

J. DALMIA

v.

COMMISSIONER OF INCOME-TAX, NEW DELHI

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

1964

April 1

Company Law—Resolution of Board of Directors—Interim dividend—If creates a debt enforceable against the company—Income Tax—Payable on the dividend in the year in which it was actually paid, credited, or distributed or deemed to be paid—“Paid”—Meaning of—Indian Companies Act, 1913 (7 of 1913), s. 17(2), Art. 95 Sch. I—Income-tax Act, 1922 (11 of 1922), s. 16(2).

The appellant held shares in a company the Board of Directors of which by a resolution dated August 30, 1950 declared interim dividends. The appellant received a dividend warrant dated December 28, 1950 for a certain amount being the interim dividend in respect of its share holdings in the company. The appellant's year of accounting had ended on September 30, 1950. The revenue authorities brought to tax the amount so received with other income of the appellant in the assessment year 1952-53 after rejecting the objection of the appellant that it represented income for the assessment year 1951-52. In a reference made under s. 66(1) of the Indian Income-tax Act, 1922, the High Court agreed with the Revenue authority that the dividend was in view of Art. 95 of the First Schedule to Indian Companies Act, 1913, liable to be included in the assessment year 1952-53.

Held: A declaration of dividend by a company in a general meeting gives rise to a debt.

In re Severn and Wye and Severn Bridge Railway Co. (1896) 1 Ch. 559, referred to.

But a mere resolution of the Directors resolving to pay a certain amount as interim dividend does not create a debt enforceable against the company for it is always open to the Directors to rescind the resolution before payment of the dividend.

The Lagunas Nitrate Company (Ltd.) v. J. Henry Schroeder and Company, 17 Times Law Reports 625, referred to.

Commissioner of Income-tax, Bombay v. Laxmidas Mulraj Khatau, 16 I.T.R. 248, distinguished.

(ii) The test applied by Chagla C. J. (in C.I.T., Bombay v. Laxmidas Mulraj Khatau, 16 I.T.R. 248) that because the dividend becomes due to the assessee who has the right to deal with or dispose of the same in any manner he likes, it is taxable in the year in which it is declared cannot be regarded as correct.

(iii) Dividend may be said to be paid within the meaning of s. 16(2) of the Indian Income-tax Act, 1922 when the company discharges its liability and makes the amount thereof unconditionally available to the member entitled thereto.

Purshottamdas Thakurdas v. C.I.T., Bombay, 34 I.T.R. 204, referred to.

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(iv) The declaration of interim dividend capable of being rescinded by the directors does not operate as a payment under s. 16(2) of the Income-tax Act before the company has parted with the amount of dividend or discharged its obligation by some other act.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 505 of 1963. Appeal from the judgment and order dated March 6, 1961 of the Punjab High Court (Circuit Bench) at Delhi in I.T.R. No. 16 of 1959.

S. K. Kapur and *B. P. Maheshwari*, for the appellant.

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

April 1, 1964. The judgment of the Court was delivered by.

Shah, J.

SHAH, J.—The appellant which is a Hindu undivided family was the registered holder of 1,500 shares of M/s Govan Bros. (Rampur) Ltd. in the year of account October 1, 1950 to September 30, 1951. Pursuant to a resolution passed by the board of directors of M/s Govan Bros. (Rampur) Ltd.—hereinafter called 'Govan Bros.'—at a meeting held on August 30, 1950, the appellant received a dividend warrant dated December 28, 1950 for Rs. 4,12,500/- being interim dividend in respect of its share-holding in Govan Bros. This amount was brought to tax with the other income of the appellant in the assessment year 1952-53 by the Revenue authorities, after rejecting the objection of the appellant that it represented income for the assessment year 1951-52.

At the instance of the appellant the Appellate Tribunal drew up a statement of the case and referred the question set out hereinbelow to the High Court of Punjab under s. 66(1) of the Indian Income-tax Act:

“Whether on a true interpretation of Article 95 of the First Schedule to the Indian Companies Act, 1913, the dividend of Rs. 4,12,500/- was liable to be included in the assessment year 1952-53.”

