

(1972) 01 KL CK 0008

In the High Court Of Kerala

Case No : Income Tax Reference No. 88 of 1969

Commissioner of Income Tax

APPELLANT

Vs

V. Damodaran

RESPONDENT

Date of Decision : 18-01-1972

Acts Referred:

Income Tax Act, 1922 — Section 10, 2(6A), 2(6A)(e)

Citation : (1972) 85 ITR 590

Hon'ble Judges : T.S. Krishnamoorthy Iyer, J; P. Govindan Nair, J

Bench : Division Bench

Advocate : P.K. Krishnankutty, for the Appellant;

Judgement

Krishnamoorthy Iyer, J.—The following questions have been referred by the Income Tax Appellate Tribunal, Cochin Bench, u/s 256(1) of the Income Tax Act, 1961 :

"(1) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was legally correct in holding that the accumulated profits will not include current profits for the purpose of Section 2(6A) of the Indian Income Tax Act, 1922 ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that Rs. 18,950 constituted accumulated profits for the purpose of Section 2(6A) of the Indian Income Tax Act, 1922 ?"

2. Question No. 1 was referred at the instance of the Commissioner of Income Tax, Kerala, while question No. 2 was referred at the instance of the assessee. The reference relates to the assessment year 1959-60, the accounting year being the year ending on March 31, 1959.

3. The assessee is the managing director of a private limited company, called R.K.V. Motors and Timber (P.) Ltd. As on March 31, 1959, he had drawn a sum of Rs. 25,107.22 from the company.

4. The Income Tax Officer as well as the Appellate Assistant Commissioner treated the sum of Rs. 25,107.22, withdrawn by the assessee as dividend within the meaning of Section 2(6A)(e) of the Indian Income Tax Act, 1922, and assessed the same to tax.

5. It was contended by the assessee that the profits of the company for the year ending March 31, 1959, do not form part of the "accumulated profits" for ascertaining the dividend u/s 2(6A)(e) of the Income Tax Act, 1922, and in arriving at the accumulated profits Rs. 11,000 provided towards tax liability and Rs. 6,900 for payment of dividend already declared should be deducted from Rs. 18,950.98 representing the profits of the company as on March 31, 1958, and if so the accumulated profit is only Rs. 1,050. The sum of Rs. 1,050 was worked out by the assessee in the following manner :

Rs.

Balance as per profit & loss account ending 31-3-1958

18,950

Less provision for tax

11,000

7,950

Less provision for dividend

6,900

Rs. 1,050

6. The Income Tax Officer as well as the Appellate Assistant Commissioner held that accumulated profits would include current year's profits also. The Income Tax Officer rejected the plea of the assessee for excluding the tax liability and the amount payable to the shareholders as dividend in calculating "accumulated profits". But the Appellate Assistant Commissioner did not express any definite opinion on this aspect. The accumulated profits of the company worked out by the Appellate Assistant Commissioner was as follows :

Rs.

Opening balance in the profit & loss account (ending 31-3-1959)

18,950

Less provision for taxation made in the balance-sheet for the year ended 31-3-1958

11,000

Balance

7,950
Less dividend declared
6,900
Balance
1,050
Profit for the current year ended 31-3-1959
28,859
Total
Rs. 29,909

7. Having thus determined that the company has an accumulated profit of Rs. 29,909 which includes Rs 28,859 being the profits of the current year, the Appellate Assistant Commissioner concluded that the sum of Rs. 25,107 representing the loan advanced by the company to the assessee as on March 31, 1959, should be treated as dividend u/s 2(6A)(e) of the Indian Income Tax Act, 1922.

