

(1976) 04 MAD CK 0018

In the Madras High Court

Case No : Tax Case No. 280 of 1971 (Reference No. 101 of 1971)

Commissioner of Income Tax

APPELLANT

Vs

Amalgamations (P.) Ltd.

RESPONDENT

Date of Decision : 15-04-1976

Acts Referred:

Income Tax Act, 1922 — Section 23A

Citation : (1977) 109 ITR 115

Hon'ble Judges : V. Ramaswami, J;Sethuraman, J

Bench : Division Bench

Advocate : J. Jayaraman and Nalini Chidambaram, for the Appellant; K.R. Ramamani, assisted by S.V. Subramaniam, for Subbaraya Aiyar, Sethuraman and Padmanabhan, for the Respondent

Judgement

Sethuraman, J.—This reference arises out of the proceedings u/s 23 A of the Indian Income Tax Act, 1922, for the assessment year 1960-

61. The assessee is a holding company which has several subsidiaries. It is a company in which the public are not substantially interested. The

relevant previous year ended on 30th June, 1959. When the Income Tax Officer considered the application of Section 23A to this company, he

had already made an assessment on it for the relevant year on a total income of Rs. 25,79,508. After deducting the taxes and outgoings, there was

a distributable surplus, out of the assessable income, of Rs. 18,12,622. On the basis that the assessee is a company whose business consisted

wholly or mainly in the holding of investments, the assessee should have distributed 90% of the aforesaid distributable surplus, which came to Rs.

16,31,360. The assessee had, however, declared only a sum of Rs. 7,80,000 as dividend. The Income Tax Officer, therefore, considered that the

provisions of Section 23A were attracted to this case and he, accordingly, passed an order levying additional super-tax on a sum of Rs. 10,32,622

(Rs. 18,12,622--Rs. 7,80,000) at the rate of 50% resulting in a tax liability of Rs. 5,16,311.

2. The assessee appealed to the Appellate Assistant Commissioner. By the time he came to dispose of the appeal against the order u/s 23A, he

had already disposed of the appeal against the assessment, as a result of which the total income had been reduced to Rs. 19,51,411. After

deducting the taxes and other outgoings, there was a distributable surplus of Rs. 10,52,525. Before him the assessee contended that the statutory

percentage of distribution applicable to it was only 65 and not 90 and that, alternatively, looking to its profits in the commercial sense, it could not

have declared a larger dividend. If 65% alone had to be distributed, it was enough for it to have declared Rs. 7,03,641.25, and as it had declared

Rs. 7,80,000 as dividends, the levy of additional super-tax would not have been attracted. The Appellate Assistant Commissioner rejected the

contention that the statutory percentage was only 65 and not 90. He held also that the company had enough commercial profits and that it could

not be said that the distribution it had made had exhausted the commercial profit.

3. The assessee then appealed to the Tribunal and put forward substantially the same contentions. The Tribunal agreed with the Appellate Assistant

Commissioner with the result that the order levying additional super-tax to the extent emerging from the order of the Appellate Assistant

Commissioner was confirmed.

4. It may be mentioned here that before the Tribunal there were two appeals against the assessment for the same year, one by the assessee and the

other by the department. The result of the order of the Tribunal in both the appeals was that the order of the Appellate Assistant Commissioner

was left intact. There was a reference against the order of the Tribunal for this and other years in T.Cs. Nos. 160 of 1969 and 239 of 1971

Commissioner of Income Tax Vs. Amalgamations (P.) Ltd., . By a judgment dated 1st March, 1976, the reference was answered and the result of

the reference was, as far as this year is concerned, that the order of the Tribunal stood.

5. Against the order of the Tribunal confirming the application u/s 23A, the

assessee and the department applied for reference. The following questions have been referred to this court.

(1) Whether, on the facts and in the circumstances of the case, the provisions of Section 23A are applicable ?

(2) Whether, on the facts and in the circumstances of the case, the statutory percentage applicable to the applicant-company for the relevant assessment year, viz., 1960-61, is 90% and not 60% ?

(3) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in excluding the sums of Rs. 1,08,978 and Rs.

2,29,627 being, (i) managerial remuneration paid by the assessee during the year of account; and (ii) receipts from the liquidator of Sembiam Saw

Mills (Private) Ltd. from the distributable surplus for the purpose of levying additional super-tax u/s 23A(1) of the Indian Income Tax Act, 1922,

for the assessment year 1960-61 ?

