



The Supreme Court affirms the constitutional validity of dividend distribution tax on composite income of tea companies

Background

The Supreme Court of India in the case of Tata Tea Co. Ltd¹ (the taxpayer) while dealing with the issue with respect to the constitutional validity of Dividend Distribution Tax (DDT) on composite income of the tea company held that the provisions of Section 115-O of the Income-tax Act, 1961 (the Act) are well within the competence of Parliament. To put any limitation in the said provision that additional tax can be levied only on the 40 per cent of the dividend income shall be altering the provision of Section 115-O of the Act for which there is no warrant. Accordingly, DDT under Section 115-O of the Act will be applicable on entire dividend income of the tea company.

Facts of the case

- The taxpayer is a tea company which cultivates tea in gardens and processes it in its own factory/plants for marketing the same. The cultivation of tea is an agricultural process, although processing of tea in the factory is an industrial process. The agricultural income is within the legislative competence of the State and not in the legislative competence of the Parliament. Section 115-O of the Act imposes a tax on the dividend distributed by the company which is nothing but imposing the tax on the agricultural income of the taxpayer.
- The taxpayer and others filed a writ petition where the vires of Section 115-O of the Act was challenged in so far as it purports to levy the income tax on the profit which is decided to be distributed as dividend. Thereby imposing an additional income-tax even on the portion of the composite income which represents agricultural income and which is also to be made available for the distribution of dividend and, therefore, transgresses the limits of legislative power. The Parliament has no competence to levy income tax on agricultural income.

- The writ petition was dismissed by single judge vide its decision dated 20 September 2001 against which appeals were filed before the Division Bench of the Calcutta High Court. Subsequently, the Calcutta High Court vide its decision dated 28 July 2006 disposed of the appeals, setting aside the decision of the single judge.
- These appeals² have been filed by the Union of India against the Calcutta High Court's decision dated 28 July 2006 by which decision although, the Calcutta High Court has upheld the constitutionality of Section 115-O of the Act, but a rider has been put that additional income tax to be charged under Section 115-O of the Act can only be on 40 per cent of income which is taxable under the Act.
- Similarly, the appeal³ has been filed by the taxpayer who had also challenged the constitutional validity of Section 115-O of the Act before the Gauhati High Court. However, writ petition on the same has been dismissed vide order dated 22 June 2007. The Gauhati High Court had also considered the decision of the Calcutta High Court dated 28 July 2006.

Taxpayer's contentions

- Section 115-O of the Act imposes an additional tax on the dividend distributed by the company which arises out of the income received from agriculture. 60 per cent of the income of the taxpayer is the agricultural income which is exempt from tax.

¹ Union of India v. Tata Tea Co. Ltd. & Anr (CA No. 9178 of 2012) – Taxsutra.com

² Civil Appeal No. 9178 of 2012 and Civil Appeal No. 9180 of 2012

³ Civil Appeal No. 9179 of 2012

- The Parliament has no legislative competence to tax the agricultural income. Section 115-O of the Act transgresses the legislative field which is assigned to the State Legislature under List II Entry 46 of Seventh Schedule of the Constitution of India.
- At best, the amount of dividend distributed by the company to the extent of 40 per cent on which income tax is charged can only be subject to additional tax. The Parliament cannot touch the agricultural income.
- As per Entry 82, Union/Parliament has full power to legislate in the field of 'taxes on income'. The subject excluded from its field are agricultural income. The word income has been defined in the Act in Section 2(24) and is the inclusive definition including specifically 'dividend'. The dividend is statutorily regulated and under the article of association of companies are required to be paid as per the Rules of the companies to the shareholders.

Tax department's contention

- The dividend which is decided to be distributed by the company to its shareholders no longer remains an agricultural income. The company is being asked to pay additional tax on the amount of dividend distributed by it and not on its agricultural income. The Parliament has the full legislative competence to enact Section 115-O of the Act. Both, the Calcutta High Court and Gauhati High Court have rightly held that provisions of Section 115-O of the Act are *intra vires*.
- Section 115-O pertains to declaration, distribution or payment of a dividend by domestic company and imposition of additional tax on the dividend is thus clearly covered by subject as embraced by Entry 82. However, it has been observed that the provisions of Section 115-O cannot be said to be directly included in the field of tax on agricultural income.

Supreme Court's decision

- Part XI of the Constitution of India contains provisions relating to the distribution of legislative powers. Article 246 provides for the subject matter of laws made by the Parliament and by the Legislatures of States. Article 246 of the Constitution of India begins with a non obstante clause that is 'Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule'⁴.
- The State as per clause (3) of Article 246 subject to clauses (1) and (2) of Article 246 has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule⁵.
- The definition of agricultural income was contained in Section 2(1A) of the Act. The words agricultural income as used in the legislative entries, thus, has to be given the meaning as contained in Act.
- The Supreme Court has time and again emphasised that in the event of any overlap between the two entries of the Seventh Schedule or two legislations, it is the duty of the Court to find out its true intent and purpose and to examine the particular legislation in its pith and substance. The Supreme Court referred various decisions⁶.
- Even if for the sake of argument it is considered that the provision trenches the field covered by Entry 46 of List II, the effect is only incidental, and the legislation cannot be annulled on the ground of such incidental trenching in the field of the State legislature. Looking to the nature of the provision of Section 115-O and its consequences, the pith, and substance of the legislation is clearly covered by Entry 82 of List I. The Supreme Court repel the argument of the taxpayers that provision of Section 115-O is beyond the legislative competence of the Parliament.
- The Guahati High Court has dismissed the writ petition whereas the Calcutta High Court while upholding the vires of Section 115-O of the Act has put a rider that the additional tax as levied by Section 115-O on the dividend declared, distributed or paid additional tax shall be only to the extent of 40 per cent which is taxable income of the Tea Company.
- The Supreme Court referred various decisions⁷ wherein the Supreme Court had occasion to consider the nature of income in the hands of shareholders of company consequent to the payment of dividend amount. The Supreme Court in the case of Nalin Behari Lal Singha⁸ held that dividend distributed by a company being a share of its profits declared as distributable among the shareholders, is not impressed with the character of the profits from which it reaches the hands of the shareholder.

