The Commissioner Of Income-Tax,Bombay ... vs Bipinchandra Maganlal And Co. ... on 17 November, 1960

Equivalent citations: 1961 AIR 1040, 1961 SCR (2) 493, AIR 1961 SUPREME COURT 1040, ILR 1963 1 MADLJ(SC) 8, 1961 2 SCR 470, 1961 2 SCR 493, 1961 (1) SCJ 523, 1961 41 ITR 290, ILR 40 PAT 326

Author: J.C. Shah

Bench: J.C. Shah, S.K. Das, M. Hidayatullah

PETITIONER:
THE COMMISSIONER OF INCOME-TAX,BOMBAY CITY, BOMBAY

Vs.

RESPONDENT:
BIPINCHANDRA MAGANLAL AND CO. LTD.,BOMBAY

DATE OF JUDGMENT:
17/11/1960

BENCH:
SHAH, J.C.
BENCH:
SHAH, J.C.
DAS, S.K.
HIDAYATULLAH, M.

CITATION:
1961 AIR 1040 1961 SCR (2) 493
CITATOR INFO :
R 1965 SC1977 (11)
RF 1966 SC 870 (11)
R 1973 SC1034 (21)
F 1977 SC 560 (7)
R 1978 SC1099 (4,7)

ACT:
Income-tax-Profit and assessable income-Difference between -Smallness of profit--How determined-Indian Income-tax Act, 1922 (11 of 1922), SS. 10 (2) (VII) second proviso, 66(1).

HEADNOTE:
The respondent company purchased certain machinery for Rs. 89,000 and sold it for the same value, but in the books of

account the written down value of the machinery was shown in the year of account as Rs. 73,392. The Income Tax Officer in computing the assessable income of the company added the difference, i.e. Rs. 15,608, between the actual value and the written down value to the profit of the company. The Income Tax Officer also passed an order under S. 23A of the Income Tax Act, and directed that the undistributed portion of the assessable income, shall be deemed to have been distributed amongst the shareholders as dividend. Appeals against the order of the Income-tax Officer proved unsuccessful and the Appellate Tribunal referred the following question to the High Court under s. 66(1):-

"Whether the sum of Rs. 15,608 should have been included in the assessee company's "profit" for the purpose of determining whether the payment of a larger dividend than that declared by it would be unreasonable."

The High Court answered the question in the negative. On appeal by special leave,

Held, that the view taken by the High Court was correct.

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By the fiction in S. 10(2)(Vii) second proviso, read with s.2(6C), what is really not income is, for the purpose of computation of assessable income, made taxable income: but on that account, it does not become commercial profit, and if it is not commercial profit, it is not liable to be taken into account in assessing whether in view of the smallness of profits a larger dividend would be unreasonable.

"Smallness of profit" should not be equated with "smallness of assessable income" but should be determined in accordance with commercial principles.

Sir Kasturchand Ltd. v. Commissioner of Income-tax, Bombay City, (1949) XVII I.T.R. 493, Ezra Proprietary Estates Ltd. v. Commissioner of Income-tax, West Bengal, (1950) XVIII I.T.R. 762 and Commissioner of Income-tax Bombay City v. F. L. Smith & Co. (Bombay) Ltd., (1959) XXXV I.T.R. 183, referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 761 of 1957. Appeal by special leave from the judgment and order dated February 24, 1955, of the former Bombay High Court in I.T.R. 48/X of 1954.

Hardayal Hardy and D. Gupta, for the appellant. N. A. Palkhivala and I. N. Shroff, for the respondent. 1960. November 17. The Judgment of the Court was delivered by SHAH, J.-The Income Tax Appellate Tribunal, Bombay Bench "A", referred under s. 66(1) of the Indian Income Tax Act, 1922-hereinafter referred to as the Act-the following question:

> "Whether the sum of Rs. 15,608 should have been included in the assessee Company's "profit" for the purpose of determining whether the payment of a larger dividend than that declared by it would be unreasonable ?"

The High Court answered the question in the negative. Against the order of the High Court, with special leave under Art. 136 of the Constitution, this appeal is preferred.

