**IN THE INCOME TAX APPELLATE TRIBUNAL, "B" BENCH, KOLKATA**

Before : **Shri M. Balaganesh, Accountant Member, and**
**Shri S.S. Viswanethra Ravi, Judicial Member**

**I.T.A No. 1703/Kol/2014** A.Y 2007-08

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| Sri Manoj Murarka<br>PAN: AENPM 6243E<br>(Appellant/Assessee) | Vs. | A.C.I.T, Circle-35, Kolkata<br>(Respondent/Department) |

**I.T.A No. 2140/Kol/2010** A.Y 2007-08

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| A.C.I.T, Circle-35, Kolkata<br>(Appellant/Department) | Vs. | Sri Manoj Murarka<br>(Respondent/Assessee) |

For the Appellant/Assessee: Shri J.P Khaitan, Sr. Counsel &
Shri Arvind Agarwal, Advocate,ld.ARs
For the Respondent/Department : Shri Kalyan Nath, JCIT, ld.Sr.DR

Date of Hearing: 30-10-2015

Date of Pronouncement: 20 -11-2015

**ORDER**

**SHRI M.BALAGANESH, AM**

These appeals of both the assessee and the revenue arise out of the order of the Learned CIT(A) in Appeal No. 87/CIT(A)-XX/Cir-35/13-14/Kol dated 03-07-2014 against the order of assessment for the Asst Year 2007-08 framed by the Learned AO u/s 143(3) / 263 of the Income Tax Act, 1961 (hereinafter referred to as the 'Act').

2. Both the appeals arise out of the common order of the Learned CIT(A) and the issues involved are identical and they are taken up together for adjudication herein and disposed off by a common order for the sake of convenience.

3. The only issue to be decided in the appeal of the assessee is as to whether the exempt capital gain is to be excluded from accumulated profits for the purpose of section 2(22)(e) of the Act.

3.1 The only issue to be decided in the appeal of the revenue is that whether the provisions of section 2(22)(e) of the Act could be invoked on the family members of the assessee who are not shareholders in the lending company and accordingly whether clubbing provision would be applicable for deemed income.

4. The brief facts of this appeal is that the assessee is an individual having investment in shares of M/s Bathilivala and Karani Financial Consultants Pvt. Ltd (in short 'BKFCPL'). The assessee is a substantial shareholder in the said company holding 41.84% of shares. The following monies were advanced by the said company BKFCPL to the assessee and his family members :-

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| Manoj Murarka (Assessee) | - | 73,05,169 | |
| Nishita Murarka (Daughter) | - | 25,90,000 | |
| Saahil Murarka (Son) | - | 70,07,000 | |
| Swapana Murarka (Wife) | - | 17,60,000 | |
| | | ---------- | 1,86,62,169 |

4.1. The said company BKFCPL is not engaged in the business of money lending and is actually engaged in the business of dealing in shares, securities and other investments. The original assessment was completed u/s 143(3) of the Act on 10.11.2009. Later this assessment was sought to be revised by the Administrative CIT u/s 263 of the Act in order to examine the aspect of deemed dividend in respect of amounts overdrawn by the assessee from BKFCPL to the tune of Rs. 49,12,000/- during the assessment year under appeal. The show cause notice was issued by the Learned CIT was issued to bring to tax only a sum of Rs. 49,12,000/- . Later an order u/s 263 of the Act was also passed stating the order passed by the Learned AO as

erroneous and prejudicial to the interests of the revenue to the extent of Rs. 49,12,000/- towards deemed dividend in respect of amounts overdrawn by Mr.Manoj Murarka (assessee herein).

4.2. The Learned AO while giving effect to the order u/s 263 of the Act passed the impugned assessment order u/s 143(3) read with section 263 of the Act on 28.3.2013 wherein the amounts overdrawn by the following persons were added as deemed dividend:-

| | | | |
|---|---|---|---|
| Manoj Murarka (Assessee) | - | 49,12,000 | |
| Nishita Murarka (Daughter) | - | 25,90,000 | |
| Saahil Murarka (Son) | - | 70,07,000 | |
| | | ---------- | 1,45,09,000 |

4.3. On first appeal, the Learned CITA deleted the addition made towards deemed dividend in respect of sums overdrawn by Nishita Murarka (daughter) to the tune of Rs. 25,90,000/- and by Saahil Murarka (Son) to the tune of Rs. 70,07,000/- as they are not shareholders of BKFCPL and held that the deemed dividend could be taxed only in the hands of shareholder holding more than 10% voting power in the company from which monies were drawn.

