

FIRST INCOME-TAX OFFICER, SALEM

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v.

M/S. SHORT BROTHERS (P) Ltd.

December 15, 1965

[K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

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Income-tax Act (11 of 1922), ss. 2(6-A) and 12-B—"Accumulated Profits", meaning of—If includes capital gains from sale of lands yielding agricultural income.

After the respondent-company sold its assets, which included agricultural lands and buildings, it was resolved that it should be voluntarily wound up. On 30th March, the liquidator distributed Rs. 850,000 to share-holders. The appellant (Income-tax Officer) proposed to treat the amounts distributed as dividends and to call upon the liquidators to pay the tax under s. 18(3D) of the Income-tax Act, 1922. The liquidators contended that the amount was capital appreciation realised by the sale of agricultural lands and buildings and therefore not liable to tax; and that in any event the amounts represented "current profits" of the year in which it was resolved that the company be wound up and so were not dividends within the meaning of s. 2(6-A)(c). As the appellant did not agree, the liquidators moved the High Court for a writ of prohibition to restrain him from taking further action. The High Court issued the writ holding that the demand by the appellant was not in conformity with law in that the amount of Rs. 850,000 could not be deemed to be distributed as dividend without determining whether any portion of it represented capital gains, which arose out of the sale of capital assets consisting of lands from which agricultural income was derived.

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In appeal to this Court.

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HELD : (i) Normally the High Court should not entertain a petition under Art. 226, when the party claiming relief has an adequate alternative remedy, but as the matter is one of discretion and not jurisdiction of the High Court, if the High Court thought that the case was one in which its jurisdiction could be invoked, this Court would ordinarily not interfere with the exercise of the discretion. [86 F]

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(ii) The decision in *Bacha Guzdar v. Commissioner of Income-tax*, (27 I.T.R. 1), wherein it was held that dividend received by a share-holder out of profits earned from agricultural income was not exempt from liability under s. 4(3)(viii), has no application to the present case, because, the claim of the respondent to exemption from liability to tax was not under s. 4(3)(viii), but on the basis that the receipt by the share-holder was not income chargeable to tax under s. 12 as dividend. [92 B]

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(iii) By s. 12 tax is payable by an assessee under the head "income from other sources" which includes dividends. "Dividend" is defined in s. 2(6-A) and cl. (c) declares that accumulated profits *immediately before the liquidation* of the company are dividends. Since it does not say that only accumulated profits upto end of the previous year immediately preceding the year in which liquidation of the company commences are dividend, all profits earned till immediately before liquidation, if they are distributed, will be brought to tax wholly if they consist of accumulated profits, or partly to the extent they are attributable to accumulated profits. In giving effect to the definition, the taxing authority may have to com-

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- A put profits of the company for a part of the year, but there is nothing in the Act which prohibits assessment of profits for a part only of the previous year in special circumstances. In fact, the legislative history of s. 2(6-A)(c) shows that "current profits", that is, profits of a company in liquidation arising after the end of the last previous year and before liquidation commenced are brought within the net of taxation as dividend. Further, the explanation to the section plainly implies that within the expression "accumulated profits" are included capital gains outside the excepted periods specified therein. But under s. 12-B while capital gains are chargeable in respect of any profits arising from transfer of "capital assets," "capital assets" do not include lands from which the income derived is agricultural income. Therefore, on a combined reading of s. 12-B and the definition of capital asset in s. 2(4-A), profits derived by transfer of lands from which the income derived is agricultural income would not be chargeable to tax. [87 F, 88 C, H; 89 A-C, E; 91 B-C, D-E]
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CIVIL APPELLATE JURISDICTION : Civil Appeal No. 97 of 1965.

Appeal by special leave from the judgment and order dated October 3, 1963 of the Madras High Court in Writ Petition No. 1242 of 1962.

- D *S. T. Desai, N. D. Karkhanis and R. N. Sachthey*, for the appellant.
- A. *V. Viswanatha Sastri, B. R. Agarwal and H. K. Puri*, for the respondent.