6. Out of the above three questions, we may dispose of questions Nos. 2 and 3 first. It is not disputed that the answer to the second question is in

the affirmative in view of our judgment dated 1st March 1976 Commissioner of Income Tax Vs. Amalgamations (P.) Ltd., in the tax cases

mentioned already wherein we have held that the assessee is a company whose business consisted wholly or mainly in the holding of investments. It

would, therefore, follow that the statutory percentage applicable to the assessee is 90 and not 65. The second question is, accordingly, answered

in the affirmative and in favour of the revenue.

7. The third question does not, in our opinion, require to be answered, as any answer to it could only be of an academic interest. If for instance we

uphold the application of Section 23A, then the additional super-tax would have to be levied on the distributable balance of the total income minus

the tax and other outgoings provided in Section 23A(1). The figures in question No. 3 would, in that event, have no relevance. If, on the other

hand, we hold that Section 23A is not applicable, then the point regarding exclusion of the two amounts in question would not arise. The company

would have declared reasonable dividends so as to be out of the operation of the levy of additional super-tax, notwithstanding the correctness or

otherwise of the view of the Tribunal regarding the two amounts mentioned in the question. In these circumstances, we return the third question

unanswered.

8. This leaves for consideration only question No. 1. That question was argued from three facets, viz. :

(1) whether, in considering the reasonableness or unreasonableness of the distribution of the dividends by the assessee, the profits which were

undistributed and which were brought forward from the earlier year have to be taken into account;

(2) whether a sum of Rs. 3,33,011.76 representing profit on sale of investments is liable to be considered as commercial profits available for

distribution; and

(3) whether a sum of Rs. 2,29,827 being receipts from the liquidator of Sembiam Saw Mills (Private) Ltd. and credited to the capital reserve in the

balance-sheet for this year could be taken into consideration in examining the reasonableness of the distribution made by the assessee. We would

consider each of these points seriatim.

9. The profit and loss account disclosed a net profit of Rs. 7,60,016.30 for this year, which includes the profit on a sale of investments referred to

in point No. 2 above. This profit has been arrived at after providing a sum of Rs. 4,60,000 as provision for taxation. The appropriation made by

the company may be seen from the following :

Rs. Rs.

To dividends (interim and final). 7,80,000-00 By balance as at 30th June, 1958
2,46,507-96

Balance carried to balance-sheet 2,26,524-26 Profit for the year brought down
7,60,016-30

Total 10,06,524-26 Total 10,06,524-26

10. The learned counsel for the revenue contended that the assessee-company had appropriated, in declaring the dividends for this year, not only

the profits of the current year, but also a part of the profits brought forward from the earlier year and that the company could have thus distributed

the whole of the available profits including the brought-forward profits from the earlier year. In his submission unless the company had done so, the

Income Tax Officer could not have entertained the satisfaction that payment of a larger dividend than that declared would be unreasonable. For the

assessee the submission was that the question of reasonableness or unreasonableness of distribution had to be considered only from the standpoint of the current year's profit and that the action of the company in drawing upon the earlier years' profit so as to make up 200% distribution on the paid up capital of the company would have no relevance to what the statute contemplates being done.

11. The Supreme Court considered the scheme of Section 23A and the statutory requirements thereunder in Commissioner of Income Tax,

Bombay City Vs. Bipinchandra Maganlal and Co. Ltd., . That was a case in which the assessee had sold certain assets on which it had obtained

depreciation in the relevant Income Tax assessments. The difference between the original cost of the said assets and the written-down value was

brought to tax by applying the second proviso to Section 10(2)(vii) of the Indian Income Tax Act, 1922. The question before the Supreme Court

was whether this difference should have been included in the assessee's profit for the purpose of determining whether the payment of a larger

dividend than that declared would be unreasonable. The Supreme Court held that by the fiction in Section 10(2)(vii), second proviso, what was

really not income was, for the purpose of computation of assessable income, made taxable income; but that, on that account, it did not become

commercial profit and that if that was not commercial profit, it was not liable to be taken into account in assessing whether, in view of the smallness

of profits, distribution of a larger dividend would be unreasonable. In the course of the judgment, the Supreme Court observed at page 296 as

follows :

The test whether it would be unreasonable to distribute a larger dividend has to be adjudged in the light of the profit of the year in question.