4.4. The Learned CITA however, confirmed the addition made towards deemed dividend in respect of amount overdrawn by Mr. Manoj Murarka (the assessee herein) during the assessment year under appeal to the tune of Rs. 49,12,000/- by ignoring the contentions of the assessee that there is only negative accumulated profits if the long term capital gains which is exempt from tax is excluded from accumulated profits. Aggrieved, both the assessee as well as the revenue are in appeal before us on the following grounds:-

Assessee's appeal in ITA No. 1703/Kol/2014 A.Y 2007-08

1. *Because that the ld. Commissioner of Income Tax (Appeal) was erred in law as well as in facts in upholding the decision of the ld. DCIT for the addition of Rs.49,12,000/- under the provision of section 2(22)(e) of the I.T Act 1961, and his such decision is based on his surmises and guesses and are contrary to the facts and material on record and provisions of law.*
2. *Because that the ld. Commissioner of Income Tax (Appeal) was erred in law as well as in facts in not accepting that, as there was a negative accumulated profit of Batlivala and Karnani Financial Consultants Pvt. Ltd from whom the appellant had taken loan, the addition under the provision of section 2(22)(e) of the I.T Act 1961 could not be sustained.*
3. *Because that the ld. Commissioner of Income Tax (Appeal) was erred in law as well as in facts in not accepting that the exempt capital gains income would not form part of accumulated profit in the hands of Batlivala and Karnani Financial Consultants Pvt. Ltd from whom the appellant had taken loan, and as such there would be negative accumulated profit and the provision of section 2(22)(e) of the I.T Act 1961 could not be invoked.*
4. *Because that the ld. Commissioner of Income Tax (Appeal) was erred in law as well as in facts in not accepting that the deeming provision should be construed strictly, and in the given facts and circumstances of the case, as there was negative accumulated profits after excluding exempt capital gains income in the hands of Batlivala and Karnani Financial Consultants Pvt. Ltd from whom the appellant had taken loan, there would be no addition u/s. 2(22)(e) of the I.T Act 1961.*

Department appeal in ITA No. 2015/Kol/2014 A.Y 2007-08

*"1. On the facts and circumstances of the case and in law, the CIT(A) has erred in deleting that deemed dividend can be applied in the hands of a person who is the beneficial owner of shares in the company as provided u/s. 2(22)(e) of the I.T Act and the family members of the appellant are not covered under section 2(22)(e).*

*2. On the facts and circumstances of the case and in law, the CIT(A) has erred in not applying section 64 of the I.T Act."*

5. At the outset, the appeal of the revenue is time barred by 7 days and on query from the Bench to the Learned AR as to whether there is any objection on his part for condonation of delay, he fairly conceded that the delay may be condoned. The Learned DR has filed an affidavit explaining the reasons for delayed filing of appeal. The reasons adduced seems to be satisfactory and hence in the interest of justice, the delay of 7 days is condoned and appeal of the revenue is admitted.

5.1. In respect of appeal of the revenue, the Learned DR argued that the clubbing provisions contemplated under section 64 of the Act does not bifurcate clubbing of regular income and clubbing of deemed income. It only states that income of minor should be clubbed with the parent whose total income is greater. That obviously would include deemed dividend income also. He placed reliance on the decision of the Hon'ble Apex Court in the case of ***L. Alagusundaram Chettiar vs. CIT reported in (2001) 252 ITR 893 (SC)*** in support of his arguments.

