



IN THE HIGH COURT OF DELHI

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ITR NOS. 301 & 302 OF 1981

Date of Decision : 25th May, 2001

**COMMISSIONER OF INCOME TAX, DELHI-I,
NEW DELHI... .. PETITIONER
THROUGH : MR. R.D. JOLLY WITH
MS. PREMLATA BANSAL
ADVOCATES**

- VERSUS -

**M/S. DELHI CATTLE BREEDING FARMS (P) LTD.
DELHI RESPONDENT
THROUGH : MR. B.R. AGGARWAL,
ADVOCATE**

CORAM :

**THE HON'BLE MR. JUSTICE ARIJIT PASAYAT, CHIEF JUSTICE
THE HON'BLE MR. JUSTICE D.K. JAIN**

1. Whether reporters of local papers may be allowed to see the judgement? *Yes*
2. To be referred to the reporter or not? *Yes*

ARIJIT PASAYAT, C.J.

At the instance of Revenue, following questions have been referred for opinion of this Court under Section 256 (1) of the Income Tax Act, 1961 (in short, 'the Act') by the Income Tax Appellate Tribunal, Delhi Bench 'D' (in short, 'the Tribunal').

- (i) "Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the capital gains of Rs.7,45,109/- could not be considered for purposes of computing the commercial profits of the assessee-company for the purposes of Section 104



- (ii) "If the answer to the first question is in the negative, whether the Tribunal was right in cancelling the orders passed by the Income-tax Officer, u/s 104 of the Act for the two assessment years 1974-75 and 1975-76?"

Dispute relates to the assessment years 1974-75 and 1975-76 and this judgment shall cover both the references.

2. Factual position, in a nutshell, is as follows:-

Assessee, at the relevant point of time, was a private limited company carrying on business in agricultural activities and dairy farming. Previous years for the two assessment years ended on 31.06.1973 and 31.06.1974 respectively. Question that arose for consideration related to levy of tax under Section 104 of the Act. Assessee's stand before the Income Tax Officer (in short, 'the ITO') was that having regard to accumulated past losses and the smallness of profits, payment of dividend by the assessee would be unreasonable within the meaning of Section 104 (2) (i) of the Act, and therefore, provisions of Section 104 (1) were not to be invoked in its case for the two assessment years. The ITO, however, did not agree with the stand of assessee. It was noted that assessee had made substantial capital gains, which were reflected in the capital reserve of Rs.7,45,109/- and the same was available to the assessee for declaring dividend. Assessee did not require the aforesaid capital reserve for any of its business requirements and this was established from the fact that there was no utilization of this reserve in any of the accounting years. The ITO, therefore, levied tax @ 15% on the distributable surplus worked out in the following manner:-

<u>Assessment year</u>	<u>1974-75</u>	<u>1975-76</u>
1) Total income assessed	Rs.3,22,580/-	Rs. 72,130/-
2) Less taxes payable thereon	Rs.2,20,160/-	Rs. 49,228/-
3) Distributable surplus	Rs.1,02,420/-	Rs. 22,902/-



4) Dividends that ought to have been declared by the company, i.e., 90%	Rs. 92,223/-	Rs. 20,612/-
5) Dividend declared by the assessee company	Nil	Nil
6) Debit balance in profit and loss a/c	Rs. 91,472/-	Rs. 20,508/-
7) Capital reserve shown in the balance-sheet	Rs.7,45,109/-	Rs.7,45,109/-