12. The Supreme Court had again to consider the scope and scheme of Section 23A in another decision in Commissioner of Income Tax, West

Bengal Vs. Gangadhar Banerjee and Co. (Private) Ltd., which has now become, if we may say so, a classic on the subject. In the course of this

judgment the passage that we have extracted above from the earlier decision has been reproduced at page 183 with the observation that the

decision was binding on their Lordships. That was a case in which the assessee had a commercial profit of Rs. 1,28,112. After providing for

taxation, the profit left was Rs. 72,000 out of which it had declared Rs. 44,000. Though the provision for taxation was only Rs. 66,000 the actual

tax assessed was Rs. 79,400 requiring a further provision of Rs. 13,400. After the said payment, the company was left with only a sum of Rs.

4,000 and odd. The assessed income was, however, much larger and the company should have distributed Rs. 64,000, being 60% of the assessed

profit less tax. The Supreme Court held that, as the balance of the commercial profit left was only Rs. 4,000, it was not possible to hold that the

assessee should have distributed larger dividend. It is in this context that the scheme of Section 23A was considered and the above passage

adopted.

13. The problem in the present form arose more or less in a direct way for decision in *UNIVERSAL BANK OF THE INDIA LTD. Vs.*

COMMISSIONER OF Income Tax, BIHAR AND ORISSA., . The total income of the company for the relevant year was Rs. 2,07,150 and it

had distributable surplus of Rs. 1,17,169. The company had not declared any dividend. It had accumulated profit of over Rs. 7,44,000 in addition

to the profit earned during the current year. The Income Tax Officer made an order applying Section 23A. When the matter came on appeal

before the Tribunal, it took the view that as the accumulated profit of the earlier three years put together came to Rs. 88,566, the company had

sufficient funds to declare dividends. The relevance of the consideration of the earlier years' profit was put in issue before the Patna High Court. At

page 538 it was observed as follows :

Section 23A speaks of two things to be taken into consideration: losses incurred by the company in earlier years and the smallness of the profit

made. The language is clear. While the period preceding the previous year is mentioned with reference to the losses, no such reference is given

with regard to the profit. The distinction maintained by the legislature in respect of the losses and the profit is significant and can only be taken to

mean that the extent of profit to be considered in that connection is confined to the previous year and not to any period preceding that. The

distribution of dividend, ordinarily in the commercial world, is related to the profit earned during the year..... The Tribunal could not have brought

back the accumulated profits of the two preceding years which had not been

distributed either in part or in whole as dividends to the shareholders, to their consideration with a view to finding whether the profit was small enough to justify the non-distribution of any dividend in the year 1953.

14. In support of this view, the passage from Commissioner of Income Tax, Bombay City Vs. Bipinchandra Maganlal and Co. Ltd., , which we have already extracted, has been relied upon.

15. This court had occasion to consider a similar problem in Commissioner of Income Tax Vs. Meccano Floorings (P.) Ltd., . The assessable

profit in that case was Rs. 25,841 and after deducting the taxes, there was a distributable balance of Rs. 12,533 out of the assessable income. The

company had, however, declared no dividend. In objecting to the application of Section 23A, the company contended that it had sustained losses

in the subsequent year. For the revenue the stand taken was that there was a sum of Rs. 12,000 under the dividend equalisation reserve and that, if

the accounts were properly worked out, there would be sufficient profit for distribution as dividend. It was also contended that the losses incurred

in the subsequent year could not be taken into account. The latter contention was rejected in view of the decision of the Supreme Court in

Commissioner of Income Tax, West Bengal Vs. Gangadhar Banerjee and Co. (Private) Ltd., . In disposing of the former contention, viz., that the

company had sufficient reserve on which it could have drawn for the purpose of distribution of dividends, after reproducing the passage from

Commissioner of Income Tax, Bombay City Vs. Bipinchandra Maganlal and Co. Ltd., which we have already extracted, this court observed at

page 355 Commissioner of Income Tax Vs. Meccano Floorings (P.) Ltd., as follows :

It is, therefore, not open to the Income Tax Officer to take the dividend equalisation reserve and add it to the profits earned during the year and

hold that not distributing the larger dividend was unreasonable.

16. In support of this conclusion, reference was also made to the decision of the Bombay High Court in Bombay Cycle Stores Co. (P.) Ltd. Vs.

Commissioner of Income Tax, Nagpur, .

17. It was pointed out by the Bombay High Court in Commissioner of Income Tax, Bombay City II Vs. Suleman and Co. Ltd., , after referring to

the decision of the Supreme Court in Commissioner of Income Tax, West Bengal

Vs. Gangadhar Banerjee and Co. (Private) Ltd., , that one of the points settled in that decision was that the "smallness of profit" has to be adjudged in the light of the commercial principles and not in the light of the total receipts, actual or fictional, and that "commercial or accounting profits are the actual profits earned by an assessee calculated on commercial principles". It was added that the words "smallness of profit" in the section referred to actual accounting profits, in comparison with the assessable profits of the year.