5.2. In response to this, the Learned AR argued that the Learned AO while passing the order giving effect to section 263 directions, sought to bring to tax as deemed dividend in respect of amounts overdrawn by Nishita Murarka (daughter) to the tune of Rs. 25,90,000/- and by Saahil Murarka (Son) to the tune of Rs. 70,07,000/- which were not the subject matter of revision proceedings u/s 263 of the Act by the Learned CIT. In other words, he argued that the Learned CIT directed the Learned AO to examine the aspect of deemed dividend only in respect of amounts overdrawn by the assessee and not in respect of other family members.

In this regard , he placed reliance on the following decisions :-

- ***CIT vs Hindustan Coconut Oil Mill reported in (2002) 255 ITR 428 (Cal)***
- ***CIT vs Howrah Flour Mills Ltd reported in (1999) 236 ITR 156 (Cal)***

5.2.1. The Learned AR further stated that both the son and daughter are not shareholders in the lending company and in any case, the provisions of section 2(22)(e) of the Act could not be invoked in the facts and circumstances of the case.

5.2.2. The Learned AR further argued that the provisions of section 2(22)(e) of the Act creates a deeming fiction and hence has to be construed strictly. In this regard, he placed reliance on the decision of the Hon'ble Apex Court in the case of ***CIT vs C.P.Sarathy Mudaliar reported in (1972) 83 ITR 170 (SC).***

6. We have heard the rival submissions and perused the materials available on record. We find that the Learned AO had travelled beyond the jurisdiction vested on him by the order of the Learned CIT u/s 263 of the Act by treating the amounts overdrawn by the son and daughter of the assessee thereby bringing the same to tax as deemed dividend. The relevant operative portion of the section 263 order of the Learned CIT is reproduced herein below:-

> *"It has been noticed that the following issues are involved in this case-*
> *[i] Deemed dividend of Rs.73.05 lakhs in the hand of Manoj Murarka for AY 2007-08, who is a substantial share holder of 41.84% in M/s. Bathlivala and Karnai Financial Consultants Pvt. Ltd. Hence, all the conditions mentioned in sec. 2(22)(e) of the I.T Act, 1961 are satisfied.*
> *In the instant case, it was clear that after the assessee had filed his return, a notice under section 143(2) was issued to him for the purpose of carrying out a scrutiny in respect of the return of income filed by him. In the course of scrutiny no enquiry or investigation was made by the Assessing officer on the applicability of section 2(22)(e) of the Income Tax Act 1961. The assessee is a substantial share holder (41.84%) in M/s. Bathlivala and Karnai Financial Consultants Pvt. Ltd had a debit balance of Rs.73.05 lakhs in the books of the Company. Hence prima facie, the amount in question was to be treated as deemed dividend in the hand of the assessee, subject to satisfaction of other conditions.*

*It is well settled that failure to conduct necessary inquiry and investigation makes an order erroneous as the Assessing Officer is required to act as an investigator. Such an order is also prejudicial to the interest of the revenue. The amount deposited of debit balance is substantial. Hence, the inquiries were necessary and required but were not made by the Assessing Officer. In this circumstances, I feel that, the assessment made by the Assessing officer is prejudicial to the interest of the Revenue.*

*During the course of 263 proceeding, the assessee has furnished the details of advance/loan taken from M/s. Bathlivala and Karnani Financial Consultants Pvt. Ltd. It was submitted that the carried forward balance of loan from previous year could not be treated as deemed dividend. It was further submitted that the amount in question was taken by the assessee in usual course of business of M/s. Bathlivala and Karnani Financial Consultants Pvt. Ltd, which includes business of granting loans and advances. Considering above and since these aspects has not been considered or examined by the Assessing Officer during the course of assessment proceeding, the assessment order passed by the AO is set aside with a direction to the AO to verify that the above issue and pass a fresh order as per provision of the Act. Before passing the fresh assessment order, the AO shall grant the assessee a reasonable opportunity of being heard. "*

In this regard, the following decisions relied upon by the Learned AR are well placed :-

