(1962) 02 CAL CK 0002

Calcutta High Court

Case No: IT Reference No. 91 of 1956

Commissioner of Income Tax		APPELLANT
	Vs	
Sri Bibhuti Bhusan Dutt		RESPONDENT

Date of Decision: Feb. 1, 1962

Acts Referred:

- Income Tax Act, 1922 - Section 10, 2(6A), 9

Citation: (1963) 48 ITR 233

Hon'ble Judges: Ray, J; G.K. Mitter, J

Bench: Division Bench

Advocate: E.R. Meyer and B. Pal, for the Appellant;R. Pal and J. Pal, for the Respondent

Judgement

G.K. Mitter, J.

The only question referred to us in this case is " Whether, on the facts and in the circumstances of the case, the Tribunal was justified in excluding Rs. 46,200 from the sum computed by the income tax Officer as available for distribution to the shareholders by Dutt Estates Limited?" The facts are as follows: The assessee was one of the three sons of Raghunath Dutt, deceased. The company, Dutt Estates Limited, was formed in 1930 to take over the properties of the said deceased. The assessee with his wife held 1/3rd of the issued share capital of 210 shares. There were some disputes and dissensions among the brothers in the year 1944, which were referred to the arbitration of Das J. (as he then was) and an award was made by him with the consent of the three brothers. In pursuance of the said award various. immoveable properties belonging to the company, Dutt Estates Ltd., were allotted to the shareholders including the assessee in this case. Three lots of properties were allotted to the three brothers and the valuation of each lot of property to be transferred from the company to the assessee and his brothers was fixed at Rs. 2,34,473-5-4. The balance-sheet of the company as at 31st March, 1948, showed that the total valuation of the properties exceeded Rs. 22,00,000 so that the loss on distribution of assets amounted to Rs. 15,46,688-7-3 and this was shown in the balance-sheet under the heading "Property and Assets". According to the income tax Officer "this transaction resulted in the distribution of the assets within the meaning of section 2(6A) of the Indian income tax Act and as such the dividend paid out of the undistributed profit by way of distribution of assets must be brought to tax in the hands of each of the shareholders". Under the relevant portion of section 2(6A) dividend includes:

"(a) any distribution by a company of accumulated profits, whether capitalized or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company."

2. As on the 31st March, 1947, the company''s profit and loss account disclosed a credit of Rs. 2,52,939-6-3. The said amount was shown in the Profit and Loss Appropriation Account for the year ending 31st March, 1948, to which were added the net profit from house property and investment raising the total to Rs. 2,55,232-5-6. This last mentioned amount was shown in the balance-sheet of the company for the year ended March 31, 1948, under the heading "capital and liabilities" and deducting from it the amount of income tax, i.e., Rs. 64,995, paid up to 31st March, 1947, the figure of undistributed profit came to Rs. 1,87,944-6-3. The income tax Officer not only took this figure into consideration for finding out the profits of the company which were held to be distributed among the shareholders as a result of the transfer of assets but he also added two other items under the heading "capital liabilities", namely, depreciation fund, Rs. 46,200 and "reserve for bad debts", Rs. 8,652. The company ultimately went into liquidation in the year 1956. The Tribunal held that the "reserve for bad debts" was profits in the hands of the company which could be treated as dividend for the purpose of section 2(6A) but not the sum of Rs. 46,200. The transfer of the assets took place on the 19th April, 1947, that is to say, very soon after the preparation of the balance-sheet as at 31st March, 1947, disclosing a profit balance of Rs. 2,52,939. The Tribunal observed:

"If there was a distribution of assets, the first thing to distribute would be the surplus of profit remaining in the hands of the company. As such we must hold that the balance at the credit of the profit and loss account was distributed to the shareholders in the process of transfer of these assets. We, however, find that the quantum of the surplus profits has to be adjusted and we do not agree with the computation made by the income tax Officer. We do not find any reason why the income tax Officer added the depreciation reserve amounting to Rs. 46,200 and we also do not find any reason for the addition of the refund of income tax of Rs. 2,187-8-0. The reserve for depreciation fund was no doubt created out of the profits but this was a reserve created as against the depreciation of the properties in the normal way. In the alternative the company could have written off the reserve from the cost of the properties in which case the income tax Officer could not find any reason to add this sum. In fact depreciation reserve is not a reserve on which dividend could be paid. It was merely a reserve created against the depreciation of the property."

