1964

April 2

BHARAT FIRE AND GENERAL INSURANCE CO. LTD. NEW DELHI

v.

THE COMMISSIONER OF INCOME TAX, NEW DELHI

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

Income Tax—Dividend declared out of premiums on shares received by a company—Amount whether receipt of dividend—Whether taxable—What is dividend—Effect of s. 78. Companies Act, 1956—Indian Income-tax Act, 1922, s. 2(6A).

The Rohtas Industries Ltd. issued in 1945 shares at a premium and the share premiums so received were kept separate under the head Capital Reserve. In the calendar year ending December 31, 1953, the company paid a sum of Rs. 50,787/- as dividend to the appellant company. For the year 1954-55, this sum was taxed in the hands of appellant as dividend by the Income-tax Officer. The Appellate Assistant Commissioner set aside the order of the Income-tax Officer, but the same was restored by the Income-tax Appellate Tribunal. The Tribunal referred to the Punjab High Court the question whether on the facts and in the circumstances of the case, the receipt of Rs. 50,787/- was a receipt of dividend and was taxable under the Indian Income-tax Act. The High Court answered the question against the appellant and the latter appealed this Court with special leave. Dismissing the appeal.

Held: The receipt of Rs. 50,787/- was a receipt of dividend and was taxable under the Indian Income-tax Act, 1922. It was well-established before the Companies Act, 1956, that premiums received on the issue of shares were profits available for distribution and the word "profits" in Regulation 97 of Table A of Companies Act 1913 should be understood to include share premiums also. S. 78 of the Companies Act does not in any way change the taxability of dividends declared out of premiums on shares received by a Company before the Act of 1956 came into force. If it was taxable, apart from s. 78, it remains so taxable.

Re Hoare & Co. Ltd., (1904) 2 Ch. 208; *Drown* v. *Gaumint-British Picture Corporation*, (1937) Ch. 402; re Duff's Settlements. *National Provincial Bank Ltd.*, vs. *Gregson*, (1961) 1 Ch. 923; *Land Revenue Commissioners* v. *Reids Trustees*, (1949) 1 All E.R. 354, referred to.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 613/1963. Appeal by special leave from the judgment dated December 12, 1960, of the Punjab High Court in Income-tax Reference No. 2 of 1958.

S. K. Kapur, K. K. Jain, Bishambar Lal Khanna and *S. Murthy*, for the appellant.

C.K. Daphtary, Attorney-General, R. Ganapathy Iyer and *R.N. Sachthey*, for the respondent.

1964

Bharat Fire and General Insurance Co. Ltd., New Delhi
v.
The Commissioner of Income Tax, New Delhi

Sikri, J.

April 2, 1964. The Judgment of the Court was delivered by

SIKRI, J.—The appellant is a Joint Stock Company, hereinafter referred to as the assessee, having its registered office in Delhi. It held 11950 'B' Preference shares in another company, called Rohtas Industries Ltd., in the previous year (calendar year ending December 31, 1953). The latter company paid a sum of Rs. 50,787/- as dividend on the said Preference Shares to the assessee, and for the assessment year 1954-55 this sum was taxed in the hands of the assessee as dividend, within s. 2(6A) of the Indian Income Tax Act, 1922, by the Income Tax Officer. The Appellate Assistant Commissioner, on appeal by the assessee, held it not to be taxable. The Income Tax Appellate Tribunal, on an appeal by the Department, however, agreed with the Income Tax Officer and allowed the appeal. On the application of the assessee, the Appellate Tribunal stated a case for the opinion of the Punjab High Court. The High Court upheld the contention of the Department and answered the question referred to it against the assessee. The assessee, after failing to get a certificate under s. 66A(2) of the Income Tax Act, obtained special leave from this Court and now the appeal is before us for disposal.

The question referred to the High Court is as follows:—

> "Whether on the facts and in the circumstances of the case, the receipt of Rs. 50,787/- was a receipt of dividend and is taxable under the Indian Income Tax Act."

The facts and circumstances referred to in the question are as follows. Rohtas Industries Ltd., hereinafter referred to as the declaring company, had in the year 1946 issued shares at a premium and the share premiums so received by it were kept separate under the head 'Capital Reserve'. The declaring company declared a dividend in the previous year of the assessee out of the above capital reserve.

