

## **The Commissioner of Income Tax, Haryana, Himachal Pradesh and Delhi-III, New Delhi Vs M/s Krishan Parshad and Company Pvt. Ltd., Ambala City**

**Court:** High Court Of Punjab And Haryana At Chandigarh

**Date of Decision:** Sept. 20, 1971

**Acts Referred:** Income Tax Act, 1961 " Section 256(1)

**Citation:** (1974) 1 ILR (P&H) 383

**Hon'ble Judges:** H.R. Sodhi, J; D.K. Mahajan, J

**Bench:** Division Bench

**Advocate:** D.N. Awasthy with Mr. B.S. Gupta, for the Appellant; Assa Ram Aggarwal with M/s R.N. Mittal and D.K. Gupta, for the Respondent

### **Judgement**

D.K. Mahajan, J.

In this reference u/s 256(1) of the income tax Act, 1961, the only question that requires determination is whether in the circumstances of the case section 104 is attracted?

2. The assessee-company derives its income from interest on securities, dividends and hire-purchase business. The dispute in this case relates to

the assessment year 1963-64, accounting year ending 30th September, 1962. The total income, of the assessee-company in the year ending 30th

September, 1962, was Rs. 58,336/-. Initially, the assessment was completed u/s 143(3) on 28th November, 1963, and the income assessed was

at Rs. 58,037/-. It was enhanced to Rs. 58,336/- by an order u/s 154 dated 13th September, 1967. A notice u/s 105(1) of the income tax Act,

1961, was issued to the company on 17th June, 1965, requiring it to show cause why penal super-tax be not levied for non-distribution of the

prescribed percentage of the distributable profits as dividends.

3. The stand taken by the assessee company in reply to the said notice was as follows:-

In the accounting year ending 30th September, 1962 (assessment year 1963-64) there was a profit of Rs. 58,798/-. Out of this a sum of Rs.

30,000/- was provided for the payment of income tax for this very year and a further sum of Rs. 36,838.98 had to be paid as income tax for the

previous years over and above the provisions already made for those years. The deficiency of about Rs. 10,000/- was met from the "contingency

fund". There was, thus, no payment of profit left in the hands of the company to pay any dividend.

The Company has shown losses during the assessment year 1957-58, 1958-59 and 1959-60 on account of huge amounts of "Bad Debts" written

off by the company in those years. The learned income tax Officer disallowed these "bad debts" along with other items like "carry forward" in the

vehicle account and "loss in the sale of securities". This resulted in the payment of heavy amount of income tax by the company for which no

provision was made or anticipated. A sum of Rs. 36,838.98 was paid from out of the profits of the year in question and the balance of about Rs.

77,000/- had to be met from out of the profits of the succeeding years. Therefore, there was no question of payment of dividend to the share-

holders during the year, mentioned above.

This stand was not accepted by the income tax Officer and he passed an order imposing penal super-tax at the rate of 37% of Rs. 29,168/-

amounting to Rs. 10,792/-. The reasons given by the income tax Officer for rejecting the stand taken by the assessee were:-

(a) The assessee had a "contingency reserve" of Rs 7,50,000/- as on 1st October, 1961, and a further provision of Rs. 26,838.98 was made

during the year under consideration out of profits for the year ending 30th September, 1962, as "provision; for contingency". This shows that the

financial position of the assessee was very sound and as such it was incumbent upon the assessee to declare the dividends. If the deficiency of Rs.

10,000/- for payment of income tax could be met out of the contingency fund, the dividends as well could be paid from the same source which is

nothing else but the accumulated undistributed profits in the hands of the company.

(b) No doubt the assessee suffered business loss in 1957-58 on account of bad debts, but this old loss was finally adjusted in the year 1962-63

and after that the assessee has been earning good income. Even in the earlier years the assessee had good income from sources other than

business. The company had sufficient liquid assets from which the dividends could have been easily paid.

