

## Gobald Motor Service (P.) Ltd. vs Commissioner Of Income-Tax, Madras on 16 December, 1965

**Equivalent citations:** [1966]60ITR417(SC), AIRONLINE 1965 SC 15, (1966) 60 ITR 417

**Bench:** J.C. Shah, K. Subba Rao, S.M. Sikri

### JUDGMENT

Sikri, J.

1. This appeal by special leave is directed against the judgment of the High Court of Judicature at Madras in a reference made to it by the Income-tax Appellate Tribunal under section 66(1) of the Income-tax Act, 1922 hereinafter referred to as the Act. The following question of law was referred.

"Whether on the facts and in the circumstances of the case, section 23A was properly applied ?

2. The relevant facts and circumstances are as follows. The Income-tax Officer, in his order dated February 13, 1957, passed under section 23A, found that the appellant, Gobald Motor Service, hereinafter referred to as the assessee, was a private limited company which ran a fleet of buses and lorries from Mettupalayam in the accounting year relevant to the assessment year 1952-53. He arrived at the following figures in respect of the total income, taxes paid, dividend, etc. :

Rs.

Total income as finally determined	...	2,04,222
Taxes paid	...	81,529
Balances available for distribution	...	73,617
Dividends declared	...	45,000

3. On the scrutiny of these figures he came to the conclusion that section 23A of the Act was applicable because the dividend declared was less than 60% of the profits available for distribution. He then considered the point whether having regard to the profits made, i.e., profits as distinct from assessable income, the assessee could or could not have reasonably declared a larger dividend. For this purpose, he extracted

the following relevant figures :

Rs.

Book profit before appropriation of income-tax, etc.	...	1,01,902
Less : Taxes actually payable on total income as finally determined on appeal	...	81,529
Profits available for distribution	...	20,373
Dividends declared by the company	...	45,000

4. He felt these figures showed that the assessee could not reasonably have declared dividend of more than Rs. 20,373, but he observed :

"In the case of banking companies or companies with income from property, the computation of income for purposes of the Income-tax Act may in some cases be different from that adopted by the companies themselves. Hence, there may be variation between the 'assessable income' and 'profits made.' In such cases, if the companies are asked to declare dividends on the basis of 'assessable income', the companies may be forced to declare dividends out of capital which is prohibited under the Companies Act. In this case the difference between the 'assessable income' and 'profits made' is not due to any such variation on the basis of any different statutory of luggage collections and to the addition of Rs. 20,000 made on account of luggage collections and to the addition of Rs. 25,000 on account of spare parts, etc. These additions have been sustained by the Appellate Assistant Commissioner. This clearly shows that the books are not so properly maintained as to deduce the distributable income from the assessee company's book profits.

Moreover if the additions of Rs. 45,000 are made to the profits of Rs. 20,373 available for distribution, the company could very well have declared a larger dividend than what has been actually declared by it. I, therefore, apply the provisions of section 23A."

5. Accordingly, he held that "the company is deemed to have declared the dividend of Rs. 38,840 to each of the two shareholders as under :

Rs.

Net income as determined finally on appeal	...	2,04,222
Less : Taxes paid	...	81,530
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Balance available for distribution	...	1,22,692
Dividends declared	...	45,000
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Balance deemed to have been declared under this	...	77,692
order Share of dividends deemed to have been distributed under section 23A		
(1) N.Veerasami Chettiar 1/2	...	38,846
(2) N.Shanmugam Chettiar 1/2	...	38,846"

6. This order was modified by him as he found that there were six shareholders during the relevant period, and he accordingly revised the allocations amongst the six shareholders.

7. We have set out the order of the Income-tax Officer in detail because of the argument addressed to us by Mr. K. Srinivasan, the learned counsel for the assessee. One of his contentions before us was that the Income-tax Officer had not considered the question of reasonableness or unreasonableness of the amount distributed as dividend from the standpoint of business considerations such as previous losses, the present profits, the availability of surplus money and the reasonable requirements of the future, etc. It is true that the Income-tax Officer dose not appear to have borne these considerations in mind, but it may be that the assessee did not take this point before the Appellate Assistant Commissioner and the Income- tax Appellate Tribunal.

8. The Appellate Assistant Commissioner found on analysis that the difference of nearly a lakh of rupees between the total income as finally determined, namely, Rs. 2,04,222 and the book profits amounting to Rs. 1,01,902 was principally due to the following additions made in the assessment :

Rs.

(a) Spare parts, tyres, tubes, etc.	...	25,000
(b) Suppression of luggage collections	...	15,000
(c) Difference between depreciation allowed and claimed	...	34,906

9. The Appellate Assistant Commissioner held that the expenditure on spare parts had probably been inflated and the luggage collections of Rs. 15,000 had entirely been kept out of accounts. He further observed that "at the time the accounts were made up the directors must have been aware that the profits as per books were very much less than the real profits, as the book profits had been shown at a lesser figure by inflation of the first and the third items and suppression of the second item." In view of these considerations, the Appellate Assistant Commissioner held that the Income-tax Officer justified in rejection the appellant's contention regarding the adequacy of dividends declared and in applying the provisions of section 23A. The

Appellate Tribunal, on appeal, confirmed the order of the Income-tax Officer.

