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May 4.

THE COMMISSIONER OF INCOME-TAX, BOMBAY CITY

v.

THE KHATAU MAKANJI SPINNING AND WEAVING CO. LTD., BOMBAY.

(S. K. DAS, J. L. KAPUR and M. HIDAYATULLAH, JJ.)

Income-tax—Additional Income-tax—Total income—Method of computing—Indian Income-tax Act, 1922 (11 of 1922), s. 3—The Indian Finance Act, 1953 (XIV of 1953).

The Income-tax Officer found that in the assessment year 1953-54 the respondent assessee-company had declared excess dividends amounting to Rs. 1,87,691 and he levied additional income-tax on it at 5 annas in the rupee after deducting income-tax borne by the profits of the previous year at 4 annas per rupee, a surcharge of 5 per cent. less rebate of one anna in the rupee as allowed by the Finance Act, 1953. The Income-tax Tribunal held that the excess dividends were deemed to be paid out of undistributed profits of the earlier year ending June 30, 1951 on which a rebate of one anna in the rupee was given in the assessment year 1952-53. It further observed that additional income-tax was also a tax on income, and that the Finance Act could say that the tax would be payable on the income of any year preceding the previous year. The Tribunal, however, referred three questions to the High Court which the High Court compressed into one as below :—

"Whether additional income-tax has been legally charged under Clause (ii) of the proviso to paragraph B of Part I of the First Schedule to the Indian Finance Act, 1951, as applied to the assessment year 1953-54 by the Indian Finance Act, 1953, read with s. 3 of the Indian Income-tax Act?"

The High Court held that s. 3 of the Indian Income-tax Act put the liability to tax on the total income of the previous year or what can be deemed to be income. The Finance Act provided the rate applicable to the income so found and a method of computing the total income. The Finance Act in providing that additional income-tax should be paid upon the accumulated profits of the previous years went beyond the purpose for which the Finance Act was passed every year, and the Finance Act could not stand by itself without the support of s. 3 of the Indian Income-tax Act. On appeal by the Commissioner of Income-tax on certificate of the High Court:

Held, that the High Court was right in answering the question framed by it, in the negative. The Finance Act provided that the tax should be levied on the "total income" as defined in and determined under the Indian Income-tax Act. The Additional income-tax was not properly laid upon the total income because what was actually taxed was never a part of the total income of the previous year, nor deemed to be so.

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CIVIL APPELLATE JURISDICTION: Civil Appeal No. 303 of 1958.

Appeal from the judgment and order dated August 3, 1956, of the Bombay High Court in Income-tax Reference No. 10 of 1956.

K. N. Rajagopal Sastri and *D. Gupta*, for the appellant.

N. A. Palkhivala, *S. N. Andley*, *J. B. Dadachanji* and *Rameshwar Nath*, for the respondents.

1960. May 4. The Judgment of the Court was delivered by

Hidayatullah J.

HIDAYATULLAH, J.—This is an appeal against the judgment and order of the High Court of Bombay dated August 3, 1956, in a reference under s. 66(1) of the Indian Income-tax Act by the Appellate Tribunal, Bombay. The Tribunal referred four questions for the decision of the High Court. The High Court did not answer the first question because it was not pressed, and answered the remaining in the negative, after modifying them. It has certified this case as fit for appeal to this Court, and hence this appeal. The Commissioner of Income-tax, Bombay City, is the appellant, and the Khatau Makanji Spinning and Weaving Co. Ltd., Bombay, (the assessee Company), is the respondent.

The assessee Company has its year of account ending June 30 every year. At the close of the account year 1951, it carried forward profits amounting to Rs. 30,680. In that year, it appears it had earned a rebate by declaring dividends below the limit fixed by the Finance Act. For the account year 1952 its book profits were Rs. 28,67,235 less allowances for depreciation and tax. After these and other sundry adjustments, the balance available for distribution was Rs. 5,02,915. It may be pointed out that the Income-tax Officer on processing the income found the total income to be Rs. 5,26,681. For the account year 1952, the assessee Company declared dividends amounting to Rs. 4,78,950 and carried forward the balance of Rs. 23,965.

We are concerned with the assessment year 1953-54, and the Finance Act, 1953, is applicable. That Finance

Act applied the Finance Act, 1951, with some changes. The Finance Act, 1953, with the modifications will be referred to briefly, hereinafter, as the Finance Act. The Income-tax Officer found that the assessee Company had declared excess dividends amounting to Rs. 1,87,691. He calculated additional income-tax on it at 5 annas in the rupee after deducting income-tax borne by the profits of the previous year at 4 annas per rupee, a surcharge of 5 per cent. less rebate of one anna in the rupee as allowed by the Finance Act. This additional tax amounted to Rs. 21,115-4-0.

