

A THE COMMISSIONER OF INCOME-TAX, MADRAS

v.

URMILA RAMESH ETC.

FEBRUARY 4, 1997

B [B.P. JEEVAN REDDY AND K.S. PARIPOORNAN, JJ.]

Income Tax Act, 1961 : Sections 2(22)(c), 2(24) and 41(2).

Income Tax Act, 1922 : Section 10(2)(vii) :

C *Income Tax—Assessee shareholder of a Transport Company—Liquidation of Company—Distribution of dividends from time to time by liquidator—Assessment for 1970-71, 1971-72 and 1972-73—Expression "Accumulated profits"—Meaning of—Whether covers balancing charge brought to tax and shown as capital reserve by Company—Amount assessed under Section 41(2) as profits on sale of liquidated company's capital assets whether covered and distribution made out of such an amount whether assessable in the hands of shareholders as deemed dividends—Held an indepth analysis of the provisions of 1922 Act vis-a-vis the provisions of 1961 Act is called for—In view of the importance of questions involved matter referred to a larger Bench.*

E *Commissioner of Income-tax Tamil Nadu I v. T.S. Rajam, (1980) 125 ITR 207; C.I.T. v. Bipinchandra Maganlal & Co. Ltd., (1961) 41 ITR 290 SC; CIT v. Express Newspapers Ltd., (1964) 53 ITR 250 SC; Cambay Electric Supply Industrial Co. Ltd. v. CIT, (1978) 119 ITR 113; Cambay Electric Supply Industrial Co. Ltd. v. Commissioner of Income-tax, Gujarat - II, 113 ITR 84 and Bishop v. Smyrana and Cassaba Railway Company (No. 2), (1895) 2 Ch. 596, referred to.*

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 2141-43 of 1982 Etc.

G From the Judgment and Order dated 9.3.79 of the Madras High Court in T.C. No. 267 of 1975.

Dr. V. Gaurishankar, S. Rajappa and B.K. Prasad for the Appellant.

T.A. Ramachandran and A.T.M. Sampath for the Respondent in

H C.A. No. 2150-52/82.

J. Ramamurthy, Ms. Janki Ramachandran for the Respondent in A
C.A. No. 3274/84.

The following Order of the Court was delivered :

In this batch of cases, the following two questions of law arise for B
consideration :

(i) Whether, on the facts and in the circumstances of the case, C
the Appellate Tribunal was justified in confirming the deletion of the income assessed as deemed dividends under the provisions of S. 2(22)(c) in the assessee's case?

(ii) Whether, on the facts and in the circumstances of the case, D
the Appellate Tribunal was right in law in holding that the sum of Rs. 7,28,760 representing profits assessed under section 41(2) in the preceding years cannot form part of the accumulated profits for the purpose of section 2(22)(c) of the Income-tax Act, 1961?

2. The Revenue has preferred the appeals from the common judgment rendered by the High Court of Madras dated 9.3.1979, reported as *Commissioner of Income-tax, Tamil Nadu I v. T.S. Rajam*, (1980) 125 ITR 207. E

3. We heard counsel at some length. The main facts are not in dispute. The respondents are assesseees under the Income-tax Act. They were shareholders of a company known as "Tinnevely Motor Service Company Private Ltd.". The company carried on transport business. F
government took over all the vehicles owned by the company. The company went into liquidation. The Liquidator distributed the dividends from time to time. Assessments were made for the years 1970-71, 1971-72 and 1972-73. The Income-tax Officer assessed a sum of Rs. 7,28,760, as representing profits on sale of company's capital assets, which had been subjected to depreciation and not trading or business profits, and the company had shown it as a capital reserve. The plea of the Revenue was that though the amount was shown as capital reserve, it was purely the accumulation of G
profits, either assessed or equal to the amounts assessed under Section 41(2) of the Act from 1962-63 to 1969-70. On this basis, it was concluded that the said amount represented the income of the shareholders under H

A Section 2(24) read with Section 2(22)(c) of the Income-tax Act. The plea of the assesseees was that the amounts assessed under Section 41(2) of the Act cannot be treated as 'commercial profits' at all in the real sense and so it can not come within the mischief of Section 2(22)(c) of the Act.

B 4. The High Court of Madras held that Section 41(2) of the 1961 act creates a legal fiction under which the balancing charge is treated as "business income" chargeable to tax. The legal fiction should be limited for the purpose for which it was created. The receipt of excess on written down value on the sale of capital assets cannot be held to be profit apart from the legal fiction created by Section 41(2) of the Act. It cannot form part of commercial profit. So, it cannot form part of "accumulated profits" within the meaning of Section 2(22)(c) read with Section 2(24) of the Act and any distribution out of such amount cannot be assessed in the hands of shareholders as "deemed dividends". If at all, it represents only a capital receipt. The above decision was rendered placing reliance on the decisions of this Court rendered in (1) *CIT v. Bipinchandra Maganlal & Co. Ltd.*, (1961) 41 ITR 290 SC; (2) *CIT v. Express Newspapers Ltd.*, (1964) 53 ITR 250 SC; (3) *Cambay Electric Supply Industrial Co. Ltd. v. CIT*, (1978) 119 ITR 113. The first two decisions were rendered with reference to Section 10(2)(vii) of the Income-tax Act, 1922. The said provision clearly created a legal fiction. The third decision was rendered in the context of Section E 41(2) of the Income-tax Act, 1961.

