

PETITIONER:
C. I. T. (CENTRAL) CALCUTTA

Vs.

RESPONDENT:
ASIATIC TEXTILE LTD.

DATE OF JUDGMENT 09/08/1971

BENCH:
HEGDE, K.S.
BENCH:
HEGDE, K.S.
GROVER, A.N.

CITATION:
1973 AIR 2323 1972 SCR (1) 81
1971 SCC (3) 536

ACT:
Income-tax Act, 1922, s. 23A (1)-Direction of Company deciding not to distribute profit owing to huge capital loss-Capital loss a relevant consideration-Reasonableness of decision has to be looked at from view point of prudent business man.

HEADNOTE:
The assessee was a limited company doing business as selling agents of a Textile Mill. During the previous years relevant for the assessment years 1955-56 and 1956-57 the company had assessable profits but did not declare dividend, because capital loss far in excess of profits was incurred by it due to fall in value of its share-holdings. The Income-tax Officer exercised his powers under s. 23A (1) and levied additional super-tax on the distributable surplus in the relevant years. The Appellate Assistant Commissioner, the Tribunal and the High Court however, took the opposite view, holding that in the circumstances it was not reasonable to expect the company to declare dividend. In appeal to this Court by the Revenue,
HELD : Whether in a particular year dividend should be declared or, not is a matter primarily for the Directors of a company. The Income-tax Officer can step in under s. 23A(1) only if the Directors unjustifiably refrain from declaring dividend.- If the Directors of a company had reasonable grounds for not declaring any dividend, it is not open for the Income-tax Officer to constitute himself as a super-Director. 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 business man. [85C-E]
Commissioner of Income-tax, West Bengal v. Gangadliar Bannerjee & Co. (P) Ltd. 57 1. T. R. 176, relied on.
In the present case in view of the capital loss of Rs. 12 lacs as found by the Tribunal, any reasonable body of Directors of a company would have done just what the Directors of the Assessee company did. The Income-tax Officer took an erroneous view of s. 23A (1). [85H]
The fact that the company continued to hold the shares whose value could possible go up again was irrelevant. The Directors of a company will be justified in taking things as

they stand and not be fool themselves in the wild hope that the value of the shares may come up again. [86C]
It would be incorrect to say that capital loss cannot be taken into consideration in the application of s. 23A(1). [86E-F]
Commissioner of Income-tax v. Williamson Diamonds Ltd. 35 I.T.R. 290, applied.
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JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeals Nos. 1687 and 1688 of 1968

Appeals from the judgment and order dated August 29, 30, 1967 of the Calcutta High Court in Income-Tax Reference No. 16 of 1964.

S. Mitra, R. N. Sachthey and B. D. Sharma, for the appellant (in both the appeals).

M. C. Chagla, S. M. Jain, B. P. Maheshwari and R. K. Maheshwari for the respondent (in both the appeals).

The Judgment of the Court was delivered by Hegde, J.-These appeals by certificate arise from the decision of the Calcutta High Court in Income-tax Reference No. 16 of 1964 on its file. Therein the High Court was considering a reference made by the Income Tax Appellate Tribunal 'B' Bench Calcutta under section 66 (1) of the Indian Income Tax Act, 1922-to be hereinafter referred to as 'the Act'. The question of law which was referred for the opinion of the High Court reads thus :

"Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that in view of the capital loss of Rs. 12,00,000/- suffered by the assessee on account of depreciation in the value of the shares of Messrs. Elphinstone Mills Ltd. payment of any dividend at all during any of the two relevant accounting years would have been unreasonable ?"

The assessment years with which we are concerned in these appeals are 1955-56 and 1956-57, the corresponding accounting years being the years ending on June 30, 1954 and June 30, 1955.

The assessee is a limited company doing business as selling agents of a Textile Mill. For the assessment year 1955-56 the assessee was assessed on a total income of Rs. 1,61,089/- and taxes paid were Rs. 69,973/- leaving a distributable balance of Rs. 91,116/-. According to the Profit & Loss Account, however, the company suffered a net loss of Rs. 11,63,874/- and this was due to the loss of Rs. 12,00,000/- on account of depreciation in the value of

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shares held by the company in Elphinstone Mill Ltd. of Bombay. The Income-tax authorities disallowed an amount of Rs. 11,88,000/ out of this loss on the ground that it relates to the price paid for the shares purchased for the sake of acquiring the managing agency of the: Elphinstone Mills Ltd. The Tribunal upheld the disallowance on the ground that the amount of Rs. 11,88,000/was a loss relating to shares held by the company in its, investment account. The company however, did not declare any dividend for the year in question. The Income-tax Officer in exercise of his powers under Section 23 A(1) levied additional super-tax @ -/4/- per rupee on the distributable surplus of Rs. 91,116/-. In so doing be ignored. the loss in the value of

the, shares in Elphinstone Mills. Ltd.
For the assessment year 1956-57 the total income assessed was Rs. 1,07,429/- and the taxes payable thereon were Rs. 46,668/- leaving a distributable surplus of Rs60,761/-. In this year also the company did not declare any dividend because of the loss referred to earlier. The income-tax Officer, however, again invoked the provisions of Section 23A (1) and levied additional super-tax @ -/4/- per rupee on the surplus of Rs. 60,761/-.

In appeal, the Asstt. Commissioner took the view that the loss incurred by the company was a capital loss. But all the same as there was no commercial profits in the relevant accounting years it was not reasonable to expect the assessee company to declare any dividend in respect of those years in view of the capital loss incurred and he, therefore, cancelled the orders of the Income-tax Officer under section 23A (1).