The appeals of the assessee Company under the Income-tax Act failed. The Tribunal held that the excess dividends were deemed to be paid out of undistributed profits of earlier year ending June 30, 1951, amounting to Rs. 6,60,720 on which a rebate of 1 anna in the rupee was given in the assessment year, 1952-53. The Tribunal observed that additional income-tax was also a tax on income, and that the Finance Act could say that the tax would be payable on the income of any year preceding the previous year. The Tribunal, however, referred four questions to the High Court, of which the first need not be quoted because it was abandoned before the High Court. The other questions were:

> "(ii) If the answer to question No. 1 is in the negative whether the said provisions go beyond the ambit and scope of the Indian Income-tax Act?
>
> (iii) Whether additional income-tax can be levied, assessed and recovered under the provisions of the Indian Income-tax Act?
>
> (iv) Whether at any rate the additional income-tax has been legally charged under the Indian Finance Act, 1953, read with the Indian Income-tax Act?"

The High Court compressed the three questions into one, and it reads:

> "Whether additional income-tax has been legally charged under clause (ii) of the proviso to paragraph B of Part I of the First Schedule to the Indian Finance Act, 1951, as applied to the assessment year 1953-54 by the Indian Finance Act, 1953, read with Section 3 of the Indian Income-tax Act?"

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This question was answered by the High Court in the negative.

In the opinion of the High Court, s. 3 of the Indian Income-tax Act lays down the liability to tax, and it puts the tax on the total income of the previous year. The method of computing this total income is also to be found in the Finance Act. The Finance Act merely provides the rate applicable to the income so found. According to the High Court, the Finance Act in providing that additional income-tax should be paid upon the accumulated profits of the previous years goes beyond the purpose for which the Central Act is passed every year, and cannot stand by itself without the support of s. 3 of the Indian Income-tax Act. The High Court held that the Finance Act had 'misfired', because it did not resort to legislation which would have conformed to the object for which the Finance Act was passed every year. The learned Chief Justice, who delivered the judgment of the High Court, stated that there were several methods open to the legislature to achieve that purpose but that it had not resorted to any of them. This is what the learned Chief Justice observed:

> "The Legislature could have achieved this object by one of three methods. It could have treated the excess dividend declared by the company as a notional income and made it a part of the total income of the previous year. It could have provided for rectification of the assessment of the year in which these profits were charged at a lesser rate, and we now find that Parliament has actually provided for this in the Finance Act, 1956. Or, finally, it could have provided for a penalty imposed upon a company which transgressed the direction of Parliament that it should not pay dividend beyond a particular ceiling...The ambit of Section 3 is clear and the ambit is that the tax to be levied must be a tax on income and the power of Parliament is equally clear and that is to fix the rate at which income-tax is to be charged upon the total income of the previous year of the assessee. In our opinion, the provision of the Finance Act travels beyond the ambit of Section 3, and if Parliament

has done so then no effective charge can be made on the total income of the previous year of the assessee under the provisions of the Finance Act which deals with additional tax on excess dividend."

It may be pointed out that before the High Court it was conceded that in order that the provisions of the Finance Act might be effective, the Finance Act had to come within the scope of s. 3 of the Income-tax Act. The point that was argued here was that it was not necessary to look only to s. 3 of the Indian Income-tax Act but also to the provisions of the Finance Act, through which Parliament could impose a new tax, if it so pleased. Other arguments involved modifications of language suitable to sustain the tax independently of s. 3 of the Indian Income-tax Act, a procedure which we do not think is open, for reasons which we have given in Civil Appeal No. 427 of 1957, decided today. These modifications, which were suggested, involve a re-casting of the entire relevant paragraph of the Finance Act to make it independent of s. 3 of the Indian Income-tax Act, a course which is only open to a legislature and not to a Court. We need not give all the modifications suggested, because, in our opinion, the words of the Finance Act must be given their due meaning, and must be construed as they stand.

