

SUPREME COURT OF INDIA

Mrs. Bacha F. Guzdar

v.

Commissioner of Income-tax

MEHR CHAND MAHAJAN, C.J. AND S.R. DAS, GHULAM HASAN, N.H. BHAGWATI AND T.L. VENKATARAMA
AYYAR, JJ.

IT APPEAL NO. 5228 OF 1950-51 (CIVIL APPEAL NO. 104 OF 1954)

OCTOBER 28, 1954

Jamshedji Kanga, R.J. Kolah, M.M. Jhavari and Rajinder Narain for the Appellant.

M.C. Setalvad, G.N. Joshi and R.H. Dhebar for the Respondent.

JUDGMENT

Ghulam Hasan, J.—This appeal raises an interesting point of law under the Indian Income-tax Act.

The question referred by the Tribunal to the High Court of Judicature at Bombay was stated thus:

"Whether 60% of the dividend amounting to Rs. 2,750 received by the assessee from the two tea companies is agricultural income and as such exempt under section 4(3) (viii) of the Act."

Chagla, C.J., and Tendolkar, J., who heard the reference, answered the question in the negative by two separate but concurring judgments dated 28th March, 1952.

The facts lie within a narrow compass. The appellant, Mrs. Bacha F. Guzdar, was, in the accounting year 1949-50, a shareholder in two tea companies, Patrakola Tea Company Ltd., and Bishnauth Tea Company Ltd., and received from the aforesaid companies dividends aggregating to Rs. 2,750. The two companies carried on business of growing and manufacturing tea. By rule 24 of the Indian Income-tax Rules, 1922, made in exercise of the powers conferred by section 59 of the Indian Income-tax Act, it is provided that "income derived from the sale of tea grown and manufactured by the seller in the taxable territories shall be computed as if it were income derived from business and 40% of such income shall be deemed to be income, profits and gains, liable to tax." It is common ground that 40% of the income of the tea companies was taxed as income from the manufacture and sale of tea and 60% of such income was exempt from tax as agricultural income. According to the appellant, the dividend income received by her in respect of the shares held by her in the said tea companies is to the extent of 60% agricultural income in her hands and therefore pro tanto exempt from tax while the Revenue contends that dividend income is not agricultural income and therefore the whole of the income is liable to tax. The Income-tax Officer and, on appeal, the Appellate Assistant Commissioner both concurred in holding the whole of the said income to be liable to tax. The Income-tax Appellate Tribunal confirmed the view that the dividend income could not be treated as agricultural income in the hands of the shareholder and decided in favour of the Revenue, but agreed that its order gave rise to a question of law and formulated the same as set out above and referred it to the High Court. The High Court upheld the order of the Tribunal but granted leave to appeal, to this Court.

The question, we comprehend, is capable of an easy solution and can best be answered by reference to the material provisions of the Income-tax Act. Under section 2(1) "agricultural income" means:

"(a) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land-revenue in the taxable territories or subject to a local rate assessed and collected by officers of the Government as such;..."

Sub-section (15) of section 2 defines "total income" as total amount of income, profits and gains, referred to in sub-section (1) of section 4 computed in the manner laid down in this Act. Section 3 authorises income-tax to be charged upon a person in respect of the total income of the previous year. Section 4 lays down that the total income of any previous year of any person to be charged must include all income, profits and gains, from whatever source derived and defines the scope of its application for purposes of tax. Sub-section (3) of the same section enacts certain exemptions upon the chargeability of the income and clause (viii) includes agricultural income in the category of exemptions. Section 6 mentions the various heads of income, profits and gains, chargeable to income-tax including in that category clause (v), "income from other sources". It is common ground that dividend falls under this category.

