

# **BOMBAY HIGH COURT**

Bombay Cycle Stores Co. (P.) Ltd

Vs

Commissioner of Income-Tax

(N Abhyankar, C.J. Y Tambe, J.)

24.03.1963

## **JUDGMENT**

**Tambe, J.**

1. This is a reference under sub-section (2) of section 66 of the Indian Income-tax Act and the question referred to us is "whether, under the facts and circumstances of the case, was the Income-tax Officer right in passing an order under section 23A of the Income-tax Act ?"

2. The assessee is a private limited company consisting of two partners, husband and wife. It is not in dispute that the assessee is a company in which the public are not interested. It is also not in dispute that action under section 23A could be taken against this assessee company provided the conditions mentioned therein are fulfilled. We are here concerned with the assessment year 1951-52, the accounting year being the calendar year ending 31st December, 1950. The profit and loss statement of the assessee company showed a profit of Rs. 61,483-10-6. The balance-sheet further showed that there was a loss amounting to Rs. 30,956-9-8 incurred in the previous year which was brought forward to this year and adjusted against the profits of the company. In the result the balance-sheet showed the resulting profit at Rs. 30,572-0-10. The directors in their report recommended that the said amount of Rs. 30,572 be distributed in the following manner : Rs. 29,100 to declaration of dividend on ordinary shares and preference shares. Rs. 1,427 to general reserve fund.

3. In the general meeting held on 29th June, 1951, the recommendations of the directors were adopted by the company and accordingly Rs. 29,100 had been distributed as dividend. In the assessment proceedings the assessable income determined by the Income-tax Officer was Rs. 1,05,983. The amount of income-tax and super-tax payable on that amount came to Rs. 42,311, leaving a balance of Rs. 63,672. The amount distributed as dividend, viz., Rs. 29,100, being less than 60 per cent. of the balance, action under section 23A of the Income-tax Act was taken by the Income-tax Officer against the assessee. The order of the Income-tax Officer was affirmed in appeal by the Appellate Assistant Commissioner of Income-tax as well as by the Appellate Tribunal.

4. The contention raised by the assessee was that having regard to the loss incurred by the assessee company in the previous year and having regard to the smallness or profit cannot be

said that the dividend declared was unreasonable or that it would be reasonable to say that the assessee company could have declared a larger dividend than declared by it. It appears that it was also argued that the assessee company was liable to pay the tax liability of Rs. 42,311 should be taken into consideration in determining the question of smallness of profits and the reasonableness as to the declaration of a higher dividend. The Tribunal has overruled this contention and the decision appears to be influenced by the fact that the assessee company had a general reserve of Rs. 41,337 which had been created out of the distributable profits of the previous year. On a requisition made by this court, the Tribunal has submitted a statement of the case and referred to this court the question quoted above.

5. In our judgment, the answer will have to be in favour of the assessee. It is well settled that in considering the question as to the reasonableness or otherwise of the distribution of dividend what has to be taken into consideration is the commercial profits and the question that an Income-tax Officer and the Tribunal have to consider is whether in the circumstances of the case it would be reasonable for a businessman to declare a dividend higher than what he has declared. In considering the question, the subsidiary question that arises for consideration is what were the distributable profits available in the hands of the assessee company at the time the annual general meeting is held. As pointed out by this court, in ascertaining the amount of distributable profits the approximate tax liability on commercial profits has also to be taken into consideration : *vide New Mahalaxmi Silk Mills Ltd. v. Commissioner of Income-tax. Keeping these principles in view the facts of this case will have to be approached.*

6. Now, the commercial profits ascertained in this case by the Tribunal are, for the purposes of this reference, Rs. 61,483. The approximate tax liability on the said amount of Rs. 61,483 would be about Rs. 28,000. It had been found that over Rs. 12,000 and odd have been paid by the assessee as advance payment of income-tax and excess profits tax. Thus on the date of the annual general meeting the approximate tax liability that had remained to be satisfied on the footing that the income of the assessee company was Rs. 61,483 was about Rs. 16,000. Taking that amount from the said amount of Rs. 61,483, the available distributable profits in the hands of the company were about Rs. 45,000 to Rs. 46,000. The company had only distributed Rs. 29,000 and odd. Had the matter rested here we would have no hesitation in upholding the decisions of the Appellate Tribunal that the assessee company could reasonably have distributed a larger dividend. But the matter does not rest there. It is the company's case that it had incurred a loss in the previous year to the extent of Rs. 30,000 and that according to the assessee company had to be taken into account in consideration the question whether an order under section 23A of the Income-tax Act should be made or not.

7. The contention of the assessee company is well-founded on the language of the section as it then stood which directs the Income-tax Officer to have regard to the losses incurred by the company in earlier years as well as to the smallness of the profits made by it. The Tribunal has taken a view that the amount of loss need not be taken into account because there were accumulated reserves which exceeded the amount of the loss. In our opinion that approach was not a proper approach as is required by law. Section 23A requires the losses incurred in the previous year to be taken into consideration in considering the question of reasonableness or otherwise of the distribution of dividend by the company. Whether the losses of the previous year should be adjusted against the profits of the current year or should be adjusted against the reserve is for the businessman to consider. In our opinion, it could not be for the Income-tax Officer to

direct a businessman the manner in which he should conduct his business. If the businessman chooses to adjust the losses in the previous year against the profits of the current year he is within his right to do so and that has to be taken into consideration in deciding whether an order under section 23A of the Income-tax Act should be made or not.

8. If the two amounts are taken into consideration, viz., the approximate tax liability remaining to be paid on commercial profits, viz., Rs. 61,000 and odd, and the loss of previous year, viz., 16,000 and Rs. 30,000 respectively, and if they are deducted from the commercial profits of Rs. 61,000 and odd, the balance that comes is about Rs. 15,000. The company has already distributed dividend to the extent of Rs. 29,000. In these circumstances, in our opinion, the Tribunal was not justified in holding that this was a case in which an order under section 23A of the Income-tax Act should be made.

9. It has been argued on behalf of the revenue that the commercial profits ascertained are not Rs. 61,483 but Rs. 61,483 plus Rs. 24,375 received by the assessee company from Messrs. Shah Trading Company Limited and which have been included in the assessable income of the company. There is slight difficulty in the way of Mr. Joshi because the statement of the case proceeds on the footing that the amount of commercial profits ascertained by the Tribunal is only Rs. 61,483. However, we would proceed on the footing that the commercial profits ascertained by the Tribunal amount to Rs. 61,483 plus Rs. 24,375, which together would come approximately to about Rs. 86,000. The tax liability on this amount would be about Rs. 35,000. It is not disputed by the revenue that the tax liability on Rs. 86,000 would come to about Rs. 35,000. The previous losses admittedly are over Rs. 30,000. If Rs. 65,000 are deducted from Rs. 86,000 available distributable profits would only be to the extent of Rs. 21,000. The company has distributed a dividend of Rs. 29,000. Even on this footing, with respect, it is not possible to sustain the order section 23A of the Income-tax Act.

10. For the reasons stated above, in the result we answer the question referred to us in the negative.

11. The department shall pay the costs of the assessee.

12. Question answered in the negative.