5. Dr. Gaurishanker, Senior Counsel for Revenue submitted as follows :

F The language of Section 41(2) of 1961 Act is different. Under Section 41(2) of the act, if the amount for which the asset is sold exceeds the written down value, so much of the excess as does not exceed the difference between the actual costs and the written down value, *shall be chargeable* to income-tax as income of the business or profession of the previous year. There is *no fiction*, similar to the second proviso to Section 10(2)(vii) of the Income-tax Act, 1922. Even so, as stated in *Cambay Electric Supply Industrial Co. Ltd. v. Commissioner of Income-tax, Gujarat-II*, 113 ITR 84; the fiction should be applied to its logical limit. If so done, the receipt of excess on written down value of the capital of assets, is "income" for all purposes under the Act. There is no dichotomy in applying the above G H concept as "profits simpliciter" and "commercial profits". The language of

Section 2(22)(c) "accumulated profits" taken along with Section 2(24) and Section 2(45) of the act defining "income" and "total income" read with Section 5 of the Act, should be given its plain meaning and the balancing charge assessed under section 41(2) of the Act, is "profit" and the distribution thereof to the shareholders should be assessed as "dividend". Placing reliance on the decision in *Bishop v. Smyrna and Cassaba Railway Company (No. 2)*, (1895) 2 Ch. 596, counsel contended that the income brought to tax under section 41(2) of the Act is one by way of restitution; what had been written off (allowed) for the purpose of accounts, has later been made good by the increase in value. In particular, counsel stressed the following passage occurring at page 601 of the said decision :

It is writing back what was before written off; and I cannot for myself see why, since the amount written off was treated as a deduction from profits in former accounts, the amount that is now written up should not be treated as profits in the same way. It seems to me to be not an accretion of principal, but a restitution of what was before taken away -- taken away from profits, and therefore a restitution to profits."

On the other hand, counsel for the assessee, Mr. T.A. Ramachandran and Mr. J. Ramamurthy, contended that there is difference between "profits" and "commercial profits", and dividend can be declared only out of commercial profits. The meaning to be given to the words "accumulated profits" should be construed in that background. The balancing charge in the instant case, is merely a capital reserve and cannot be treated as commercial profits and so, will not come within Section 2(22)(c) of the Act. It was also contended by Sri J. Ramamurthy, that Section 41(2) of the Act contains words which are similar on akin to a legal fiction and so it is not correct to say that the language and import of Section 10(2)(vii) proviso of 1922 Act and Section 41(2) of 1961 Act are different.

6. On hearing the rival pleas urged before us, we are *prima facie* of the view that the language employed in Section 10(2)(vii) of the Income Tax Act, 1922 and that employed in Section 41(2) of the Income-tax Act, 1961, are materially different. It is doubtful, whether the language used in Section 41(2) of the 1961 Act is akin to a legal fiction. The earlier decisions reported in *CIT v. Bipinchandra Maganlal & Co. Ltd.*, (1961) 41 ITR 290 SC and *CIT v. Express Newspapers Ltd.*, (1964) 53 ITR 250 SC were based

- A on the relevant provisions of 1922 Act. The decision in *Cambay Electric Supply Industrial Co. Ltd. v. Commissioner of Income-tax, Gujarat-II*, 113 ITR 84 was with reference to Section 41(2) of the Income-tax Act, 1961. This later decision was rendered mainly placing emphasis on Section 80E of the Income-tax Act, 1961. Incidentally, the language used in Section 41(2) of the Act has also been referred to as a fiction. We are *prima facie*
- B inclined to the view that when once certain amount is treated as income under the Act, it should be so for all intents and purposes - and in all situations arising under the act. Based on this approach, it will be difficult to hold that the receipt of excess on written down value on the sale of capital assets, is a "fictional income" and cannot form part of the profits.
- C Once it is profit, it is so for all purposes, and any distribution made out of such a amount should be assessed in the hands of shareholders as dividends. Section 41(2) of 1961 Act plainly makes the "excess" amount "chargeable" as "Income". If it is so, it will be taken in by Section 2(24) read with Section 2(22)(c) of the Act. An indepth analysis of the provisions of the Income-tax Act, 1922, vis-a-vis the provisions of the Income-tax Act, 1961, is called for in the circumstances. The matter is not free from difficulty. The earlier decisions of this Court reported in *CIT v. Bipinchandra Maganlal & Co. Ltd.*, (1961) 41 ITR 290 SC and *CIT v. Express Newspapers Ltd.*, (1964) 53 ITR 250 SC were rendered by a Bench of three-Judges while the later decision in *Cambay Electric Supply Industrial Co. Ltd. v. Commissioner of Income-tax, Gujarat-II*, 113 ITR 84 was rendered by a Bench of two-Judges.
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- D

7. In the circumstances and in view of the importance of the questions involved in this batch of cases, we think that it is only appropriate that this batch of cases be heard and disposed of by a larger Bench.
- F Accordingly, we direct the registry to place the matter before the Hon'ble the Chief Justice for appropriate orders in this behalf.

T.N.A.

Appeals disposed of.