3. This reference does not concern the figure of Rs. 2,187-8-0 and the only question before us is whether the Tribunal was right in knocking off the sum of Rs. 46,200 from the quantification of the profits as was done by the income tax Officer. There is no question before us as to the applicability of section 2(6A) to the assessment and the parties agreed and proceeded on the basis that there was distribution by the company entailing release of its assets within the meaning of section 2(6A) of the Indian income tax Act. Mr. Meyer, learned counsel for the revenue, urged that the order of the income tax Officer went to show that it was a property-holding company and as such the computation of profits could only be u/s 9 of the Act in which case the question of depreciation would not come in at all. On the other hand, it was argued for the assessee that there was nothing on the record to show whether the computation was done u/s 9 or section 10. However that may be, the balance-sheet prepared by the company shows that a depreciation fund was created which stood at the figure of Rs. 46,200 as on 31st March, 1948.

4. What are "divisible profits" have been dealt with in Palmer''s Company Law, twentieth edition, Chapter 64. "divisible profits", according to the learned author, means the profits which the law allows the company to distribute to the shareholders by way of dividend. The terms "divisible profits" and "profits in the legal sense" are synonymous. At page 637 the learned author goes on to add: "It is evident from the preceding observations that it is legally permissible for the company to distribute dividend out of assets which do not represent profits made as the result of its trading or business. The connotation of divisible profits, or profits in the legal sense, is much wider than that of profits in the business sense: the former term includes, e.g., reserves accumulated from past profits, from realised capital profits, indeed, before the requirement of a share premium account by the 1947-1948 legislation, from premiums obtained on issue of new shares, whereas none of these items is regarded-and rightly so-by the businessman or accountant as trading profits". Rule 4 with the heading "loss of depreciation of assets" of the same book, at page 639, reads:

"Loss or depreciation of fixed capital does not affect the divisible profits or render it necessary to make good the same out of income."

5. According to rule 7 of Palmer''s Book "profits carried to reserve remain profits unless capitalized". Mr. Meyer also drew our attention to a passage, from the judgment of Lord President Clyde, in the case of Edward Collins & Sons Ltd. v. Commissioners of Inland Revenue [1930] 12 Tax Cas. 773, reading:

"It is, however, quite consistent with this that a prudent commercial man may put part of the profits made in one year to reserve, and carry forward that reserve to the next year, in order to provide against an expected, or (it may be) an inevitable, loss which he foresees will fall upon his business during the next year. This process is a familiar one. But its adoption has no effect on the true amount of the profits actually made, and does not prevent the whole of the profits, whereof a part is put to reserve, from being taken into computation in the year in question for purposes of assessment. On the contrary, the balance of profits and gains is determined independently altogether of the way in which the trader uses that balance when he has got it; and, if he puts part of it to reserve and carries it forward into the next year, that has no effect whatever upon his taxable income for the year in which he makes the profit."

6. Mr. Meyer also relied on the observations of Lawrence L. J. on the question of reserves in the case of Naval Colliery Co. Ltd. v. Inland Revenue Commissioners [1928] 12 Tax Cas. 1017 :

"These entries in my opinion show that the company purported to allocate a portion of its receipts during the accounting period to a reserve fund in order to meet the expenditure which the company intended subsequently to incur in making good the capital loss which the company had suffered. It is well settled, and indeed was not disputed, that a sum set aside for reserve to meet apprehended losses in the future is not deductible from receipts when ascertaining profits for income tax purposes as it is not an expenditure before ascertaining profits but an application of the profits themselves. In my opinion the same principle applies to a reserve fund set aside out of income to meet a loss to fixed capital assets which although in fact incurred during the accounting period has not been made good during that period."