The High Court recorded an answer to the question in the affirmative. Against the order of the High Court, this appeal is preferred by the appellant with certificate granted by the High Court.

Even though the question was framed as if article 95 of the First Schedule to the Indian Companies Act, 1913, applies to Govan Bros, it is common ground that the company

was registered under the Companies Act of the former Rampur State, and it had adopted special Articles of Association in supersession of Table A of the Companies Act. The relevant articles of Govan Bros. dealing with declaration or payment of final and interim dividends were articles 73 and 74. The High Court therefore proceeded to deal with the question on the footing that it was, by the question referred, called upon to interpret article 74 of the Articles of Association of Govan Bros. It is common ground between the appellant and the Revenue that the provisions of the Companies Act of the former Rampur State were in terms identical with the provisions of the Indian Companies Act, 1913.

The appellant contends that the directors of Govan Bros. had in exercise of authority expressly conferred upon them by article 74 declared dividend in their meeting dated August 30, 1950 and on such declaration the dividend became a debt due to the appellant and under the Indian Income-tax Act it became taxable in the year of assessment 1951-52, for the previous year of the appellant had ended on September 30, 1951. The Commissioner of Income-tax says that the directors of Govan Bros. had paid by warrant issued on December 28, 1950 pursuant to a resolution dated August 30, 1950, interim dividend and it was only on payment the dividend became taxable under s. 16(2) of the Indian Income-tax Act. It is said by the Commissioner that dividend final or interim is taxable not in the year in which it is declared but only in the year in which it is paid, credited or distributed, or deemed to be paid, credited or distributed, and that in any event a resolution by the Board of Directors to pay interim dividend does not create an enforceable obligation, for it is always open to the directors to rescind the resolution for payment of dividend even if it is one in form declaring dividend.

The Indian Companies Act, 1913 contains no provision for declaration of dividend either interim or final: it does not say as to who shall declare the dividend, nor does it say that dividend may be declared in a general meeting of the company. But s. 17(2) provides that the company may adopt all or any of the regulations contained in Table A in the First Schedule to the Companies Act as its articles of association, and shall in any event be deemed to contain regulations identical with or to the same effect, amongst others, as regulation 95 and regulation 97 contained in that Table. Regulation 95 of Table A provides that the company in general meeting may declare dividends, but no dividends shall exceed the amount recommended by the directors, and regulation 97 states that no dividends shall be paid otherwise than out of profits of the year or any other undistributed profits. Regulation 96, which is not an obligatory article, provides that the

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directors may from time to time pay to the members such interim dividends as appear to the directors to be justified by the profits of the company. Govan Bros. had in their Articles of Association made the following provision with regard to dividends:

“Art. 73. The Company in general meeting may declare a dividend to be paid to the members according to their rights and interests in the profits.

Art. 74. When in their opinion the profits of the company permit, the directors may declare an interim dividend.

Art. 77. No dividend shall be payable, except out of the net profits arising from the business of the company, and no larger dividends shall be declared than is recommended by the directors.”

By Art. 80 it was provided that unless otherwise directed by the company in general meeting any dividends may be paid by cheque or warrant sent through the post to the registered address of the member entitled to the same. In Art. 74 relating to payment of interim dividend, there was a slight departure from the regulation under Table A of the First Schedule to the Companies Act. Whereas under regulation 96 Table A the directors are authorised to *pay* to the members interim dividends, by Art. 74 of the Articles of Association of Govan Bros. the directors are authorised to *declare* interim dividend. It may be noticed that under s. 17, adoption of an article in form identical with, or to the same effect as regulation 96 of Table A, is not made obligatory.

The material part of s. 16(2) of the Income-tax Act as it stood before it was deleted by s. 7 of the Finance Act, 1959 with effect from April 1, 1960, read as follows:

“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 * * *”

The clause in terms made dividend the income of the year in which it was paid, credited or distributed or was deemed to have been paid, credited or distributed. In the present case dividend was paid to the appellant on December 28, 1950. It is not the case of the appellant that the amount was either credited in the books of account of Govan Bros. to the appellant or was distributed or deemed to have been paid, credited or distributed to the appellant before the close of the appellant's year of account ending September 30, 1950. But Mr. Kapur contends that under the law governing companies

on declaration, dividend interim or final becomes due, and it must be regarded for the purpose of the Income-tax Act as paid to the member on the date on which it is declared.