4. Against this decision, an appeal was taken to the Appellate Assistant Commissioner of income tax. The Appellate Assistant Commissioner

rejected the appeal for the following reasons:-

The first argument urged by the Learned Counsel for the company is that the distribution as per resolution dated 30th November, 1963, should be

taken into account in deciding whether the statutory percentage of profit was distributed. It is argued that the income tax Officer has to consider the

revenue effect as on the date of passing the order. Since on the date of passing the order u/s 104(1) the company had already declared the

dividend it is urged that distribution of the dividend under the provisions of the section would not have resulted in gain to revenue. This argument is

unacceptable as what the company has to show in this connection u/s 104(2)(ii) is that a distribution within the period of twelve months would not

have resulted in benefit to the revenue, and not that the distribution having been made subsequently there would not be any further gain to revenue.

Otherwise the time limit of 12 months laid down in the section has no meaning.

The second argument advanced is that the provisions of section 105(1) lend support to the appellant's argument discussed above as they

contemplate that distribution can be made later on receipt of notice from the income tax Officer. This is also not a valid plea as the said provisions

applied only to the fractional short-fall in distribution referred to therein and not to cases in which no dividend has been declared.

Thirdly it is urged that though the period of 12 months is mentioned in the section the income tax Officer has power to condone delay if distribution

is made later. This plea is unacceptable as Learned Counsel for the company is unable to cite any authority or legal provision in support of this

view.

Fourthly, it is argued that the non-declaration of dividend is justified by the smallness of the profits within the meaning of section 104(2)(i). It is

stated that the entire profit of this year has been wiped out by payment of taxes of this year and arrears of tax for earlier years amounting to Rs.

37,839/-. This argument is untenable as the tax payable for this year has been taken into account while considering the distributable surplus while

the taxes for earlier years were fully covered by the provision for income tax which stood at Rs. 1,78,938/- as at the beginning of the previous year

(exclusive of the provision of Rs. 30,000/- of the previous year). Apart from the provision for taxation the company had a General Reserve of Rs.

7,82,000/- as at the end of the year after the payment of arrears of tax amounting to Rs. 37,839/-. The profits of this year cannot, therefore, be

considered small on this ground.

Next, it is argued that non-declaration of the dividend was also due to loss of earlier years. This is also not a valid reason as the past losses had

been wiped out by subsequent profits in the accounts of the company and a substantial general reserve mentioned above had been created.

It is further argued that as per balance sheet there were bad and doubtful debts of Rs. 1,52,350/- and some provision was necessary in respect of

bad debts. It is admitted that there were no bad debts even upto the assessment year 1968-69. If the company considered any provision

necessary in this connection it would be undoubtedly have made it in the accounts. Since this was not done and no bad debts were in fact incurred

even in the subsequent five years and the company had ample general reserves. this is not a valid reason for non-declaration of dividend.

Lastly, it is urged that u/s 205 of the Companies Act dividends can be paid only out of profits of the year. This argument does not help the

appellant as there were sufficient profits available for the year out of which the required dividend could be declared.

5. Against the order of the Appellate Assistant Commissioner, a further appeal was taken to the income tax Appellate Tribunal. The Tribunal, while

allowing the appeal observed as under:-

It is now well known that section 104 (old section 23A) was an anti-avoidance section. The purpose of this section was to see that a rich person

with larger incomes should not evade super-tax by the simple expedient of not declaring dividends. The *raison d'être* was to check and plug this

loophole. It is, therefore, laid out in section 104(2) that this section should not be invoked unless there was a loss of revenue by non declaration. In

this case, there was a further reasoning in as much as the assessee had to pay and had paid more than 2 1/2 lakhs of income tax of which the

details have been given. We, therefore, consider that there was a reasonable cause for the assessee not to declare a larger dividend than it did. We

also see that the main purpose of the section viz., to force the private companies to declare appropriate dividends was also duly served. We,

therefore, see no reason to support the order u/s 104 which is hereby annulled.

However, the Tribunal observed in the last paragraph of its order that in their opinion the assessee had reasonable cause for not declaring a larger

dividend before the expiry of 12 months because of the taxes falling due and which were paid during the year.

