

1962

April 19.

KISHINCHAND CHELLARAM

v.

COMMISSIONER OF INCOME-TAX,
CENTRAL BOMBAY

(S. K. DAS, M. HIDAYATULLAH and J. C. SHAH, JJ.)

Income Tax— Dividend declared by company inadvertently without providing for taxation—Can the character of dividend be altered to a loan by a subsequent resolution— Indian Income-Tax Act, 1922 (11 of 1922), s. 16 (2).

Chellsons Ltd., a private Ltd. Company, declared dividends without taking into account the company's liability for taxation, including Extra Profits Tax. The dividends so declared were credited in the books of the company to the accounts of each of the share-holders. Share-holders in their return for the relevant assessment year included the amounts credited to them in the company's books of account.

Payment of dividends otherwise than out of profits of the year, or other undistributed profits was at the material time prohibited, by Art. 97 of Table A of the Indian Companies Act, 1913, as amended by Act XXXII of 1936 read with s. 17 (2) of the Act; therefore such payment could not be regarded as lawful, the company having failed to provide for payment of tax before declaring dividend. On discovering its mistake at an Extra Ordinary General Meeting another resolution purporting to reverse the earlier resolutions declaring the dividends was moved, and the shareholders unanimously resolved *inter alia* that all the shareholders having been fully apprised of the *bonafide* mistake, the dividends inadvertently paid be considered as loans to such individual shareholders. Before the Income Tax Officer the assessee who was a shareholder did not file a revised return, nor did he claim that the amount received by him was not liable to tax. But on appeal before the Appellate Assistant Commissioner the assessee contended that amount credited by the company to his account was not in view of the subsequent resolution, liable to be taxed as dividend income. The plea was rejected. Before the Tribunal the assessee contended that the dividends were declared out of capital and such declaration was invalid under the Companies Act.

The tribunal held that what was paid and received as dividend could not by a subsequent resolution of the company be treated as paid otherwise than as dividend. The High

Court agreed with the Tribunal observing that assessment for each year is self-contained and subsequent events cannot justify modification of the assessment.

The assessee came up in appeal to the Supreme Court.

Held, that if the directors of the company have deliberately paid or negligently been instrumental in paying dividends out of capital they may have, in an action by the company or if the company is being wound up at the instance of the liquidator, to compensate the company for loss occasioned by their wrongful or negligent conduct.

In Matter of The Union Bank, Allahabad Ltd. (1925)
I.L. R. 47 All. 669 approved.

Held, further, in ascertaining whether liability to pay income tax on dividend arose, a resolution of the company whereby payments made to the shareholders as dividends are to be treated as loans cannot retrospectively alter the character of the payment and thereby exempt it from liability which has already attached thereto.

Held, also, the payment made as dividend by a company to its share holders does not lose the character, of dividend merely because it is paid out of capital. Under the Income Tax Act, liability to pay tax attaches as soon as dividend is paid, credited or distributed or is declared. The Act does not contemplate an enquiry whether the dividend is properly paid, credited or distributed before liability to pay tax attaches thereto.

CIVIL APPELLATE JURISDICTION : Civil Appeal
Nos. 462 to 465 of 1960.

Appeals from the judgment and order dated September 26, 1955, of the Bombay High Court I. T. R. No. 22 of 1955.

K. N. Rajagopal Sastri, J. K. Hiranandi and N.H. Hingorani for the appellants.

N. D. Karkhanis and D. Gupta for the respondents.

1962. April 19. The Judgment of the Court was delivered by

1962

Kishinchand
Chellaram
v.
Commissioner of
Income-tax,
Central Bombay

1962

Kishinchand
Chellaram

v.

Commissioner of
Income-tax
Central Bombay

Shah J.

SHAH, J.—This is a group of appeals against orders passed by the High Court of Bombay in Income Tax Reference under s. 66(1) of the Indian Income Tax Act.

