

Commissioner of Income-Tax

Vs

Urmila Ramesh.

civil appeals nos. 2141 to 2143 of 1982 with civil appeals nos. 2144 to 2146, 2147 to 2149, 2150 to 2152, 2153 to 2155 and 4204 of 1982 and 3274 of 1984, appeals from the judgment and order dated march 9, 1979, of the madras high court in tax cases nos. 256, 261, 292, 295, 296, 299, 362 and 363 of 1975, 500 and 501 of 1976, 227, 244, 245, 267, 289, 298 and 469 of 1975 and 234 and 235 of 1976. the judgment of the high court is reported as CIT v. T.S. Rajam [1980] 125 ITR 207 (Mad)

(B. P. Jeevan Reddy, K. S. Paripoornan JJ)

04.02.1997

ORDER

In this batch of cases, the following two questions of law arise for consideration (see [1980] 125 ITR 207, 210) :

"(i) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in confirming the deletion of the income assessed as deemed dividends under the provisions of section 2(22)(c) in the assessee's case ?

(ii) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the sum of Rs. 7,28,760 representing profits assessed under section 41(2) in the preceding years cannot form part of the accumulated profits for the purpose of section 2(22)(c) of the Income-tax Act, 1961 ?"

The Revenue has preferred the appeals from the common judgment rendered by the High Court of Madras dated March 9, 1979, reported as CIT v. T.S. Rajam [1980] 125 ITR 207.

We heard counsel at some length. The main facts are not in dispute. The respondents are the assesseees under the Income-tax Act. They were shareholders of a company known as "Tinnevely Motor Service Company Private Ltd.". The company carried on transport business. The Government took over all the vehicles owned by the company. The company went into liquidation. The liquidator distributed the dividends from time to time. Assessments were made for the years 1970-71, 1971-72 and 1972-73. The Income-tax Officer assessed a sum of Rs. 7,28,760, as representing profits on sale of the company's capital assets, which had been subjected to depreciation and not trading or business profits, and the company had shown it as a capital reserve. The plea of the Revenue was that though the amount was shown as capital reserve, it was purely the accumulation of profits, either assessed or equal to the amounts assessed under section 41(2) of the Act from 1962-63 to 1969-70. On this basis, it was concluded that the said amount represented the income of the shareholders under section 2(24) read with section 2(22)(c) of the Income-tax Act. The plea of the assesseees was that the amounts assessed under section 41(2) of the Act cannot be treated as "commercial profits" at all in the real sense and so, it cannot come within the mischief of section 2(22)(c) of the Act.

The High Court of Madras held that section 41(2) of the 1961 Act creates a legal fiction under which the balancing charge is treated as "business income" chargeable to tax. The legal fiction should be limited for the purpose for which it was created. The receipt of excess on written down value on the sale of capital assets cannot be held to be profit apart from the legal fiction created by section 41(2) of the Act. It cannot form part of commercial profit. So, it cannot form part of "accumulated profits" within the meaning of section 2(22)(c) read with section 2(24) of the Act and any distribution out of such amount cannot be assessed in the hands of the shareholders as "deemed dividends". If at all, it represents only a capital receipt. The above decision was rendered placing reliance on the decisions of this court rendered in (1) CIT v. Bipinchandra Maganlal and Co. Ltd. [1961] 41 ITR 290 (SC); (2) CIT v. Express Newspapers Ltd. [1964] 53 ITR 250 (SC) and (3) Cambay Electric Supply Industrial Co. Ltd. v. CIT [1978] 113 ITR 84. The first two decisions were rendered with reference to section 10(2)(vii) of the Indian Income-tax Act, 1922. The said provision clearly created a legal fiction. The third decision was rendered in the context of section 41(2) of the Income-tax Act, 1961.

