

# PATNA HIGH COURT

Universal Bank of India

Vs

Commissioner of Income-Tax, Ltd

(Narasimham, C.J.)

15.04.1966

## JUDGMENT

### **Narasimham, C.J.**

1. These two reference are in relation to the assessment year 1952-53 and 1953-54. The assessee is a banking company. The Income-tax Officer had taken action against it under section 23A of the Indian Income-tax Act and made an order that the undistributed portion of the assessable income of the company of the previous years reduced by the amount of income-tax and super-tax payable by the company was to be deemed to have been distributed as dividend among shareholders. The assessee went against that order to the Appellate Assistant Commissioner, but without success. It then appealed to the Income-tax Appellate Tribunal, where there was difference of opinion between the two members of the Tribunal on some points, and, ultimately, the appeal was referred to a third member. The result was that the application of the provisions of section 23A of the Act was annulled. Against that, the revenue wanted a reference under section 66(1) of the Income-tax Act. When the Tribunal refused that prayer, the revenue came to this court and obtained a rule under sub-section (2) of section 66 of the Act calling upon the Income-tax Appellate Tribunal to state a case formulating the point for consideration of this court as follows :

"Whether, on the facts and in the circumstances of the case, the provisions of section 23A of the Indian Income-tax Act have been properly applied according to law to the assessee-company by the Appellate Tribunal for the years under consideration ?"The previous year in relation to the two assessment years were calendar years 1951 and 1952, respectively. It is now undisputed that the accounting or commercial profit for 1951 was Rs. 52,519 and the actual tax liability was Rs. 31,129 the balance being Rs. 21,390. The corresponding figures for the previous year 39,521 and Rs. 10,283 the balance being Rs. 29,238. The banking company had transferred Rs. 25,000 during each of the two years to the reserve fund under section 17 of the Banking Companies Act. 20% of the profit, which is required at least to be transferred till the reserve fund is equate with the capital issued,

comes to Rs. 10,504 and Rs. 7,904 respectively, in those two years. Deducting those amounts from the accounting profit reduced by the tax liability, the net balance came to Rs. 10,886 for the year 1951 and Rs. 21,334 for the year 1952. The Tribunal was of the opinion that in view of the smallness of profit it could not have been reasonable for the assessee-banking company to distribute that as dividend amongst the shareholders.

The subscribed and paid up capital of the company is Rs. 20,00,000. Compared with that, the commercial profit for the year 1951 (Rs. 10,886) would work to about 1/2 % and by the same calculation the profit for the year 1952 will come to about 1%.

Section 23A of the Indian Income-tax Act, as it stood during the period under examination, has three stages. The first stage is that if any company, in which public are not substantially interested, has not distributed at all or distributed less than 60% of its assessable income for a particular previous year reduced by the liability for the income-tax and super-tax as dividends to the shareholders, the Income-tax Officer can assume jurisdiction under section 23A of the Act. In this case, it has been found and not now challenged that in the assessee-company the public are not substantially interested. Admittedly, no dividend was distributed though there was an assessable income reduced by tax liability. The second stage is what the taxing officer will have to consider next. He will have to keep in view all relevant matters in regard to the overall financial position of the company including its loss, if any, in earlier years, and smallness, if so, of the commercial profit of the year in question and find if he distribution (if made) or non-distribution of dividend was unreasonable. If he thinks that was unreasonable, he will proceed to the third stage; otherwise nothing more will be done and the proceeding will be dropped. The third stage is about the final orders saying that the assessable income reduced by the tax liability will be deemed as dividends distributed. This is obviously by way of penalty, as it were, for the company having not done what was reasonable for it to do. The dividend has a higher tax incidence and is assessable in the hands of the shareholders. On the fact of the present case, the Tribunal held that the non-distribution of any dividend was reasonable and the orders made under section 23A were unjustified in both the years.

Learned counsel, appearing for the revenue, contended that the Tribunal took irrelevant matters into consideration for deciding that the non-distribution was not unreasonable. He argued that though matters other than previous loss and profit could be taken into account, the extent of the dividend that could have been distributed was not one such matter. The opinion of the Appellate Tribunal that a company should not have declared a dividend of 1/2 or 1% was challenged. It is true that the Account Member held that any dividend less than 5% was not justifiable. The third Member, to whom the appeal was referred on

account of difference between the two Members of the Patina Bench, agreed with the Accountant member that "an adequate percentage of dividend is a proper factor in the determination of the reasonableness to declare it"; but he disagreed that 5% was to be taken as the minimum and, if that was not available, non-distribution of any dividend was to be held reasonable. In this opinion, however, the available profit of 1951 and 1952 was too small for distribution. When section 23A itself specifically requires the extent of the available profit to be taken into account to see if it is small enough, what amount of dividend, if distribution would have been, necessarily falls for consideration. The two are inter-related. The credit of shares of a company in stock exchange depends also upon what dividend was declared in the immediate past. So that cannot be said to be an irrelevant matter for consideration under section 23A. The view that dividend not exceeding 1 1/2% was too small, as stated by the third Member, is the same, as the net commercial profit available was too small to justify a distribution of dividend. That was a legitimate opinion. Actually, the available not profit could have given about 1/2 % and 1% dividend in 1951 and 1952, respectively. We can recall here what the Supreme Court said in the case of Commissioner of Income-tax v. Gangadhar Banerjee & Co. (Private) Ltd.