Chellsons Ltd. a Private Company was incorporated in April 1941. The shareholders of the company at the material time were Kishinchand Chellaram holding 6 shares and Shewakram Kishinchand, Lokumal Kishinchand and Murli Tabilram each holding three shares. Kishinchand, Shewakram and Lokumal were directors of the company. At a General meeting of the shareholders of the company held on July 10, 1943, it was resolved to declare dividend at "60 per cent on the shares" of the company and for the purpose of that of declaration the profits of the year 1941-43 were included in the profit of the year 1942-43. Pursuant to this resolution, Rs. 46,000/- were credited in the books of the company to the account of Kishinchand Chellaram on March 31, 1944 and Rs. 23,000/- were credited to each of the other three shareholders. Another meeting of the shareholders was held on July 15, 1944, and it was resolved to declare dividend at "60 per cent on the shares" out of the profit of the company for 1943-44. Pursuant to this resolution, on September 29, 1944, Rs. 30,000/- were credited in the company's books of account to Kishinchand and Rs. 15,000/- were credited to the accounts of each of the other three shareholders.

In their respective returns for the assessment year 1945-46, Kishinchand, Shewakram, Lokumal and Murli—who will hereinafter be collectively called the assesseees—included the amounts credited to them in the company's books of account as dividends for the three years 1941-42 to 1943-44. On December 4, 1947, at an Extraordinary General Meeting another resolution purporting to reverse the earlier resolutions dated July 10, 1943 and July

15, 1944, was passed by the company. The resolution read as follows:—

“The notice dated 25th November, 1947 calling the Extraordinary General Body Meeting for today, was placed on the table.

“Whereas the sum of Rs. 1,90,000 paid to the shareholders during the year 1944-45 as per details given below viz—

1962
Kishinchand
Chellaram
v.
Commissioner of
Income-tax
Central Bombay
Shah J.

	For			
	1941-42	1942-43	1943-44	Total
Mr. Kishinchand Chellaram	10,000	36,000	30,000	76,000
Mr. Shewakram Kishinchand	5,000	18,000	15,000	38,000
Mr. Lokumaj Kishinchand	5,000	18,000	15,000	38,000
Mr. Murli Tahilram	5,000	18,000	15,000	38,000
Total	25,000	90,000	75,000	190,000

was sanctioned by the General Body inadvertently without taking into consideration the Company's liability for taxation, including E. P. T. and all the shareholders having been fully apprised of the *bona fide* mistake it is hereby unanimously resolved that such dividend inadvertently paid be considered as loan to such individual shareholders, and be paid back to the Company forthwith, and the consideration of any dividend to the shareholder be deferred to the next Annual General Meeting. The adjustment in this regard will not

1963

*Kishinchand
Challaram**v.
Commissioner of
Income-tax
Central Bombay**Shah J.*

be made in the books of the Company as on 6th April, 1947.”

Even though this resolution was passed, and the proceedings for assessment before the Income Tax Officer were not disposed of the assessee did not file revised returns excluding the amounts credited as dividend, nor did they claim before the Income Tax Officer that those amounts not being income were not liable to tax.

By his order dated January 1, 1950, the Income Tax Officer brought the income returned by the assessee including the amounts credited to them as dividends for the three years to tax. In appeals to the Appellate Assistant Commissioner, the assessee contended that the amounts credited by the Company to their accounts in respect of the years 1941-42, 1942-43 and 1943-44 were not, in view of the subsequent resolution, liable to be taxed as dividend income. The Appellate Assistant Commissioner rejected this plea. The assessee then appealed to the Appellate Tribunal and contended that the dividends for the three years in question were declared out of capital and such declaration of dividend being under the Indian Companies Act invalid, in the assessment the amounts credited to their accounts as dividend should be excluded. The Income Tax Appellate Tribunal held that the dividends in respect of the years 1941-42 and 1942-43, having been received before the year of account relevant to the year of assessment 1945-46, were not liable to be taxed in that year. But the Tribunal confirmed the orders of assessment as to the dividend for the year 1943-44, because, in their view, the resolution declaring dividend could not be reversed by a resolution at a subsequent General Meeting after the dividends had been paid. At the instance of

the assessee the Appellate Tribunal referred in each of the four cases the following two questions:—