M/s. Bipinchandra Maganlal & Co., Ltd.-hereinafter referred to as the Company-is registered under the Indian Companies Act, The Company is one in which the public are not substantially interested within the meaning of s. 23A Explanation of the Act. Its paid-up capital at the material time was Rs. 20,800 made up as follows:

> 20 shares of Rs. 50 each fully paid up and 1980 shares of Rs. 50 each, Rs. 10 being paid up per share.

In December 1945, the Company purchased certain machinery for Rs. 89,000 and sold it sometime in March, 1947, for the price for which it was originally purchased. In the books of account of the Company, the written down value of the machinery in the year of account 1946-47 (April 1, 1946 to March 31, 1947) was Rs. 73,392. The trading profits of the Company as disclosed by its books of account for the year 194647 were Rs. 33,245. At the General Meeting held on October 21, 1947. the Company declared a dividend of Rs. 12,000 for the year of account. In assessing tax for the year of assessment 1947-48, the Income Tax Officer computed the assessable income of the Company for the year of account 1946-47 at Rs. 48,761 after adding back to the profit of Rs. 33,245 returned by the Company, Rs. 15,608 realised in excess of the written down value of the machinery sold in March, 1947. The Income Tax Officer passed an order under s. 23A of the Act that Rs. 15,429 (being the undistributed portion of the assessable income of the Company as reduced by taxes payable) shall be deemed to have been distributed as dividend amongst the shareholders as at the date of the General Meeting, and the proportionate share of each shareholder shall be included in his total income. Appeals preferred against his order to the Appellate Assistant Commissioner and the Income Tax Appellate Tribunal proved unsuccessful, but the Appellate Tribunal at the instance of the Company referred the question set out hereinbefore to the High Court at Bombay under a. 66(1) of the Act. Section 23A(1) of the Act as it stood at the relevant time (in so far as it is material) was as follows:

> "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 60% of the assessable income of the company of that previous year, as reduced by the amount of 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 dividends amongst the share-holders as at the date of the general meeting aforesaid.....
>
> Clearly, by s. 23A, the Income Tax Officer is required to pass an order directing that the undistributed portion of the assessable income of any company (in which the public are not substantially interested) shall be deemed to have been distributed as dividends amongst the shareholders if he is satisfied that (i) the company has not distributed 60% of its assessable income of the previous year reduced by the Income-tax and super-tax payable, (ii) unless payment of a dividend, or a larger dividend than that declared, having regard to (a) losses incurred by the company in the earlier years or (b) the smallness of the profits made in the previous year, be unreasonable. The total assessable income of the Company for the year of account was Rs. 48,761 and the tax payable thereon was Rs. 21,332: 60% of Rs. 27,249 (assessable income reduced by the income tax and super-tax due) exceeded the dividend declared by Rs. 4,458. The first condition to the exercise of jurisdiction by the Income Tax Officer under S. 23A was therefore indisputably fulfilled.

But the Income Tax Officer had still to be satisfied whether having regard to the smallness of the profit (there is no evidence in this case that loss was incurred by the Company in earlier years), it would be unreasonable to distribute dividend larger than the dividend actually declared. The Income Tax Officer did not expressly consider this question: he rested his decision on the rejection of the contention raised by the Company that the difference between the price of the machinery realised by sale and the written down value in the year of account could not be taken into account in passing an order under S. 23A. He, it seems, assumed that if that difference be taken into account, distribution of larger dividend was not unreasonable, and the Tribunal proceeded upon the footing that the assumption was correctly made.

Counsel for the Revenue submits in support of the appeal that the expression " smallness of profit " means no more than smallness of the assessable income, and that in any event, in the computation of profits, the amount realised by sale of the machinery in the year of account in excess of its written down value was liable to be included in considering whether the condition relating to "smallness of profit" was fulfilled.

At the material time, s. 2(6C) of the Act defined "income" as inclusive amongst others of any sum deemed to be profits under the second proviso to cl. (vii) of sub-s. (2) of s.

