, J

Bench : Division Bench

Advocate : V. Balasubrahmanyam and J. Jayaraman, for the Appellant; S. Swaminathan and K. Ramgopal, for the Respondent

Judgement

Ramaswami, J.—The assessee, late P. Appavoo Pillai, whose legal representative is the respondent herein, held 160 shares of Rs. 100 each in M/s. S.D.U.M.S. Private Ltd., Dharmapuri, a private limited company in which the public is not substantially interested within the meaning of Section 23A of the Indian Income Tax Act, 1922 (hereinafter called "the Act"). The assessee transferred 20 shares to his minor son, Vimalan, the respondent herein, for cash consideration some years ago. Out of the remaining 140 shares he transferred to his wife and five minor children 20 shares each, totalling 120 shares without receiving any consideration. The Income Tax Officer included the dividend income of these 120 shares in the income of the assessee for the assessment year 1958-59, relying on the provisions of Section 16(3) and this is not now in dispute. The Income Tax Officer also treated the loans to the extent of Rs. 26,065 advanced by M/s. S.D.U.M.S. Private Ltd. (hereinafter referred to as "the company") to the assessee's wife and minor children as dividend u/s 2(6A)(e) and assessed it in the hands of the assessee by invoking Section 16(3) of the Act. The company charged interest on the loan advanced to the minor children and this amount which came to Rs. 1,201 was not allowed as a deduction from the income by the Income Tax Officer. The assessee preferred an appeal to the Appellate Assistant Commissioner and contended that the legal fiction of considering the income of

the wife and minor children as that of the assessee cannot be extended to the loan taken by the wife and minor children from the company and that when the assessee himself had not taken any loan from the company the question of assessment of the loans taken by his wife and minor children does not arise. The Appellate Assistant Commissioner did not agree with the assessee in these contentions and held that the Income Tax Officer was right in treating the loans taken by the assessee's wife and minor children as dividend income of the assessee under Sections 2(6A)(e) and 16(3) of the Act. He also held that the interest paid on the loans availed of by the wife and minor children cannot be said to have been incurred solely for the purpose of earning the income and as such he is not entitled to claim any set off of the interest against the income treated as dividend u/s 2(6A)(e). On a further appeal, the Tribunal held that the loans taken by the wife and minor children as such have no relationship to the shares held by them and that the loan was not an income arising directly or indirectly from the shares held; the fact that u/s 2(6A)(e) such loan will be deemed to be dividend cannot be used for the purpose of holding that the loan would be deemed as income arising from the shares; and the expression "arising directly or indirectly" in Section 16(3) cannot be construed as "deemed arising directly or indirectly". On these reasonings the Tribunal held that the said sum of Rs. 26,065 was not includible u/s 16(3) of the Act in the total income of the assessee. In support of this view the Tribunal also relied on the decision in Commissioner of Income Tax, Bombay City Vs. Phirozshaw Pallonji Mistry and Others, and the Privy Council decision in George N. Houry v. Commissioner of Income Tax, [1960] 40 ITR 413. At the instance of the revenue the following question of law has been referred :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the loan amount of Rs. 26,065 advanced by M/s. S.D.U.M.S. Private Ltd. to the assessee's wife and minor children which was treated as dividend u/s 2(6A)(e) of the Indian Income Tax Act, 1922, was not includible u/s 16(3) of the said Act in the total income of the assessee ?"

2. The relevant portion of Section 2(6A)(e) and Section 16(3)(a)(iii) and (iv) read as follows:

"2. (6A) "dividend" includes--...

(e) any payment by a company, not being a company in which the public are substantially interested within the meaning of Section 23A of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan to a shareholder or any payment by any such company on behalf or for the individual benefit of a shareholder, to the extent to which the company in either case possesses accumulated profits,..."

"16. (3) In computing the total income of any individual for the purpose of assessment, there shall be included--

(a) so much of the income of a wife or minor child of such individual as arises

directly or indirectly--...

(iii) from assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration or in connection with an agreement to live apart; or

(iv) from assets transferred directly or indirectly to the minor child, not being a married daughter, by such individual otherwise than for adequate consideration."

3. It is not in dispute that all the conditions in Section 2(6A)(e) are satisfied in the present case and the said sum of Rs. 26,065 will have to be treated as dividend as contemplated by that provision.