- (1) Whether the shareholders of the company at the meeting held on December 4, 1947 could reverse the resolutions passed on July 10, 1943 and July 15, 1944 ?
- (2) Whether the sum of Rs.....received by the assessee.....as dividend in the account year 1944-45 relevant for the assessment year 1945-46 has been lawfully taxed in the assessment year 1945-46? If not, could only the dividends that could have been paid out of the profits or a part thereof be taxed in the assessment year 1945-46 ?

(In each set of questions the appropriate amount received and the name of the assessee was incorporated in the second question).

The Tribunal observed in the order of reference that the Income Tax Department challenged the correctness of the claim made by the shareholders that dividend was paid without making provision for payment of tax, but they did not desire to go into accounts to ascertain whether provision for tax was made, as "the parties at the time of the hearing of the appeals proceeded on the footing that no such provision was made. Even if provision was made, it makes no difference in so far as the Department is concerned. The question is whether any dividend has been declared out of capital and that question will have to be examined at the time of passing the order under Section 66 (5) of the Act, in view of question No. 2."

The High Court declined to answer the first question because in their view it was unnecessary, and answered the first part of the second

1962

*Kishinchand
Chellaram*

v.

*Commissioner of
Income-tax
Central Bombay*

Shah J.

1962

Kishinchand
Chellaram

v.

Commissioner of
Income-tax
Central Bombay

Shah J.

question in the affirmative, and held that the second part did not on that view arise for decision. Against the order of the High Court these four appeals have been preferred by the assesseees.

The only question material to these appeals which was argued by the assesseees before the Tribunal was whether it was competent to the company by a subsequent resolution to reverse an earlier resolution declaring the dividend. The Tribunal held that the earlier resolution could not be reversed by a subsequent resolution, and therefore what was paid and received as dividend could not by a subsequent resolution of the company be treated as paid otherwise than as dividend. The High Court held that the assessments were properly made by the Income Tax Officer. They observed that the assessment of an assessee for each year is self-contained and subsequent events cannot justify modification of the assessment.

Section 16(2) provided (in so far as it is material) that "for the purposes of inclusion in the total income of an assessee any dividend shall be deemed to be income of the previous year in which it is paid, credited or distributed or deemed to have been paid, credited or distributed to him. x x x". It is common ground that on July 15, 1944 dividend was declared by a resolution of the company and the amounts payable to the assesseees were, in fact, credited on September 29, 1944, in the accounts maintained by the company, to each of the shareholders as dividend. The amounts were therefore declared as dividend, treated as dividend and received by the assesseees as dividend. The assesseees included the dividends so credited to their accounts in the returns. It may be assumed that the company failed to provide for payment of tax before declaring dividend and that after providing for payment of tax, the net profits of the company may not have

been sufficient to justify declaration of dividend at 60% of the value of the shares. On that assumption it may be inferred that the dividend or a part thereof was in truth paid out of the capital of the company. Payment of dividend otherwise than out of profits of the year, or other undistributed profits was at the material time prohibited by Art. 97 of Table A of the Indian Companies Act, 1913 as amended by Act. XXXII of 1936 read with s. 17(2) of the Act; and therefore such payment may be regarded as unlawful. If the Directors of a company have deliberately paid or negligently been instrumental in paying dividend out of capital they may have, in an action by the company—or if the company is being wound up at the instance of the Liquidator—to compensate the company for loss occasioned by their wrongful or negligent conduct. (In *the matter of The Union Bank Allahabad Ltd.* (1). In this case we are not concerned with the validity of the distribution of dividend, or the liability of the directors arising out of improper distribution of dividend. We are concerned with the true character of the payment made on September 29, 1944, to the assesseees. If dividend is declared and the amount is credited or paid to the shareholders as dividend can the character of the credit or payment be altered by a subsequent resolution so as to alter the incidence of tax which attaches to that amount?