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There is no doubt that a declaration of dividend by a company in general meeting gives rise to a debt. "When a company declares a dividend on its shares, a debt immediately becomes payable to each shareholder in respect of his dividend for which he can sue at law, and the Statute of Limitation immediately begins to run": *In re Severn and Wye and Severn Bridge Railway Company*(¹). But this rule applies only in case of dividend declared by the company in general meeting. A final dividend in general may be sanctioned at an annual meeting when the accounts are presented to the members. But power to pay interim dividend is usually vested, by the articles of association, in the directors. For paying interim dividend a resolution of the company is not required: if the directors are authorised by the articles of association they may pay such amount as they think proper, having regard to their estimate of the profits made by the company. Interim dividend is therefore paid pursuant to the resolution of the directors on some day between the ordinary general meetings of the company. On payment, undoubtedly interim dividend becomes the property of the shareholder. But a mere resolution of the directors resolving to pay a certain amount as interim dividend does not create a debt enforceable against the company, for it is always open to the directors to rescind the resolution before payment of the dividend. In *The Laganas Nitrate Company (Limited) v. J. Henry Schroeder and Company* (²) the directors of a company passed a resolution declaring interim dividend payable on a future date, and requested the company's bankers to set apart, out of the money of the company in their hand, into a special account entitled "interim Dividend Account", a sum sufficient to cover the dividend, pending the company's instructions. But before the date fixed for payment, the directors resolved that pending certain litigation to which the company was a party, payment of dividend be postponed. It was held by the Court that the directors had the right even after resolving to pay interim dividend to rescind the resolution and no enforceable right arose in favour of the members of the company by the declaration of interim dividend.

In Halsbury's Laws of England, III Edn., Vol. 6 p. 402, Art. 778, it has been stated:

"A directors' declaration of an interim dividend may be rescinded before payment has been made."

(¹) (1896) 1 Ch. 559.

(²) 17 Times Law Reports 625.

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Therefore a declaration by a company in general meeting gives rise to an enforceable obligation, but a resolution of the Board of Directors resolving to pay interim dividend or even resolving to declare interim dividend pursuant to the authority conferred upon them by the articles of association gives rise to no enforceable obligation against the company, because the resolution is always capable of being rescinded. Therefore departure in the text of Art. 74 of the Articles of Association of Govan Bros. from the statutory version under Table A of the power in respect of interim dividend which may be entrusted to the directors, makes no real difference in the true character of the right arising in favour of the members of the company on execution of the power. The directors by the Articles of Association are entrusted with the administration of the affairs of a company; it is open to them if so authorised to declare interim dividend. They may, but are not bound to, pay interim dividend, even if the finances of the company justify such payment, even if the directors have resolved to pay interim dividend, they may before payment rescind the resolution.

Counsel for the appellant does not rely upon any evidence of actual payment or upon any credit given to the appellant in the books of account of the company nor upon any distribution. Even the resolution of the directors of August 30, 1950 is not on the record, and there is no evidence that it was resolved to pay the dividend on any date before it was actually paid, and the company had taken any step to implement the resolution within the year of account corresponding to the assessment year 1951-52. There is no statutory provision which gives rise to a fiction that on declaration of interim dividend, it should be deemed to be paid, credited or distributed.

In support of the plea that interim dividend was taxable in the year of assessment 1951-52, the appellant relies upon two facts only—the power vested in the directors to declare interim dividend, and the passing of a resolution by the directors relating to interim dividend on August 30, 1950 followed by the drawing of dividend warrants dated December 28, 1950. But for reasons already stated a resolution of the board of directors declaring interim dividend, until it is implemented by some step taken by the company, creates no enforceable right in the shareholders. The judgment of the Bombay High Court in *Commissioner of Income-tax, Bombay v. Laxmidas Mulraj Khatau*⁽¹⁾ on which counsel for the appellant relies, does not assist him either. In that case the company declared a dividend out of its profits, and made it payable a few days later. The dividend was paid on the