The learned counsel for the assessee contends before us that the sum received by the assessee is not dividend within the definition of the word in s. 2(6A) of the Income Tax Act. He says that the share premiums were not profits capable of being distributed as profits within Regulation 97 of Table A of Companies Act of 1913 which lays down that "no dividend shall be paid otherwise than out of the profits of the year or any other undistributed profits." He argues further that it was a capital gain in the hands of the declaring company and capital gains are expressly excluded from the definition of 'dividend' by the explanation to s. 2(6A) which provides that 'the

1964

Bharat Fire and General Insurance Co. Ltd., New Delhi
v.
The Commissioner of Income-Tax, New Delhi

Sikri, J.

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'. Lastly, he urges that in any event, s. 78 of the Companies Act, 1956, has placed this sum beyond the reach of the Revenue.

Before adverting to the arguments addressed to us, it is necessary to reproduce the relevant statutory provisions. Section 2(6A) of the Income Tax Act defines 'dividend' as follows:—

"(6A) 'dividend' includes—

(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

(b).....

(c) .....

Provided that

(d) .....

Provided that .....

Provided further that 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."

Section 78, of the Companies Act, 1956, reads:—

"78. (1) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called "the share premium account"; and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the share premium account were paid-up share capital of the company.

(2) The share premium account may, notwithstanding anything in sub-section (1), be applied by the company—

(a) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the compa

3) Where a company has, before the commencement of this Act, issued any shares at a premium, this section shall apply as if the shares had been issued after the commencement of this Act:

Provided that any part of the premiums which has been so applied that it does not at the commencement of this Act from an identifiable part of the company's reserves within the meaning of Schedule VI, shall be disregarded in determining the sum to be included in the share premium account."

It is evident from the definition of the word 'dividend' that if a distribution of accumulated profits, whether capitalised or not, entails the release by the company to its shareholder of all or any part of its assets, it is dividend. It is not disputed that the distribution of Rs. 50,787/- entails the release of the assets of the declaring company. But it is contended that there was no distribution of accumulated profits, because by virtue of Regulation 97, Table A of the Companies Act, 1913, no dividend could be paid otherwise than out of the profits of the year or any other undistributed profits. It is said that the premiums received by the declaring company were not profits within Regulation 97. We are unable to accede to this contention. Previous to the enactment of s. 78 of the Companies Act of 1956, and the corresponding section in the English Companies Act, it was recognised that a company could distribute premiums received on the issue of shares as dividends (vide Palmer's Company Law, Twentieth Edition). At page 637, it is stated:

"It is evident from the preceding observations that it is legally permissible for the company to distribute dividend out of assets which do not represent profits made as the result of its trading or business. The connotation of divisible profits, or profits in the legal sense, is much wider than that of profits in the business sense: the former term includes, e.g., reserves accumulated from past profits, from realised capital profits indeed, before the requirement of a share premium account by the 1947-48 legislation, from premiums obtained on issue of

1964

Bharat Fire and General Insurance Co. Ltd., New Delhi
v.
The Commissioner of Income-Tax, New Delhi

Sikri, J.

new shares, whereas none of these items is regarded—and rightly so—by the businessman or accountant as trading profits."

Palmer relies on two cases: *Re Hoare & Co. Ltd.*,(1) and *Drown* v. *Caumin-British Picture Corporation*(2). In *Re Hoare's* (1) case the company had created a reserve fund consisting partly of premiums received on the issue of preference shares. It having incurred a loss arising from the depreciation in the value of the public houses below the amount stated in the company's balance sheet, applied for sanction of the Court to a scheme for reduction of capital whereby the company, while retaining a small portion of the reserve, attributed to the reserve more than its rateable proportion and to capital account less than that of its rateable proportion Buckley J. apparently held that these premiums were not 'profits' in the strict sense; and, on appeal, the counsel for the company contended before the Court of Appeal that this was wrong. Romer, L.J., disposed of this contention in the following words";

> "The surplus which was carried to the reserve fund represented that which might have been properly applied at the time, if the company had so thought fit, in paying further dividends to shareholders and no person could have complained if they had done so".

Thus, Romer, L.J., thought that there was nothing objectionable in utilising premiums received on the issue of shares for the purpose of declaring dividend.

In *Drown's case*(2), a company proposed to pay a dividend on its preference shares and utilise in part premiums received by the company on the issue of shares, which had in fact been invested in the assets of the company. The plaintiff asked for an injunction to restrain the company from paying the dividend. Clauson, J., held that part of a reserve fund consisting of moneys paid by way of premiums on shares, unless set aside in some particular fund which has been wholly spent, is available for dividend purposes. We are not concerned with other points that arose in the case and we have only set out the facts and findings relevant to the question before us. We may here set out Article 129 of the Gaumont-British Picture Corporation Ltd. Article 129 reads thus:—

> "The Directors may, with the sanction of a general meeting, from time to time declare dividends or bonuses, but no such dividend shall (except as by

(1) [1904] 2 Ch. 208. (2) [1937] Ch. 402.

the statutes expressly authorised) be payable otherwise than out of the profits of the company .....".