6. An application was made by the Department u/s 256(1) of the income tax Act, 1961, and in pursuance of that application, the following

question of law has been referred to this Court for our opinion:-

Whether in the circumstances of the case, section 104 was attracted?

Mr. Awasthy, Learned Counsel for the Department, contended that the decision of the Tribunal that there was sufficient cause for explaining the

delay in declaring the dividend cannot be supported either on principle or authority. According to the Learned Counsel, there is no provision in the

income tax Act which enables the income tax Officer to extend the period fixed by section 104(1) within which the dividend has to be declared.

It is also maintained by the Learned Counsel that on the facts and in the circumstances of the present case the decision of the income tax. Officer

and the Appellate Assistant Commissioner was correct and the Tribunal has gone wrong in holding that there was reasonable cause for the

assessee not to declare a larger dividend than it did. The Learned Counsel maintains that it is no reason to hold that the dividend was declared.

According to him, the dividend had to be declared in terms of section 104. In other words, it had to be declared within twelve months immediately

following the expiry of the previous year, i.e., before the 30th September, 1963. There is no question of extending this period for any reasonable

cause.

7. On the other hand, it is contended by the Learned Counsel for the assessee that the mere fact that there were reserves with the company is no

ground that the dividend should be declared out of those reserves. The dividend had to be declared out of the profits of that year and as the

position as to profits was precarious the dividend could not be declared. A clear position emerged after the period specified in section 104(1) had

expired when the order allowing refund of income tax was passed and as soon as it was passed the company declared the dividend. It is

maintained that it is not a case where an attempt has been made to circumvent the provisions of section 104. On the other hand, the conduct of the

company shows that there was a keen desire on their part to comply with the aforesaid provision. It is also maintained that the approach of the

authorities is wrong because they have gone on the basis that the bad debts had been previously adjusted. This is no ground in law as not to accept

the explanation offered by the assessee.

8. Before we proceed to examine the contentions of the Learned Counsel for the assessee, it will be appropriate to set out section 23A of the

income tax Act, 1922 and section 104 of the income tax Act, 1961. These provisions are reproduced side-by-side for facility of reference:-

23A 104

23A(1) Where the income tax Officer is satisfied 104(1) Subject to the provisions of sub-section

that in respect of any previous year the profits (2) and of sections 105, 106 and 107, where the

and gains distributed as dividends by any income tax Officer is satisfied that in respect of

company within the twelve months immediately any previous year the profits and gains

following the expiry of that previous year are less distributed as dividends by any company within

than the statutory percentage of the total income the twelve months immediately following the

of the company of that previous year as reduced expiry of that previous year are less than the

by  $\frac{1}{2}$  statutory percentage of the distributable income

of the company of that previous year, the income

tax Officer shall make an order in writing that the

company shall, apart from the sum determined as payable by it on the basis of the assessment u/s 143 or section 144, be liable to pay supertax at the rate of  $\tilde{A} \hat{A} \hat{A} \frac{1}{2}$

(a) the amount of income tax and super-tax (a) fifty per cent, in the case of an investment payable by the company in respect of its total company, and income, but excluding the amount of any super-tax payable under this section;

(b) the amount of any other tax levied under any (b) thirty-seven per cent, in the case of any other law for the time being in force on the company company, on the distributable income as reduced by the Government or by a local authority in by  $\tilde{A} \hat{A} \hat{A} \frac{1}{2}$  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 (i) the amount of dividends actually distributed, actually transferred to a reserve fund u/s 17 of and the Banking Companies Act, 1949 (10 of 1949); the income tax Officer shall, unless he is (ii) any expenditure actually incurred bona fide satisfied  $\tilde{A} \hat{A} \hat{A} \frac{1}{2}$  for the purposes of the business, but not deducted in computing the income chargeable under the head ""Profits and gains of business or profession"" being  $\tilde{A} \hat{A} \hat{A} \frac{1}{2}$