Aggrieved by the Order of the Appellate Assistant Commissioner, the department appealed to the Tribunal. The Tribunal agreed with the conclusions reached by the Appellate Assistant Commissioner. It held that under the circumstances the Directors were justified in 'not declaring any dividend in respect of the profits that had accrued in the accounting years.

At the instance of the Commissioner, the Tribunal submitted to the High Court of Calcutta the question of law set out by us earlier. The High Court answered that question in favour of the assessee.

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The Tribunal-the final fact finding authority has come to the conclusion that the assessee had incurred a capital loss of Rs. 12,00,000/- as a result of the depreciation of the value of the shares of Elphinstone Mills Ltd. The question is whether that was a relevant circumstance for not 'declaring any dividend. The further question is whether the Directors of the assessee company acted as prudent businessmen in refraining from declaring any dividend. Section 23A (1) of the Act reads :

" Where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company within the twelve months immediately following the expiry of that previous year are less than the statutory percentage of the total income of the company of that previous year as reduced by-

(a) the amount of income-tax and super-tax payable by the company in respect of its total income, but excluding the amount of any super-tax payable under this section

(b) the amount of any other tax levied under any law for the time being in force on the company by the Government or by a local authority in excess of the amount, if any, which has been allowed in computing the total income; and

(c) in the case of a banking company, the amount actually transferred to a reserve fund under section 17 of the Banking Companies Act, 1949;

the Income-tax Officer shall, unless he is satisfied that, having regard to the losses incurred by the company in earlier years or to the smallness of the profits made in the previous year, the payment of a dividend or a

larger dividend than that declared would be unreasonable, make an order in writing that the company shall, apart from the sum determined as payable by it on the basis of the assessment under section 23, be liable to pay super-tax at the rate of fifty per cent in the case of a company whose business consists wholly or mainly in the

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dealing in or holding of investments, and at the rate of thirty-seven per cent in the case of any other company on the undistributed balance of the total income of the previous year, that is to say, on the total income as reduced by the amounts, if any, referred to in clause (a), clause (b) or clause (c) and the dividends actually distributed, if any."

Whether in a particular year dividend should be declared or not is a matter primarily for the Directors of a company. The Income-tax Officer can step in under Section 23A (1) only if the Directors unjustifiably refrain from declaring dividend. If the Directors of a company had reasonable grounds for not declaring any dividend, it is not open for the Income-tax Officer to constitute himself as a super-Director. As observed by this Court in Commissioner of Income-tax, West Bengal, v. Gangadliar Bannerjee and Co. (Pvt.) Ltd.' the Income-tax Officer, in considering whether the payment of a dividend or a larger dividend than that declared by a company would be unreasonable within the meaning of Section 23A of the Act does not assess any income to tax. He only does what the directors should have done putting himself in their place. 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 unreasonableness of the amount distributed 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. The Income-tax Officer must take an overall picture of the financial position of the business. He should put himself in the position of a prudent businessman or the director of a company and deal with the problem with a sympathetic and objective approach.

On the facts found by the Tribunal, there can be hardly any doubt that the assessee had suffered a capital loss of Rs. 12,00,000/-. In our opinion, in view of the the said loss, any reasonable body of Directors of a company would have done just what the Directors of the

(1) 57 I.T.R., 176.

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assessee company did. We think, that the Income-tax officer took an erroneous view of the scope of Section 23A (1). Mr. Mitra, learned counsel for the department contended that the assessee had not in fact incurred any loss though the value of the shares had gone down in the market. As the assessee was still in possession of those shares, there was still a possibility of avoiding the anticipated loss. Hence there was no occasion to take note of the depreciation in the value of the shares in the matter of declaration of dividends. This is an unacceptable contention. The Directors of a company will be justified in taking things as they stand and not befool themselves in the wild hope that the value of the shares may come up again. They are expected to act as hard headed businessmen. They are not

expected to gamble with the future of the concern. The question is not whether the value of the shares may not go up in future but whether the Directors were justified in not declaring dividends in view of the loss incurred. The Income-tax Officer overlooked the fact the Directors were naturally more interested in the stability of their concern rather than in increasing the tax payable to the Government. Before the High Court, it appears to have been urged Mr. Mitra rightly did not press that plea that the loss incurred being a capital loss the same cannot be taken into consideration in the application of Section 23A (1). This very contention was examined and rejected by the Judicial Committee in Commissioner of Income-tax v. Williamson Diamonds Ltd.(1). In that case their Lordships were considering the scope of section 21 (1) "(Consolidation) Ordinance, 1950 of Tanganyika." That provision corresponds very closely to Section 23A (1) of the Act. Dealing with the scope of that provision, their Lordships observed:

"It does not follow from what has been said that capital losses should not be taken into account by the Commissioner. Two matters are mentioned specifically in the words which give him a direction the first is 'losses' (as interpreted above) and the second is 'smallness of profit.'" The Commissioner
(1) 35 I.T.R.. 290.

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is directed to come to a decision upon the question whether "the payment of a dividend or a larger dividend than that declared" is unreasonable.

"The form of the word used no doubt lends itself to, the suggestion that regard should be paid only to the two matters mentioned, but it appears to their Lordships that it is impossible to arrive at a conclusion as to reasonableness by considering the two matters mentioned isolated from other relevant factors. Moreover, the Statute does not say 'having regard only' to losses previously incurred by the company and to the smallness of the profits made. No answer which can be said to be in any measure adequate, can be given to the question "unreasonableness" considering these two matters only. Their Lordships are of the opinion that the Statute by the words used while making sure that "losses and smallness of profit" are never lost sight of require all matters relevant to the question of unreasonableness to be considered capital loss, if established is one of them." We respectfully agree with these observations.

For the reasons mentioned above, these appeals fail and they are dismissed with costs. One hearing fee.

G.C.

Appeals dismissed.

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