8. The Tribunal found, relying on the decision of the Madras High Court in Commissioner of Income Tax, Madras Vs. M.V. Murugappan and Others. Commissioner of Income Tax, Madras V. A.M. M.V. Valliammai Achi and Others, that "accumulated profit" would not include current year's profits. On the question whether the amounts of Rs. 6,900 and Rs. 11,000 have to be taken into account in arriving at the accumulated profit as on March 31, 1958, the Tribunal held against the assessee in the following words :

"The other aspect is whether the two sums of Rs. 6,900 and Rs. 11,000 are to be taken into account in arriving at the accumulated profit on March 31, 1958. Both these amounts are only appropriations and not charge against the profits. The sum of Rs. 18,950 stands to the credit of the profit and loss account in the balance-sheet as on March 31, 1958, and the company had not set apart any amount towards tax liability. We are concerned with the position as disclosed by the company's accounts and not what it should have or ought to have done. If any special reserve had been created it will be possible to say that such amounts had been taken out of accumulated profits. But, as we stated earlier, the company had not created any such specific reserve as on March 31, 1958. Even if it had set apart any amount as provision towards taxation, there is nothing in the company law which would prevent the company from re transferring and utilising it in the distribution of dividend. The only restriction under the Companies' Act is that no dividend shall be paid except out of profits. Such reserve would still form part of the accumulated profits. The payment of dividend of Rs. 6,900 is also an appropriation and cannot go to reduce the accumulated profits and a set-off is possible only in terms of Section 2(6A)(e)(iii)."

9. The question for consideration is whether the disputed sum of Rs, 25,107.22 is dividend within the meaning of Section 2(6A)(e) of the Indian Income Tax Act, 1922, Section 2(6A)(e) of the Indian Income Tax Act, 1922, as it stood at the relevant time, reads as follows :

"" dividend " includes-

(e) any payment by a. company, not being a company in which the public are substantially interested within the meaning of Section 23A, of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan to a shareholder or any payment by any such company on behalf or for the individual benefit of a shareholder, to the extent to which the company in either case possesses accumulated profits."

10. Section 2(6A) has an Explanation, which reads thus :

"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, and before the 1st day of April, 1956."

11. The above Explanation is not relevant to answer the questions raised before us.

12. There was no definition of the term ""dividend" originally in the Indian Income Tax Act, 1922. The definition which is only an inclusive one was introduced in 1919 as the legislature thought it necessary to bring to tax distribution made out of accumulated profits of a company viewing such distribution as dividend in so far as it came out of accumulated profits. Section 2(6A) of the Indian Income Tax Act enables the department to bring to tax loans or advances of the description therein made by companies to the shareholders. The object of these provisions is to prevent companies from distributing dividends under the guise of loans, A safeguard has, therefore, been enacted that the loans should be treated as dividends if made out of the accumulated profits of the company as, under the law, dividends cannot be paid except out of profits. Section 2(6A)(e) thus creates a fiction by which the loan is treated as a dividend subject to the condition that it shall be treated as dividend only to the extent of the "accumulated profits" of the companies. The sum advanced, even though a borrowing and not income, is to be deemed to be dividend under the provision and the shareholder must, therefore, include it as forming part of his income for purposes of assessment.

13. Counsel for the revenue contended that the term "accumulated profits" in Section 2(6A) would also include the current year's profits of the company. In our view, there is no substance in this contention.

14. In T. Appavu Chettiar Vs. Commissioner of Income Tax, Madras, , the Madras High Court had to examine the meaning of the term "accumulated profits" in Section 2(6A)(c) of the Indian Income Tax Act, 1922, as it stood before 1955. The said provision read :

"" Dividend includes-

any distribution made to the shareholders of a company out of accumulated profits of the company on the liquidation of the company :

Provided that only the accumulated profits so distributed which arose during the six previous years of the company preceding the date of liquidation shall be so included."

15. The Madras High Court held :

"Assuming that the distribution by the liquidator was out of "accumulated profits of the company", the proviso to Sub-clause (c) of Section 2(6A) would exclude the profits of the company which accrued to it in its year of account ending with 31st March, 1947."

16. According to the Madras High Court, therefore, current profits could not be included in the expression "accumulated profits" used in Section 2(6A)(c) of the Indian Income Tax Act; 1922. Chajfla C.J., following this decision in Girdhardas and Co. Ltd. Vs. Commissioner of Income Tax, Ahmedabad, , observed :

"Therefore, u/s 2(6A)(c), the legislature has limited and restricted the distribution of only certain type of profit which should be included in the definition of dividend. It is not all profits or any profits distributed by the liquidator which constitute dividend. The limitation imposed by the legislature is that the profits must in the first place be accumulated in contradistinction to the profits being current....."