(i) that having regard to the losses incurred by (a) a bonus or gratuity paid to an employee, the company in earlier years or to the smallness of the profits made in the previous year, the (b) legal charges, payment of a dividend or a larger dividend than that declared would be unreasonable: or

(ii) that the payment of a dividend or a larger (c) any such expenditure as is referred to in dividend than that declared would not have clause (c) of section 40, resulted in a benefit to the revenue;

make an order in writing that the company shall, (d) any expenditure claimed as a revenue apart from the sum determined as payable by it expenditure but not allowed to be deducted as on the basis of the assessment u/s 23, be liable to such and not resulting in the creation of an asset

pay super-tax at the rate of fifty per cent in the or enhancement in the value of an existing asset.

case of a company whose business consists wholly or mainly in the 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.

(2) No order under sub-section (1) shall be made,  $\tilde{\hat{\Delta}}_{\hat{\Delta}}^{\hat{\Delta}} \frac{1}{2}$  order under sub-section (1) if he is satisfied  $\tilde{\hat{\Delta}}_{\hat{\Delta}}^{\hat{\Delta}} \frac{1}{2}$

(i) in the case of a company whose business (i) that, having regard to the losses incurred by consists wholly or mainly in the dealing in or the company in earlier years or to the smallness holding of investments which has distributed not of the profits made in the previous year, the less than ninety per cent of its total income as payment of a dividend or a larger dividend than reduced by the amounts, if any, referred to in that declared would be unreasonable; or clause (a) clause (b) or clause (c) of sub-section

(1); or

(ii) in the case of any other company whose (ii) that the payment of a dividend or a larger distribution falls short of the statutory percentage dividend than that declared would not have by not more than five per cent of its total income resulted in a benefit to the revenue; or as reduced by the amounts, if any, aforesaid; or

(iii) in any case where according to the return (iii) that at least seventy-five per cent of the share made by a company u/s 22 it has distributed not capital of the company is throughout the previous less than the statutory percentage of its total year beneficially held by an institution or fund income as reduced by the amounts, if any, established in India for a charitable purpose the aforesaid, but in the assessment made by the income from dividend whereof is exempt u/s 11.

income tax Officer u/s 23 a higher total income is arrived at and the difference in the total income does not arise out of the application of the proviso to section 13 or subsection (4) of section

23 or the omission by the company to disclose its income fully and truly; unless the company, on receipt of a notice from the income tax Officer that he proposes to make such an order, fails to make within three months of the receipt of such notice a further distribution of its profits and gains so that the total distribution made is not less than the statutory percentage of the total income of the company as reduced by the amounts, if any, aforesaid.

9. It is common ground that the provisions of both these sections are more or less identical. The decisions u/s 23-A of the 1922-Act hold good so

far as section 104 of the 1961-Act is concerned.

10. The ambit and scope of section 23-A of the 1922-Act was considered in Commissioner of Income Tax, West Bengal Vs. Gangadhar

Banerjee and Co. (Private) Ltd., The relevant observations are at pages 181-82 and are quoted below:-

The section is in three parts; the first part defines the scope of the jurisdiction of the income tax Officer to act u/s 23-A of the Act; the second part

provides for the exercise of the jurisdiction in the manner prescribed thereunder and the third part provides for the assessment of the statutory

dividends in the hands of the shareholders. This section was introduced to prevent exploitation of juristic personality of a private company by the

members thereof for the purpose of evading higher taxation. To act under this section the income tax Officer has to be satisfied that the dividends

distributed by the company during the prescribed period are less than the statutory percentage, i.e. 60 percent, of the assessable income of the

company of the previous year less the amount of income tax and super-tax payable by the company in respect thereof. Unless there is a deficiency

in the statutory percentage, the income tax Officer has no jurisdiction to take further action thereunder. If that condition is complied with, he shall

make an order declaring that the undistributed portion of the assessable income less the said taxes shall be deemed to have been distributed as

dividends amongst the shareholders. But before doing so, a duty is cast on him to satisfy himself that, having regard to the losses incurred by the

company in earlier years or "the smallness of the profit made", the payment of a dividend or a larger dividend than that declared would be

reasonable. The argument mainly centred on this part of the section. Would the satisfaction of the income tax Officer depend only on the two

circumstances, namely, losses and smallness of profit? Can he take into consideration other relevant circumstances? What does the expression

