

PETITIONER:
THE COMMISSIONER OF INCOME-TAX, MADRAS

Vs.

RESPONDENT:
M. V. MURUGAPPAN & ORS.

DATE OF JUDGMENT:
24/04/1970

BENCH:
SHAH, J.C.
BENCH:
SHAH, J.C.
HEGDE, K.S.
GROVER, A.N.

CITATION:
1970 AIR 1712 1971 SCR (1) 377
1970 SCC (2) 145
CITATOR INFO :
D 1980 SC 478 (8,9)

ACT:
Income Tax Act 1922, s. 2(6-4) (c)--Company in liquidation-Distribution of profits earned in year of liquidation to shareholders if liable to tax as dividend.

HEADNOTE:

The respondents were shareholders of a public limited company. The Company maintained its accounts according to the Calendar Year. The company went into liquidation on October 31, 1954. The Liquidators of the company, distributed on March 10, 1955 among the shareholders for each share of the company a share of another company a I share of equal face value. The distribution was made out of profits earned by the company between January 1, 1954 and October 31, 1954. The Income-tax officer brought the value of the shares received by the shareholders to tax on the footing that it represented "accumulated profits" as contemplated by s. 2(6A)(c) of the Income-tax Act. 1922. In appeal the Appellate Assistant Commissioner held that the profits earned between January 1, 1954 and October 31, 1954 were not accumulated profits and when distributed the amount in question represented capital in the hands of the shareholders. This order was confirmed by the Tribunal and upon a reference, by the High Court. On appeal to this Court, HELD:Dismissing the appeal,

The question whether the distribution was dividend had to be determined in the light of the provisions of s. 2(6A) (c) of the Income-tax Act as amended by the Finance Act of 1955. The amount distributed by the liquidator on March 10, 1955, represented the current profits and not profits earned before January 1, 1954. The amount distributed as dividend out of the current profits could not, in the state of law in force in the year of assessment 1955-56, be deemed dividend in the hands of the shareholders. [381 A-B]

Birch v. Cropper (1889) L.R. 14 A.C. 525; Commissioner of Inland Revenue v. George Burral (1924) 2 K.B. 52; Staffordshire Coal and Iron Co. Ltd. v. Brogan (Inspector of Taxes) 54 I.T.R. 555; Appavu Chettiar v. Commissioner of

Income-tax, Madras 29 I.T.R. 768; Girdhardas & Company Ltd. v. Commissioner of Income-tax Ahmedabad 31 I.T.R. 82; First Income-tax Officer, Salem v. Short Brothers (P) Ltd. 60 I.T.R. 82, referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 566 of 1967. Appeal from the judgment and order dated November 18, 1965 of the Madras High Court in Tax Case No. 162 of 1963. Jagadish Swarup, Solicitor-General, G. C. Sharma and B. D. Sharma, for the appellant.

378

K. Srinivasan and R., Gopalakrishnan, for respondents Nos. 1 to 10.

The judgment of the Court was delivered by Shah, J. Income-tax Appellate Tribunal submitted the under s. 66(1) of the Indian Income-tax Act, Court of Madras for opinion:

"Whether on the facts and in the circumstances of the case the Tribunal was right in holding that the sum of Rs. 81,611 and Rs. 1,491,444 were not the part of the accumulated profits of the Company as on December 31, 1954 as contemplated under s. 2(6A)(c) of the Income-tax Act of 1922

The High Court answered the question in the affirmative. The Commissioner of Income-tax asked for and obtained a certificate from the High Court only in respect of the amount of Rs. 81,611. This appeal is therefore restricted to the claim of the Revenue that the amount of Rs. 81,611 was not part of the "accumulated profits of the Company as on October 31, 1954 as contemplated by s. 2(6A)(c) of the Income-tax Act. 1922."

Ajax Products Ltd. was a public limited company incorporated in 1939. It maintained its accounts according to the calendar year. The respondents to this appeal were shareholders of the Company. The Company "went into liquidation on October 31, 1954". The liquidators of the Company distributed on March 10, 1955 to the shareholders for each share Rs. 100 by allotment of a share in Carborundum Universal Ltd. of the same face value. Between January 1, 1954 and October 31, 1954 the Company earned a profit of Rs. 1,79,704. On the profit of Rs. 1,79,704 the Company was assessed to pay Rs. 98,093 as tax, leaving a balance of Rs. 81,611 which formed part of the amount distributed. The Income-tax Officer brought the value of the share received by the shareholders to tax, on the footing that it represented "accumulated profits". In appeal the Appellate Assistant Commissioner held that under relay as it then stood, the amount of Rs. 81,611 was not accumulated profits and when distributed it was capital in the hands of, the shareholders. This order was confirmed by the Tribunal. The High Court agreed with the view of the Tribunal that under the definition of the expression "dividend" in s. 2 (6A) (c) in force in the year of assessment 1955-56 distribution of the current profits in the year in which the Company was ordered to be wound up was not dividend and was on that account not liable to be taxed as dividend,