10. By s. 10, in the computation of profits or gains of an assessee under the head "Profits and gains of business, profession or vocation" carried on by him, the amount by which the written down value of any building, machinery or plant which has been sold, discarded or demolished. or destroyed exceeds the amount for which the building, machinery or plant is actually sold or its scrap value is to be allowed as a deduction. This allowance is however subject to an exception prescribed by the second proviso to el. (vii) sub-s. (2) of s. 10 that where the amount for which any building,

machinery or plant is sold exceeds the written down value, so much of the excess as does not exceed the difference between the original cost and the written down value shall be deemed to be profit of the previous year in which the sale took place. In computing the profits and gains of the Company under s. 10 of the Act, for the purpose of assessing the taxable income, the difference between the written down value of the machinery in the year of account and the price at which it was sold (the price not being in excess of the original cost) was to be deemed to be profit in the year of account, and being such profit, it was liable to be included in the assessable income in the year of assessment. But this is the result of a fiction introduced by the Act. What in truth is a capital return is by a fiction regarded for the purposes of the Act as income. Because this difference between the price realized and the written. down value is made chargeable to income tax, its character is not altered, and it is not converted into the assessee's business profits. It does not reach the assessee as his profits: it reaches him as part of the capital invested by him, the fiction created by s. 10(2)(vii) second proviso notwithstanding. The reason for introducing this fiction appears to be this. Where in the previous years, by the depreciation allowance, the taxable income is reduced for those years and ultimately the asset fetches on sale an amount exceeding the written down value, i.e., the original cost less depreciation allowance, the Revenue is justified in taking back what it had allowed in recoupment against wear and tear, because in fact the depreciation did not result. But the reason of the rule does not alter the real character of the receipt. Again, it is the accumulated depreciation over a number of years which is regarded as income of the year in which the asset is sold. The difference between the written down value of an asset and the price realized by sale thereof though not profit earned in the conduct of the business of the assessee is nationally regarded as profit in the year in which the asset is sold, for the purpose of taking back what had been allowed in the earlier years.

A company normally distributes dividends out of its business profits and not out of its assessable income.

There is no definable relation between the assessable income and the profits of a business concern in a commercial sense. Computation of income for purposes of assessment of income tax is based on a variety of artificial rules and takes into account several fictional receipts, deductions and allowances. In considering whether a larger distribution of dividend would be unreasonable, the source from which the dividend is to be distributed and not the assessable income has to be taken into account. The Legislature has not provided in s. 23A that in considering whether an order directing that the undistributed profits shall be deemed to be distributed, the smallness of the assessable income shall be taken into account. 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. Even though the assessable income of a company may be large, the commercial profits may be so small that compelling distribution of the difference between the balance of the assessable income reduced by the taxes payable and the amount distributed as dividend would require the company to fall back either upon its reserves or upon its capital which in law it cannot do. For instance, in the case of companies receiving income from property, even though tax is levied under s. 9 of the Act on the bona fide annual value of the property, the actual receipts may be considerably less than the annual value and if the test of reasonableness is the extent of the assessable income and not the commercial profit, there may frequently arise cases in which companies may have to sell off their income producing assets. The Legislature has deliberately used the expression "smallness of profit" and not

"smallness of assessable income" and there is nothing in the context in which the expression "smallness of profit" occurs which justifies equation of the expression "profit" with "assessable income". Smallness of the profit in s. 23A has to be adjudged in the light of commercial principles and not in the light of total receipts, actual or fictional. This view appears to have been taken by the High Courts in India without any dissentient opinion, see Sir Kasturchand Ltd. v. Commissioner of Income Tax, Bombay City (1), Ezra Proprietary Estates Ltd. v. Commissioner of Income Tax, West Bengal (2) and Commissioner of income Tax, Bombay City v. F. L. Smith & Co., (Bombay) Ltd. (3).

By the fiction in s. 10(2)(vii) second proviso, read with s. 2(6C), what is really not income is, for the purpose of computation of assessable income, made taxable income: but on that account, it does not become commercial profit, and if it is not commercial profit, it is not liable to be taken into account in assessing whether in view of the smallness of profits a larger dividend would be unreasonable. In our judgment, the High Court was right in holding that the amount of Rs. 15,608 was not liable to be taken into account in considering whether having regard to the smallness of the profit made by the Company, it would be unreasonable to declare a larger dividend.

The appeal therefore fails and is dismissed with costs.

Appeal dismissed.

(1) (1940) XVII I.T.R. 493.

(2) (1950) XVIII I.T.R. 762.

(3) (1959) XXXV I.T.R. 183.