
(1967) 03 CAL CK 0004

In the Calcutta High Court

Case No : Income-tax Reference No. 48 of 1963

M. A. ISPAHANI

APPELLANT

Vs

COMMISSIONER OF Income Tax (CENTRAL), CALCUTTA.

RESPONDENT

Date of Decision : 04-03-1967

Acts Referred:

Income Tax Act, 1922 — Section 23A

Citation : (1968) 70 ITR 141

Hon'ble Judges : K. L. Roy, J; Banerjee, J

Bench : Full Bench

Judgement

BANERJEE J. - This is a reference u/s 66(1) of the Indian Income Tax Act.

The assessment year involved is the year 1949-50, the relevant accounting year being the year ended on December 31, 1948. The question referred to this court is :

"Whether, on the facts and in the circumstances of the case, the amount deemed to have been distributed to the assessee by virtue of an order u/s 23A of the Indian Income Tax Act, 1922, against Messrs. M. M. Ispahani Ltd. had been validly assessed under the Indian Income Tax Act, 1922, in his hands during the relevant assessment year ?"

The question arises in the following circumstances. The assessee is an individual and a shareholder of a company known as M. M. Ispahani Ltd. It is admitted that :

(a) M. M. Ispahani Ltd. was originally incorporated in British India as a private company and used to have its registered office in the town of Calcutta.

(b) On the eve of the partition of India, M. M. Ispahani Ltd. shifted its registered office to Chittagong, now in East Pakistan, on June 26, 1947.

(c) Thereafter, on July 10, 1947, M. M. Ispahani Ltd., converted itself into a public limited company.

(d) On August 5, 1948, the annual general meeting of the shareholders of M. M. Ispahani Ltd. was held at Chittagong and a dividend was declared for the year ended December 31, 1946.

(e) In the assessment year 1947-48, the Income Tax Officer found that the dividend declared by M. M. Ispahani Ltd. was less than the statutory percentage, contemplated u/s 23A of the Indian Income Tax Act, as it stood prior to the amendment in 1955. He, therefore, took action against M. M. Ispahani Ltd., u/s 23A and made an order, on February 27, 1954, deeming that a sum of Rs. 5,72,491 was distributed as dividend, on August 5, 1948, amongst six named shareholders of M. M. Ispahani Ltd. including the assessee.

We have proceeded on the above-stated admitted facts because the statement of case is much too cryptic. We do not, however, think it necessary to call for a supplementary statement on the above facts of historical importance, in the context of the instant reference, firstly because they were admitted facts, and, secondly, because we noticed the above facts in our judgment in Income Tax Reference No. 41 of 1963 (M. M. Ispahani Ltd. v. Commissioner of income tax) only a few days ago, on June 22, 1967, and decided to take note of that judgment.

Now, the date of the annual general meeting of M. M. Ispahani Ltd., being August 5, 1948, the undistributed portion of the assessable income of M. M. Ispahani Ltd. (reduced under the provisions of section 23A) which was deemed to have been distributed as dividend became assessable, if at all, in the hands of the shareholders, including the assessee, in the assessment year 1949-50. Since the assessment of the assessee for that year had already been completed, a notice u/s 34(1) (b) of the Indian Income Tax Act was issued to the assessee, on March 18, 1954, shortly after the making of the order u/s 23A. The assessee did not pay any heed to the notice. The Income Tax Officer, therefore, completed the assessment, in section 34 proceeding, by recourse to section 23(4) of the Indian Income Tax Act and added back a sum of Rs. 3,39,937 to the income of the assessee.

The assessee appealed against the order of the Income Tax Officer before the Appellate Assistant Commissioner and objected to the add-back on the following grounds :

(i) The order u/s 23A was bad in law inasmuch as M. M. Ispahani Ltd. was a non-resident company on the deemed date of the declaration of the dividend.

(ii) The dividend was declared outside the taxable territory because Chittagong, where the annual general meeting was held and the dividend was declared, was a part of Pakistan on August 5, 1948. Therefore, the dividend was not liable to be taxed in the hands of the assessee, who again was a non-resident.

(iii) The amount of dividend cannot be brought within the four corners of the charging section 4 or of the definition of dividend as in section 2(6A) or of the

definition of income as in section 2(6C) of the Indian Income Tax Act and as such cannot be dealt with u/s 23A.