"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 not what the directors should have done. He put himself in the place of the directors. Though the object of the section is to prevent evasion of tax, the provisions must be worked not from the standpoint of the tax collector but from that of a businessman. The yardstick is that of a prudent businessman. The reasonableness or he unreasonableness of the amount distributed a 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. It is neither nor advisable to lay down any decisive tests for the guidance of the Income-tax Officer. It depends upon the facts of each case. The only guidance is his capacity to put himself in the position of a prudent businessman or the director of a company and his sympathetic and objective approach to the difficult problem that arises in each case. We find it difficult to accept the argument that the Income-tax Officer cannot take into consideration any circumstances other than losses and smallness of profits. This argument ignores the expression having regard to that precedes the said words."

It is now well settled and beyond any range of doubt that the profit which is to be

considered with reference to its smallness or otherwise is the net commercial profit available in the "previous year" only. Judged by the standard indicated in the aforesaid decision of the Supreme Court, the non-distribution of dividend cannot be said to be unreasonable. Learned counsel contended that after having provided for all contingencies, such as, reserve fund, etc., the company had this amount left in its hands and it could have easily distributed that amount. In other words, if this argument is pushed to its logical consequence, it will come to this : Whenever any fund, however small, is found available for distribution as dividend, its non-distribution will amount to an unreasonable act on the part of the company. Section 23A does not contemplate that at all. If it were so, then the consideration of smallness of the profit would not have been stated to be one of the essential considerations before the provisions under that sections are applied to a particular case. If in the decision of the Supreme Court, to which reference has already been made above, admittedly Rs. 4,000 at least were found available for distribution with the company, still it was held was that non-distribution of that amount was not unreasonable on the facts of that case. If the relevant matters other than the losses of the earlier years or the smallness of the profit of the previous year are to be taken into account while considering the case under section 23A, then the aspect which was considered by the Appellate Tribunal with reference to the likelihood of the commercial credit of the company being affected by the distribution of the merge dividend cannot be said to be outside the scope of the section 23A. But, as we have indicated, apart from that consideration, the other undisputed factors, particularly in regard to the smallness of the profit compared to the amount of subscribed and paid-up capital, could be taken as a justifying cause for non-distribution of dividends in this case. Learned counsel referred to the case of Srinivas Banking Company Ltd. v. Commissioner of Income-tax. He relied upon certain observations which, according to him, indicated the principle that is to be followed in a case where the provisions under section 23A are to be applied. He referred to the passage where the learned judge observed as follows :

"The percentage (of profit) compared to the paid-up capital may be small but the shareholding may have been distributed in such a manner that each shareholder would get a substantial sum."

That, learned counsel continued, should be a very relevant matter for consideration in the instant case. The capital structure disclosed that the shareholdings were concentrated to a very large extent in the hands of one person and his wife, and a small portion of the shares, about 45,000 shares, were owned by others. In that view, even if a small dividend was declared, the amount receivable by the two of the shareholders would have been quite substantial. It is difficult to accept this contention for more than the one reason. What will be the amount of dividends

available in the hands of a particular shareholder cannot be a legitimate consideration in a case where the application of the provisions under section 23A is in issue. Profit ceases to be profit when it is distributed. It becomes dividend with the shareholders. With reference to a particular year, the extent of profit (net) has to be judged as to whether it is small or large compared to the capital put in the working of a company. Even in the Calcutta case, their Lordships did not proceed to examine the question with reference to the capital structure. They, no doubt, stated that there were no materials available on the record before them to form any idea about the capital structure, and for that reason they abandoned it. Even while stating the argument advanced on behalf of the other side in that respect and repelling the same, they observed :

"We are, therefore, not inclined to go into this question in this reference." In our view, the other observation, which we have already referred to, does not lay down that the capital structure is a relevant matter to be taken into account with reference to the smallness of the profit. That is relevant no doubt, to the question if the public are substantially interested in and assessee-company, which is a basic consideration under section 23A. Another argument for the revenue was that large sums were available to the assessee-company from its reserve fund. If the company would have declared a dividend, it would not have been faced with any difficulty so as to fall back upon its capital and it could have easily carried on with money taken from the reserve fund, if necessary. Reserved fund in this case was created by the assessee-company as it was statutorily required to do under section 17 of the Banking Companies Act and, for working purposes, working capital cannot be drawn from that the reserve in the ordinary course. No other materials were placed by the revenue to show that any fund other than that was available or any reserve fund had been created in an inflated manner with any mala fide intention so as to reduce the commercial profit of the relevant previous years. If the revenue could have shown that, then certainly that would have been a very pertinent factor to be considered, and possibly the non-distribution of dividends would have been held to be unreasonable. In the absence of any such materials and on the facts available on record, there can be little doubt that the profit earned was very small and that its distribution by way of dividend would not have been reasonable. Consideration is to be based on commercial standards as held by the Supreme Court and also as stated in the Calcutta decision where it was said :

"The tax authorities must show that it was commercially possible for the company to distribute as dividend a reasonable part of its actual income."

The question, as framed, does not appear to have been properly worded. Provisions of section 23A of the Income-tax Officer originally. But that was annulled by the Appellate Tribunal. Therefore, the question should be reframed as follows : "Whether, on the facts and in the

circumstances of the case, the provisions of section 23A of the Income-tax Appellate Tribunal for the assessment years 1952-53 and 1953-54 ?To this question, our answer will be in the negative and for the assessee, that is to say, the provisions of section 23A of the Act were not applicable against the assessee for both the years.The two references are, accordingly, disposed of. The revenue will pay a consolidated sum of Rs. 200 (rupees two hundred) as costs to the assessee.Question answered in the negative.