***CIT vs Hindustan Coconut Oil Mill reported in (2002) 255 ITR 428 (Cal)***

*"Broadly speaking, the Tribunal has opined that in the order passed in the revision there being no specific mention of the sales tax matter, it could form no part of the directions which were to be followed by the Income-tax Officer for the purpose of making alterations. Thus, the alterations sought to be made by the Income-tax Officer in the fresh assessment of February 26, 1988, in regard to sales tax addition was without jurisdiction. It should be mentioned here that in the fresh assessment the Income-tax Officer practically verbatim repeated the order which had been passed by him in the rectification order dated January 7, 1986. The addition of Rs. 32,00,000 and odd*

*was maintained in the fresh assessment order and upon the same reasoning as was adopted in the order passed under Section 154.*

*We have received excellent assistance from both sides in this matter where the facts are slightly unusual ; but the sustained efforts and expertise of Mr. Poddar certainly deserve special mention.*

*From the first part of the two compilations of cases given to us by Mr. Poddar, two Division Bench decisions of the reference court of our High Court, make it amply clear that, even if a superior departmental authority sets aside the entire assessment order and calls for the assessment to be made again, that does not mean that the Income-tax Officer in his new exercise will treat the matter as if it is coming before it for the first time. Rather, the Income-tax Officer would have to examine the body of the order of the superior departmental authority and gather from it the points upon which the assessment has been directed to be made once again. Excepting for making changes in the new areas as indicated, the Income-tax Officer has no Jurisdiction to touch on his own once again the matters which have already formed the subject of assessment before him, and which parts the superior departmental authority has left completely untouched.*

*The two cases mentioned above are the cases of Katihar Jute Mills (P.) Ltd. v. CIT and Surrendra Overseas Ltd. v. CIT .*

*Those were, of course, both cases of income-tax appeals and not of revision. In one of the cases an intervening Supreme Court decision was sought to be given effect to by the Income-tax Officer in regard to the value of loom hours which had been ruled to be receipts of a capital nature rather than of a revenue nature, the ruling being of the Supreme Court. It was held, however, that beyond the terms of the appellate authority's direction the Income-tax Officer could not touch its own original order.*

*In the second case deductions were sought to be withdrawn from the head of development rebate because the ships were sold within two years. This time the decision went in favour of the assessee ; even though the ships had actually been sold, the rebate could not be withdrawn because the appellate authority's remand order did not permit the Income-tax Officer to reshape its assessment order on those issues.*

*After the amendments made in the year 2001, Section 263, which deals with revision, and Section 251, which deals with appeals, have marked differences in wording. But previously, Section 251 contained words which allowed the appellate authority in*

*appropriate circumstances to set aside the entire assessment and calf for a fresh assessment to be made. These words are no longer expressly there in Section 251. But so far as Section 263 is concerned, the power of cancellation of assessments made to the prejudice of the Revenue and of directions for fresh assessment were all along there and those are still there. Thus, the ratio given in the two above reference decisions of the Calcutta High Court would have to be followed by us, there being no material differences between the appellate provisions and the provisions for revision, at the relevant time. We respectfully opine that we are in full agreement with the reasoning of the two above cases, and we follow those cases here.*

*On this basis, we would no doubt have to opine that the Tribunal was quite right in forming the view that the Income-tax Officer had no authority to say anything new about the sales tax addition ; this is so, simply because the Commissioner in revision did not permit, in the reasoning portion of his order, any change to be made in the Section 43B matter of addition of the sales tax amount received".*

***CIT vs Howrah Flour Mills Ltd reported in (1999) 236 ITR 156 (Cal)***

*" …. ….. It is all the more so, because the revenue has not been given any right of appeal under the Act against an order of the Commissioner under section 263(1) of the Act In case he proceeds thereunder after hearing the assessee in pursuance of the notice given by him, then the appeal filed by the assessee under section 253(1)(c) of the Act cannot be treated on the same footing as an appeal against the order of the Appellate Assistant Commissioner passed in assessment proceedings, where both the parties have been given the right of appeal In this view of the matter, the argument raised on behalf of the revenue, that, in appeal, the Tribunal may uphold the order appealed against on the grounds other than those taken by the Commissioner in his order, is not tenable Under section 263 of the Act it is only the Commissioner who has been authorised to proceed in the matter, and, therefore, it is his satisfaction according to which he may pass necessary orders thereunder in accordance with law If the grounds which were available to him at the time of the passing of the order do not find a mention in his order, appealed against, then it will he deemed that he rejected those grounds for the purpose of any action under section 263(1) of the Act In this situation, the Tribunal, while hearing an appeal filed by the assessee, cannot substitute the grounds which the Commissioner himself did not think proper to form the basis of his order"*