The Appellate Assistant Commissioner overruled the first ground of objection with the following observation :

"This contention has been discussed at length in the appeal filed in the case of Messrs. M. M. Ispahani Ltd., and during the assessment year 1947-48 for which the accounting year was the calendar year 1946, the company, Messrs. M. M. Ispahani Ltd., was an Indian company and, therefore, the provisions of section 23A are attracted."

He overruled the second ground with the following observation :

"In view of the Explanation 3 to section 4(1) the dividend paid by an Indian company without the taxable territories shall be deemed to be income accruing and arising in the taxable territories to the extent to which it has been paid out of the profits subjected to Income Tax in the taxable territories and, therefore, the dividend to the extent to which it is paid out of the profit subjected to tax in India is taxable in the hands of the appellant who is a non-resident, because it is deemed to accrued or arise in the taxable territories."

Although overruling the second ground the reminded himself of item 3 of the agreement for Avoidance of Double Taxation between India and Pakistan and showed this concession to the assessee that he directed the Income Tax Officer to tax u/s 23A, proportionate dividends pertaining to the profits that ultimately would bear tax in India in connection with the assessment for 1947-48, after considering the decision of the two-men committee interpreting the articles of the Agreement for Avoidance of Double Taxation between India and Pakistan.

He also overruled the third ground with the following observation :

"Section 23A before its amendment in 1955 authorised the Income Tax Officer to tax the deemed dividend in the hands of the shareholders and in view of Explanation 3 to section 4 (1) the deemed dividend is deemed to accrued or arise in the taxable territories to the extent to which the profits of the company have borne Indian Income Tax and, therefore, the income which is deemed dividend is taxable in the hands of the non-resident shareholder. The definition of dividend u/s 2(6A) is not exhaustive and even the definition of income u/s 2(6C) is not exhaustive and is only illustrative."

Aggrieved by the order of the Appellate Assistant Commissioner, the assessee filed a second appeal before the Appellate Tribunal. Two points were urged before the Tribunal against the order u/s 23A, namely :

(i) the assessee was a non-resident at the point of time when he was deemed to have received these dividends, and

(ii) under the cash system of accounting of the assessee as accepted by the department, deemed dividend would only be assessed when they were received

by the assessee and since there was no evidence that the assessee received such income, it should not be included in the income of the assessee.

The Tribunal rejected the first point because :

"The previous year during which the company is deemed to have earned the profits ended on 31st December, 1946, when admittedly the assessee was a resident in India. If, subsequently, he turns out to be a non-resident in India, that is a factor which is not material for judging the taxability of the person concerned in respect of an income which accrued to him at a time when he was resident of India."

The second point was rejected because the Tribunal was of the opinion that such an argument was not acceptable in cases where deemed dividends were concerned, for the purpose of assessment in the hands of the assessee. Accordingly, the Tribunal observed :

"Deemed income, it may be mentioned, is itself a notional income and, therefore, for the purposes of assessment of such income, the system of accountancy whether cash or mercantile has no relevancy."

Thereupon, the assessee obtained a reference of the question of law, quoted at the beginning of this judgment to this court.

It was argued on behalf of the assessee that, in order to fall within the mischief of section 23A as it stood before the amendment of 1955, there must be :

- (1) distribution of dividend by a company in which the public were not substantially interested,
- (2) dividend must fall below the statutory percentage without reasonable cause, and
- (3) an order must be made that the undistributed portion of the assessable income shall be deemed to have been distributed as dividend amongst the shareholders on the date of the annual general meeting.