379

Under the Indian Companies Act, 1913, no dividend could be paid otherwise than out of profits of the year or undistributed profits of previous years. A Company as a going concern may distribute by way of dividend to the

shareholders profits of the year or accumulated profits of the previous years. But a share in the assets of the Company distributed in the course of winding up is of the nature of capital and not of dividend, and it cannot be apportioned into capital and accumulated profits.

In *Birch v. Cropper*(1), Lord Macnaghten observed

"I think it rather leads to confusion to speak of the assets which are the subject of this application as 'surplus assets' as if they were an accretion or addition to the capital of the company capable of being distinguished from it and open to different considerations. They are part and parcel of the property of the company-part and parcel of the joint stock or common fund-which at the date of the winding up represented the capital of the company."

This view was affirmed in a later judgment in *Commissioner of Inland Revenue v. George Burrell*, (2) where Pollock, M. R. observed

"..... it is a misapprehension, after the liquidator has assumed his duties to continue the distinction between surplus profits and capital."

This decision was recently affirmed by the House of Lords in *Staffordshire Coal and Iron Co. Ltd. v. Brogan* (Inspector, of Taxes) (3). The House of Lords held that there was no ground for making an exception to the general rule that the surplus assets of a company, after providing for all liabilities. were divisible among its members as capital. Accordingly, the receipt by a constituent company of its appropriate proportions of the distributed surplus was a receipt of a capital nature. Lord Evershed observed at p. 5-65

"It cannot now be in doubt that surplus assets in the hands of the liquidator of a limited liability company whether limited by share capital or by guarantee-are in his hands capital. Such a conclusion was laid down by the Court of Appeal in *Inland Revenue Commissioners v. Burrell*-(1924)2 K.B. 52 (see especially per Atkin L.J.), and it has never since been questioned."

(1) (1899) L.R. 14 A.C. 525. (3) 54 I.T.R. 555.

(2) (1924) 2 K.B. 52.

380

The Indian Income-tax Act, 1922, when originally enacted, contained no definition of "dividend" : the expression "dividend" had therefore the same meaning as it had in the Indian Companies Act, 1913, and the amount distributed among the shareholders by the liquidator out of the assets of the company after meeting the liabilities was regarded as a capital' receipt in the hands of the shareholders. In 1939 the Indian Legislature incorporated by s. 2 of the Indian Income-tax (Amendment) Act 7 of 1939, an inclusive definition of the express "dividend". Clause (c) of that definition read :

"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 1 six previous years of the company preceding the date of liquidation shall be so included;"

But the profits of the year in the course of which the

Company was ordered to be wound up not being accumulated profits were not part of the dividend : Appavu Chettiar v. Commissioner of Income-tax, Madras;(1) Girdhardas & Company Ltd. v. Commissioner of Income-tax, Ahmedabad;(2) and also the observations of this Court in First Income-tax Officer, - Salem x. Short Brothers (P) Ltd.(6) at pp 88 & 89.

Clause (c) to s. 2(6A) was amended by the Finance Act of 1955 and the proviso to cl. (c) was deleted. The only effect of deleting the proviso was to remove the limitation providing that distribution of profits of the six previous years preceding the date of liquidation only was dividend. By the Finance Act of 1956, cl. (c) was replaced by the following clause :

"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;"

This amendment came into operation as from April 1, 1956.

We are in this case concerned with the distribution of Rs. 100 by allotment of a share in the Carborundum Universal Ltd. made

(1) 29 I.T.R. 768. (3) 60 I.T.R. 83

(2) 31 I.T. R. 82.

381

on March 10, 1955. The question whether the distribution was dividend had to be determined in the light of the Income-tax Act as amended by the Finance Act of 1956. The amount of Rs. 81,611 distributed by the liquidator on March 10, 1955, represented by the current profits and not profits earned before January 1, 1954. The amount distributed as dividend out of the current profits could not, in the state of the law in force in the year of assessment 1955-56, be deemed dividend in the hands of the shareholders.

The appeal therefore falls and is dismissed with costs.

R.K.P.S.

Appeal dismissed.

382