"profit" mean? Does it mean only the assessable income or does it mean commercial or accounting profits? If the scope of the section is properly

appreciated the answer to the said question would be apparent. The Income tax Officer, acting under this section, is not assessing any income to

tax: that will be assessed in the hands of the shareholder. He only does what the directors should have done. He puts himself in the place of the

directors. 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 yardstick is that of a prudent businessman The reasonableness or the 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. He must take an overall picture of the financial position of the business. It is neither

possible 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 also settled law that the burden lies upon the revenue to prove that all the conditions laid down in section 23-A are satisfied, before an order

can be made thereunder. See in this connection Gobald Motor Service (P.) Ltd. Vs. Commissioner of Income Tax, Madras, and Commissioner of

Income Tax, West Bengal Vs. Gangadhar Banerjee and Co. (Private) Ltd.,

11. It was also urged by the Learned Counsel for the assessee that the period of limitation of twelve months prescribed in section 104(1) is not

mandatory. We do not agree. In M. M. SUGAR MILLS PRIVATE LTD. Vs. Income Tax OFFICER, GONDA, AND OTHERS., it was held

that the period of limitation prescribed is mandatory. We are in respectful agreement with the ratio of this decision. If there is no commercial profit

or the same is small, section 104(1) will not come into play. But in case the commercial profits are such that a larger dividend should have been

declared and it is not declared whereby liability u/s 104(1) is incurred, there will be no escape from the period of limitation prescribed in the said

sub-section. There is no provision permuting the enlargement of the said period on any considerations of sufficient cause, like section 5 in the

Limitation Act.

12. What has to be ascertained in the first place is the commercial profits and their quantum. The profits have to be worked out keeping in view the

test laid down in Commissioner of Income Tax, West Bengal Vs. Gangadhar Banerjee and Co. (Private) Ltd., The next step is to distribute those

profits so as not to attract the applicability of section 104(1). All this pre-supposes that during the account year there are enough profits or to put in

terms of section 104(2) "having regard to the smallness of the profits made in the previous year. the payment of dividend or a larger dividend than

that declared would be unreasonable", so as to attract section 104(1). The position, therefore, can be that either there are no profits, or if there are

profits they are so small that a larger dividend cannot be declared. In this situation, section 104(1) will not come into play. It will only come into

play if there are sufficient profits to warrant the declaration of a larger dividend and that dividend has not been declared within the prescribed

period.

13. There is no dispute that the refund of income tax was made in November, 1963, whereas the period of three years prescribed in section

104(1) expired in September, 1963. As we understand the finding of the Tribunal the liabilities to tax during the year were to the tune of Rs.

2,50,000/-. Of course, they were not the liabilities of that very year and were the liabilities of the previous years. But the fact still remains that the

total liability to tax during the year was Rs. 2,50,000/- and this is the reason adopted by the Tribunal in coming to the conclusion that "there was a

reasonable cause for the assessee not to declare a larger dividend than it did". The so-called larger dividend could have been declared if only the

profits of that year and the tax liability of that year had been kept in view. If that was so, the Tribunal would not be driven to the conclusion that

there was a reasonable cause for the assessee not to declare a larger dividend than it did. The fact that there was tax liability was accepted even by

the Appellate Assistant Commissioner. But he took the view that as the company had a general reserve of Rs. 7,82,000/- at the end of the year,

after the payment of arrears of tax amounting to Rs. 37,839/-, the profit of the said year could not be said to be small. The position during the year,

apart from arrears of tax or losses is as follows:-

income tax assessed on 13th September, 1967... Rs. 58,336/-

Deduct:

