1962

February 27.

THE INCOME TAX OFFICER

v

ARVIND N. MAFATLAL

(B. P. SINHA, C. J., K. SUBBA RAO, N. RAJAGOPALA AYYANGAR, J. R. MUDHOLKAR and T. L. VENKATARAMA AIYAR, JJ.)

Income Tax—Partners of registered firm holding shares of company as benamidars of the firm—Error in computing tax—Proceeding to rectify errors—Income tax officer, if could effect readjustment to avoid illogicalities—Income-tax Act, 1922(11 of 1922), ss. 16(2), 18(5), 35.

The respondents were the four partners of a firm M, which was registered under the Indian Income Tax Act. Three of these four partners held amongst them forty shares in private limited company which was registered in the Phaltan State.

For the account year ending 30-9-1945 the Phaltan Company disclosed a net profit, but did not declare any dividend out of these profits but paid income-tax and super-tax thereon. After the merger of Phaltan State in the Indian Union, the Income-tax Officer issued notice to the Phaltan Company under s. 34 of the Act and acting under the provisions of s.23A directed that the undistributed assessable income of the company should be deemed to have been distributed as dividend among the shareholders. Before the date of this order, the assessment of the firm M and the individual assessment of its four partners had been completed. In order to bring to tax the undistributed dividend deemed to be declared under s.23A among the shareholders of the company, notices were issued to the four partners under s.34 of the Income-tax Act. In response to the notice, the partners appeared and contended that the forty shares held by the three of the four partners were in fact the property of the registered firm M. This contention was accepted by the Income-Tax Officer who thereupon treated the dividend attributable to the total of the forty shares as the dividend income of the firm and proceeded to the apportion the said income among the four partners in proportion of the shares which each of them held in the firm and added this to the income already assessed. In doing so however, the Income-tax Officer commited an error. In recomputing the total income of each of these four assessees he included only the net dividend "deemed to

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be received" by each but as again this addition he allowed a deduction of the tax paid by the company attributable to such dividend. Subsequently this mistake was discovered and thereupon the Income-tax Officer issued notice pointing out the error in including in the income the net dividend without being grossed up, while at the same time allowing credit for the tax deemed to have been paid thereon, and averred that this was a mistake apparent on the record" which he proposed to rectify under s.35 of the Act.

Held, that in view of the decision in *M/s. Howrah Trading Co.* v. *Commissioner of Income-tax*, it is only the registered shareholders who are entitled to the benefit of the credit for tax paid by the company under s.18(5) as well as the corresponding grossing up under s.16(2). On that basis the only persons who were entitled to be treated as shareholders to whom the provisions of s.16(2) and s. 18(5) of the Income-Tax Act were attracted were the three partners in whose name the forty shares stood registered.

Held, further, that the Income-tax Officer and Jurisdiction under s.35 to rectify errors but not to effect merely re-adjustment so as to avoid the illogicality in an error which is still permitted to continue.

Held, also, that it is not possible to correct the initial error in the proceedings because the notice under s.35 issued to the parties which is the foundation of the jurisdiction to effect the rectification, sought not the correction of the error but the perpetuation of it though in an altered and a less objectionable from the point of view of Revenue.

Messrs. Howrah Trading Co., Ltd. v. *The Commissioner of Income-tax, Calcutta*, [1959] Supp. 2. S. C. R. 448 applied.

CIVIL APPELLATE JURISDICTION: C. As. Nos. 502 to 505 of 1960.

Appeals from the judgment and orders dated January 14, 1957 of the Bombay High Court in Special Civil Applications Nos. 1848 to 1851 of 1956.

N. D. Karkhanis and *P. D. Menon* for the appellant (in all the four appeals).

S. T. Desai and *I. N. Shroff* for the Respondents.

1962. February, 27. The Judgment of the Court was delivered by

AYYANGAR, J.—These four appeals are pursuant to certificates granted by the High Court of Bombay under Art. 133(1)(c) of the constitution and raise identical questions for consideration.

The respondent in these four appeals are each of the four partners in a firm constituted under the name of Mafatlal Gagalbhai & Sons and which was composed of Navinchandra Mafatlal, Arvind N. Mafatlal, Yoginder N. Mafatlal and Homant Mafatlal with shares of 5/16, 3/16, 3/16 and 5/16 respectively in that firm (It has to be mentioned that Navinchandra died subsequent to the decision of the High Court and his legal representatives have been brought on record in Civil Appeal No. 502 of 1959 but this circumstance being irrelevant we are ignoring it for the purposes of these appeals). The firm was registered under the Indian Income Tax Act. There was a private limited company named Mafatlal Apte and Kantilal Limited registered under the Phaltan State Companies Act. Ten Shares in this private company stood in the name of Navin Chandra, 10 in the name of Arvind and 20 in the name of Hamant. For the account year of the company ending September 30, 1945 the company disclosed a net profit of Rs. 1,09,165/-. The company, however, did not declare any dividend out of those profits but paid income-tax and super-tax thereon. After the merger of the Phaltan State in the Indian Union and the extension of the provisions of the Indian Income Tax Act thereto, the Income Tax Officer who had jurisdiction over the assessment of the company, issued notice to it under s. 34 of the Indian Income Tax Act and acting under the provisions of s. 23A thereof directed that the undistributed assessable income of the company which amounted to Rs. 68,228/- should be deemed to have been distributed as dividend