*CIT vs Jagadhri Electric Supply & Industrial Co. reported in (1993) 140 ITR 490 ( P & H):*

> *"We respectfully adopt the reasoning given in the Punjab and Haryana High Court in the case of CIT vs Jagadhri Electric Supply & Industrial Co. reported in (1993) 140 ITR 490 ( P & H) and we are also of the same view. In our opinion also, an assessee by filing an appeal from an adverse order under section 263, does not cause a reopening of his assessment order wholesale and in all respects. All that the assessee does is that it challenges the order of revision passed under section 263, which means the assessee challenges the ground on which the Commissioner has opined the Income-tax Officer's order to be erroneous (n law). In the instant case, the debt having become barred a long-term ago was never a matter on which the Commissioner had passed any revising order under section 263. The Tribunal did not enter into this question in this form either. We also do not enter this question as it would not be right to do so. "*

6.1. With regard to the decision relied upon by the Learned DR **in the case of *L. Alagusundaram Chettiar vs CIT reported in (2001) 252 ITR 893 (SC)*,** we would like to state that the facts in the said case are totally different and distinguishable to the facts of the instant case. In the case before the Supreme Court, the monies were advanced by the company to one employee K who in turn transferred the monies to the shareholder of the company and this fact was proved by the fact by shareholder admitting that he has been obtaining loan through K in this manner. Hence in these circumstances, the Hon'ble Supreme Court held that the monies were advanced by the company for the benefit of the managing director / shareholder and hence the same has to be treated as deemed dividend. Whereas in the instant case, the monies were advanced directly by the company to the son and daughter of the assessee and it is not the case of the revenue that the monies were subsequently transferred by son and daughter to the assessee and the children merely acted as a conduit to draw monies from the company for onward transmission to the assessee. We hold that the provisions of section 2(22)(e) of the

Act creates a deeming fiction and hence needs to be viewed strictly. Reliance in this regard is placed on the decision of ***CIT vs C.P.Sarathy Mudaliar reported in (1972) 83 ITR 170 (SC) ,*** wherein it was held that:-

> *"Before a payment can be considered as dividend under section 2(6A)(e), the following conditions will have to be satisfied:*
> *1. It must be a payment by a company not being a company in which the public are substantially interested within the meaning of section 23A of any sum whether as representing a part of the assets of the company or otherwise by way of advance or loan.*
> *2. (a) It must be an advance or loan to a shareholder, or*
> *2.(b) a payment by the company on behalf or for the individual benefit of the shareholder, and*
> *3. to the extent to which the company in either case possesses accumulated profits.*
>
> *There is no dispute that the first and the last conditions are satisfied in the present case. The question is whether conditions Nos.2(a) and 2(b) are satisfied. We shall first take up condition No.2(b). No contention appears to have been taken before the Tribunal that the loans in question were given by the company on behalf of the shareholders or for their individual benefit. That being so, the Tribunal did not go into that question. In fact, as can be gathered from the case stated, the contention of the assessee before the Tribunal was that the loan in question was borrowed for the benefit of another company. But the Tribunal did not go into that question. Under these circumstances, the High Court, in our opinion, was right in not going into that question because on the facts found by the Tribunal was not possible to decide that contention ".*

6.2. Moreover, it is also observed that both the son and daughter of the assessee are not shareholders in the lending company (i.e BKFCPL) and hence the deemed dividend, if any, could be assessed only in the hands of the shareholders and not otherwise. This argument was taken by the assessee even before the lower authorities and the revenue had not brought on record any contrary evidence to this fact. Hence we hold that the provisions of section 2(22)(e) of the Act could not be invoked in respect of amounts paid to Nishita Murarka (daughter) to the tune of Rs. 25,90,000/- and by Saahil

Murarka (Son) to the tune of Rs. 70,07,000/- and accordingly, the grounds raised by the revenue in this regard are dismissed. This decision is rendered independently irrespective of the decision taken on the dispute as to whether there is accumulated profits in the instant case or not and whether exempted capital gains is to be included or excluded for reckoning the accumulated profits or not.