18. We may extract the relevant portion of the provision in order to emphasise that the conclusion arrived at in the decision discussed above is inescapable on a proper construction of its language, which is as follows:

23A. (1) Where the Income Tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any

company within the twelve months immediately following the expiry of that previous year are less than the statutory percentage of the total income

of the company of the previous year as reduced by--.....

the Income Tax Officer shall, unless he is satisfied--

(i) that, having regard to the losses incurred by the company in earlier years or to the smallness of the profits made in the previous year, the

payment of a dividend or a larger dividend than that declared would be unreasonable; or..... make an order in writing that the company shall.....be

liable to pay super-tax at the rate of fifty per cent. in the case of a company whose business consists wholly or mainly in the dealing or in holding of

investments.....

19. The section requires, among others, consideration of the losses incurred by the company in the earlier years or the "smallness of profits" made

in the previous year in finding out whether the payment of a dividend or a larger dividend than that declared would be unreasonable. The

comparison is between the balance available out of the commercial profits and that available out of the assessed income. The very concept of

commercial profits involves the determination thereof between two periods of time. For the purpose of Income Tax, the period is the "previous

year", which in the present case is the year ended on 30th June, 1959. The Section does not bring in for consideration either the existence of

reserves or accumulated profits of earlier years for the purpose of finding out whether the assessee is attempting to avoid payment of appropriate

tax by the shareholders by not making any distribution or making an unreasonable distribution of dividends.

20. A contrary conclusion involves certain obvious anomalies. For instance, the company may have been distributing dividends to cover the

statutory percentage in a series of years. The statute itself provides for a small balance being left in the hands of the company. In other words, if the

business of the company consisted wholly or mainly in the holding of investments, it had to distribute only 90% of the distributable income. If it was

any other company, it could distribute 65%. The company was thus left with 10% or 35% of the surplus as the case may be. Supposing a

company had such brought-forward profits and had also current profits, and had distributed the whole of the current profits, it would be

unreasonable to expect the company to distribute more merely because it had brought-forward profits. The statute, which enabled the company to

retain a part of the profit of the earlier years, would be rendered out of force if they were to be insisted upon. We may take another case, where

the company had not declared appropriate dividends resulting in the application of Section 23A. The company would have paid additional super-

tax in the earlier years. If the balance had been brought forward in the profit and loss account and if the said brought-forward balance were also

taken into account, then it would result in the same amount being taken into consideration for more than one year in the application of Section 23A.

We do not find any warrant in the statute for any such assumption. The whole scheme of the Income Tax Act is to divert attention on the facts of

the relevant year unless as in Clause (i) of Section 23A(1) in the case of losses the position of the earlier years has also to be considered. We hold,

therefore, that the question of reasonableness or unreasonableness of the distribution has to be adjudged by taking into account the current year's

profit and not the accumulated profit of the earlier years. In the present case there is no dispute that the current year's profit was only Rs.

7,60,016.30. The provision for taxation has been found to be quite reasonable by the Tribunal. Therefore, there is no need to make any upward

adjustment to the commercial profits. As the company had not only declared the whole of the commercial profit of the year, but something more, it

cannot be said that the company had acted unreasonably in the matter of distribution of dividends. If, in law, the company could confine itself to the relevant year's profit, as we have found above, the fact that the company drew on the earlier year's profit for a portion of the actual distribution cannot tilt the balance. If the company was not obliged to draw on the earlier year's profit for making any distribution, then the fact that it tried to be more reasonable than necessary by making some distribution out of the earlier profits cannot be used against it. Distribution which is otherwise reasonable does not become unreasonable by the draw on earlier profits.

21. The learned counsel for the revenue laid great emphasis on the following passage from the judgment, of the Supreme Court in Commissioner of Income Tax, West Bengal Vs. Gangadhar Banerjee and Co. (Private) Ltd., appearing at page 182 :

The reasonableness or the unreasonableness of the amount distributed as dividends is judged by business considerations, such as the previous losses, present profits, the availability of surplus money and the reasonable requirements of the future and similar others." (The underlining is by us).