Mr. Kapur, learned counsel for the appellant, had contended that the English Law was different inasmuch as what was prohibited in English Law was payment of dividends out of capital and that it did not enjoin directors to pay dividends out of profits. This case refutes Mr. Kapur's contention. In *re Duff's Settlements, National Provincial Bank Ltd., vs. Gregson,*(1) which is strongly relied on behalf of the appellant, and which we will advert to in detail later, Jenkins, L.J., says at p. 926:—

> "The share premiums would have been profits available for distribution (see *Drown v. Gaumont-British Picture Corporation*)"(2).

It was thus well-established before the Act of 1956 and the corresponding English Act that premiums received on the issue of shares were profits available for distribution. We are of the opinion that the same connotation should be attached to the word 'profits' in Regulation 97 of Table A. In this view of the matter, it is not necessary to pronounce on the question whether even if these premiums were not profits within Regulation 97, would this necessarily exclude them from coming with the words 'accumulated profits' within s. 2(6A)(a).

This takes up to the next point raised before us: Are the premiums received on the issue of shares capital gains within the explanation to s. 2(6A)? This point was not urged before the High Court or the Appellate Tribunal and we did not allow it to be developed.

The last point may now be dealt with. In this connection it is necessary to appreciate the scheme of s. 78 of the Companies Act, 1956. Sub-section (1) enjoins a company, when it issues shares at a premium, to transfer the premiums to an account called 'the Share Premium Account' and it then applies the provisions of the Act relating to the reduction of the share capital of a company as if the share premium account were paid-up capital of the company. Sub-section (2) then provides how the share premium account may be applied. It is said that it impliedly provides that it cannot be used for the purpose of paying dividends. Sub-section (3) then deals with the issue of shares at a premium before the commencement of this Act. It deems them to have been issued after the commencement of the Act and applies the provisions of s. 78. The effect of this would be that company which has issued shares at a premium before the commencement of the Act would by

(1) [1937] Ch. 402. (2) [1951] 1 Ch. 923.

1964

Bharat Fire and General Insurance Co. Ltd., New Delhi
v.
The Commissioner of Income-Tax, New Delhi

Sikri, J.

virtue of s. 78, have to open a share premium account and transfer to it the premium so received. What is to happen if before the commencement of the Act the company has already dealt with the premiums in such a way that they had ceased to remain as an identifiable part of the company's reserves? The sub-section says that in that event the premiums so dealt with shall be disregarded in determining the sum to be included in the share premium account. If such premiums are to be disregarded for the creation of the share premium account, it means that they fall outside the purview of s. 78. It has no application to them. If this is so, it is difficult to appreciate how the appellant can utilise this section for the purpose of showing that the premiums which have already been distributed became invested with the character of capital in the hands of the distributing company. We do not say that for the purpose of income tax any future application of the share premium account in one of the ways mentioned in sub-section (2) will be treated as distribution of capital. No such question arises for our determination in this case. But we do hold that s. 78 of the Companies Act does not in any way change the taxability of dividends declared out of premiums on shares received by a Company before the Act of 1956 came into force. If it was taxable, apart from s. 78; it remains so taxable.

The case of *Duff's Settlements*(1) referred to above, on which the learned counsel strongly relied, might or might not help him if the declaration of dividend had taken place after the Act of 1956. We are of the opinion that what was decided in this case has no relevance to the facts of this appeal.

Before concluding, we may refer to the decision of the House of Lords in *Land Revenue Commissioners v. Reids Trustees*(2), relied on by the learned counsel for the respondents. This case would be relevant if we were considering generally whether the receipt of Rs. 50,787/- was income or capital in the hands of the assessee. The question, however, referred to the High Court is limited, and that is whether the receipt of Rs. 50,787/- was a receipt of dividend and taxable. It is, therefore, unnecessary to say more about this case.

In the result, we agree with the High Court that the answer to question referred to it is in the affirmative. The appeal fails and is dismissed with cost.

Appeal dismissed.

(1) [1951] 1 Ch. 923. (2) [1949] 1 All E.R. 354.