7. With regard to the appeal of the assessee, the Learned AR argued that the accumulated profits figure as on 31.3.2007 of Rs. 128.21 lacs admittedly includes exempted long term capital gains to the tune of Rs. 197.20 lacs and hence if the same is reduced then there will be only negative accumulated profits and accordingly the provisions of section 2(22)(e) of the Act could not be invoked. He further argued that the exempted capital gains does not get into the stream of accumulated profits and even as per Explanation 1 to section 2(22)(e) of the Act. He argued that the expression accumulated profits would include capital gains only if it is chargeable to tax u/s 45 of the Act and not otherwise. He placed reliance on the following decisions in support of his contentions:-

- ***CIT vs Mangesh J Sanzgiri reported in 119 ITR 962 (Bom)***
- ***ACIT vs Gautam Sarabhai Trust No. 23 reported in (2202) 81 ITD 677 (AHD ITAT)***

The Learned AR also stated that he could not find any contrary decisions from the Supreme Court or any other High Court on this issue and accordingly prayed for exclusion of exempted long term capital gains from accumulated profits and consequently there would be no positive profits to invite the provisions of section 2(22)(e) of the Act.

7.1. In response to this, the Learned DR argued that the expression accumulated profits did not include capital gains only upto 1.4.1956 and not thereafter and hence

there is no scope for reducing the exempted long term capital gains from accumulated profits and hence pleaded for confirmation of the order of the lower authorities.

8. We have heard the rival submissions and perused the materials available on record. It is pertinent to understand the meaning of the expression 'accumulated profits'.

Explanation 2 to section 2(22) of the Act states as below:-

> *"The expression 'accumulated profits' in sub-clauses (a) , (b), (d) and (e) shall include all profits of the company upto the date of distribution or payment referred to in those sub-clauses, and in sub-clause (c) shall include all profits of the company upto the date of liquidation".*

Explanation 1 to section 2(22) of the Act states as below:-

> *"The expression 'accumulated profits' , wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956".*

We find that for the purposes of artificial categories of dividends which are created by the provisions contained in section 2(22) of the Act, accumulated profits do not include any capital gains, except those which are taxable as such. Thus, accumulated profits would not include capital gains made during a period when they were not taxable under the Act, nor capital gains which are not chargeable even during the period the capital gain tax is in force. Consequently, any payment made to a shareholder of a company of non-taxable capital gains of the company would not be dividend. We place reliance on the following decisions in this regard:-

- ***CIT vs Mangesh J Sanzgiri reported in 119 ITR 962 (Bom)***

It was held that :

> *"It is thus clear that the 'accumulated profits' would not include capital gains which are not chargeable to tax even during the period the capital gains tax is in force. Distribution made to the shareholder of a company*

*out of non-taxable accumulated capital gains of a company would not be dividend".*

In the case before the Bombay High Court, the dividend was distributed in the month of May 1961 and assessment year involved therein was Asst Year 1962-63 and the decision was rendered by duly considering the Explanation 1 to section 2(22) of the Act.

- ***Smt.Chechamma Thomas vs CIT reported in (1986) 161 ITR 718 (Ker)***
- It was held that :

*"The question of law common to both the references referred to this court for decision is as follows :*

*"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the distribution to the assessees of the amount attributable to compensation and sale price received by the Periyar and Pareekanni Rubbers Ltd., on the acquisition and sale, respectively, of agricultural lands, was, in the hands of the assessees, receipt of dividend assessable to income-tax under the Income-tax Act, 1961?"*

