Commissioner Of Income-Tax, Bombay ... vs Jubilee Mills Ltd. Bombay on 5 December, 1967

Equivalent citations: 1968 AIR 883, 1968 SCR (2) 539, AIR 1968 SUPREME COURT 883

Author: V. Ramaswami

Bench: V. Ramaswami, J.C. Shah, Vishishtha Bhargava

PETITIONER:
COMMISSIONER OF INCOME-TAX, BOMBAY CITY IBOMBAY

Vs.

RESPONDENT:
JUBILEE MILLS LTD. BOMBAY

DATE OF JUDGMENT:
05/12/1967

BENCH:
RAMASWAMI, V.
BENCH:
RAMASWAMI, V.
SHAH, J.C.
BHARGAVA, VISHISHTHA

CITATION:
1968 AIR 883 1968 SCR (2) 539

ACT:
Income Tax Act, 1922, s. 23-A-Company reconstructing capital to write off accumulated losses and reducing capital-Whether losses prior to reconstruction relevant for determining reasonableness of company not declaring dividend in subsequent year as prescribed by s. 23-A-S. 66(5) -Procedure to be followed by Tribunal after High Court deciding question against the view taken by Tribunal.

HEADNOTE:
The respondent company had suffered large losses in the years prior to 1930 and in that year it reconstructed its capital by adjusting a debit balance of Rs. 12,75,000 in the profit and loss account against the paid up capital and reducing the face value of its shares. For the accounting

year relative to the assessment year 1948-49, the respondent Company declared a dividend amounting only to Rs. 24,750 although in terms of s. 23-A of the Income-tax Act, 1922, it was prima facie liable to declare a much larger dividend. The Income-tax Officer therefore held that the company should be deemed to have declared a dividend of Rs. 3,98,798. The respondent's appeals against this order to the Appellate Assistant Commissioner and the Appellate Tribunal were dismissed. The Tribunal rejected the respondent's contention that in view of the past losses suffered by the company, it was not reasonable to expect it to declare a larger dividend. It held that after the reconstruction of its capital the company emerged in a new cloak of reduced capital and for the purposes of determining the applicability of s. 23-A the reconstructed capital alone had to be taken into account and not the original capital, a great portion of which bad been wiped out by debiting losses. The High Court, upon a reference, held that the, loss of Rs. 12,75,000 incurred by the company prior to its reconstruction in 1930 could be taken into consideration for the purposes of the applicability of s. 23-A.

On appeal to this Court,

HELD:(i) The view taken by the Appellate Tribunal was erroneous in law and the High Court had rightly answered the question referred to it in favour of the respondent-company. There is nothing in the language or context of is. 23-A(1) of the Act to suggest that the expression "losses incurred in the earlier years" should be construed go as to exclude losses incurred prior to the reconstruction ,and to include only unadjusted or carried forward losses still outstanding in the books of the company. The section requires the Income-tax Officer to take into consideration "the losses incurred by the company in the earlier years" or the "smallness of profits made". It is well-established that the profits which are to be considered under s. 23-A(1) are the commercial or the accounting profits and not the assessable income or the assessable profits of the company, because it is the commercial or the actual accounting profits which are to form the source from which the dividend is to be distributed and not the assessable income or assessable profits which may have no relation to the commercial or accounting profits and which are not the actual source out of which the dividend could be paid. [544 G-H: 545 A-C]

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C.I.T. West Bengal v. Gangadhar Banerjee, 57 I.T.R. 176, referred to.

If a company which has got over its losses for some years by adjusting them against its capital and reducing its capital makes a profit in the subsequent year it may theoretically be in a position to distribute the whole of its profits for that year but it cannot be said to have acted unreasonably if it chose not to do so and retained a portion of the

profits for the purPose of building up a capital reserve which in course of time would enable the company to regain its original strength of capital. It may be that even after taking into consideration losses prior to a reconstruction it is possible to come to the conclusion that the company was not justified-in not declaring a larger dividend than that actually declared. But in the present case the Tribunal had misdirected itself in law in holding that losses incurred prior to the reconstruction are irrelevant for the purpose of application of s. 23-A in subsequent years. [545 E-G; 546 A-B]

(ii)The High Court having rightly answered the question referred to it in favour of the assessee meant that the Tribunal must now, in conformity with the judgment of the High Court, act under a. 66(5) of the Act, that is to say, dispose of the case after re-hearing the respondent company and the Commissioner in the light of the evidence and ding to law. [547 B-D]

Income-tax Appellate Tribunal, Bombay and Ors. v. SC. Cambatta & Co. Ltd. 29 I.T.R. 118 and Esthuri Aswathiah v. The C.I.T. Mysore, C.A. No. 631/1966 dated 18-4-67, referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 525 of 1967.