In order, however, that dividend may be held to be agricultural income it will be incumbent upon the appellant to show that, within the terms of the definition, it is rent or revenue derived from land which is used for agricultural purposes. Mr. Kolah, for the appellant, contends that it* is revenue derived from land because 60% of the profits of the company out of which dividends are payable are referable to the pursuit of agricultural operations on the part of the company. It is true that the agricultural process renders 60% of the profits from land which is used for agricultural purposes exempt from tax in the hands of the company but can it be said that when such company decides to distribute its profits to the shareholders and declares the dividends to be allocated to them, such dividends in the hands of the shareholders also partake of the character of revenue derived from land which is used for agricultural purposes? Such a position if accepted would extend the scope of the vital words "revenue derived from land" beyond its legitimate limits. Agricultural income as defined in the Act is obviously intended to refer to the revenue received by direct association with the land which is used for agricultural purposes and not by indirectly extending it to cases where that revenue or part thereof changes hands either by way of distribution of dividends or otherwise. In fact and truth dividend is derived from the investment made in the shares of the company and the foundation of it rests on the contractual relations between the company and the shareholder. Dividend is not derived by a shareholder by his direct relationship with the land. There can be no doubt that the initial source which has produced the revenue is land used for agricultural purposes but to give to the words "revenue derived from land" the unrestricted meaning apart from its direct association or relation with the land, would be quite unwarranted. For example, the proposition that a creditor advancing money on interest to an agriculturist and receiving interest out of the produce of the lands in the hands of the agriculturist can claim exemption of tax upon the ground that it is agricultural income within the meaning of section 4, sub-section (3) (viii), is hardly statable. The policy of the Act as gathered from the various sub-clauses of section 2(1) appears to be to exempt agricultural income from the purview of the Income-tax Act. The object appears to be not to subject to tax either the actual tiller of the soil or any other person getting land cultivated by others for deriving benefit therefrom, but to say that the benefit intended to be conferred upon this class of persons should extend to those into whosoever hands that revenue falls, however remote the receiver of such revenue may be, is hardly warranted.

It was argued by Mr. Kolah on the strength of an observation made by Lord Andersqn in *Commissioners of Inland Revenue v. Forrest* [1924] 8 Tax Cas. 704 at 710 that an investor buys in the first place a share of the assets of the industrial concern proportionate to the number of shares he has purchased and also buys the right to participate in any profits which the company may make in the future. That a shareholder acquires a right to participate in the profits of the company may be readily conceded but it is not possible to accept the contention that the shareholder acquires any interest in the assets of the company. The use of the word "assets" in the passage quoted above cannot be exploited to warrant the inference that a shareholder, on investing money in the purchase of shares, becomes entitled to the assets of the company and has any share in the property of the company. A shareholder has got no

interest in the property of the company though he has undoubtedly a right to participate in the profits if and when the company decides to divide them. The interest of a shareholder vis-a-vis the company was explained in the Sholapur Mills case [1950] SCR 869 at 904. That judgment negatives the position taken up on behalf of the appellant that a shareholder has got a right in the property of the company. It is true that the shareholders of the company have the sole determining voice in administering the affairs of the company and are entitled, as provided by the articles of association, to declare that dividends should be distributed out of the profits of the company to the shareholders but the interest of the shareholder either individually or collectively does not amount to more than a right to participate in the profits of the company. The company is a juristic person and is distinct from the shareholders. It is the company which owns the property and not the shareholders.

The dividend is a share of the profits declared by the company as liable to be distributed among the shareholders. Reliance is placed on behalf of the appellant on a passage in Buckley's Companies Act (12th Ed., page 894) where the etymological meaning of dividend is given as dividendum, the total divisible sum, but in its ordinary sense it means the sum paid and received as the quotient forming the share of the divisible sum payable to the recipient. This statement does not justify the contention that shareholders are owners of a divisible sum or that they are owners of the property of the company. The proper approach to the solution of the question is to concentrate on the plain words of the definition of agricultural income which connects in no uncertain language revenue with the land from which it directly springs and a stray observation in a case which has no bearing upon the present question does not advance the solution of the question. There is nothing in the Indian law to warrant the assumption that a shareholder who buys shares buys any interest in the property of the company which is a juristic person entirely distinct from the shareholders. The true position of a shareholder is that on buying shares an investor becomes entitled to participate in the profits of the company in which he holds the shares if and when the company declares, subject to the articles of association, that the profits or any portion thereof should be distributed by way of dividends among the shareholders. He has undoubtedly a further right to participate in the assets of the company which would be left over after winding up but not in the assets as a whole as Lord Anderson puts it.

The High Court expressed the view that until a dividend is declared there is no right in a shareholder to participate in the profits and according to them the declaration of dividend by the company is the effective source of the dividend which is subject to tax. This statement of the law we are unable to accept. Indeed the learned Attorney-General conceded that he was not prepared to subscribe to that proposition. The declaration of dividend is certainly not the source of the profit. The right to participation in the profits exists independently of any declaration by the company with the only difference that the enjoyment of profits is postponed until dividends are declared.

It was argued that the position of shareholders in a company is analogous to that of partners inter se. This analogy is wholly inaccurate. Partnership is merely an association of persons for carrying on the business of partnership and in law the firm name is a compendious method of describing the partners. Such is, however, not the case of a company which stands as a separate juristic entity distinct from the shareholders. In Halsbury's Laws of England, Vol. 6 (3rd Ed.), page 234, the law regarding the attributes of shares is thus stated:

"A share is a right to a specified amount of the share capital of a company carrying with it certain rights and liabilities while the company is a going concern and in its winding up. The shares or other interest of any member in a company are personal estate transferable in the manner provided by its articles, and are not of the nature of real estate."

