Privy Council Appeal No. 50 *of* 1935.

The Commissioner of Income Tax, Bengal - - - - *Appellant*

v.

The Hungerford Investment Trust, Limited - - - *Respondents*

FROM

THE HIGH COURT OF JUDICATURE AT FORT WILLIAM IN BENGAL

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 26TH MAY, 1936.

Present at the Hearing:
LORD ROCHE.
SIR SHADI LAL.
SIR GEORGE RANKIN.

[*Delivered by* SIR GEORGE RANKIN.]

This appeal is brought by the Commissioner of Income-tax, Bengal, from the decision of the High Court at Calcutta upon a reference made under section 66 (2) of the Indian Income-tax Act (XI of 1922). Two questions were originally referred to the High Court for its opinion, but the assessee made an admission which rendered the first question unnecessary. The sole question before the Court was as follows :—

> " The assessee's income in assessment having included dividends declared on 16th April, 1931, and 3rd November, 1931 by a Company whose profits of 1930 and 1931 were found to include specified sums to which in accordance with section 4 the Act did not apply: and the said Company having been assessed in respect of profits to which the Act did apply: is such proportion of the dividends, as the specified sums bear to the aggregate of all profits in 1930 and 1931 respectively, exempted from taxation to ordinary income-tax in accordance with section 14 (2) ? "

The question arises out of the assessment for the year 1932-3 to be made upon the Hungerford Investment Trust, Limited, a company registered outside British India which will be herein referred to as " the assessee ". The assessee holds the whole of the ordinary share capital in a company called Turner Morrison and Company, Limited, registered in India, which will be herein referred to as " the Company ". In the year of account 1931-2 the assessee received as dividend upon its shares in

the Company, two sums as follows, namely, (*a*) rupees three lakhs being final dividend declared on the 16th April, 1931, by the Company in respect of the calendar year 1930, and (*b*) rupees one and a half lakhs being an interim dividend declared on the 3rd November, 1931, by the Company in respect of the calendar year 1931. The profits and gains of the Company for the year 1930 were assessed to Indian income-tax in the year of assessment 1931-2. On the basis of that investigation the Commissioner for Income-tax purports to find as facts that 2 per cent. of the Company's profits and gains in 1930 consisted of interest on tax free securities of the Government of India; that 12 per cent. consisted of profits or gains which did not accrue or arise within British India, and which were not received in British India, or deemed so to be, and which accordingly were not profits or gains to which the Act applies; and that the remaining 85 per cent. of the Company's profits in 1930 were subjected to Indian income-tax in the hands of the Company in the year of assessment 1931-2. By a similar investigation into the profits and gains of the Company for 1931 it was found that 1 per cent. of the profits made by the Company in that year consisted of interest upon tax free securities of the Government of India, 25 per cent consisted of sums to which the Indian Income-tax Act did not apply and the remaining 74 per cent. was chargeable to Indian income-tax under the Act. Applying these proportions to the two sums received by the assessee by way of dividend from the Company in the year of account 1931-2, the Commissioner has disintegrated the total sum of Rs.4,50,000 into three parts treating Rs.7,500 as referable to interest on tax free securities of the Government of India within the meaning of the second proviso to section 8 of the Act; Rs.76,500 as dividend derived from distributable profits of the Company not taxable in the hands of the Company within section 4 (1) of the Act, and Rs.3,66,000 as dividend derived from profits and gains of the Company chargeable with Indian income-tax. The question before the Court has reference only to the second of these three sums, namely, Rs.76,500 and that question has in the end to be answered by arriving at the true construction of clause 2 (*a*) of section 14 of the Act which is in the following terms:—

> " 14.—(1) The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family.
>
> " (2) The tax shall not be payable by an assessee in respect of :—
>
> " (*a*) any sum which he receives by way of dividends as a shareholder in a company where the profits or gains of the company have been assessed to income-tax ; or
>
> " (*b*) such an amount of the profits or gains of any firm which have been assessed to income tax as is proportionate to his share in the firm at the time of such assessment ; or

"(c) any sum which he receives as his share of the profits or gains of an association of individuals, other than a Hindu undivided family, company or firm, where such profits or gains have been assessed to income-tax."