Dr. Gaurishanker, senior counsel for the Revenue, submitted as follows :

The language of section 41(2) of the 1961 Act is different. Under section 41(2) of the Act, if the amount for which the asset is sold exceeds the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value, shall be chargeable to income-tax as income of the business or profession of the previous year. There is no fiction similar to the second proviso to section 10(2)(vii) of the Indian Income-tax Act, 1922. Even so, as stated in Cambay Electric Supply Industrial Co. Ltd. v. CIT [1978] 113 ITR 84 (SC), the fiction should be applied to its logical limit. If so done, the receipt of excess on written down value of the capital assets, is "income" for all purposes under the Act. There is no dichotomy in applying the above concept as "profits simpliciter" and "commercial profits". The language of section 2(22)(c) "accumulated profits" taken along with section 2(24) and section 2(45) of the Act defining "income" and "total income" read with section 5 of the Act, should be given its plain meaning and the balancing charge assessed under section 41(2) of the Act, is "profit" and the distribution thereof to the shareholders should be assessed as "dividend". Placing reliance on the decision in Bishop v. Smyrna and Cassaba Railway Company (No. 2) [1895] 2 Ch. 596, counsel contended that the income brought to tax under section 41(2) of the Act is one by way of restitution; what had been written off (allowed) for the purpose of accounts, has later been made good by the increase in value. In particular, counsel stressed the following passage occurring at page 601 of the said decision :

"It is writing back what was before written off; and I cannot for myself see why, since the amount written off was treated as a deduction from profits in former accounts, the amount that is now written up should not be treated as profits in the same way. It seems to me to be non an accretion of principal, but a restitution of what was before taken away - taken away from profits, and therefore, a restitution to profits."

On the other hand, counsel for the assesseees, Mr. T.A. Ramachandran and Mr. J. Ramamurthy, contended that there is difference between "profits" and "commercial profits", and dividend can be declared only out of commercial profits. The meaning to be given to the words "accumulated profits" should be construed in that background. The balancing charge, in the instant case, is merely

a capital reserve and cannot be treated as commercial profits and so, will not come within section 2(22)(c) of the Act. It was also contended by Sri J. Ramamurthy that section 41(2) of the Act contains words which are similar or akin to a legal fiction and so it is not correct to say that the language and import of section 10(2)(vii), proviso, of the 1922 Act and section 41(2) of the 1961 Act are different.

On hearing the rival pleas urged before us, we are prima facie of the view that the language employed in section 10(2)(vii) of the Indian Income-tax Act, 1922, and that employed in section 41(2) of the Income-tax Act 1961, are materially different. It is doubtful whether the language used in section 41(2) of the 1961 Act is akin to a legal fiction. The earlier decisions reported in CIT v. Bipinchandra Maganlal and Co. Ltd. [1961] 41 ITR 290 (SC) and CIT v. Express Newspapers Ltd. [1964] 53 ITR 250 (SC) were based on the relevant provisions of the 1922 Act. The decision in Cambay Electric Supply Industrial Co. Ltd. v. CIT [1978] 113 ITR 84 (SC) was with reference to section 41(2) of the Income-tax Act, 1961. This later decision was rendered mainly placing emphasis on section 80E of the Income-tax Act, 1961. Incidentally, the language used in section 41(2) of the Act has also been referred to as a fiction. We are prima facie inclined to the view that when once a certain amount is treated as income under the Act, it should be so for all intents and purposes - and in all situations arising under the Act. Based on this approach, it will be difficult to hold that the receipt of excess on written down value on the sale of capital assets, is a "fictional income" and cannot form part of the profits. Once it is profit, it is so for all purposes, and any distribution made out of such an amount should be assessed in the hands of shareholders as dividends. Section 41(2) of the 1961 Act plainly makes the "excess" amount "chargeable" as "income". If it is so, it will be taken in by section 2(24) read with section 2(22)(c) of the Act. An in-depth analysis of the provisions of the Indian Income- tax Act, 1922, vis-a-vis the provisions of the Income-tax Act, 1961, is called for in the circumstances. The matter is not free from difficulty. The earlier decisions of this court reported in CIT v. Bipinchandra Maganlal and Co. Ltd. [1961] 41 ITR 290 (SC) and CIT v. Express Newspapers Ltd. [1964] 53 ITR 250 (SC) were rendered by a Bench of three judges while the later decision in Cambay Electric Supply Industrial Co. Ltd. v. CIT [1978] 113 ITR 84 was rendered by a Bench of two judges.

In the circumstances and in view of the importance of the questions involved in this batch of cases, we think that it is only appropriate that this batch of cases be heard and disposed of by a larger Bench. Accordingly, we direct the registry to place the matter before the hon'ble Chief Justice for appropriate orders in this behalf.