7. Mr. Meyer argued that a part of the profits had been set apart to provide against depreciation and it was open to the company to distribute the profits at any time it wanted to without applying the same for the purpose for which they were set apart. According to Mr. Meyer once it was shown that a portion of the profits of the company had been carved out and set apart towards meeting the depreciation of the fixed assets and this depreciation fund was added to year after year it must be held that the company had created a reserve out of the accumulated profits within the meaning of the expression used in section 2(6A) of the Act.

8. On behalf of the assessee it was argued that immoveable properties suffer depreciation with the course of time and it is up to the company to show not the actual price at which the properties were bought but to provide for depreciation year by year and reduce the value of the property to that extent. Our attention was drawn to a passage in Book-keeping and Accounts, Chapter III, page 48, by Spicer and Pegler, reading:

"Unless provision is made for depreciation, the balance-sheet cannot be said to present a true and fair view of affairs, since the assets will be shown at an amount which is in excess of the true amount of the unexpired expenditure incurred on their acquisition."

9. Dr. Pal also drew our attention to a passage in Palmer''s Company Law, Eighteenth edition, at page 215, under the Chapter "Dividends and Profits", reading:

"A balance-sheet need not state the actual value at the moment of all the company''s assets. It may show what the particular assets cost, not what they are worth. Thus, if a company buys a property for �10,000 and the value has fallen to �1,000 it can still legally be entered in the balance-sheet as property that cost �10,000. But the balance-sheet must make it clear that the �10,000 represents the cost price (Companies Act, 1929, section 124(1)), and the amount written off for depreciation must be deducted. See clause (2) of the First Schedule to the Act of 1947."

10. On the basis of this Dr. Pal argued that the company might as well have taken into consideration the depreciation which the fixed assets suffered year by year and shown the value of the assets as reduced by the depreciation suffered at the end of each year in its balance-sheets and if this course had been adopted the value of the properties in the balance-sheet as at 31st March, 1948, would not have been Rs. 22,00,000 as shown therein but that amount less Rs. 46,200. If this were done the reserve for depreciation would not have figured in the balance-sheet at all and the question of distribution of profits thereout would not have arisen. We are not, however, concerned with what the assessee might have done. We are only concerned to see what the assessee has done as a matter of fact and we find that the company''s balance-sheet shows that it had created a depreciation fund, which means that year by year a portion of the profit had been set apart to augment that fund and whether the company would ultimately have spent the amount on repairs of the properties or modernizing the same or in buying a new property to add to the number of properties is not for us to consider. The balance-sheet shows that this fund was there created out of capital and that being so we must hold that the Tribunal was wrong in deleting the sum of Rs. 46,200 from the accumulated profits as disclosed. Dr. Pal drew our attention to section 23A of the income tax Act as it stood before the amendment by the Finance Act of 1955 and relied on the judgment of the Supreme Court in the case of Commissioner of Income Tax, Bombay City Vs. Bipinchandra Maganlal and Co. Ltd., for the purpose of showing that business profits and assessable income were not in all cases the same. Relying on this he argued that according to a good businessman he would distribute profits only after taking into account the depreciation of the property and if that basis of computation were adopted the depreciation would not have figured under the heading "capital and liabilities" as shown in the balance-sheet of the company. As already pointed out we must go by the actual facts of the case and not the courses which might have been open to an assessee. Our attention was drawn by Mr. Meyer to the following observations of Lord Greene M.R. in Henriksen (Inspector of Taxes) v. Grafton Hotel Ltd. [1942] 24 Tax Cas. 453:

"It frequently happens in income tax cases that the same result in a business sense can be secured by two different legal transactions, one of which may attract tax and the other not. This is no justification for saying that a taxpayer who has adopted a method which attracts tax is to be treated as though he had chosen the method which does not, or vice versa."

With respect, the same can be said here. We, accordingly, hold that the assessee''s contention cannot be accepted and the question referred to us must be answered in the negative. The assessee must pay the costs of this reference. Certified for two counsel.

Ray, J.

I agree.