Taxes payable ... Rs. 29,168/-

Balance:

Distributable surplus ... .. Rs. 29,168/-

If the arrears of tax amounting to Rs. 37,839/- are taken into account, it will appear that there was no surplus left with the company out of its

income for the year so as to enable it to declare a dividend. The dividend was declared in November, 1963, only because during that month the

company obtained a sizable amount as refund of income tax. It appears to us that the decision of the Tribunal may appear to be erroneous if

examined superficially, but is none-the less correct in as much as the Tribunal proceeded on the admitted facts in coming to the conclusion that

there was sufficient cause for not declaring the dividend during the year. What in fact it wanted to convey was that there were no funds available

during the year to enable the company to declare the dividend within the time prescribed. The funds came into the hands of the company after the

prescribed period and as soon as it got the funds, it declared the dividend. It is true that it would have been better if the Tribunal had directly

approached the problem and had given a direct decision. In the statement of the case it is clearly stated that ""having regard to the past losses and

the circumstances of the case the assessee had a reasonable cause for not declaring a larger dividend before the expiry of twelve months because

of the tax falling due and which were paid ""during the year"". The concept of reasonable cause" entered the mind of the Tribunal because there were

past losses and arrears of tax due.

14. On the question whether the arrears of tax cannot be taken into account to determine the profits of a particular year, there is a conflict of

judicial opinion. The Madras High Court in GOBALD MOTOR SERVICE LTD. Vs. COMMISSIONER OF Income Tax, MADRAS., , and

Commissioner of Income Tax, Madras Vs. Associated Drug Co. (P.) Ltd., has taken the view that it can be done, whereas a contrary view has

been taken by the Patna High Court in Commissioner of Income Tax Vs. R.N. Bagchi and Brothers, . In our opinion, keeping in view the test laid

down in Commissioner of Income Tax, West Bengal Vs. Gangadhar Banerjee and Co. (Private) Ltd., the Madras view appears to be correct and

we have no hesitation in following it. With utmost respect to the learned Judges of the Patna High Court, we record our dissent to the proposition

that only the taxes of the year in which profits have been earned can alone be taken into account to determine whether a dividend should or should

not be declared.

15. We, however, do not agree with the view of the Tribunal that the period of limitation fixed in section 104(1) can be enlarged for a sufficient

cause. If we had come to the conclusion that in fact there was sufficient profit after taking into account the losses as well as the arrears of tax, we

would have had no hesitation in answering the question in favour of the Revenue. As already observed, the true ratio of the Tribunal's decision is

that the profits were not enough to warrant declaration of the dividend. But we do not agree with the following observations of the Tribunal:-

Before closing, we might recall one aspect of the case; section 23A of the income tax Act, 1922, was one of the most controversial section of the

Act of 1922 because it worked against the economic interest of the country. It was brought on the statute book only as an anti-avoidance measure

and, therefore, great caution was needed in its application. There have been difficulties in its application and it has been improved gradually and in

the section 104 of the new Act of 1961 several new features have been incorporated whereby all the undesirable features have been removed. The

revenue should study the changes brought about in the scheme carefully before applying this section. It is true that there is a technical default of two

months in declaring the dividends and perhaps, therefore, it could be argued that the section was technically attracted. However it cannot be

forgotten that the main purpose of the section itself was served and the company distributed the required amount of dividend though late. We,

therefore, feel that this was not a fit case for the application of section 104. To put it in legal language, in our opinion, the assessee had reasonable

cause for not declaring a larger dividend before the expiry of 12 months because of the taxes falling due and which were paid during the year.

The aforesaid reasoning proceeds on the basis that it had the power to enlarge the time fixed in section 104(1) for a sufficient cause. To this view,

we take exception. The period fixed in section 104(1) cannot be enlarged and we have already dealt with that matter in detail earlier.

16. For the reasons recorded above, we answer the question referred to us in the negative, that is in favour of the assessee and against the

Department. There will be no order as to costs.