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Assessee carried the matter in appeals before the Commissioner of Income Tax (Appeals) (in short, 'CIT (A)'). It was contended before CIT (A) that capital gains should not be considered for the purpose of determining the commercial profits of assessee, and therefore, declaration of dividend in these two assessment years would be unreasonable, having regard to past losses of the company as well as smallness of its profits in the two assessment years. CIT (A) did not accept the stand. He, therefore, held that despite its past losses, assessee had sufficient distributable funds and the conclusion of ITO was justified. It was also observed that losses, if any, sustained for the assessment year 1975-76 was irrelevant for determining the applicability of Section 104 of the Act in respect of the two assessment years. Matter was carried in further appeal before the Tribunal. Stand of the assessee before the forums below was reiterated. Tribunal held that with reference to the facts and figures relating to distributable surplus, as computed by ITO in both the years, there was hardly any scope for dispute regarding applicability of Section 104 (1) of the Act. Further question, according to it, was whether it would be unreasonable for assessee to declare a dividend having regard to losses incurred by it in the earlier years and or to the smallness of profits made in the previous year within the meaning of Section 104 (2) (i) of the Act. Though, it was noticed that there was no unanimity in view as regards the question whether capital gains could form part of the profits, it was held that the view, which leans in favour of assessee, was to be preferred. Accordingly, it was held that the provisions of Section 104 (1) of the Act could not be invoked by



3. On being moved for reference, questions, as set out above, been referred for opinion of this Court.

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4. We have heard learned counsel for the parties. According to learned counsel for the Revenue, a bare reading of the provisions contained in Section 104, the position is clear that capital gains can be taken into account while deciding the question as to whether dividend ought to have been declared. Learned counsel for assessee, on the other hand, contended that capital gains cannot be treated to be a part of commercial profits and more particularly when it related to agricultural land, income from which is exempt from tax, and therefore, the view of the Tribunal is in order.

5. At this juncture, it would be appropriate to quote Section 104 of the Act, which is the pivotal provision and around which the dispute revolves:-

***"S.104. Super-tax on undistributed
Income of certain companies. –***

(1) Subject to the provisions of sub-section (2) and of Sections 105, 106 and 107, 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 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 under Section 143 or Section 144, be liable to pay super-tax at the rate of –

- (a) fifty per cent, in the case of an investment company,
- (b) thirty-seven per cent, in the case of a trading company, and
- (c) twenty-five per cent, in the case of any other company



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- (2) The Income-tax Officer shall not make an order under sub-section (1), if he is satisfied –
- (i) 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 within the period of twelve months referred to in sub-section (1), would be unreasonable; or
 - (ii) that, the payment of a dividend or a larger dividend than that declared within the period of twelve months referred to in sub-section (1) would not have resulted in a benefit to the revenue; or
 - (iii) that at least seventy-five per cent of the share capital of the company is throughout the previous year beneficially held by an institution or fund established in India for a charitable purpose the income from dividend whereof is exempt under Section 11.
- (3) If the Central Government is of opinion that it is necessary or expedient in the public interest so to do, it may, by notification in the Official Gazette and subject to such conditions as may be specified therein, exempt any class of companies to which the provisions of this Section apply from the operation of this Section.
- (4) Without prejudice to the provisions of Section 108, nothing contained in this Section shall apply to –
- (a) an Indian company whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power;
 - (b) a company which is neither an Indian company nor a company which has made the prescribed arrangements for the declaration and payment of dividends within India.

Explanation. – For the purposes of clause (a) of this sub-section, the business of a company



processing of goods or in mining or in the generation or distribution of electricity or any other form of power, if the Income attributable to any of the aforesaid activities included, in its gross total income, for the relevant previous year is not less than fifty-one per cent of such total income."

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Section 104, in essence, re-enacts Section 23 A of the Indian Income Tax Act, 1922 (in short, '1922 Act'). The said provision so far as relevant read as follows:-

"S.23A. Power to assessee-companies to super-tax on undistributed income in certain cases. -

- (1) 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 (X of 1949);

the Income-tax Officer shall, unless he is satisfied -

- (i) 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,



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- (ii) that the payment of a dividend or a larger dividend than declared would not have resulted in a benefit to the revenue; or
- (iii) that at least seventy-five per cent of the share capital of the company is throughout the previous year beneficially held by an institution or fund established in the taxable territories for a charitable purpose the income whereof is exempt under clause (i) of sub-section (3) of Section 4;

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 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 mounts, 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. -

- (i) in the case of a company, whose business consists wholly or mainly in the dealing in or holding of investments which has distributed not less than eighty per cent of its total income as reduced by the amounts, if any, referred to in clause (a), clause (b) or clause (c) of sub-section (1); or
- (ii) in the case of any other company, whose distribution falls short of the statutory percentage by not more than five per cent of its total income as reduced by the amounts, if any, aforesaid; or
- (iii) in any case where according to the return made by a company under Section 22, it had distributed not less than the statutory percentage of its total income as reduced by the amounts, if



Section 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 sub-section (4) of Section 23 or the omission by the company to disclose its income fully and truly;

under 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 made is not less than the statutory percentage of the total income of the company as reduced by the amounts, if any, aforesaid.