Appeal from the judgment and order dated May 3/4, 1963 of the Bombay High Court in Income-tax Reference No. 40 of 1957.

B. Sen and R. N. Sachthey, for the appellant. S. P. Mehta, S., E. Dastoor and I. N. Shroff, for the, respondent.

The Judgment of the Court was delivered by Ramaswami, J. This appeal is brought, by certificate, from the judgment of the Bombay High Court dated May 3/4, 1963 in Income Tax Reference No. 40 of 1957.

The respondent-company is a limited liability company with a paid up capital of Rs. 15,25,000/- as on June 30, 1947. Prior to 1930 the respondent-company had suffered large losses and in 1930 a debit balance of Rs. 12,75,000/- in the profit and loss account of the respondent-company was adjusted by reducing the paid up capital. The face value of the Ordinary shares was reduced from Rs. 100/- to Rs. 10/- each and of Preference shares from Rs. 100/- to Rs. 25/- each after obtaining the sanction of the Bombay High Court. For the assessment year 1948-49, for which the relevant previous year was the year ended June 30, 1947, the respondent-company was assessed to a total income of Rs. 7,47,639/-. On that amount tax was calculated at Rs. 3,27,091/- and the balance available for distribution by way of dividends for the purpose of s. 23A of the Income-tax Act, 1922 (hereinafter referred to as the 'Act') was, therefore, Rs. 4,20,548/-. Section 23A of the Act requires a

company in which the public are not substantially interested to declare in the absence of certain special circumstances a dividend which would not be less than 60% of the said balance. The respondent company therefore was prima facie liable to declare a dividend of at least Rs. 2,52,358/- in order to escape the penal consequences of non- compliance with the provisions of the said section. The actual dividend which was declared by the respondent-company was only Rs. 24,750/-. The Income-tax Officer with the previous approval of the Inspecting Assistant Commissioner, therefore, applied the provisions of s. 23A of the Act to the respondent-company and held that the company should be deemed to have declared a dividend of Rs. 3,95,798/-. The respondent-company appealed to the Appellate Assistant Commissioner of Income-tax against the order of the Income-tax Officer but the appeal was dismissed. The respondent- company thereafter filed a second appeal to the Income-tax Appellate Tribunal. By its order dated September 7, 1955 the Appellate Tribunal confirmed the order made under s. 23A of the Act and dismissed the appeal. It was contended before the Appellate Tribunal on behalf of the respondent- company that in view of the past losses suffered by it the nondeclaration of a dividend larger than that actually declared was not unreasonable. It was argued that in view of the past losses of Rs. 12,75,000/- it was not reasonable to expect the respondentcompany to declare a larger dividend. The argument of the respondent-company was rejected by the Appellate Tribunal. It stated as follows in the course of its order:

> "It is true that company incurred large losses in past years. But it reconstructed its capital in 1930. In that year, the debit balance in the profit and loss account had been set off against the paid-up capital thereby reducing the paid-up capital of the company. After the reconstruction, the company emerged in a new cloak of reduced capital. For the, purpose of determining the applicability of provision of Section 23A, in our view, the reconstructed capital alone has to be taken into account and not the original capital, a great portion of which had been wiped out by debiting losses. Those prior losses had already been wiped out by writing off against the paid up capital. They cannot now be taken for consideration."

At the instance of the respondent-company the Appellate Tribunal referred the following questions of law for the opinion of the Bombay High Court:

> "1. Whether on the facts and in the circumstances of the case, the Income-tax Officer was competent to pass an order u/s. 23(1) of the Act after having allowed a rebate of one anna per rupee in the assessment under the proviso (a) to paragraph (B) of Part 1 of the Second Schedule of the Finance Act, 1948 ?
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> 2.If the answer to question No. 1 is in the affirmative whether on the facts and in the circumstances of the case, the assessee company is a company in which the public are substantially interested for the purposes of sec. 23A of the Act ? and
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> 3.Whether the loss of Rs. 12,75,000/- incurred by the company prior to its reconstruction in 1930, could be taken into consideration for purposes of the applicability of sec. 23A (1) of the Act?"