It was submitted that a company, according to the definition thereof in section 2(5A), either meant an Indian company or an association, whether incorporated or not and whether Indian or non-Indian which is or was assessable or was a company for the assessment for the year ending March 31, 1948, or which is declared by general or special order of the Central Board of Revenue to be company for the purposes of the Act. An Indian company again, according to the definition in section 2(7A), means a company as defined in the Companies Act, 1913, or a company formed and registered under a law in force in any of the merged territories, registered office of which is situated in the taxable territories, which latter expression would not include Pakistan after partition of British India. According to the definition in the Companies Act, a company means a company formed or registered under the Companies Act, 1913, or an existing company, that is to say, a company formed and registered under the predecessor Act of

1913. On the above line of reasonings it was submitted that the company, in this case, was not a company within the meaning of section 23A, because on the material date, (1) it was not an Indian company but a foreign company, (2) was not assessed to tax or assessable to tax, in the taxable territories, for the year ending December 31, 1948, and (3) was not declared to be a company for the purposes of the Income Tax Act by the Central Board of Revenue. It was further submitted that the dividend was declared by a foreign company, on July 5, 1948, at Chittagong, outside the taxable territories. If the undistributed income of the company be deemed to have been distributed as dividend, the deeming provision must be taken to its logical consequences and the dividend must be deemed to have been distributed, on July 5, 1948, when there was no Indian company. It was, therefore, submitted that Explanation 3 to section 4(1) of the Indian Income Tax Act had no application to the facts of the instant case because the dividend was not paid by an Indian company.

In our opinion, the arguments on behalf of the assessee are substantial arguments. It is true that the year for which the dividend was declared was the year ended December 31, 1946, when the company was an Indian company and a private company. It is also true that the dividend actually declared and distributed was in respect of profits earned in the year ended December 31, 1946. The position, however, is not the same in respect of the dividends deemed to have been distributed to shareholders u/s 23A. The section says that :

".... the undistributed portion of the assessable income of the company of that previous year as computed for Income Tax purposes and reduced by the amount of Income Tax and super-tax payable by the company in respect thereof shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting...."

The section deals with an imaginary state of affairs. What has to be done in such state of affairs has been well-stated by Lord Asquith of Bishopstone in *East End Dwellings Company Limited v. Finsbury Borough Council* in the following language :

"If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequences and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it... The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle..."

Approving of the above observations the Supreme Court further observed in the case of *Commissioner of Income Tax v. Godavari Sugar Mills Ltd.* :

"It is, indeed, true that as a result of the order of the Income Tax Officer there is no factual distribution of dividend but it is only a fictional or notional distribution of dividend which was not, in fact, received by the shareholders. The section merely enacts that notional dividend is deemed to have been distributed at the

date of the annual general meeting..."

We, therefore, allow our imagination a free play and come to the finding that, on August 5, 1948, a foreign public company held a general meeting on a foreign country and on that date a dividend was seemingly declared to the assessee, who was non-resident, over and above the dividend actually received by him. Now, a dividend is to be deemed to be income of the previous year in which it is paid (vide section 16 (2) of the Indian Income Tax Act). The deemed dividend, therefore, shall be deemed to have been paid to the non-resident assessee by a foreign company outside the taxable territory on a date when neither the company nor the assessee was within the taxable territory. These facts will not attract the provisions of section 23A to the assessee.

The next argument that remains for consideration is the effect of the Explanation to section 4 (1) which is couched in the following language :

"4. (1) Subject to the provisions of this Act, the total income of any previous year of any person includes all income, profits and gains from whatever source derived which -

(a) are received or are deemed to be received in the taxable territories in such year by or on behalf of such person, or

(b) if such person is resident in the taxable territories during such year,

(i) accrued or arise or are deemed to accrue or arise to him in the taxable territories during such year, or

(ii) accrue or arise to him without the taxable territories during such year, or

(iii) having accrued or arisen to him without the taxable territories before the beginning of such year and after the first day of April, 1933, are brought into or received in the taxable territories by him during such year, or

(c) if such person is not resident in the taxable territories during such year, accrue or arise or are deemed to accrue or arise to him in the taxable territories during such year :...

Explanation 3. - A dividend paid by an Indian company without the taxable territories shall be deemed to be income accruing and arise to him in the taxable territories to the extent to which it has been paid out of profits subjected to Income Tax in the taxable territories."

Now, as we have already observed, the payment of dividend was not made by an Indian company : the dividend cannot also be deemed to have accrued to the non-resident shareholder in the taxable territory in the year of declaration of the dividend. Thus fiction eclipses facts and calls for negative answer to the question referred to his court.

We, therefore, answer the question in the negative and in favour of the assessee. The commissioner of Income Tax shall pay to the assessee the costs of this

reference.

K. L. Roy J. - I agree.

Question answered in the negative.