4. The learned counsel for the revenue contended that having regard to the purpose and nature of the provision in Section 16(3) as an anti-tax avoidance provision and as a provision intended to bring in the income of a third party in certain circumstances into that of the assessee, a broad and liberal interpretation should be given to this provision. Section 2(6A)(e) also created a fiction by which the amount ostensibly and nominally advanced to a shareholder as a loan is treated in reality for tax purposes as payment of dividend to him. If that is so really this deemed dividend is attributable to the shares transferred. If this fiction of dividend substitute is to be given full effect, in computing the total income of the assessee this deemed dividend also should have to be included as the income of the assessee u/s 16(3). On the other hand, it was contended by the learned counsel for the assessee that the loan or advance u/s 2(6A)(e) is not an income or dividend derived directly or indirectly from the shares transferred. Whenever the statute intended to include a deemed income in the computation of the total income it specifically and expressly provided. Section 2(6A)(e) is a complete code by itself; by a fiction it treats the loans and advances as the shareholder's income. It does not go further and say that it is to be included as deemed income of somebody else. In order to attract the provisions of Section 16(3) the income should have been derived directly or indirectly from the assets transferred. The fiction created u/s 2(6A)(e) cannot be projected into the provisions of Section 16(3).

5. Section 2(6C) defines "income" as including dividend. "Dividend" proper under the general law is a distribution or payment out of the profits or any other undistributed profits to the shareholders. It represents the proportionate amount a particular shareholder is to get on the basis of the shares held by him. Thus, payment of dividend is related to and proportionate to the shares held by the shareholder. Any payment to a shareholder unrelated to his shares will not be treated as dividend. Though this is the position under the general law; Parliament created a fiction while defining the dividend u/s 2(6A)(e) treating for tax purposes the amount ostensibly and nominally advanced to a shareholder as a payment of dividend to him. In other words, the loans and advances which would come within the provision are treated as distribution of the accumulated profits or as dividend substitutes. This fiction thus created has two distinguishing

features. Firstly, this dividend substitute need not be proportionate to the number of shares held by the shareholder. In other words, it is immaterial what the extent of the shareholding is. Secondly, it will be treated as such dividend only to the extent of the accumulated profits. In spite of these distinguishing features since one of the conditions for the applicability of the section is that the borrower should be a shareholder and such loans and advances are by fiction treated as dividend substitutes, such dividend shall be deemed to arise to the borrower out of the shares held by him. The fiction created by Section 2(6A)(e) stops with including the loan as dividend. It does not go further and say in whose total income this will be included for the purpose of the Act. That will have to be decided only with reference to the other provisions of the Act. Once this position is reached there would be no difficulty at all in testing the applicability of Section 16(3). Under the last mentioned provision so much of the income of the wife or minor child as arises directly or indirectly from the assets transferred to the wife or minor child otherwise than for adequate consideration shall be included in the total income of the individual. The assets transferred to the wife and minor children otherwise than for adequate consideration are the shares in the company. By deeming the loans and advances as dividend paid to the shareholder, Section 2(6A)(e) has made such loans as income arising to such shareholder from the shares held. The learned counsel for the assessee then submitted that by transferring the shares without consideration to his minor children and wife the assessee had only conferred a status of a shareholding which was one of the conditions necessary for the applicability of Section 2(6A)(e) and that if the minor child or wife is already a shareholder the transfer has absolutely no effect as far as the acquiring of the status is concerned. We have already seen that the fiction created u/s 2(6A)(e) has no relation to the number of shares held by the shareholder. That section did not also say that when the loans or advances are made to a shareholder the proportionate amounts with reference to the number of shares held will have to be treated as the "deemed dividend" in respect of each share. It is true that on the same reasoning it could also be said that the dividend shall be deemed to have arisen from the shares transferred in spite of the shares already held by the minor child or wife. But that question does not arise here as none of the minors of the assessee nor his wife were holding any shares prior to the transfer.