The Indian Income-tax Act, as sections 19 (*a*) and 23 make clear, requires a return to be made by every company, as well as by every person other than a company whose total income is, in the Income-tax Officer's opinion, of such an amount as to render such person liable to income tax. This brings about the principle or method which is sometimes described as double assessment and sometimes as assessment at the source (as distinct from deduction at the source which is employed in the case of "interest on securities" and "salaries"). The method of double assessment is applied not only in the case of companies but in the case of firms, Hindu undivided families, and other associations of individuals. When a company has made its return of the profits and gains in the year of account—that is of what the Act calls the "total income" of the company during the previous year, the Income-tax Officer, if satisfied that it is correct and complete is directed by section 23 (1) that he shall assess the total income of the assessee and shall determine the sum payable on the basis of such return. If the return is not correct or complete the same result is to be arrived at after taking further proceedings as described in the section. The like process is carried out in respect of the return made by the individual shareholder if he is chargeable with Indian income tax at all. As part of his total income, he has to include the dividend which he has received from the company during the previous year in order that his "total income" within the meaning of the Act may be ascertained, a figure which is necessary if only to fix the rate of tax payable by him in the year of assessment. Section 14 contains directions to the effect that certain sums which have been received by the assessee in the year of account and which are part of his "total income" within the meaning of the Act are to be free so far as payment by the individual is concerned, the reason being that although companies, firms and other associations are as such subjected to assessment, double assessment is not intended in all cases to carry with it the consequence of double payment. If, for example, the Hindu undivided family has been assessed in respect of a sum, the part which the individual member has received is not to be taxed for the second time in his hands. If a firm of three partners have been assessed to tax upon their profits the partner is not to pay again upon his share of the same profits. Clause (*a*) of sub-section 2 is a more or less similar provision in the case of a company paying dividends. Its object is to ensure that tax shall not be paid more than once upon what the statute regards as the same thing. The company though a separate legal persona in the contemplation of law and liable to assessment as a subject chargeable with tax is not for all purposes to be regarded as entirely separate and

distinct from the corporators. The underlying principle of the clause as the Commissioner in stating the present case has recognised is " that the dividend represents merely the shareholders' share in the income of the company."

To arrive at a true construction of section 14 (2) (*a*) it is necessary to consider all references in the Act to "profits and gains"—in particular section 4 and the definition of total income in section 2 (15) of the Act: also sections 20 and 48. Certain arguments have been drawn from the language of clauses (*b*) and (*c*) of sub-section 2 of section 14 but it is difficult to regard them as decisive in favour of either side to the controversy.

The contention on the part of the assessee is in effect that clause 14 (2) (*a*) is satisfied in any case in which the company has been assessed to income-tax in respect of its profits or gains in the relevant year. If it has been assessed at all it has presumably been assessed upon its " total income " within the meaning of the Act; and the fact that it may have been in receipt of sums distributable as dividend, but not chargeable to Indian Income-tax because not profits or gains to which the Act applies, does not, upon this view, prevent the clause from freeing the dividend received by the shareholder from any further payment of tax.

The view contended for by the Income-tax authorities has been put in different ways. The Commissioner of Income-tax in giving his opinion upon the reference, drew a distinction between income that is specifically exempt under the Act, e.g., agricultural income, or income from tax free securities, and what he calls (somewhat unfortunately having regard in particular to section 34 of the Act) "income that has merely escaped assessment ", by which he means profits and gains that are not chargeable to Indian income-tax because they have neither accrued nor been received in India. With regard to the former he admits the applicability of the principle before mentioned that a dividend represents merely a shareholder's share in the income of the company. With regard to the latter he rejects this principle as " it cannot be said that the place of receipt by the company constitutes a characteristic of the income which is retained, against the actual place of receipt by the shareholder, when the income passes on to the shareholder." In his view section 14 is among " provisions for the avoidance of levying the tax twice over upon the same accrual—it is important to avoid calling it the same ' income ' ". These observations of the Commissioner were doubtless made with specific reference to the first of the two questions originally stated, a question with which their Lordships are not now concerned; but it is important to notice that it is impossible to suggest any construction of clause (*a*) of section 14 (2) which would make the clause discriminate between these two classes of income which are not charged with tax. Whether it be that the legislature has not sufficiently appreciated the importance

of the distinction between the same accrual and the same income, or has given unexpected weight to the principle that a dividend represents merely the shareholders' share in the income of the company, the distinction drawn by the Commissioner cannot in their Lordships' view be discovered in the clause.

Before the High Court of Calcutta the contention put forward by the Advocate General was that the clause only applied where the whole of the profits of the company had been assessed to income-tax, that is to say, where the "total income" within the meaning of the Act contained everything that was distributable as profit. If this view be accepted it is true, as Panckridge J. observed, that some startling results would follow. In the first place, every shareholder in a bank, insurance company or other company whose profits and gains consist in part of interest from tax free securities would be taxed again upon the whole of his dividend, and the same would apply in the case of a company with agricultural income. This is an impossible conclusion, as is sufficiently illustrated by the circumstance that the Commissioner in the present case does not claim to charge the assessee with tax upon the sum of Rs.7,500, being the proportion of the assessee's dividend which he brings within the ambit of the second proviso of section 8. Indeed it is clearly inadmissible to read "*all* the profits or gains of the company have been assessed" or "the *total* profits or gains" in expansion of the phrase used by the section, since even if it could be shown that some of the assessable profit of the company had escaped assessment it cannot be supposed that instead of dealing with the matter under section 34 by making an additional assessment on the company the Income-tax Officer is to be at liberty to raise it *vis a vis* the individual shareholder.

Before the Board, however, another construction of clause (*a*) was propounded. It was stated in the appellant's case as reason No. 5:—

> "Alternatively because section 14 (2) confers exemption only upon that part of the aforesaid dividends which was paid, or may be taken to have been paid, out of the profits of Turner Morrison & Co., which were assessed to income-tax."