*It is an admitted fact that the company itself is not liable to pay any tax by way of capital gains on the said receipts of compensation/sale price. In First ITO v. Short Brothers P. Ltd. [1966] 60 ITR 83, a Bench of the Supreme Court consisting of Subba Rao, Shah and Sikri JJ. had held that capital appreciation in respect of the lands from which the income was derived was agricultural income ; and that was not taxable in the hands of the company as capital gains would not, on distribution, be liable to be so taxed as dividend under Section 12 of the Indian Income-tax Act, 1922. In Tea Estate India P. Ltd. v. CIT [1976] (03 ITR 785, the Supreme Court had reiterated this position. Again, in CIT v. Nalin Behari Lall Singha [1969] 74 ITR 849, the Supreme Court held as follows (at p. 852) :*

*"There is no warrant for the view expressed by the Tribunal that the definition of 'dividend' only includes deemed dividend. To hold that the capital gains within the excepted period are not part of the accumulated profits for the purpose of the definition under Section 2(6A) and a distributive share thereof does not on that account fall within the definition of 'dividend' and, therefore, of income chargeable to tax and still to regard them as a part of accumulated profits for the purpose of dividend in the popular connotation and to bring the share to tax in the hands of the shareholders is to nullify an express provision of the statute. We do not see any reason why such a strained construction should be adopted."*

*We do not also agree with the Tribunal's reasoning that the decisions in Short Brothers' case [1966] 60 ITR 83 (SC) and in Tea Estate India P. Ltd.'s case [1976] 103 ITR 785 (SC), would not apply to the present case because there had been changes in the definition of Section 2(22) of the Act, which corresponds to Section 2(6A) of the 1922 Act. The Tribunal has not enlightened as to how the difference in the definition had rendered the decisions inapplicable. The principle enunciated in those cases, which is applicable to the present case, is contained in the last two paragraphs in the decision in Short Brothers' case [1966] 60 ITR 83, which reads as follows (at pp. 89 and 90) :*

*"The question which remains to be considered is whether capital appreciation in respect of the lands from which the income derived is agricultural income and which was not taxable in the hands of the company as capital gains would still on distribution be liable to be taxed as dividend under Section 12 of the Income-tax Act. As we have already pointed out, capital gains under Section 12B ate chargeable in respect of any profits arising from transfer of 'capital assets', and 'capital assets' do not include lands from which the income derived is agricultural income. Profits derived by transfer of lands from which the income derived is agricultural income would not, therefore, be chargeable on a combined reading of Section 12B with Section 2(4A) of the Income-tax Act under the head 'Capital gains'. The expression 'accumulated profits' does not include capital gains arising within the excepted periods: vide Explanation to Section 2(6A). ' Accumulated profits' are, therefore, profits which are so regarded in commercial practice, and capital gains as defined in the Income-tax Act. Realisation of appreciated value of assets in commercial practice is regarded as realisation of capital rise, and not profits of the business. Unless, therefore, appreciation in the value of capital assets is included in the capital gains, distribution by the liquidator of the rise in the capital value will not be deemed dividend for the purpose of the Income-tax Act.*

*Counsel for the Department contended, relying upon Mrs. Bacha F. Guzdar v. CIT [1955J 27 ITR I (SC), that since dividend received by a shareholder of a company out of the profits earned from agricultural income is not exempt from liability to tax under Section 4(3)(viii), dividend distributed from profits earned out of sale of capital assets inclusive of land from which the income derived is agricultural income, is also not exempt from income-tax. But the company does not claim exemption from liability to tax under Section 4(3)(viii) : it claims exemption because the receipt is not income which is chargeable to tax under Section 12 under the head 'Dividend'. The case of Mrs. Bacha F. Guzdar v. CIT [1955] 27 ITR 1 (SC) has, therefore, no application to this case."*

*Capital gain, in fact, is made taxable by Section 45 of the Income-tax Act, 1961, as such a special deeming provision was felt necessary because capital gains would not otherwise come within the ordinary commercial concept of profit. By virtue of the definition of "Capital asset", inSection 2(14),*

*agricultural land is excluded ; hence capital gain on agricultural land is neither part of normal commercial profit nor taxable capital gains.*

- ***ACIT vs Gautam Sarabhai Trust No. 23 reported in (2202) 81 ITD 677 (AHD ITAT)***