10. The High Court first held that on the figures the dividend declared was less than 60% of the assessable income minus the taxes, and the first condition relevant to the application of section 23A was, therefore, satisfied. Then the High Court considered the question whether, on account of the smallness of the profits made, the payment of any larger dividend than Rs. 45,000 would have been reasonable. In this connection the High Court repelled the contention of the assessee that the profits displayed by the assessee in its books of account were the only profits which could come in for consideration. It held that the concealed profits totalling nearly Rs. 40,000 had to be added to the book profits in order to arrive at the correct figure of the profits of the assessee. The High Court concluded that the Income-tax Officer certainly had material before him on the basis of which he was entitled to conclude that it would not have been unreasonable for the assessee to have declared a dividend larger than that which had actually been declared.

11. In the result the High Court answered the question in the affirmative and against the assessee.

12. Mr. Srinivasan raised two contentions before us : first that the additions in respect of luggage collections and expenditure on spare parts, tyres, tubes, etc., disallowed should not be added to the book profits because they represent only notional income. We are unable to agree to this contention. The commercial or accounting profits which have to be taken into consideration are the real commercial or accounting profits. If an item is deliberately omitted from the accounts, it cannot be said that commercial principles prevent that amount being added to the profits in order to arrive at the real commercial or accounting profits. In our opinion, the High Court was right in holding that these two items had to be added to the book profits in order to arrive at the true commercial or accounting profits of the assessee.

13. The second contention of the learned counsel for the assessee was that on the findings the Income-tax Officer was not entitled to distribute more than Rs. 60,000 because the assessee was now being made to distribute much more than the commercial profits. This may be so; but once the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividend by any company are less than 60% of the assessable income of the previous year, as reduced by the amount of income-tax and super-tax payable by the assessee in respect thereof, and that it would not be unreasonable to distribute a larger dividend than that declared, he has no option but to pass an order that the undistributed portion of the assessable income of the assessee of the previous year, as computed for income-tax purposes and reduced by the amount of income-tax and super-tax payable by the company, shall be deemed to have been distributed as dividend amongst the shareholders. But Mr. Srinivasan said that the Income-tax Officer had really not considered the question whether "having regard to the losses incurred by the

company in earlier years or to the smallness of the profits made, the payment of a dividend or a larger dividend than that declared would be unreasonable." He further urged before us that this court had held in Commissioner of Income-tax v. Gangadhar Banerjee & Co. that the burden lay upon the revenue to prove that all the conditions laid down in section 23A were satisfied before the order was made, and he said that one of the conditions was that the Income-tax Officer, after having examined the question, was satisfied that having regard to the losses incurred by the company in earlier years or to the smallness of the profits made the payment of a dividend or a larger dividend than that declared would not be unreasonable. He further relied on the following observations of Subba Rao J. in Commissioner of Income-tax v. Gangadhar Banerjee & co.

"Would the satisfaction of the Income-tax Officer depend only on the two circumstances, namely, losses and smallness of profit ? Can he take into consideration other relevant circumstances ? What does it mean commercial or accounting profits ? If the scope of the section is properly appreciated, the answer to the said question would be apparent. The Income-tax Officer, acting under this section, is not assessing any income to tax; that will be assessed in the hands of the shareholders. He only does what the directors should have done. He puts himself in the place of the directors. Though the object of the section is to prevent evasion of tax, the provision must be worked not from the standpoint of the tax collector but from that of a businessman. The reasonableness or the unreasonableness of the amount distributed as dividends as dividends is judged by business considerations, such as the previous losses, the present profits, the availability of surplus money and the reasonable requirements of the future and similar others. He must take an overall picture of the financial position of the business."

He urged that it was quite apparent from the order of the Income-tax Officer that none of the considerations pointed out by this court had been considered. We agree with him that the Income-tax Officer did not consider the question like a prudent businessman. But, as we have already said, the assessee did not raise this point either before the Appellate Assistant Commissioner or the Appellate Tribunal. If this point had been raised, the facts relating to the considerations mentioned in the observations of Subba Rao J. would have been brought on the record. We feel that it is now too late to permit him to raise this point. Further, it appears from the judgment of the High Court that the assessee's contention before it was that the expression "profits made" in section 23A refers to profits disclosed by the accounts and further to the profits of the previous year that might have been carried forward as such. The fact that this argument was raised before the High Court further shows that the assessee never urged at any previous stage that in view of previous losses and other facts, it would not be reasonable to require the assessee to distribute a larger dividend.

14. We may mention that the High Court proceeded on the assumption that concealed profits amounted to Rs. 40,000. Mr. Srinivasan said that the correct figure is Rs. 37,000, but nothing turns on the difference of the Rs. 3,000.

15. In the result, we agree with the High Court that the answer to the question must be in the affirmative. The appeal fails and is dismissed with costs.

16. Appeal dismissed.