17. The learned judge observed again at page 90 ;

"Mr. Joshi says that there is no reason or logic why profits of the current year distributed by the liquidator should not constitute dividend and should not be liable to tax in the hands of the shareholder as dividend. It is always a mistake to try and look for logic or reason in the provisions of any taxing statute. It may be that the legislature did not want to subject all the assets distributed by the liquidator to tax and, therefore, it enacted that only those assets which represented accumulated profits of six previous years should be artificially looked upon as dividends and be liable to tax as dividend."

18. In Commissioner of Income Tax v. M. V. Murugappan the learned judges of the Madras High Court again examined the scope of the term "accumulated profits" in Section 2(6A)(c) of the Indian Income Tax Act, 1922, as it stood in 1955. There a company went into liquidation on 31st of October, 1954. The question was whether for the assessment year 1955-56, the corresponding accounting year being the year ending on April 12, 1955, the profits made by the company in the period from January 1, 1954, to the date of liquidation amounting to Rs. 81,611 and a sum of Rs. 1,49,444 received by the company in 1960 as refund of tax paid at the end of 1953 were part of its accumulated profits as on 31st October, 1954, within the meaning of Section 2(6A)(c) of the

Act as it stood then. In holding that the accumulated profits in Section 2(6A)(c) as it stood in 1955 did not include the current profits of the company made during the broken period between January 1, 1954, and October 31, 1954, Veeraswami J. pointed out :

"No doubt, the object of Clause (c) is to bring to tax any distribution to the shareholders of a company in liquidation out of its accumulated profits. Clause (c), be it noted, used not the expression "profits" but "accumulated profits". "Accumulated" normally means heaped up, stored up or put by". It also, to our minds, indicates an effort on the part of a person in that direction. It seems to us to be inappropriate to call a current profit as a profit "heaped up, stored up or put by". Current profit is what accrues in praesenti : accumulated profit is meant to relate to the past. Mr. Balasubrahmanyam for the revenue suggested that the word "accumulated" in Clause (c) only means "undistributed" or "what is not appropriated." If that were the meaning, nothing would have been easier for the legislature to stop short of using the expression "accumulated", and the word "profits" by itself would have conveyed that sense. We think that the word "accumulated" in Clause (c) cannot be given that meaning and that something more than mere profits was meant. The legislature confined the clause to a particular kind of profits and did not extend it to all kinds of profits."

19. In coming to this conclusion their Lordships relied on the decision of the High Court of Australia in *Hooper & Harrison Ltd. (In liquidation) v. Federal Commissioner of Taxation* 33 C.L.R. 458, construing the words "accumulated trading profits" in Section 17(1) of the Australian War-time Profits Tax Assessment Act, 1917-18. The learned judges of the High Court of Australia said :

"The expression "accumulated profits" is familiar in judicial decisions and well known in the mercantile world for over 150 years. But for present purposes it will be sufficient to refer to very few cases, namely, *Hollins v. Alien* [1866] 14W.R. 980, decided by Kindersley V.C. in 1866, and *Sproule v. Bouch* [1885] 29 Ch D.635, in 1887. Later cases exemplify and support this, the most important of which is *Commissioners of Inland Revenue v. Blott*, [1921] 2 AX 171 (H.L.). In *Hollins v. Alien*, the Vice-Chancellor drew a distinction between "current profits" and other profits. That is to say, he drew a distinction between, on the one hand, "current profits" of a given year, in which he included a surplus balance of profits of a previous year not appropriated to any fund, and, on the other, profits in a fund accumulated in previous years for any purpose. And, in our view, the true import of the term "accumulated profits" is that they are profits which the company has appropriated to some reserve account, whether that account be of a capital nature or not. "Accumulation" in that connection does not mean the mere existence of profits, even over a lengthened period, however they are employed ; but it connotes the affirmative gathering of these profits, or such as may be selected, into a measured or measurable heap and allocated to a named reserve fund, whatever its nature may be."

20. Latham C.J. observed in *Federal Commissioner of Taxation v. Miller and*

Anderson Ltd., 3 C.L.R. 341, while construing Section 24 of the War-time (Company) Tax Assessment Act, 1940-41 :

"But "accumulation" plainly refers to the past and not to a current period."