- E The Judgment of the Court was delivered by

- Shah, J.** On December 24, 1959, M/s. Short Brothers (Private) Ltd. sold its coffee estates and other assets, and by resolution, dated February 6, 1960, it was resolved that it be voluntarily wound up and liquidators be appointed to administer its affairs. Out of the proceeds realized by sale of its assets, the liquidators of the Company distributed on March 30, 1960 Rs. 8,50,000 to the shareholders. By letter, dated December 19, 1960, the Income-tax Officer, Salem, informed the liquidators that he proposed to treat that amount distributed as dividends in the hands of the shareholders, and to call upon the liquidators to pay the amount of tax deductible under s. 18(3D) of the Income-tax Act. The liquidators submitted that the amount distributed to the shareholders was capital appreciation realised by sale of agricultural lands and buildings of the Company, and was not liable to tax, and that in any event the amounts distributed represented "current profits" of the year in which it was resolved that the Company be wound up and were on that account not dividend within the meaning of s. 2(6A)(c) of the Income-tax Act. After some correspondence the Income-tax Officer, Salem by his
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order, dated October 18, 1962, finally called upon the liquidators to pay Rs. 4,11,700 which was retained by the liquidators from the distribution made to the shareholders. A

The liquidators then moved the High Court of Judicature at Madras, for a writ of prohibition restraining the First Income-tax Officer from taking further action to enforce collection of the amount referred to by him in his communication, dated October 18, 1962. Holding that the demand made by the Income-tax Officer was "not in conformity with the law" in that the amount of Rs. 8,50,000 which had been distributed could not be deemed to be distributed as dividend without determining whether any portion of the amount represented capital gains, which arose out of the sale of capital assets consisting of lands from which agricultural income was derived, the High Court issued a writ restraining the Income-tax Officer from enforcing the demand for tax. The High Court reserved liberty to the Income-tax Officer to examine the question afresh, and to determine "the correct amount of dividend within the meaning of s. 2(6A)(c)". With special leave, the First Income-tax Officer has appealed to this Court. B C D

It was submitted on behalf of the Income-tax Officer that the High Court in entertaining the petition in its extra-ordinary jurisdiction under Art. 226 of the Constitution, bypassed the machinery of assessment and rectification of orders of assessment prescribed by the Indian Income-tax Act which is both adequate and efficacious. But the High Court has under Art. 226 of the Constitution jurisdiction to issue to any person or authority within the territories in relation to which it exercises jurisdiction, directions, orders, or writs in the nature, amongst others, of *mandamus*, prohibition and *certiorari* for the enforcement of any of the rights conferred by Part III and for any other purpose. It is true that normally the High Court will not entertain a petition in exercise of its jurisdiction under Art. 226 of the Constitution when the party claiming relief has an alternative remedy which is adequate and efficacious. The question however is one of discretion of the High Court and not of its jurisdiction, and if the High Court in exercise of its discretion thought that the case was one in which its jurisdiction may be permitted to be invoked, this Court would normally not interfere with the exercise of that discretion. E F G

The High Court was of the view that all profits accumulated in the previous years and the profits till the date on which it was resolved that the Company be voluntarily wound up would be H

- A included in the expression "accumulated profits" under s. 2(6A) (c) of the Indian Income-tax Act read with the Explanation. They held that even capital gains taxable under s. 12B except for the period mentioned in the Explanation were when distributed, "dividend" within the definition, but profits realised by transfer of property used for agricultural purposes and which
- B yielded agricultural income not being capital gains taxable under the law are not "dividend", and on that account the order of the Income-tax Officer bringing to tax the entire amount distributed without determining whether any portion of that amount represented capital gains arising from the sale of capital assets
- C consisting of lands from which agricultural income was derived was not within his authority.