By its judgment dated March 13, 1958 the High Court answered the first question in the affirmative, holding that the Income-tax Officer was competent to pass an order under s. 23A(1) and he was not precluded from doing so by reason of his having granted rebate to the respondent-company. On the second question also the High Court gave its answer in the affirmative, holding that the respondent-company was a company in which the public was substantially interested for the purpose of s. 23A of the Act. In view of the answer to the second question the provisions of S. 23A of the Act would not be applicable to the respondent-company and the third question became academic, and the High Court declined to answer it. The Commissioner of Income-Tax took the matter in appeal to this Court which reversed the answer which the High Court had given to question No. 2 and held that the respondentcompany was a company in which the public were not substantially interested for the purpose of S. 23A of the Act. In view of the decision of this Court on the second question it became necessary for the High Court to consider the third question and this Court therefore remanded the reference to the High Court for consideration of the third question. After the remand the High Court heard the reference again and by its judgment dated May 3/4, 1963 answered the third question in the affirmative and in favour of the respondent-company. It was held by the High Court that the losses prior to reconstruction of the respondent-company in 1930 which were set off against the paid-up capital could be taken into consideration for the purpose of application of S. 23A of the Act.

Section 23A of the Act before its amendment in 1955, in so far as it is material, states as follows:

> "23A. Power to assess individual members of certain companies-
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> (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 upto the end of the sixth month after its accounts for that previous year are laid before the company in general meeting are less than sixty per cent of the assessable income of the company of that previous year, as reduced by the amount of the income-tax and super-

tax payable by the company in respect thereof he, shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profit made, the payment of a dividend or a larger dividend than that declared would be unreasonable, make with the previous approval of the Inspecting Assistant Commissioner an order in writing that the undistributed portion of the assessable income of the company of that previous year as computed for income-tax purposes and reduced by the amount of income-tax and super-tax payable by the company in respect thereof shall be deemed to have been distributed as dividend amongst the shareholders as at the date of the general meeting aforesaid and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income Provided further that this sub-section shall not apply to any company in which the public are substantially interested or to a subsidiary company of such a company if the whole of the share capital of such subsidiary company is held by the parent company or by the nominees thereof.

Explanation.-For the purpose of this sub-section, a company shall be deemed to be a company in which the public are substantially interested if shares of the company (not being shares entitled to a

fixed rate of dividend, whether with or without a further right to participate in profits) carrying not less than twenty-five per cent of the voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by the public (not including a company to which the provisions of this subsection apply), and if any such shares have in the course of such previous year been the subject of dealings in any stock exchange in the taxable territories or are in fact freely transferable by the holders to other members of the public."

when it is found that the company in which the public are not substantially interested has declared a dividend of less than 60% of the assessable income of the company as reduced by the amount of income-tax and super-tax payable by the company in respect thereof for any previous year. The section, however, has provided that even if the applicability of the section is attracted, the Incometax Officer has to consider whether, having regard to the losses incurred by the company in earlier years or having regard to the smallness of its profits, it would have been unreasonable for the company to declare a dividend larger than which it had actually declared., The object of the section is to collect super-tax from the shareholders which would be payable if the company had distributed its income by way of dividends and to discourage avoidance of tax by failing to distribute its income.

On behalf of the appellant Mr. B. Sen put forward the argu- ment that as a result of the reconstruction of the capital in 1930 a new chapter had opened in the life of the respondent-company and losses which it had suffered prior to the reconstruction of its capital were irrelevant and should not be considered for the purpose of s. 23A of the Act so far as subsequent years are concerned. It was said that for determining the application of S. 23A of the Act it was the reconstructed capital alone and not the original capital that had to be taken into account. It was pointed on,,, that though the reduction of the capital had been necessitated by lcsses suffered, the reconstruction of the capital had resulted in wiping out the losses and starting the company afresh with reduced capital as its paid-up share capital. The argument was stressed that where the company adjusts losses against the paid-up capital and reconstructs its capital, the financial position of the company and its dividend distributing capacity in subsequent years have to be judged only by the result of its trading after reconstruction and not with reference to earlier losses which have disappeared by adjustment. In our opinion, there is no warrant, for the argument put forward on behalf of the appellant. There is nothing in the language or context of s. 23A(1) of the Act to suggest that the expression "losses incurred in the earlier years" should be construed so as to exclude losses incurred prior to the reconstruction and to include only unadjusted or carried forward losses still outstanding in the books of the company., In our opinion, the losses which have been ad- justed in the books of the company at the time of reconstruction do not cease to be "losses incurred by the company in the earlier years" within the meaning of S. 23A(1). The section requires the Income-tax Officer to take into consideration "the losses incurred by the company in the earlier years" or "the smallness of profits made." It is Well-established that the profits which are to be considered under s. 23A(j) are the commercial or the accounting profits and not the assessable income or the assessable profits, of the company, because it is the commercial or the actual accounting profits which are to form the source from which the dividend is to be distributed and not the assessable income or assessable profits which may have no relation to the commercial or accounting profits and which are not the actual source out of which the dividend could be paid.-See C.I.T., West Bengal v. Gangadhar Banerjee(1). On a similar line of reasoning the consideration of losses in the earlier years should be