22. From the words underlined above, the attempt was to show that when the company had certain surplus available from the earlier year's profit,

it would have to be taken into account in considering the reasonableness of the distribution. We are unable to accept this submission. We have

already pointed out that the Supreme Court in Commissioner of Income Tax, West Bengal Vs. Gangadhar Banerjee and Co. (Private) Ltd.,

extracted the passage from Commissioner of Income Tax, Bombay City Vs. Bipinchandra Maganlal and Co. Ltd., to the effect that the test was

whether it would be unreasonable to distribute a larger dividend has to be adjudged in the light of the profits of the year in question and took this

passage as binding on it. Having regard to the specific approval of the said passage from the judgment of Commissioner of Income Tax, Bombay

City Vs. Bipinchandra Maganlal and Co. Ltd., it would be unreasonable to assume that the Supreme Court thereafter came to a contrary

conclusion and considered as relevant the availability of surplus money of earlier years. In our opinion, the words "availability of surplus money" in

the passage mentioned above have to be taken as drawing attention to the liquidity of the resources of the company. Further, the attempt of the

learned counsel for the revenue is to construe the expressions used in the passage as if they are statutory words. The effect of the whole judgment

has to be taken and we are of the opinion that the Supreme Court in Commissioner of Income Tax, West Bengal Vs. Gangadhar Banerjee and

Co. (Private) Ltd., did not intend to express any opinion contrary to what had been expressed in Commissioner of Income Tax, Bombay City Vs.

Bipinchandra Maganlal and Co. Ltd., .

23. The learned counsel for the revenue then submitted that the question of reasonableness or unreasonableness in the matter of distribution of

dividends is a question of fact and that, in the present case, the conclusion of the Tribunal holding that the action of the company in the matter of

distribution of dividend was not reasonable cannot be interfered with. We consider that this is not a pure question of fact especially in the context

of the facts mentioned above. The real question that has been put in issue here is whether the company was obliged to draw on or distribute the

earlier year's profits also, so as to demonstrate its reasonableness in the matter of distribution of dividends. This involves consideration of a

question of principle and, therefore, the conclusion is open for review by courts.

24. The second aspect as mentioned above was whether the sum of Rs. 3,35,011.76 being the profit on sale of investments could be taken as

available for distribution. The contention of the assessee was that this profit being capital profit was not available for distribution. There are two

answers to this submission. The first is that the company itself had credited the amount to the profit and loss account as if it was commercial profit

and distributed the said amount also as dividend. The point raised is, therefore, academic. Secondly, even assuming that this point deserves to be

considered, it is concluded by a decision of this court in Factors (P.) Ltd. Vs. Commissioner of Income Tax, wherein it was pointed out that unless

the constitution of the company restricted the distribution of capital profit or gain, nothing would stand in the way of the distribution of the capital

gains or capital profits also. No such restriction was brought to our notice in this case.

25. The third point as mentioned already was whether "the sum of Rs. 2,29,627 being receipts from the liquidator of a subsidiary in liquidation

were available for the purpose of distribution. The learned counsel for the

revenue submitted that though this amount was directly credited to capital reserve, it was a receipt which should be taken into account for the purpose of considering the reasonableness of the distribution. In effect, the submission of the learned counsel was that this amount also could have been drawn upon for dividend distribution. The adjustment of the commercial profits by taking this amount also into account had not been adverted to at any earlier stage. The Tribunal has proceeded on the basis that the commercial profit was only Rs. 7,60,016.30. The question of adjustment of commercial profit by reference to this amount is primarily a question of fact and is not, therefore, open for debate at this stage. Assuming that we have to go into this point, we would make the following observations thereon. The assessee had a subsidiary by name, Sembiam Saw Mills (Pvt.) Ltd. Sembiam Saw Mills had taken an overdraft for Rs. 9,08,764 which was guaranteed by the assessee. As Sembiam Saw Mills failed to repay the amount to the bank, the guarantee was enforced against the assessee and the assessee paid the whole amount. From the liquidator the assessee received various amounts in several years. The amount received in this year came to Rs. 2,29,627. The total amount received from the liquidator came to Rs. 4,85,508.28. There was thus a loss suffered by the assessee to the extent of Rs. 4,23,256. The allowability of this loss came up for consideration in T. C. Nos. 160 of 1969 and 239 of 1971 [Commissioner of Income Tax v. Amalgamations (P.) Ltd. [1971] 108 ITR 895 and we have held that it was allowable as deduction in the assessment year 1962-63. As the sum of Rs. 2,29,627 has been received only in recoupment of the amount paid to the bank and as the assessee had ultimately sustained a loss in the transaction of arranging funds for its subsidiary it would not be reasonable to expect the company to distribute the said sum of Rs. 2,29,627 as dividends.

26. Question No. 1 is answered in the negative and in favour of the assessee. As neither party has succeeded wholly in the reference, there will be no order as to costs.