By virtue of s. 16(2) the liability to pay tax attaches as soon as dividend is paid, credited or distributed or deemed to have been paid, credited or distributed to the shareholders and the Income Tax Act contains no provision for altering the incidence of liability to pay tax on the dividend, merely because it is found that in declaring dividend and paying it the company violated a prohibition

(1) (1925) I.L.R. 47 All. 669.

1968

Kishinchand
Chellaram

9.
Commissioner of
Income-tax
Central Bombay

Shah J.

1962

Kishinchand
Chellaram
v.
Commissioner of
Income-tax
Central Bombay

Shah J.

relating to payment of dividend in the Indian Companies Act.

It is not necessary to consider in this case whether the shareholders may be compelled by the company to refund the amount improperly paid as dividend out of capital. Even if the shareholders agree to refund the amounts received by them as dividend the original character of the receipt as dividend is not thereby altered. In ascertaining whether liability to pay Income-tax on dividend arose, a resolution of the company whereby payments made to the shareholders as dividend are to be treated as loans cannot retrospectively alter the character of the payment and thereby exempt it from liability which has already attached thereto.

Before this Court two contentions were raised by counsel for the assesses : (1) that on the amount received by each of the assessee's tax was not exigible because it was not dividend at all, and (2) that what was declared and paid as dividend ceased to be such by virtue of the subsequent resolution. The first plea was not raised before the Tribunal, and on the question as framed it did not arise for decision on a reference under s. 66 of the Indian Income Tax Act. The jurisdiction of the High Court under s. 66 being advisory, they were concerned to give their opinion on questions which fairly arose out of the order of the Tribunal, and were in fact raised and referred. The question whether the payment made by the Company was not in the nature of dividend not having fairly arisen out of the order of the Tribunal, it cannot be raised in this Court as it could not in the High Court. In any event, we are of the opinion that payment made as dividend by a company to its shareholders does not lose that character merely because it is paid out of capital. Under the Income Tax Act, liability to pay tax attaches as soon as dividend is paid, credited or distributed or is so

declared. The Act does not contemplate an enquiry whether the dividend is properly paid credited or distributed before liability to pay Tax attaches thereto. The answer to the second contention for reasons already set out by us must be in the negative.

The appeals therefore fail and are dismissed. In the circumstances of the case there will be no order as to costs.

Appeals dismissed.

1962
Kishinchand
Chellaram
v.
Commissioner of
Income-tax
Central Bombay
Shah J.

THE COLLECTOR OF CUSTOMS, MADRAS

v.

K. GANGA SETTY

(B. P. SINHA, C. J., P. B. GAJENDRAGADKAR, K. N. WANCHOO, N. RAJAGOPALA AYYANGAR and T. L. VENKATARAMA AIYAR, JJ.)

1962
April 19.

High Court—Decision of Customs Authorities—Construction of entries in tariff Schedule—Jurisdiction to interfere—“Feed oats” used horse feed—Whether falls within “fodder” or “grain”—Import Trade Control Schedule, Part IV. Item Nos. 32 and 42—Specific Relief Act, 1877 (1 of 1877). s. 45

Item 42 of Part IV of the Import Trade Control Schedule permitted “fodder....” to be imported without a special import licence from a soft Currency area... Item 32 of the same Schedule related to “grain....” and included oats; and a licence was necessary for importing goods covered by this item. The respondent imported from Australia, without a licence, goods described as “feed-oats” for feeding race horses. He claimed that the goods were covered by Item 42 and could be imported without a licence. The customs authorities held that the goods were “grains” within the meaning of Item 32 which could not be imported without a licence, confiscated the goods and imposed a penalty in lieu of confiscation. The respondent moved the High Court for the issue of a writ of mandamus under s. 45 specific Relief Act. The High Court held that the