- D Counsel for the liquidators contended in the first instance that all profits whatever may be their character arising in the year in which the Company is voluntarily wound up are not liable to be taxed as they did not fall within the definition of "dividend" in s. 2(6A)(c). Counsel for the Department while supporting the view of the High Court relating to the chargeability to tax of "current profits", contended that the entire amount of Rs. 8,50,000 distributed to the shareholders, whatever may be the source from which the profits were earned, was liable to be brought to tax under s. 12 of the Income-tax Act as dividend distributed.
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- F By s. 12 of the Income-tax Act, tax is payable by an assessee under the head "Income from other sources" in respect of income, profits and gains of every kind which may be included in his total income if not included under any of the preceding heads in ss. 7 to 10 of the Act. By sub-s. (1A) "income from other sources" includes dividends. Section 2(6A) defined "dividend" and at the relevant time cl. (c) and the Explanation to the clause stood as follows :

"dividend" includes—

- G (c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;

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Explanation.—The expression "accumulated profits" wherever it occurs in this clause, shall not include

capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956.”

By the Explanation to s. 2(6A) accumulated profits include capital gains not arising within the excepted period. The Explanation is undoubtedly couched in negative form, but there is no ground for accepting the argument of counsel that in the substantive clauses of the definition, accumulated profits do not include capital gains. The Explanation plainly implies that within the expression “accumulated profits” are included capital gains outside the excepted periods. On the interpretation contended for by counsel, the Explanation which seeks to exclude “capital gains” from the content of accumulated profits would have no meaning. By sub-s. (1) of s. 12B tax is payable by an assessee under the head “capital gains” in respect of any profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March, 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place. Under the Indian Income-tax Act, 1922, “capital gains” arising after March 31, 1946 were made chargeable by the Income-tax and Excess Profits Tax (Amendment) Act, 1947, which inserted s. 12B in the Act. The levy was, however, abolished by the Finance Act, 1949, and the operation of s. 12B as enacted by the Amendment Act of 1947 was restricted to capital gains arising before April 1, 1948. By the Finance Act 3 of 1956 which introduced a new s. 12B, capital gains were again made chargeable to tax with effect from April 1, 1957 on the profits or gains arising from the transfer of capital assets, which expression is defined in s. 2(4A) as meaning “property of any kind held by an assessee, whether or not connected with his business, profession or vocation, but does not include—

- (i)
- (ii)
- (iii) any land from which the income derived is agricultural income;”

The contention raised by counsel for the Company that the profits earned in the “current year” i.e., the year in which it was resolved that the Company be wound up, were not “dividend” within the meaning of s. 2(6A)(c) of the Act cannot be accepted. Sub-clause (c) of s. 2(6A) declares that accumulated profits *immediately before the liquidation* of the company, are

- A dividend : it does not say that accumulated profits up to the end of the previous year immediately preceding the year in which liquidation of the company commences are dividend. It is true that in giving effect to the definition, the taxing authorities have to compute profits of the company for a part of the year, but that is not a ground for reading the plain words of the statute in an artificial sense. Under s. 3 of the Act read with s. 4, the charge to income-tax is on the total income of the previous year, and in accordance with and subject to the provisions of the Indian Income-tax Act. But there is nothing in the Act which prohibits assessment of profits for a part only of the previous year in certain special circumstances. For instance, under s. 26(2) it is provided that in the case of succession to a person carrying on any business, profession or vocation, in such capacity by another person, such person and such other person shall each be assessed in respect of his actual share of the profits of the previous year.
- B In amending the definition in s. 2(6A)(c) by the Finance Acts of 1955 and 1956, the Parliament has sought to clarify its meaning and to avoid the argument which was successfully raised in certain cases on the interpretation of the statute before it was amended. By the terms of the definition, distribution which is attributable to the accumulated profits of the Company immediately before its liquidation is to be deemed dividend. Thereby all profits earned till immediately before liquidation, if they are distributed, will be brought to tax wholly if they consist of accumulated profits, or partially to the extent they are attributable to accumulated profits.
- C Amendments which have been made from time to time in the Act clearly disclose the intention of the Parliament that it was not intended to allow the profits of the current year distributed by a liquidator of a company to escape liability to tax. In *Inland Revenue Commissioners v. George Burrell*,⁽¹⁾ it was held that on the undivided profits of past years and of the year in which the winding up of a company occurred which were distributed among the shareholders, super-tax was not payable, because in the winding up they had ceased to be profits and were assets only. It was observed in *Burrell's* case⁽¹⁾ that the only thing the liquidator of a company in liquidation may do is to turn the assets into money, and divide the money among the shareholders in proportion to their shares. Surplus of trading profit made in a particular year are distributable rateably among all the

(1) [1924] 2 K.B. 52.