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6. As per Section 104 (1), additional tax is leviable in case dividend is distributed at a figure less than the statutory percentage of distributable income. Section 109 of the Act defines both "*distributable income*" and "*gross total income*". According to definition of "*distributable income*" in Section 109 of the Act, '*it is the gross total income as reduced by the income-tax payable and certain other items of income/expenses specified*'. Gross total income defined in Section 109 of the Act means '*total income as computed in accordance with provisions of the Act*'. Section 2 (45) of the Act defines "*total income*" to mean '*total amount of income*'. Under Section 2 (24) of the Act, income has been defined in an inclusive manner and it is stated to include *inter alia* capital gain chargeable under Section 45 of the Act. While determining distributable income in terms of Section 109 of the Act, long-term capital loss has been provided to be set off for the reason that any computation of total income, same is permitted to be set off only it is a long-term capital gain.

7. Assessee's stand is that since capital gain had arisen from agricultural land transferred in 1962, which was not a part of the gross total income, there is no scope for its inclusion in distributable income, as defined in Section 109 of the Act. Reliance is placed on Section 47 (viii) of the Act to



was no scope for inclusion of capital gains. On the contrary, the stand of learned counsel for Revenue is that merely because the income from agricultural land is exempt from income-tax that would be of no consequence while considering capital gains in respect of agricultural land. Learned counsel for both the parties relied on the decision of the Apex Court in *Commissioner of Income Tax v. Gangadhar Banarjee & Co. Ltd., (1965) 57 ITR 176 (SC)*. The said case related to Section 23A of the 1922 Act. Relevant observations made in the said case are as follows:-

"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 per cent 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 shareholder. 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."

8. In the background of what has been stated by the Apex Court, the assessing officer has the jurisdiction to proceed viz. a viz. the assessable income or distributable income, as defined in the Act. Then, the said income is to be judged in the light of losses of previous years or smallness of profit. For adjudicating the question whether declaration of higher amount of dividend could be reasonable, what has to be kept in view is smallness of profit, which is relatable to actual accounting profits in comparison to assessable profits of the year. Assessable income may include several fictional receipts, deductions and



different. (*See Commissioner of Income-tax v. Bipinchandra Maganlal & Co. Ltd., (1961) 41 ITR 290 (SC)*).

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9. While acting under Section 104 of the Act, assessing officer has to consider the point of view of the Board of Directors and if a prudent decision for business considerations has been taken holding that higher dividends should not be declared, assessing officer should not take a view that higher dividend ought to have been declared by the company. (*See Commissioner of Income Tax v. Aslatic Textiles Limited, (1971) 82 ITR 816 (SC)*). It was observed as follows:-

"It is not open for the Income-tax Officer to constitute himself as a super director."

10. Several High Courts have taken the view that capital gain was part of assessable income of assessee. (*See Indra Singh & Sons v. Commissioner of Income Tax, (1958) 33 ITR 341 (Cal)*; *Factors (P) Ltd. v. Commissioner of Income Tax, (1975) 98 ITR 195 (Mad)*; *Commissioner of Income Tax v. Amalgamations (P) Ltd., (1977) 109 ITR 105 (Mad)*; *Cardamom Marketing Company (TRAV), Ltd. v. Commissioner of Income Tax, (1986) 158 ITR 621 (Ker.)*; *M.R.M. Plantations (P) Ltd. v. Commissioner of Income Tax, (1990) 160 ITR 213 (Mad)* and *Commissioner of Income Tax v. South India Corporation Ltd., (1990) 183 ITR 361 (Ker.)*).

Learned counsel for assessee wanted to bring out a distinction submitting that capital gain may have been held to be a part of profit for declaration of dividend; but in none of these cases, the question related to capital gains from sale of agricultural land, income from which is exempted from tax.