It was held that :

> *"Section 2(22) deals with various types of cases and creates a fiction by which certain amounts which are actually not distributed as dividends, are also brought within the net of dividend. It is a cardinal rule of interpretation that such a deeming section must receive a strict interpretation. The object and purpose of introducing the legal fiction in the statute is to frustrate any attempt by a company to avoid dividend tax by distributing the profits of the company to its shareholders under the guise of loan, reduction of capital, etc.*
>
> *In so far as profits of capital nature are concerned arising from the sale of capital assets, such profits are to be excluded for the purpose of ascertaining the accumulated profits u/s 2(22) unless such capital profits have been subjected to capital gains u/s 45. In first ITO vs Short Bros (P) Ltd reported in (1966) 60 ITR 83 (SC), it has been held that capital appreciation in respect of the lands from which the income was derived was agricultural income and that was not taxable in the hands of the company as capital gains, would not, on distribution be liable to be so taxed as dividend under section 12 of the Indian Income Tax Act 1922.*
>
> *In a nutshell, it may be said that no part of any capital profits, except capital gains as assessable u/s 12(b) of the 1922 Act as well as under section 45 of the 1961 Act, of a company can ordinarily be included in "accumulated profits" for the purpose of determination of dividend u/s 2(22). In view of specific provision in the constitution of Alkapuri Investment Pvt Ltd (AIPL) capital profits of the company could not be distributed and, therefore, such profit, unless charged to capital gains tax, would not form part of "accumulated profits".*

We hold that the legal fiction created in the Explanation 2 to section 2(22) of the Act that 'accumulated profits' shall include all profits of the company upto the date of distribution or payment should be understood to include the current year profits of the company and not otherwise. In other words, for reckoning the accumulated profits,

apart from the opening balance of accumulated profits, the profits earned in the current year also are to be added and then the total accumulated profits should be considered for the purpose of calculation of dividend out of accumulated profits, if any. The said Explanation nowhere contemplates to bring within the ambit of expression 'accumulated profits', any capital profits which are not liable to capital gains tax. Accordingly, even going by the provisions of the statute, it can safely be concluded that the capital gains could be included for reckoning the accumulated profits only when the said capital gains has been duly subjected to tax. In the instant case, the capital gains derived by the company to the tune of Rs. 197.20 lacs is exempt and hence the same should not be included in accumulated profits and if the same is excluded, then there is only negative accumulated profits available with the company. Admittedly, the provisions of section 2(22)(e) could be invoked only to the extent of the company possessing accumulated profits. In the absence of accumulated profits, there is no scope for making any addition towards deemed dividend.

9. In view of the aforesaid findings and respectfully following the aforesaid judicial precedents relied upon , we hold that the exempted capital gains shall not enter the stream of the expression 'accumulated profits' and the company BKFCPL has got only negative accumulated profits after exclusion of exempted capital gains and hence the provisions of section 2(22)(e) of the Act cannot be invoked in the facts and circumstances of the case. Accordingly, the grounds raised by the assessee are allowed.

10. In the result , the appeal of the assessee in ITA No. 1703/2014 is allowed and appeal of the revenue in ITA No. 2015/2014 is dismissed.

THIS ORDER IS PRONOUNCED IN OPEN COURT ON 20/11 /2015

| | |
|---|---|
| Sd/- | Sd/- |
| ( S.S Viswanethra Ravi, Judicial Member ) | (M. Balaganesh, Accountant Member) |
| Date 20 /11/2015 | |

Copy of the order forwarded to:

1.. The Appellant/Assessee: Shri Manoj Murarka C/o G.P Agarwal & Associates 71, Kiran Shankar Ray Road, 2nd fl, Kol-1.

2 The Respondent/Department- ACIT, Cir-35,Aaykar Bhavan Poorva, 110 Shantipally, 8th Fl, Kol-107,

3 /The CIT,
/
The CIT(A)

4..

5. DR, Kolkata Bench

6. Guard file.

True Copy, By order, Asstt Registrar

** PRADIP SPS