(1) 16 I.T.R. 248.

date on which it was made payable by the resolution of the company. The Income-tax Officer treated the amount received by the member as dividend income for the assessment year in which it was actually received. The High Court of Bombay in a reference under s. 66 observed that as soon as the dividend was declared it became the income of the assessee which income the assessee could deal with or dispose of in any manner he liked. Chagla C. J., speaking for the Court enunciated the law as follows:

“It is impossible to give a literal construction to the expression “paid” used in this sub-section (sub-s. (2) of s. 16). If a literal construction were to be given, then it would amount to this that “until the dividend warrant was actually cashed and the dividend amount was actually realised it cannot be stated that the dividend was paid to the shareholder. * * * * * I think the proper construction to give to that word is when the dividend is declared then a liability arises on the part of the company to make that payment to the shareholder and with regard to the shareholder when the income represented by that dividend accrues or arises to him. The mere fact that the actual payment of the income is deferred is immaterial and irrelevant.”

But whether dividend—interim or fixed—is income taxable in a particular year of assessment must be determined in the light of s. 16(2) of the Indian Income-tax Act. The Legislature had not made dividend income taxable in the year in which it becomes due: by express words of the statute, it is taxable only in the year in which it is paid, credited or distributed or is deemed to be paid, credited or distributed. The Legislature has made distinct provisions relating to the year in which different heads of income become taxable. Salary becomes taxable by s. 7 when it is allowed to the employee or becomes due to him, whether it is actually paid to him or not. Interest on securities under s. 8 is taxable when it is received by the assessee. Under s. 9 tax on property becomes payable not on any actual receipt of income from the property but on a purely national computation in the year of account of a *bona fide* annual value of the property, subject to the adjustments provided in that section. Profits and gains of business, profession or vocation carried on by an assessee are computed in accordance with the method of accounting regularly employed by the assessee, unless the Income-tax Officer being of the opinion that profits or gains cannot properly be deduced therefrom, directs otherwise. Other sources of income—and dividends are included in this residuary class—become taxable in the year in which they

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are received or accrue or arise or are deemed to be received, accrued or arise, according to the nature of the particular income. The year in which a particular class of income becomes taxable must therefore be determined, in the light of its true character, and subject to the special provision, if any, applicable thereto. The Legislature has enacted an express provision making dividend income taxable in the year in which it is paid, credited or distributed or is to be deemed, so paid, credited or distributed. The test applied by Chagla C. J., that because the dividend becomes due to the assessee who has the right to deal with or dispose of the same in any manner he likes, it is taxable in the year in which it is declared, cannot be regarded as correct. The expression "paid" in s. 16(2) it is true does not contemplate actual receipt of the dividend by the member. In general, dividend may be said to be paid within the meaning of s. 16(2) when the company discharges its liability and makes the amount of dividend unconditionally available to the member entitled thereto. Chagla C. J., has himself in *Purshotamdas Thakurdas v. Commissioner of Income-tax, Bombay City I*⁽¹⁾ expressed a different view. The learned Chief Justice in delivering the judgment of the court referred to *Laxmidas Mulraj Khatau's case* (3) and observed that the principle of that case applied only to those cases where in facts the dividend was paid to the shareholder and not to cases where a contingent liability was undertaken and no payment was made. He observed:

" * * * one thing is clear from the language used by the Legislature that it did not intend to equate "paid" with "declared" in every case. Therefore, it is open to us to consider, notwithstanding the Khatau Mills' case, whether on the facts of this case, it could be said that dividend has been paid, which although it may have been declared may never be payable and in fact has not been paid."

If the mere declaration of dividend in general meeting of the company is not to be regarded as payment within the meaning of s. 16(2), much less can it be said that a resolution declaring interim dividend—which is capable of being rescinded by directors—operates as payment before the company has actually parted with the amount of dividend or discharged obligation by some other act. The High Court was therefore right in recording an affirmative answer to the question propounded for the consideration of the Court.

The appeal fails and is dismissed with costs.

Appeal dismissed.

(1) 34 I.T.R. 204.