The learned Chief Justice, with respect, very rightly pointed out that the Income-tax Act puts the tax on income or something which it deems to be income. In other words, the tax deals with income and income only. It further provides that this tax shall be collected at a particular rate on the total income for which provision shall be made in an yearly Central Act. The Finance Act also follows the same scheme, and lays down the rate at which the tax is to be collected. In the Finance Act, the tax is laid on the total income, but two provisos modify the rate under certain circumstances. We may at this stage read the relevant provision (Part I, First Schedule):

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"B. In the case of every company—

	Rate.	Surcharge.
On the whole of total income.	Four annas in the rupee.	One-twentieth of the rate specified in the preceding column :

Provided that in the case of a company which, in respect of its profits liable to tax under the Income-tax Act for the year ending on the 31st day of March, 1953, has made the prescribed arrangements for the declaration and payment within the territory of India excluding the State of Jammu and Kashmir, of the dividends payable out of such profits, and has deducted super-tax from the dividends in accordance with the provisions of sub-section (3D) or (3E) of section 18 of the Act—

(i) Where the total income, as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, exceeds the amount of any dividends (including dividends payable at a fixed rate) declared in respect of the whole or part of the previous year for the assessment for the year ending on the 31st day of March, 1953, and no order has been made under sub-section (1) of section 23A of the Income-tax Act, a rebate shall be allowed at the rate of one anna per rupee on the amount of such excess ;

(ii) Where the amount of dividends referred to in clause (i) above exceeds the total income as reduced by seven annas in the rupee and by the amount, if any, exempt from income-tax, there shall be chargeable on the total income an additional income-tax equal to the sum, if any, by which the aggregate amount of income-tax actually borne by such excess (hereinafter referred to as 'excess dividend') falls short of the amount calculated at the rate of five annas per rupee on the excess dividend.

For the purpose of clause (ii) of the above proviso, the aggregate amount of income-tax actually borne by the excess dividend shall be determined as follows :—

(i) the excess dividend shall be deemed to be out of the whole or such portion of the undistributed profits of one or more years immediately preceding the previous year as would be just sufficient to cover the amount of the excess dividend and as have not likewise been taken into account to cover an excess dividend of a preceding year;

(ii) such portion of the excess dividend as is deemed to be out of the undistributed profits of each of the said years shall be deemed to have borne tax,—

(a) if an order has been made under sub-section (1) of section 23A of the Income-tax Act, in respect of the undistributed profits of that year, at the rate of five annas in the rupee, and

(b) in respect of any other year, at the rate applicable to the total income of the company for that year reduced by the rate at which rebate, if any, was allowed on the undistributed profits."

By the first Proviso, a rebate of one anna per rupee is given to a company which pays dividends less than 9 annas in the rupee out of its profits. By the second Proviso, the rebate disappears, and an additional income-tax has to be paid on dividends in excess of that limit, paid in the year. The explanation says that "the excess dividend shall be deemed to be out of the whole or such portion of the undistributed profits of one or more years immediately preceding the previous year as would be just sufficient to cover the amount of the excess dividend and as have not likewise been taken into account to cover an excess dividend of a preceding year". This fiction, as we have already pointed out, provides only that the dividends shall be deemed to be out of the profits not of the previous year under assessment but of some other years. What the Finance Act fails to do is to make them "total income", so as to take in the rate which is prescribed for the total income in the Proviso. Unless the Finance Act stated that after the working out of the fiction the profits of the back year or years shall be deemed to be a part of the total income of the previous year under assessment, the purpose of the Act clearly fails. Income-tax is a tax on income

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of the previous year, and it would not cover something which is not the income of the previous year, or made fictionally so. The Finance Act could have gone further, as pointed out by the learned Chief Justice in the extract quoted, and made the profits a part of the total income of the previous year under assessment, but it did not do so. The Finance Act could have also resorted to some other fiction, which might conceivably have met the case; but it has failed to do so. Even if one considers the dividends as having come out of the profits of preceding years, they do not become the income of the relevant previous year, and unless the Finance Act expressly laid down that it should be taxed as part of the total income, the purpose is not achieved. Indeed, the Finance Act continues to say that the tax shall be on the total income, as defined in the Indian Income-tax Act and as determined under that Act. It is impossible to say that the additional income-tax was properly laid upon the total income, because what was actually taxed was never a part of the total income of the previous year.

For these reasons, we are of opinion that the High Court was right in answering the question which it had framed, in the negative.

In the result, the appeal fails, and is dismissed with costs.

Appeal dismissed.

THE COMMISSIONER OF INCOME-TAX, BOMBAY

v.

THE JALGAON ELECTRICITY SUPPLY CO., LTD.

1960

May 4.

(S. K. Das, J. L. Kapur and M. Hidayatullah, JJ.)

Additional Income-tax—If could be levied on excess dividends, when there are profits in the preceding years—Manner of calculation of tax—Indian Finance Act, 1949 and 1950, Para. B, of Part I of the First Schedule.

After making all allowances and deductions, the income of the assessee company was finally assessed for the years 1949-50