21. The decision in Commissioner of Income Tax v. M. V. Murugappan was confirmed by the Supreme Court in the decision reported in Commissioner of Income Tax v. M. V. Murugappan. Their Lordships observed :

"But the profits of the year in the course of which the company was ordered to be wound up not being accumulated profits were not part of the dividend : Appavu Chettiar v. Commissioner of Income Tax, Girdhardas & Company Ltd. v. Commissioner of Income Tax, and also the observations of this court in First Income Tax Officer, Salem Vs. Short Brothers (P) Ltd., , at pages 88 and 89."

22. These decisions, therefore, establish that in the term "accumulated profits" current profits cannot be included. The only submission to distinguish these decisions by counsel for the revenue was that they interpreted Section 2(6A)(c) of the 1922 Act and they were not concerned with Section 2(6A)(e) of the Act. In our view, there is no substance in this contention for the reason that on a fair reading of Section 2(6A) the term "accumulated profits" in sections 2(6A)(c) and 2(6A)(e), as it stood before the Finance Act of 1956, should bear the same meaning. In Commissioner of Income Tax (Central), Bombay Vs. P.K. Badiani, , the Bombay High Court explained the term "accumulated profits" in Section 2(6A) (e) of the Indian Income Tax Act, 1922, thus:

"Now, the word "accumulated" in the phrase "accumulated profits" in Section 2(6A)(e) clearly indicates that "accumulated profits" mean, profits which have been accumulated before the beginning of the accounting year which would be the previous year relevant to the assessment year. The provision of Section 2(6A) (e) may fall for consideration during that previous year and at that point of time it would not be even possible to know whether in that previous year there were any profits or to ascertain their amount and even if there were profits of that previous year up to that point of time, whether they would not be wiped out during the subsequent period of that previous year. The profits of that previous year would be current profits as distinguished from "accumulated profits". Therefore, the profits of that previous year cannot be included in "accumulated profits."

23. In view of these decisions, we are not inclined with great respect to adapt the reasoning in T. Sundaram Chettiar Vs. Commissioner of Income Tax, Madras, . We are, therefore, satisfied that the view taken by the Tribunal that the profits of the company in the year ending March 31, 1959, should not be taken into consideration for determining the dividend u/s 2(6A)(e) of the Indian Income Tax Act, 1922, is right.

24. The next aspect for consideration is whether in arriving at the accumulated profits the sum of Rs. 11,000 being the provision for taxation made in the

balance-sheet for the year ending March 31, 1958, and the sum of Rs. 6,900 being the dividend declared for that year have to be deducted. In our view, the term "accumulated profits" cannot mean the profits or gains of any company determined u/s 10 of the Income Tax Act, 1922, for the levy of tax. The expression "accumulated" should necessarily relate to profits which could be accumulated by the company from time to time. This obviously means that all liabilities due from the company will have to be deducted from the profits to enable the company to accumulate the same. The learned judges of the Rajpal Brothers (P.) Ltd. Vs. Commissioner of Income Tax, Bombay City - I, , pointed out :

"It is difficult to hold that the phrase " accumulated profits" in this section refers to the aggregate of the assessed income arrived at by dis allowing disbursements and expenditures in fact incurred. There was no justification for the tax authorities and the Appellate Tribunal to proceed to arrive at the accumulated profits of the assessee-company by merely totalling up the income of the assessee-company as assessed by previous assessment orders. That the profits and/or income mentioned in these orders will not reflect the profits accumulated and in fact in the hands of the assessee-company is patent."

25. With great respect we follow the above observations. We are, therefore, of the view that the two amounts have to be excluded in order to arrive at the accumulated profits for the purpose of Section 2(6A)(e) of the Indian Income Tax Act, 1922.

26. We answer question No. 1 in the affirmative, that is, in favour of the assessee and against the department. We answer question No. 2 in the negative also in favour of the assessee and against the department.

27. A copy of this judgment will be forwarded to the Income Tax Appellate Tribunal, Cochin Bench, under the seal of this court and the signature of the Registrar.