6. The learned counsel in support of his argument that the fiction created for the purpose of one section should not be extended in applying the provisions of another section relied on the decisions in *Commissioner of Income Tax v. Phirozshaw Pallonji Mistry*, *George N. Houry v. Commissioner of Income Tax* and *Commissioner of Income Tax, Kerala Vs. M.K. Mackar Pillai*, . u/s 23A of the Income Tax Act, before it was amended by Finance Act of 1955 in certain eventualities it was open to the Income Tax Officer to make an order that the undistributed portion of the assessable income of a company as computed for Income Tax purposes and reduced by the Income Tax and super-tax payable by the company in respect thereof, shall be deemed to have been distributed as

dividend among the shareholders. On the footing that the undistributed profits are deemed to have been distributed, the income will be taxable in the hands of the shareholders. The question for consideration in Commissioner of Income Tax v. Phirozshaw Pallonji Mistry was where a wife purchased shares in a company with the funds provided by her husband the dividend deemed to have been distributed u/s 23A out of the undistributed profits of the company with reference to these shares cannot be included in the total income of the husband u/s 16(3). While holding that it cannot be included the Bombay High Court observed:

"But Section 16(3) permits inclusion of the income of a wife in the income of her husband for purposes of assessment only if such income arises directly or indirectly from assets transferred to the wife by the husband otherwise than for adequate consideration; in other words, such inclusion is permissible only where the income of the wife actually arises directly or indirectly. Where by a mere fiction the income is deemed to have been received but which has not in fact been received, in our judgment, Section 16(3) can have no application. There is no warrant for the submission that the expression "as arises directly or indirectly" in Clause (a) of Sub-section (3) of Section 16 is to be equated with the expression "deemed to have been distributed" in Section 23A(1)."

7. A similar question came up for consideration before the Privy Council in George N. Houry v. Commissioner of Income Tax. Section 22 of the East African Income Tax (Management) Act, 1952, which was similar to Section 23A of the Indian Income Tax Act, 1922, as it stood prior to its amendment by the Finance Act of 1955, provided that the undistributed portion of the total income of certain companies subject to a limit of 50 per cent. of such income is deemed to have been distributed as dividend among the shareholders of the company if the Commissioner of Income Tax makes an order to that effect and the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of the Act. Section 24 of the East African Income Tax (Management) Act, 1952, which is similar to Section 16(3) of the Indian Income Tax Act, 1922, reads as follows:

"(1) Where, by virtue or in consequence of any settlement to which this section applies and during the life of the settlor, any income is paid to or for the benefit of a child of the settlor in any year of income, the income shall be treated for all the purposes of this Act as the income of the settlor for that year and not as the income of any other person."

8. The question for consideration was whether the dividend which is deemed to have been paid u/s 22 is to be reckoned as a payment of income to or for the benefit of a child shareholder when the computation of a settlor's income is made for the purpose of Section 24. The Privy Council held:

"The two sections are independent charging provisions and the charges which they impose are mutually exclusive. If the relevant words of Section 22(1) are set out, it will be seen that they run as follows: "the undistributed portion of

sixty per cent. of such total income of the company for that period shall be deemed to have been distributed as dividends amongst the shareholders and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purposes of this Act." It is not merely that there is to be a notional payment of dividend ; it is also that each shareholder's share of the dividend is to be included in his total income for the purposes of the Act. The dividend then must go into the total income of the child who owns the shares, and for the purpose of taxation it is to be treated as his income. Such an enactment would be blankly inconsistent with the enactment contained in Section 24 that whatever is paid to or for the benefit of a child is to be treated for all the purposes of the Act as the income of the father and not as the income of any other person if "paid" in this section were to include what is deemed to be paid by the earlier section. It appears to their Lordships to be the unavoidable conclusion that in construing Section 24 the income "paid" within the meaning of that section and as such attributed to the father cannot include income deemed to be distributed by virtue of Section 22 and as such attributed to the child."

9. These two decisions were followed in *Commissioner of Income Tax v. M.K. Mockar Pillai*, when a similar question arose with reference to the deemed dividend distributed u/s 23A. It could be seen from Section 23A that the fictional distribution of the dividend was without reference to the amount in fact reaching the hands of the shareholder. Though the amount has not reached the hands of the shareholder by the fiction created, the undistributed profits were deemed to have been distributed and the income was made taxable in the hands of the shareholder, Thus unlike Section 2(6A)(e) the section not only creates a fiction but goes further and says in whose total income such deemed distribution will have to be included for the purpose of the Act. Section 23A specifically directs such notional dividend to be included in the total income of the shareholders. If in such a case Section 16(3) is to be invoked it would be totally inconsistent and contrary to the provisions of Section 23A itself. It is for these reasons it was held in these cases that the fiction created in Section 23A should not be projected into Section 16(3). These decisions, therefore, do not help the assessee.

10. The result is that the loans advanced to the wife and the other five minor children were includible u/s 16(3) of the Act in the total income of the assessee. Accordingly, we answer the reference in the negative and in favour of the revenue. Counsel's fee Rs. 250.