11. It needs no reiteration that provisions of Section 104 are penal in nature and have to be strictly construed. It has also to be noted that Section 104 is not a charging Section and orders under Section 104 are not orders of assessment. The provision does not seek to impose a tax on income, which it itself has to bear



personality of a company by the individuals. Section 104 consists of distinctive parts – (i) it defines the scope of the jurisdiction of the Income-tax Officer to act under the provision; (ii) it provides for the exercise of that jurisdiction; and (iii) it relates to the computation of extra tax. The ingredients necessary for bringing an application of the provision are as follows:-

Income-tax Officer must be satisfied on the following aspects:-

- a) in respect of any previous year;
- b) the profits and gains distributed as dividends by a company;
- c) within 12 months immediately following the expiry of the relevant previous year;
- d) were less than the statutory percentage of its distributable income for that previous year.

Levy of additional tax is not automatic. The requisite conditions must be satisfied before bringing in application of the provision. Once the Income-tax Office is satisfied that in respect of any previous year the profits and gains distributed as dividend by any closely held company within the 12 months immediately following the expiry of that previous year is less than the statutory percentage of the distributable income of that previous year and that it would not be unreasonable to distribute a larger dividend than the declared one, an order in terms of Section 104 has to be passed.

12. That brings us to the scope of Section 104 (2). In substance, the said provision involves a consideration as to the reasonableness of the conduct of the assessee in declaring a lower dividend or not declaring any dividend due to business considerations. Section 104 (2) speaks of two things – (i) losses incurred by the company in earlier years; and (ii) the smallness of profits made in the previous year.

13. Learned counsel for the assessee questioned the scope of including capital gains. Section 109 (ii) of the Act defines “*distributable income*” to mean



sub-clauses (a) to (h). Sub-clause (d) relates to 'losses' under the head 'gains' relating to capital assets other than certain capital assets. If such losses as are referred to in clause (d) are deductible from the gross total income, there is no scope for entertaining a doubt that the capital gains received form part of the gross total income of the company within the meaning of Section 109 of the Act. This position was highlighted by the Kerala High Court in *Cardamom Marketing Co. (Trav.) Ltd.'s case (Supra)*. The position was again reiterated by the said High Court in *South Indla Corporation (P) Ltd.'s case (supra)*. We are in agreement with the view.

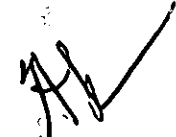
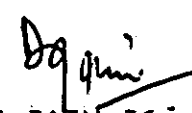
14. According to learned counsel for the assessee, even if it is held that capital gains are to be reckoned, yet capital gains accruing on sale of agricultural land, income from which is non-taxable, cannot be taken into consideration. We find no substance in this plea. While computing capital gains, further distinction is sought to be made by categorizing the properties into two, i.e., (i) where income from property is taxable and (ii) income from property is not taxable. Such a distinction is neither prescribed nor permissible and, therefore, the position that the capital gains related to a property, income from which was not taxable, is hardly of any consequence.

15. Above being the position, Tribunal's view holding that no order was required to be passed under Section 104 of the Act is not legally tenable. Our answer to the first question is in the negative, in favour of the Revenue and against the assessee. Consequentially, the second question is answered in the negative, in favour of the Revenue and against the assessee. References are accordingly disposed of.


CHIEF JUSTICE





Sr. No.	Date	Orders
2	01.6.2001	<p>Present: Mr. Rajendra Gupta for the applicant Mr. R.D. Jolly with Ms. Prem Lata Bansal for the non-applicant/respondent</p> <p><u>CM No. 4/2001 in ITR 301/81</u></p> <p>Name of the counsel for respondent, appearing in the judgment dated 25th May, 2001, shall be read as Mr. V.P. Gupta with Mr. Rajendra Gupta, Advocates.</p> <p>Application stands disposed of.</p> <p style="text-align: right;">  CHIEF JUSTICE </p> <p style="text-align: right;">  D.K. JAIN, Jr. </p> <p>1st June, 2001</p>