In *Borland's Trustee v. Steel Brothers & Co. Ltd.* [1901] 1 Ch. 279 Farwell, J., held that "a share in a company cannot properly be likened to a sum of money settled upon and subject to executory

limitations to arise in the future; it is rather to be regarded as the interest of the shareholder in the company, measured, for the purposes of liability and dividend, by a sum of money....." It was suggested that the dividend« arises out of the profits accruing from land and is impressed with the same character as the profits and that it does not change its character merely because of the incident that it reaches the hands of the shareholder. This argument runs counter to the definition of agricultural income which emphasizes the necessity of the recipient of income having a direct and an immediate rather than an indirect and remote relation with land. To accept this argument will be tantamount to saying that the creditor recovering interest on money debt due from the agriculturist who pays out of the produce of the land is equally entitled to the exemption. In fairness to Mr. Kolah it must, however, be stated that the contention was not so broadly put but there is no reason why one should stop at a particular stage and not pursue the analogy to its logical limits.

English decisions resting upon the peculiarities of the English Income-tax law can hardly be a safe guide in determining upon the language of the Indian Income-tax Act the true meaning of the word "agricultural income". A few cases of the Privy Council decided with reference to the provisions of the Indian Income-tax Act, however, deserve notice. The first case, viz., Commissioner of Income-tax v. Raja Bahadur Kamakshya Narayan Singh [1948] 16 ITR 325 dealt with the question whether interest on arrears of rent payable in respect of land used for agricultural purposes is agricultural income and therefore exempt from income-tax. It was held that it was neither rent nor revenue derived from land within the meaning of section 2(1) of the Income-tax Act. Lord Uthwatt who delivered the judgment of the Privy Council used the following piquant language in coming to that conclusion;

"The word 'derived' is not a term of art. Its use in the definition indeed demands an enquiry into genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent, which has suffered the accident-of non-payment. And rent is not land within the meaning of the definition."

The second case, viz., Premier Construction Co., Ltd. v. Commissioner of Income-tax [1948] 16 ITR 380 (Bom.), dealt with the nature of the commission of a managing agent of the company a part of whose income was agricultural income. The assessee claimed exemption from tax on the ground that his remuneration at 10% of the profits was calculated with reference to the income of the company part of which was agricultural income. It was held that the assessee received no agricultural income as defined by the Act but that he received a remuneration under a contract for personal service calculated on the amount of profits earned by the employer, payable not in specie out of any item of such profits, but out of any moneys of the employer available for the purpose, and that the remuneration therefore was not agricultural income and was not exempt from tax. Sir John Beaumont in the above case observed :

"In their Lordships' view the principle to be derived from a consideration of the terms of the Income-tax Act and the authorities referred to is that where an assessee receives income, not itself of a character to fall within the definition of agricultural income contained in the Act, such income does not assume the character of agricultural income by reason of the source from which it is derived, or the method by which it is calculated."

In the third case, viz., Maharajkumar Gopal Saran Narain Singh v. Commissioner of Income-tax [1935] 3 ITR 237 , an annual payment for life to the assessee was not held to be agricultural income and therefore not exempt from tax where the annuity arose out of a transfer made by the assessee of a portion of his estate for discharging his debts and for obtaining an adequate income for his life it being held that it was not rent or revenue derived from land but money paid under a contract imposing personal liability on the covenantor the discharge of which was secured by a charge on land. But reliance was placed upon another judgment of the Privy Council in the same volume at page 305 in

Commissioner of Income-tax v. Sir Kameshwar Singh [1935] 3 ITR 305 . That was a case of a usufructuary mortgagee the profits received by whom were exempt from income-tax on the ground that they were agricultural income in his hands. Lord Macmillan, after referring to certain sections of the Act, observed that " the result of those sections is to exclude agricultural income altogether from the scope of the Act howsoever or by whomsoever it may be received." These observations must be held to be confined to the facts of that particular case which was a case of usufructuary mortgagee who had received profits directly from the land. The obvious implication of the words used by Lord Macmillan was that whosoever receives profit from the land directly is entitled to the exemption.

Reference was also made to some English decisions but they have no bearing upon the present case as they were founded on the English income-tax law and the provisions of the particular statute.

The learned Attorney-General also contended that the conclusion that dividend is not agricultural income also follows from the provisions of section 16, sub-section (2), and the proviso to the Act. According to him, this section compels the assessee to show in his return the whole dividend including the portion which is excluded on the ground of agricultural income. We do not consider it necessary to express any opinion upon this contention as our conclusion reached as a result of the foregoing discussion is sufficient to dispose of the appeal. We accordingly dismiss the appeal with costs.