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shareholders as capital, and 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 shareholders subsequently into component parts based on an estimate of what might possibly have been done, but was not done. As the Indian Companies Act, 1913, closely followed the scheme of the English Companies Act, and the view expressed in *Burrell's* case⁽¹⁾ applied to the Indian Income-tax Act, a special definition of "dividend" was devised by Parliament by the enactment of Income-tax (Amendment) Act 7 of 1939, with a view to supersede the view in *Burrell's* case⁽¹⁾. Clause (c) of sub-s. (6A) as originally enacted stood as follows :

" '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 :

Provided that only the accumulated profits so distributed which arose during the six previous years of the company preceding the date of liquidation shall be so included :"

By the Finance Act, 1955 the proviso to sub-cl. (c) of cl. (6A) was omitted. There was a further amendment made by the Finance Act, 1956 and cl. (c) to the amended section read as follows :

" 'dividend' includes—

(c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;"

Under Act 7 of 1939 profits which arose within six previous years preceding the date of liquidation when distributed were to be deemed dividends. But the effect of the definition was that distribution of profits accumulated after the last day of the previous year whatever their nature could not be regarded as distribution of dividend : *Sheth Haridas Achratlal v. The Commissioner of Income-tax*.⁽²⁾ It was held in that case by the Bombay High Court that for the purpose of s. 2(6A)(c) as it

- A stood in 1949, a broken period between the last day of the previous year of a company, and the commencement of winding up could not be considered "a previous year". The Parliament with a view to supersede the view in *Sheth Haridas Achratala's* case⁽¹⁾ deleted by the Finance Act, 1955, the proviso to sub-clause (c). To make its meaning more clear Parliament by the Finance Act, 1956, recast the substantive clause (c). Viewed in the context of this legislative history, there is no doubt that "current profits" i.e., profits of a company in liquidation arising after the end of the last previous year and before liquidation commenced, were brought within the net of taxation as dividend. The contention raised by counsel for the Company on this part of the case must fail.

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The question which remains to be considered is whether capital appreciation in respect of the lands from which the income derived is agricultural income and which was not taxable in the hands of the company as capital gains would still on distribution be liable to be taxed as dividend under s. 12 of the Income-tax Act. As we have already pointed out capital gains under s. 12B are chargeable in respect of any profits arising from transfer of "capital assets", and "capital assets" do not include lands from which the income derived is agricultural income. Profits derived by transfer of lands from which the income derived is agricultural income would not therefore be chargeable on a combined reading of s. 12B with s. 2(4A) of the Income-tax Act under the head "capital gains". The expression "accumulated profits" does not include capital gains arising within the excepted periods : *vide* Explanation to s. 2(6A). "Accumulated profits" are therefore profits which are so regarded in commercial practice, and capital gains as defined in the Income-tax Act. Realization of appreciated value of assets in commercial practice is regarded as realization of capital rise, and not of profits of the business. Unless, therefore, appreciation in the value of capital assets is included in the capital gains, distribution by the liquidator of the rise in the capital value will not be deemed dividend for the purpose of the Income-tax Act.

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Counsel for the Department contended, relying upon *Mrs. Bacha F. Guzdar, Bombay v. Commissioner of Income-tax, Bombay*⁽²⁾ that since dividend received by a shareholder of a company out of the profits earned from agricultural income is not exempt from liability to pay tax under s. 4(3)(viii), dividend

distributed from profits earned out of sale of capital assets inclusive of lands from which the income derived is agricultural income is also not exempt from income-tax. But the Company does not claim exemption from liability to tax under s. 4(3)(viii): it claims exemption because the receipt is not income which is chargeable to tax under s. 12 under the head "dividend". The case of *Mrs. Bacha F. Guzdar*⁽¹⁾ has therefore no application to this case. A B

The appeal therefore fails and is dismissed with costs.

Appeal dismissed.