made in the setting and context of the inquiry whether the company could be regarded as acting reasonably in declaring a smaller dividend. It is true that as a result of the losses having been adjusted against the paid-up, capital they no longer remain as unadjusted losses or carried forward losses but it does not mean that they cease to have any impact on the financial position of the company in sub- sequent years. Even if the company resorts to the method of wiping out the losses by adjusting them against its capital, the procedure results in crippling its finances and the company in future years may reasonably take steps for improving its crippled financial position. If therefore a company which has got over its losses for some years by adjusting them against its capital and reducing its capital makes a profit in the subsequent year it may theoretically be in a position to distribute the whole of its profits for that year but it cannot be said to have acted unreasonably if it chose not to do so and retained a portion of the profits for the purpose of building up a capital reserve which in course of time would enable the company to regain its original strength of capital which had been crippled by the adjustment of losses at the time of reconstruction. We are therefore unable to accept the argument put forward on behalf of the appellant on this aspect of the case. In our opinion, the Appellate Tribunal misdirected itself in law in holding that the losses incurred prior to the reconstruction of the respondent-company are irrelevant for the purpose of application of s. 23A of the Act in subsequent years. As we have already said, the losses incurred prior to the reconstruction having been adjusted are no longer shown in the books of the company. It does not, however, mean that the losses cease to have their effect on the financial position of the company in subsequent years. It cannot therefore be said that the losses prior to reconstruction do not fall within the ambit of the expression "losses incurred by the company in earlier years" for the purpose of the application of s. 23A of the Act. Such losses are relevant to be considered even though they may not be surviving in the books of (1) 57 I.T.R. 176.

L2S up CI/68-4 the company as unadjusted or carried forward losses. It may be that even after taking such losses into consideration it is possible to come to the conclusion that the company was not justified in not declaring a larger dividend than that actually declared. But what the Tribunal has done in this case is that it has refused to take such losses into account at all because it has taken the view that by their adjustment against the capital the losses do not survive for consideration for the purpose of the application of s. 23A of the Act. The view taken by the Appellate Tribunal is erroneous in law and we are of opinion that the High Court has rightly answered the third question in the affirmative and in favour of the respondent-company.

But it is necessary to give certain effective directions, so that a mere order of dismissal of this appeal may not result in injustice. Section 66(5) of the Act requires the Tribunal on receiving a COPY of the judgment of the High Court to pass such orders as are necessary to dispose of the case conformably to such judgment. The section clearly imposes an obligation upon the Tribunal to dispose of the appeal in the light of and conformably with the judgment of the High Court. If the High Court agrees with the view of the Tribunal, the appeal may be disposed of by a formal order. But if the High Court disagrees with the Tribunal on a question of law, the Appellate Tribunal must modify its order in the light of the order of the High Court. If for example the High Court has held that the judgment of the Tribunal is vitiated, because it is based on no evidence or because the judgment proceeds upon a misconstruction of the statute, the Appellate Tribunal would be under a duty to dispose of the case conformably with the opinion of the High Court and on the merits of the dispute, and rehear the

appeal after giving notice to the parties and redetermine it in accordance with law. In Income-tax Appellate Tribunal, Bombay and Ors. v. S. C. Cambatta and Co. Ltd.,(1) the Bombay High Court explained the procedure to be followed as under :

> when a reference, is made to the High Court either under s. 66(1) or section 66(2) the decision of the Appellate Tribunal cannot be looked upon as final; in other words, the appeal is not finally disposed of. It is only when the High Court decides the, case, exercises its advisory jurisdiction, and gives directions to the Tribunal on questions of law, and the Tribunal reconsiders the matter and decides it, that the appeal is finally 'disposed of..... it is clear that what the Appellate Tribunal is doing after the High Court has heard the case is to exercise its appellate powers under section (1) 29T.T.R.118
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> 33..... The shape that the appeal would ultimately take and -the decision that the Appellate Tribunal would ultimately give would entirely depend upon the view taken by the High Court."' This passage was quoted with approval by this Court in Esthuri Aswathiah v. The C.I.T., Mysore(1). In the present case, the High Court has held, and we agree with the High Court, that the judgment of the Appellate Tribunal is vitiated in law because it has proceeded on an erroneous interpretation of the statute. The High Court accordingly answered the third question in the affirmative and in favour of the respondent-company. We must make it clear that the answer of the High Court to this question means that the Appellate Tribunal must now, in conformity with the judgment of the High Court, act under s. 66(5) of the Act, that is to say, dispose of the case after rehearing the respondent-

company and the Commissioner in the light of the evidence and according to law.

Subject to this direction, the appeal is dismissed with costs.

R.K.P.S. Appeal dismissed.

(1) Civil Appeal No. 631 of 1966, decided on April 18, 1967.