This view may perhaps be put by saying that clause 14 (2) (*a*) should be read to mean that the tax shall not be payable by an assessee in respect of any of the profits or gains of a company which the shareholder receives by way of dividend where such profits or gains have been assessed to income-tax, or again, that the tax shall not be payable by an assessee in respect of any sum which he receives by way of dividends . . . to the extent to which the profits or gains of the company have been assessed to income tax. This, which may be called a distributive construction of clause (*a*), cannot be dismissed on the ground that the meaning given to the clause is unreasonable in itself. It is, however, very difficult to think that it is the true meaning of the clause.

One would not expect the phrase " where the profits or gains of the company have been assessed " to be used in such sense as to point to the possible existence of receipts which are not profits or gains within the meaning of the Act at all, or at least are not part of the company's " total income " but profits or gains to which the Act does not apply. It is not readily to be assumed that the Act intends the Indian Income-tax authorities to investigate and settle the exact amount of such "profits and gains "—involving as this process must, receipts which have never accrued or been received in India or brought to India, and expenditure made in the course of carrying on business in another country. The terms of section 20 providing for a certificate to be given by the company do not assist such a construction of section 14 (2) (*a*). Again, the vagueness of this construction makes it somewhat incredible. It may be that on any view the clause does not make clear whether the contemplated assessment of the company's profits has reference to the same year of assessment as the shareholder is concerned with, and, if not, how the relevant year is otherwise to be ascertained. But if the sums available for distribution by a company under the company law are to be examined and disintegrated, one would not merely desire but expect directions on the question whether, in the case of dividends paid out of accumulated profits, the dividends received by the shareholder were to be free of further payment if the company had paid tax on the relevant profits at any time and at any rate prevailing at the time. A construction which raises so important a matter and then leaves it utterly at large is not without grave difficulty. It is also to be observed that the construction proposed assumes that it is possible and reasonable to ascertain whether and to what extent a particular dividend represents, to use a neutral term, profits brought to charge in the hands of the company. No doubt a rule of proportion can be applied as is proposed in the present case, but no such rule has been laid down by the Act and the construction contended for involves difficulty in the absence of a rule. Indeed the Commissioner himself has not unreasonably argued that in the case of dividends it is not possible to say what funds they were paid from : " Payments are made out of one pool of liquid assets on account of one liability or another. There is no separate pool of profits—still less of each separate type of profits." He suggests, however, that the legislature intended to leave " this very difficult relation of the dividends and the profits " to be wholly determined as facts ". In the case before the Board, in order to obtain an authoritative ruling on the construction of clause 14 (2) (*a*) an admission has been made by the assessee that no part of the sum of Rs.76,500 now in question was paid out of profits which had at any time been assessed to Indian income-tax. Still in construing clause (*a*) their Lordships have to consider whether the proposed construction which ignores this difficulty can be accepted. What

is involved in leaving the relation between the dividends and the profits to be determined as facts can be seen from annexure (*d*) (II) to the letter of reference where the Assistant Commissioner in dealing with the assessment of Turner Morrison & Co. Ltd. (to which in the present case he referred for his reasons) stated:—

> "The assessees further contend that the Companies did not bring the foreign income to India but declared the dividend out of the Indian income but, I don't think it is possible to split up the income in such a manner in declaring the dividends. The dividends are declared out of the total income of the Company."

If the construction contended for involves that the income-tax authorities are to find something as matter of fact which is not matter of fact, that again is an infirmity of some importance and it is not made better by the circumstance that there is small chance of evidence to fetter them in their findings.

No doubt the case may be put of a company in which only the smallest fraction of its distributable profit has been received in India and become chargeable to Indian income-tax, and where, notwithstanding this fact, by some process of borrowing or otherwise, the rest of the real profit or part thereof is being distributed among shareholders in India. It is, however, difficult to be sure that the legislature was so dissatisfied with the provisions of section 4 (2) (as they stood before 1933) as to assume that it rendered probable any important leakage by this means. It has been suggested that the wording of section 48 (1) assists the contention of the Income-tax authorities but that section throws little light upon the meaning of clause (*a*) of section 14 (2).

Their Lordships have to be satisfied as to the meaning of clause (*a*). In their opinion it was rightly construed by the High Court of Calcutta who have given to the phrase " where the profits and gains of the company have been assessed to income-tax " its ordinary and natural meaning. This in itself is a sufficient ground of decision, but their Lordships are satisfied that any departure from the immediate and direct meaning of the phrase leads to difficulties of interpretation and to results which cannot be imputed to the legislature as within its intention. The answer to the question propounded is in the affirmative.

Their Lordships will humbly advise His Majesty that this appeal should be dismissed with costs.

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In the Privy Council.

THE COMMISSIONER OF INCOME TAX, BENGAL

v.

THE HUNGERFORD INVESTMENT TRUST, LIMITED

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