⁴ Taxes on income other than agricultural income

⁵ Taxes on agricultural income

⁶ Kartar Singh v. State of Punjab, 1994 (3) SCC 569, Union of India and others v. Shah Govedhan L. Kabra Teachers' College, 2002 (8) SCC 228

⁷ Mrs. Bacha F. Guzdar, Bombay v. CIT [1955] 27 ITR 1 (SC), CIT v. Nalin Behari Lal Singha, etc., 1969 (2) SCC 310

⁸ CIT v. Nalin Behari Lal Singha, etc., 1969 (2) SCC 310

- The Supreme Court find substances in the contention of the Union of India that when the dividend is declared to be distributed and paid to company's shareholder, it is not impressed with the character of source of its income.
- The provisions of Section 115-O of the Act are well within the competence of Parliament. To put any limitation in the said provision as held by the Calcutta High Court that additional tax can be levied only on the 40 per cent of the dividend income shall be altering the provision of Section 115-O of the Act for which there is no warrant. The Calcutta High Court has upheld the vires of Section 115-O of the Act, no further order was necessary for that writ petition.

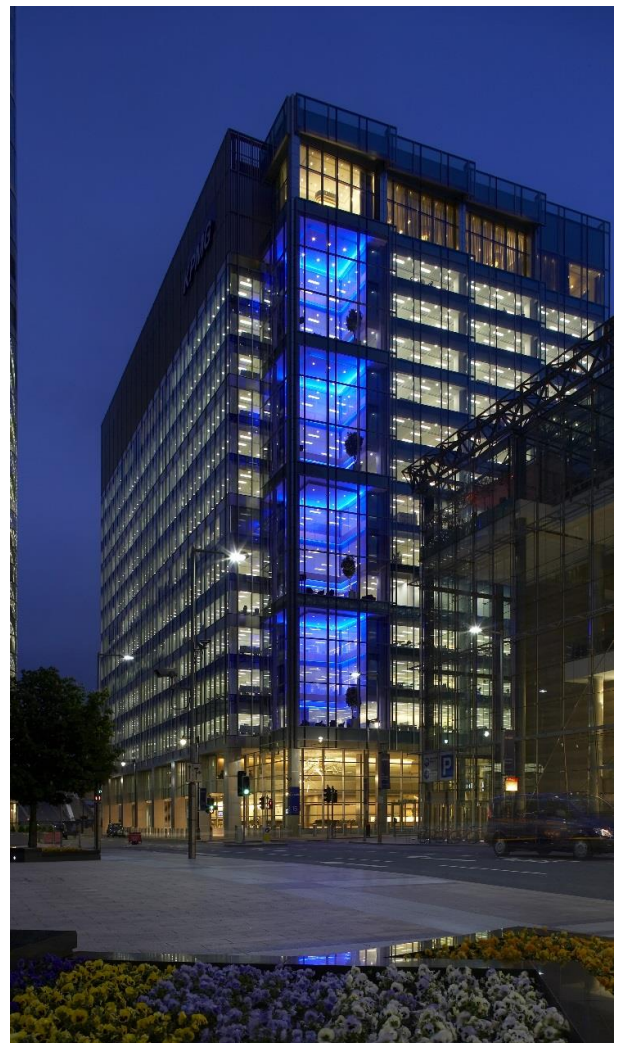
Our comments

As per Rule 8 of the Income-tax Rules, 1962 (the Rules), income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and forty per cent of such income shall be deemed to be income liable to tax. However, balance 60 per cent will be treated as agricultural income, exempt from tax.

In instant case, the taxpayer (a tea company) filed a writ petition where the vires of Section 115-O of the Act was challenged in so far as it purports to levy the income tax on the profit which is decided to be distributed as dividend. Thereby imposing an additional income-tax even on the portion of the composite income which represents agricultural income and which is also to be made available for the distribution of dividend. The taxpayer claimed that the Parliament has no competence to levy income-tax on such agricultural income.

Earlier the Calcutta High Court in the taxpayer's case while upholding the vires of Section 115-O of the Act has put a rider that the additional tax as levied by Section 115-O of the Act on the dividend declared, distributed or paid shall be only to the extent of 40 per cent which is taxable income of the tea company.

In the present case, the Supreme Court of India while dealing with this issue held that the provisions of Section 115-O of the Act are well within the competence of the Parliament. To put any limitation in the said provision that additional tax can be levied only on the 40 per cent of the dividend income shall be altering the provision of Section 115-O of the Act for which there is no warrant.



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