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among the shareholders as on the date of the General Body Meeting of the company (i.e., on March 11 1946). Before the date of this order the assessment of the firm of Mafatlal Gagalbhai & Sons and the individual assessment of its four partners had been completed. In order to bring to tax the undistributed dividend "deemed to be declared" under s. 23A among the shareholders of the company notices were issued to the four partners under s. 34 of the Income Tax Act. In response to the notice the partners appeared and it was stated in their behalf that the 40 shares held by three of the partners in the company were in fact the property of the Registered firm and were held by them benami for the firm. This contention was accepted by the Income Tax Officer who thereupon treated the dividend attributable to the 40 shares as the dividend-income of the firm and proceeded to apportion the said income among the four partners in the proportion of the shares which each of them held in the firm and added this to the income already assessed, In doing so however, the Income Tax Officer committed an error. In recomputing the total income of each of these four assessees he included only the net dividend "deemed to be received" by each but as against this addition he allowed a deduction of the tax paid by the company attributable to such dividend. There was no appeal against these assessment orders which became final. Subsequently this mistake was discovered and thereupon the Income Tax officer issued notices to the four partners on April 13, 1954 pointing out the error in including in the income the net divident without being grossed up, while at the same time allowing credit for the tax deemed to have been paid thereon. He averred that this was a mistake apparent from the records and stated that he intended to rectify the same under s. 35 of the Income Tax Act. The four assessees objected to the rectification, but almost the entirely of the grounds on which the objection was

based related to the legality of the original assessment and the assessees desired that if any rectification was to be made it must be in relation to those items and not in regard to that for which notice had been served. The Income Tax Officer by his order dated October 12, 1955 rectified the assessment by grossing up the newly added dividend-income by the addition of the tax deemed to have been paid by the company thereon and retained the original relief granted under s. 18(5) of the Act. After unsuccessfully appealing to the higher authorities for relief against this rectification the assessees filed writ petitions invoking the jurisdiction of the High Court under Arts. 226 and 227 of the constitution for prohibiting the authorities from taking proceedings for the enforcement of the orders dated October 12, 1955. The learned Judges allowed the petitions. The Income Tax Officer thereafter moved the High Court for certificates of fitness under Art. 133(1)(c) and these having been granted the appeals are now before us.

The ground upon which the learned Judges granted the relief to the respondents was briefly this : The order of assessment had proceeded on the basis that the firm of Mafatlal Gagalbhai & Sons was the shareholder who had been in receipt of the dividend-income and the individual partners of the firm had been made liable for their share of the profits derived from this registered firm. In such circumstances the learned Judges held that what was distributed to the individual partners could not be deemed to be dividend-income within s. 16(2) of the Income Tax Act. It is to test the correctness of this construction of s. 16(2) that these appeals have been preferred.

In our opinion, however the appeals have to be dismissed on a short ground which does not involve any consideration of the correctness of the construction adopted by the High Court, of s. 16(2)

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of the Income Tax Act. This Court has held in *Messrs. Howrah Trading Co., Ltd.* v. *The Commissioner of Income-Tax Calcutta* (1) that it is only the registered shareholder who is entitled to the benefit of the credit for tax paid by the company under s. 18(5) as well as the corresponding grossing up under s. 16(2). On that basis the only persons who were entitled to be treated as shareholders to whom the provisions of ss. 16(2) and 18(5) of the Income Tax Act were attracted were the three partners in whose names the 40 shares stood registered, as detailed earlier. An error had therefore been committed by the Income Tax Officer in treating the registered firm as the owner of the shares in respect of the entire number of 40 shares. It was not this initial and fundamental error that was sought to be rectified by the proceedings under s. 35, but the removal of an anomaly in that error which continued to be affirmed; in other words the object of the proceedings under s. 35 was to carry out to its logical conclusion the error which had been committed in the order of assessment dated October 12, 1955 passed after invoking the provisions of s. 34. We consider the submission of learned Counsel for the respondents that the Income Tax Officer had jurisdiction under s. 35 to rectify errors but not to effect merely readjustments so as to avoid illogicalities in an error which is still permitted to continue is well-founded.

It has further to be mentioned that it is not possible to correct the initial error in these proceedings because the notice under s. 35 which is the foundation of the jurisdiction of the officer to effect the rectification, sought in reality not the correction of the error but the perpetuation of it though in an altered and less objectionable form from the point of view of Revenue. In this connection it would be noticed that one of the four partners-Yoginder Mafatlal had no shares standing in his name and by

(1) [1959] Supp. 2 S.C.R. 448.

the order of assessment under s. 34 he had been saddled with a liability to the extent of his 3/16th share in the firm, though this has been partially offset by the credit given to him, obviously wrongly, of relief under s. 18(5) of the tax deemed to have been paid by the company on that incomes.

We therefore consider that the appeals must fail. They are accordingly dismissed but in the circumstances of this case there will be no order as to costs.

Appeals dismissed.